Five forces model: u.s. automobile industry

Business, Industries

Michael Porter's Five Forces Model is a model used to analyze a particularenvironmentof an industry. An industry is a group of firms that market products which are close substitutes for each other, such as the automobile industry. According to Porter, there are five forces that determine an industry's long-run profitability and attractiveness. These five competitive forces are the threat of entry of new competitors, or new entrants; the threat of substitutes; the bargaining power of buyers; the bargaining power of suppliers, and the degree of rivalry between existing competitors.

In the auto manufacturing industry, the threat of new entrants is generally very low. For this threat, factors to examine include all barriers to entry such as upfront capital requirements since it costs a lot to set up a car manufacturing facility. They also need to look at brand equity since a new firm may have none. Also, legislation and government policy are considered and this includes safety, EPA, and emissions. Finally, they'll look at the ability to distribute the product.

The emergence of foreign competitors with the capital, management skills, and required technologies began to undermine the market share of North American companies. The bargaining power of suppliers must be examined. Historically, the bargaining power of automakers went unchallenged. The American consumer, however, became undeceived with many of the products being offered by some auto companies and began looking for alternatives, particularly foreign cars. On the other hand, while consumers can be very price sensitive, they do not hold much buying power since they never purchase a large volume of cars.

If buyers can look at the competition or other comparable products, and switch easily, there may be a high threat competitive rivalry. The switching cost is high with new cars because you can't sell a brand new car for the same price you paid for it. You also need to look at public transportation and the likelihood of people taking the bus, train or airplane to get around. The higher the cost of operating a vehicle, the more likely people will look for alternative transportation options.

The price of gasoline has a big impact on consumers' decisions to buy vehicles as well. SUV’s and trucks have higher profit margins, but they also consume more gas compared to smaller sedans and light trucks. Product differentiation is important too since there are usually many cars that are similar. The automobile supply business tends to have many firms. Many suppliers rely on one or two automakers to buy a majority of their products. If an automaker decided to switch suppliers, it could be devastating to the previous supplier's business.

So, suppliers are extremely susceptible to the demands and requirements of the automobile manufacturer and hold very little power. But some suppliers are small firms who rely on the carmakers, and may only have one carmaker as a client. So this can be a tricky force to evaluate. In most countries, all auto makers are engaged in fierce competition. Price slashes, product developments, and ad campaigns keep them on the edge of innovation and profitability. Margins are low and pressure between rivals is high. Highly competitive industries generally earn low returns because the cost of competition is high.

The automobile industry is considered to be an oligopoly, which helps to minimize the effects of price-based competition. The automakers understand that price-based competition does not necessarily lead to increases in the size of the marketplace. In the past, they have tried to avoid price-based competition, but more recently the competition has intensified - rebates, preferred financing and long-term warranties have helped attract customers, but they also put pressure on the profit margins for vehicle sales. Works Cited

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