

THE FOUR ANALYTICAL TECHNIQUES EVERY ANALYST MUST KNOW:

2. PORTER'S FIVE FORCES ANALYSIS



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OK, you may be thinking to yourself “If I see one more article on Porter’s Five Forces in *CI Magazine*, I’m going to start lining my bird cage with them.” Please pause and give me a chance to explain.

Writing about Porter’s Five Forces — perhaps the most fundamental (and revered) analytic technique known to mankind (OK, maybe known to CI analysts and strategic planners) — is like writing that James Watson’s and Francis Crick’s discovery 50 years ago of the double-helix structure of DNA was sort of important for the development of the biotechnology industry.

COMPETITIVE STRATEGY

Five Forces was developed by Michael Porter in his book *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (current printing is by Free Press, 1998). This is one of those books that if, as a CI analyst, it is not on your shelf, great woe and sadness will befall you.

Porter’s Five Forces has numerous applications in the analysis of companies and industries. It has been applied principally in strategic planning to help managers understand likely future directions of industries and the drivers that influence industry participants.

My intent this month is not to tell you what you already know — that Porter’s Five Forces is a critically important model that is extremely valuable in conducting CI analysis — nor even tell you exactly how to use it. I’ll try to add to the public discourse by refining just a bit, how CI analysts view and apply the tool.

MEASURING COMPETITIVE INTENSITY

But the technique has also found a home among CI analysts as a means to examine the competitive intensity of an industry and the relative strengths, weaknesses, and leverage of key players. While strategic planners might use Five Forces to look holistically at industries and their companies’ place within industry structures, we tend to use it to first look at industry players individually, and then in the aggregate to identify competitive pressures impacting our company. (See Figure 1.)

For CI analysts, using Porter’s Five Forces can bring to light many competitive conditions that may not be readily apparent. That’s why Porter’s Five Forces ought to be at the heart of just about any analytic endeavor. I have used it countless times to the point that

it has almost become part of my mental make-up when conducting CI analysis. It’s always there running in the background, a frame through which I view competitive conditions, circumstances, and events. The model helps me look at industry players not in isolation, but within relationships.

FOUR ADVANTAGES

Bill Fiora, a guest contributor to The Corner this month and my partner in presenting the Analysis I Workshop at the SCIP Annual Conference in Anaheim, California in March (part of SCIP’s new certificate program) has identified four particular advantages of using Porter’s Five Forces as a basic CI analysis tool.

First, the model allows both analysts and management to isolate the

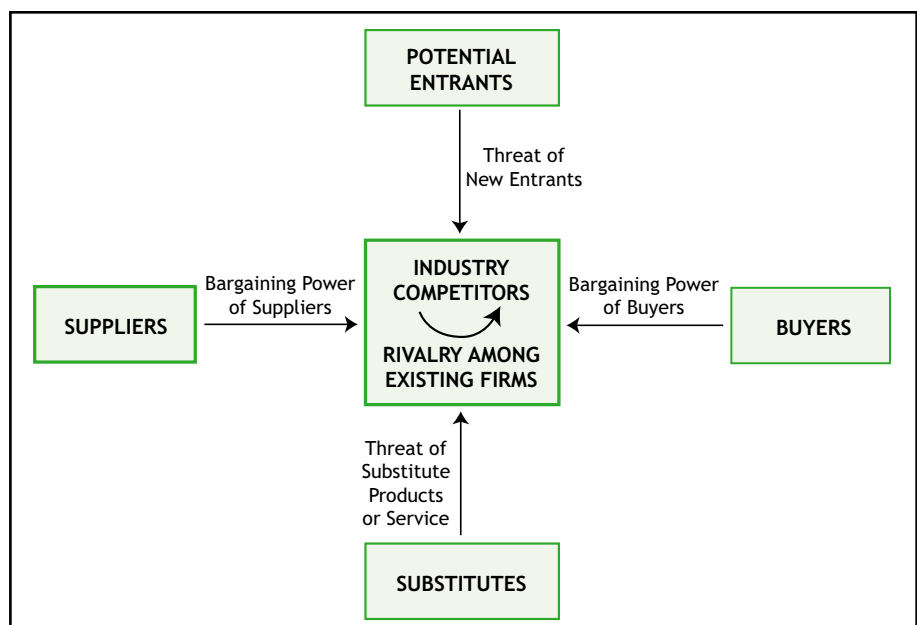


Figure 1: Porter’s Five Forces is a structured technique to analyze the complex relationships of an entire industry according to five major forces, depicted above (Source: Competitive Strategy, Michael Porter, 1980)

