

Gaining The Competitive Edge - Porter's 5 Force Analysis

Porter's Five Forces Analysis is an important tool for assessing the potential for any company's profitability.

How does it work?

It works by looking at the strength of five important forces that affect competition, as follows:-

1. Supplier Power: Here you assess how easy it is for suppliers to drive up prices. This is driven by the number of suppliers of each key input, the uniqueness of their product or service, their strength and control over you, the cost of switching from one to another, and so on. The fewer the supplier choices you have, and the more you need suppliers' help, the more powerful your suppliers are.

2. Buyer Power: Here you ask yourself how easy it is for buyers to drive prices down. Again, this is driven by the number of buyers, the importance of each individual buyer to your business, the cost to them of switching from your products and services to those of someone else, and so on. If you deal with few, powerful buyers, they are often able to dictate terms to you.

3. Competitive Rivalry: What is important here is the number and capability of your competitors – if you have many competitors, and they offer equally attractive products and services, then you'll most likely have little power in the situation. If suppliers and buyers don't get a good deal from you, they'll go elsewhere. On the other hand, if no-one else can do what you do, then you can often have tremendous strength.

4. Threat of Substitution: This is affected by the ability of your customers to find a different way of doing what you do. E.g. substituting addiction counseling services for alternative /homeopathic medication or even exercise classes. If substitution is easy and substitution is viable, then this weakens your power.

5. Threat of New Entry: Power is also affected by the ability of people to enter your market. If it costs little in time or money to enter your market and compete effectively, if there are few economies of scale in place, then new competitors can quickly enter your market and weaken your position. If you have strong and durable barriers to entry, then you can preserve a favorable position and take fair advantage of it.

Identify the effects, strength and direction of each force, then work out your ability to make a sustained impact in the industry.

- Look at how you can affect each of the forces to move the balance of power more in your favor.
- With a clear understanding of where power lies, you can take fair advantage of a situation of strength, improve a situation of weakness, and avoid taking wrong steps. Therefore making this an important part of your planning toolkit.
- Look at the attached diagram, to understand your situation, go through each force one-by-one.
- Rationalise the relevant factors for your market or situation, and then check against the factors listed for the force on the diagram.
- Then look at the situation you find using this analysis and think through how it affects you.
- Bear in mind that few situations are perfect; however use environmental overview as a framework for thinking through what you could change to increase your impact with respect to each force.

