

Porters Five Forces

Definition:

Porters Five Forces is a tool to determine the ability of a business to influence the market and therefore the likely profitability of a given industry, based on 5 key forces: Barriers to entry, level of competition, buyer power, supplier power and threat of substitutes.

Barriers to entry

- Barriers to entry relates to the level of threat of new entrants to the market.
- If it is easier for businesses to enter markets then future competition is likely to be greater – this will restrict the ability of a firm to influence the market.
- The higher the barriers to entry the businesses will be prevented or deterred from entering the market.
- **Examples of barriers to entry:** the need to invest heavily in new plant and machinery, the need to match high levels of promotional spending, the brand / market share of current businesses, etc.

Level of competition (focus here on wider competition and also the rivalry of the competition)

- Porter argues that competitive rivalry is the main force that affects the ability of businesses to influence the markets (and thus control prices / profitability).
- The number of competitors – the more competitors the less likely it is that a business will be able to have influence
- Their ability to differentiate products – the more a business can differentiate its product the greater the influence they will have
- The rate of growth in the market – in a fast growing market competition may be less intense and individual firm will have more scope to influence the market

Threat of substitute's products

- This depends upon the extent to which businesses can differentiate their products from those of competitors.
- A business which struggles to differentiate its products is likely to face intense competition.

Buyer power (bargaining power of customers)

- Where buyer (customer) power is strong there is likely to be more competition between producers and their influence will tend to be weaker.
- The factors affecting the power of customers:
- The number of customer (the less there is the more power customers have)
- Their importance / amount of purchases (the higher this is the more power they have)
- Their ability to switch products (e.g. the available number of suppliers) – the greater the ability to switch the more power they have
- Regularity of purchases, e.g. one-off purchases usually mean customers are prepared to pay a higher price

Supplier power (the bargaining power of suppliers)

- Powerful suppliers can increase the costs of a business and decrease the extent to which it can control its operations. The power of suppliers is likely to depend on:
- The number of suppliers able to supply a business (the less there are the more power each supplier will have)
- The ability to switch supplier (the harder it is to switch the more power they will have)
- The number of customers available to the supplier (the more customers they have the more power they have)

Answering a Porters Five Forces question

Definition – show understanding of the theory and what it is used for

For each force:

- First sentence show understanding of the theory of that force
- Use a separate argument for each force (and sub-heading)
- Judge the likely degree of that force
- Support why you think this – apply to the case study and/or you own knowledge of the industry
- Bring the argument back to the impact of the level of this force to the ability of the business to influence the market (think price and profitability)

Conclusion – using all the arguments given arrive at an overall conclusion of the likely influence that business will have over the market (the link to its ability to make own decisions on prices, and thus the likely overall profitability)

Examiners note: The main reason cause of confusion on this topic is student's inability to distinguish between competition and substitutes.

- **Level of competition** – competition is concerned with people business who are trying to sell the same product or service to the same potential customer (by employing the **same method**). E.g. Ryanair and easyjet are competitors as they both offer low cost air travel around Europe
- **Substitutes** – are an alternative method of satisfying the need to the customer. E.g. if a potential customer wishes to go to France the options are: Aeroplane, boat, drive or train. These can be substituted for each other as **different methods** of meeting customer needs.
- **Apply** – it is crucial you apply to the individual business (and support / show your logic)