A critical analysis of porter’s five forces as applied to online financial servic...

Business, Marketing

Porter’s Five Forces Theory is a relatively old theory, but one that has helped numerous businesses understand the market place and achieve competitive advantage.

Some people have called it “ Game Theory” because one either wins or loses, although it has been argued that “ Business is not about winning and losing, nor is it about how well you play the game. Companies can succeed spectacularly without requiring others to fail. And they can fail miserably no matter how well they play if they make the mistake of playing the wrong game.” (Brandenburg 1995 p 57)

Discussions, reviews and appraisals of this theory abound, with some expressing the view that this theory is found sadly lacking yet until now it remains a cornerstone of deliberations and studies on strategy. This paper aims to evaluate the theory and show that there are truths and learning to be gleaned from using it as an analytical framework while also pointing out its limitations.

In order to illustrate these points further, Porter’s five forces theory shall be applied to an analysis of online financial service institutions. The conclusion will discuss whether Porters five forces is still useful and appropriate to today’s ever changing businessenvironment, or whether new workable theories should be adopted.

I. WHAT IS PORTER’S FIVE FORCES MODEL?

Porter’s Five Forces Model is a theoretical framework that can be used by companies to analyse their competition and determine their competitive

strategy by looking at five distinct forces that determine success and long-term profitability.

The Rivalry Between Existing Sellers in the Market

Unless a company is a monopoly, there will be other companies in the same market offering a similar product or service. Rivalries develop naturally as companies compete with one another.

There are of course, a variety of actions that companies take in order to gain an advantage. Such actions include advertising, changing prices even if only for the interim, improving product features, using new distribution channels or enhancing the customer's buying experience, longer warranties and the like.

In Competitive Strategy (1980), Porter explains that the intensity of this rivalry among the competitors is influenced by several factors. One such factor is the number of firms in the market.

A larger number of companies in the same industry increase this rivalry. Another factor is slow market growth. If markets are expanding rapidly, companies tend to expand in line with the increased demand and because firms are all increasing their revenues, the intensity of the rivalry is lessened; however, when there is slow growth, firms fight for their share of the market, thus intensifying this rivalry.

High fixed costs also intensify rivalry. Since production must be kept at a high level in order to maximise these costs, there is increased pressure to also increase market share in order to dispose of these products. High

storage costs or producing highly perishable goods intensifies rivalry as well since producers want to unload as much of their products at the soonest possible time.

Low switching costs further intensifies rivalry. When customers can switch at ease, then the rivalry for these same customers are strengthened. Low levels of product differentiation also produce intense rivalry in very much the same way.

The diversity of the competitors whether it is background, philosophyor ideals produces a rather volatile rivalry. Other instances when rivalry is intensified includes when a firm is in danger of losing its market position and when there are high exit barriers because so much has been invested or fixed assets such as machinery and equipment cannot be readily adapted for other uses.

A difficult situation where all competitors are threatened takes place when there are new entrants into the industry and the market demand does not expand, leading to excess capacity. When inventory is high, there is a natural progression to resort to price wars, among other strategies, which in the end hurts all the sellers in the market.

Threat of Substitute Products Becoming Available in the Market

Substitute products are products found in other industries, but whose demand lessens the demand for the original product because it has the same function. The presence of substitute products may result in lower profitability expectations and limit industry attractiveness.

The determinants of this force includes the relative price performance of substitutes, switching costs and the buyer’s propensity to substitute as well as the perceived level of product differentiation. With a greater number of substitutes, buyers now have a wider choice which is why adding the other level of product differentiation is a key step in keeping buyers from switching.

This makes it difficult for firms to increase prices. In fact, these determinants may gravitate towards a situation where there is intense price competition, driving them down. More than that, however, it has been seen that there are situations wherein new developments intechnologyrender certain products or even services obsolete.