Forces that shape competition

Business, Company

Forces that shape competition:

The configuration of the five forces differs by industry. The strongest competitive force or forces determine the profitability of an industry and become the most important to strategy formulation.

1) Rivalry among existing competitors:

Rivalry competition is intensity because rivalry among existing competitors could include price discounting, new product introductions, advertising campaigns and service improvement.

The intensity of rivalry is greatest if:
There are many competitors or few but equal in size, power and in same situation. Industry growth is slow.
Exit to barriers are high, if organization earns low or negative returns. Rivals are highly committed to the business and have aspirations forleadership. Firms can't read each other's signals because of competition between them.

The competition not only occur through intensity, but also can occur in price. As price competition transfers profits directly from an industry to its customers.

Price competition can occur if:
Rivals have similar products or services with few switching costs for buyers. Capacity must be expanded in large increments to be efficient. The product is unsold or perishable.

Finally, Competition can be occur on different dimensions, like price, product features, support services, delivery time and brand image

Same dimensions competition can occur if many competitors aims to meet the

same needs or compete on the same attributes

2) The threat of substitutes:

A substitute performs the same or similar function as an industry's product by different means.

Threats of substitutes is high if:

It offers an attractive price-performance trade-off to the industry's product. The buyer's cost of switching to the substitutes is low.

3) Threat of new entrant:

new entrants to an industry bring new capacity and a desire to gain market share that puts pressure on prices, costs and the rate of investment which is needed.

Barriers to entry

a) Supply-side economics of scale: arises when a firms that produce larger volume enjoy lower costs per unit. Because new entries must accept a cost disadvantage.

b) Demand-side benefits of scale: arises when more buyers wants to buy the product, they will be more willing to reduce the price.

c) Customer switching costs: switching costs are fixed when buyers or customers change suppliers. The larger the switching costs, the harder it will be for an entrant to gain customers.

d) Capital requirements: the need to invest large financial resources to compete can deter new entrants.

e) Incumbency advantage independent of size: no matter what their size, incumbents may have cost or quality advantages not available to rivals.

f) Equal Access to distribution channels: Entrants firm will have limited capacity within distribution channels and suppliers.

g) Restrictive government policy: New entrants require license by public authority and there will be barriers such as copy-right.

h) Expected retaliation: new firms should expect retaliation if:

Incumbents have previously bad history to new entrants.

Incumbents have rare resources to fight back, including excess cash and unused borrowing power. Incumbents likely to cut prices because they are committed to retaining market share or the industry has high fixed costs. Industry growth is slow so new comers can gain volume only by taking it from incumbents.

4) The power of supplier:

Powerful suppliers capture more of the value for themselves by charging higher prices, limiting quality or services, or shifting costs to industry participants

Company can depend on different suppliers. Supplier can be powerful if: It’s more concentrated than the industry it sells. Like Microsoft, it’s near to monopoly operating the system The supplier group doesn’t depend heavily in the industry for its revenues. It arises when supplier serving many companies. Firm faces switching costs in changing suppliers. Shifting supplier is difficult and costly to the company.

Supplier offer differentiated products. So supplier can deal with variety companies. There is no substitute for what the supplier provides. The supplier group can credibly threaten to integrate forward into the industry 5) The power of buyers:

Powerful customers can capture more value by forcing down prices demanding better quality or more services. i. Negotiation leverage of customers can be occur if: Few buyers and large purchases by each one of them. The industry's products are standardized or undifferentiated. And there is equivalent product. Buyers face few switching costs in changing vendors. Buyers can credibly threaten to integrate backward

ii. Also buyer can be price sensitive if:

The product represent significant of its cost structure. Here buyer would like to shop around and bargaining hard. The buyer earns low profits, he will be price sensitivity. The quality of buyer's products or service is little affected by the industry's product. Block3 Unit1 The criticisms of porter's five forces models

Resource based criticisms: assumptions are: Organizations within an industry are identical in terms of their strategic resources. If resources heterogeneity in the industry, these resources will be short lived Dynamic criticisms:

1. Porter's model is static model.

2. The criticism is increase by the increasing dynamism of theenvironmentand the speed with which industry boundaries are seen to shift. 3. Grant suggested there should be complement or complementary products and services as a new force. Practice based criticisms:

Porter's model can't help in identify the industry attractiveness because there's no exactly way to measure the power of each force and its implications Not all suppliers and buyers are alike.

Sectors based criticisms:

Porter's model can't be applied to all sectors of organizations. Monopoly hasn't rivals force, threat of new entrant and threat of substitute. 4. Public sector is under the government control, so government should be treated as sixth factor and set boundaries of organization

The arguments of porter and reply to the criticisms:

Five forces isn't static model but framework to understand the industry environment's developments and their impact on the industry attractiveness.

Shifting threat of new entry: changes to any of the seven barriers (mentioned before) can raise or lower the threat of new entrant. Changing supplier or buyer power: the power of suppliers and buyers change with time, and the clouts of them may rise or decline. Shifting threat of substitution: advance intechnologycreate new substitutes or shift price performance comparisons in one direction to another. New bases or rivalry:

rivalry often intensifies over time because of slow growth, technology expansion and consumer tastes.

Complements shouldn't be treated as sixth factors, because it's not influence the availability of profitability, but can change the evaluation of each force within an industry. Complementary products or services: complements are products or services used together with an industry's product. Complementary products and service has affect on the five forces. Complements can raise or lower barriers to entry. Complements can affect the threat of substitutes. Read R oyal Dutch Shell PESTLE analysis

Complements can affectthe rivalcompetitors positive (through switching costs) or negative (when they stop product differentiation)

Governments shouldn't be treated as sixth force. But you should understand the influence of government on competition, you should analyze the government policies affect the five competitive forces. Porter didn't reply the criticisms of RBV, but lately at 1996 he made acase studytalking about it.

SWOT Analysis

Fahey and narayman introduced four segments for exploring the far environment in terms of sociological, political, economic and technological factors;

Those four segments are: Sociological factors: include the demographics, lifestyle and the social values of a society. For example: lifestyle trends and fashion model. Technological factors: include thetechnological progressor advances. For example: innovations and technological developments. Economic factors: include general set of economic factors and conditions. For example: Interest and exchange rate. Political factors: include political processes occurring in a society and actions of regulatory. For example: government policies. Those four segments represent STEP tool that is used to analyze the far environment.

To make STEP analysis, we should follow four stages:
a) Scanning the environment to detect the changes.
b) Monitoring specific environmental trends and patterns.
c) Forecast the future direction of the environment changes. d) Assessing current and future environmental changes for strategic and organizational implications. In recent years, STEP model was expanded to additional factors, those two factors are: Legal factors and Environmental factors and became STEEPL model. After the expanded, STEEPL tool is included six segments: Political which involves government action, Economic which has impact on demand and affect the prices, Social influenced by wider societal attitudes toward greening, Technology involves technological developments, Legal involves government action that should be legally enforced and last is Environment which is trying to achieve sustainability objectives.