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Title of Attachment: Porter's five field analysis (Part-1)

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Porter's five force analysis - (Part-1)

Michel E. Porter developed an extremely useful model for formulating competitive strategy of business. A model has been proposed by him to determine the intensity of industry competition and profitability. The model consists of 5 competitive forces:

1. The threat of New Entrants: Any industry that is perceived as being profitable attracts new entrants. In such cases, the existing firms have to face increased competition and, therefore, may have lesser sale volume or market share.

The chances that new entrants will enter into an industry depends on 2 factors: the entry barriers to an industry and the expected retaliation from the existing firms. Of these, entry barriers are more significant demotivators for new entrants. So, higher entry barriers tend to keep out potential entrants into an industry. The entry barriers may arise due to several factors such as those given below:

- Economies of scale in production and sale of products leading to lower cost for existing firms.
- Capital requirements being very high prevent new entrants from making investments.
- Switching costs from the existing product or services to a new one may discourage customers from changing their preference.
- Product differentiation by existing firms based on perceived distinctiveness by the customers due to effective advertising, reputation as a service provider, brand loyalty of the customers may also act as a barrier for prospective entrants.
- Access to distribution channels can be monopolized by the existing firms on the basis of their long-term relationship with the distributors.
- Cost advantage independent of scale may arise propriety product technology, exclusive access to raw materials, favourable location and benefit of governmental subsidy.
- Government policies through licensing and other means can prevent the entry of new

firms to an industry.

Besides the entry barriers, the expected retaliation to the new entrants from the existing firms may be a potential threat to entry. For example, an existing firm with large market share may reduce its price to make it more difficult for the new entrants. Or, an existing firm with large resources may go for huge advertising to offset the new entry plans.

Despite the difficult barriers posed by the existing firms, new firms do enter industries if they find them to be promising. The popular strategy for doing so is finding market niches not served by existing firms and to gradually build up a presence in the market.

2. Rivalry among Competitors: Competition is a game in which normally, one player gains at the expense of the other. Moves and counter-moves are frequently played in the market by rival firms for serving respective interests. The nature and extent of rivalry among Competitors vary from industry to industry. This has implications for existing firms as well as those forms contemplating entry into the industry. Some major dimensions of such rivalry are described below:

- Competitive structure - It prefers to the number of competitors, their size and their diversity. Different types of competitive structure have different implications for the existing firms and the new entrants. Structures could either be Fragmented or Consolidated.

  A fragmented structure means that there are a large number of small or medium-sized firms in the market and none of them is in a position to dominate the industry. There is stiff competition in such industries and firms often face booms and busts, causing frequent restructuring of the market. This structure is characterised by low 'entry barrier' and less or no product differentiation.

  A consolidated structure consists of a few large companies (an oligopolistic market), who fiercely compete with one another. Such industries pose high risk to potential entrants.

- Demand conditions - High or growing demand leads to moderate competition, as each firm has enough of sale and even new entrants have better prospects. But stagnant demand leads to stiff fight for market share among the existing firms and low prospects for new entrants. Existing firms or new entrants need to take the demand condition into account for the purpose of formulating business strategies.

- Exit barriers- Exit barriers are economic, strategic or emotional factors preventing companies from moving out of the industry. Economic factors could be high sink cost or fixed costs. Strategic factors could be inter linkages between between different businesses of a company or different businesses sharing a common pool of resources. Emotional factors could be sentimental attachment with it or its employees or

distributors.

Collectively, the above three factors determine the business strategies that a firm is likely to adopt.