areas of an industry where there is the greatest potential for change. What's the point of focusing primarily on competitors if you're concerned about disruptions in your supply chain? Five Forces lets you isolate suppliers, and then examine how their changing influence and leverage impacts your company and your competitors. Conversely, the technique also lets you identify areas where a company — you or your competitors — may have little or no leverage.

Second, it provides management with a focused list of strategic options for improving your company's competitive standing. One of the greatest challenges CI analysts face is structuring analysis so that it gets serious consideration from management. Outlining strategic options at management's disposal is one way to do so. Five Forces provides a means to identify and communicate those options.

Third, Five Forces helps identify which players may be the weakest, or most favorably disposed toward alliances, partnerships, or acquisitions. Likewise, it identifies those players in the best position to acquire another player. This capability helps you anticipate acquisitive behavior among your direct competitors, and also assesses the prospects for forward or backward integration within an industry.

Lastly, Five Forces helps management determine the attractiveness of an industry in a relatively short time. Having the ability to look critically at an industry in this fashion can help shape the debate around industry entry or exit strategies. It can also help chart shifts in product or business unit strategy (from *growth* to *harvest*, for example).

CI analysts can make the best use of Five Forces by asking themselves a series of questions highlighted in Chapter 1 of Porter's *Competitive Strategy*. Use the answers to identify industry players' strengths, weaknesses, and leverage points. (See Sidebar 1.)

APPLYING FIVE FORCES

A consumer products manufacturer used Porter's Five Forces as one tool in an overall strategic development exercise intended to prepare a series of revenue and share growth options. The company operated in an industry with saturated markets for its products and flat revenue growth over the past several years. The industry was dominated by a handful of major competitors (of which this company was one) and numerous minor players. Questions it sought to answer included:

- Exactly how powerful are the dominant companies (itself included)?
- What opportunities exist for further industry consolidation?
- What are the paths of least resistance to growing share, given existing relationships?
- What threats exist from minor players?

The company convened a two-day Five Forces workshop where representatives from each functional area (marketing, manufacturing, regulatory affairs) presented their Five Forces based analysis of the industry from their perspective. During the course of the workshop, they developed one comprehensive Five Forces industry view by piecing together and analyzing each functional area's contribution.

Surprisingly, there was little overlap in each analysis. Marketing's view of the industry looked closely at buyers, while manufacturing examined suppliers intently. Allowing each functional area to present its view of the industry ensured that each component of the model was given fair and thorough treatment.

SHOWING POSITIONAL DIFFERENCES

As a result of this exercise, the company identified opportunities for share growth at the expense of one of

SIDEBAR 1: QUESTIONS TO ASK

Threat of new entrants:

- Where are there economies of scale in the industry?
- How differentiated are the industry's products and services?
- Would buyers encounter switching costs to move business to a new entrant?

Substitute products:

- What product functionalities can be replicated in some other fashion?
- Are their lower cost alternatives to current products?

Bargaining power of suppliers:

- Is the supply chain dominated by only a few companies?
- How important is the industry to its suppliers?
- How differentiated are suppliers' products?

Bargaining power of buyers:

- Are there large concentrations of buyers in the industry?
- Are products a high percentage of buyers' costs?
- Do buyers pose a threat of backward integration to your company?

Rivalry among existing competitors:

- How many competitors are there?
- How differentiated are they?
- What do exit barriers look like?

the dominant companies in the industry, given existing relationships and leverage points among major competitors and their buyers. The Five Forces analysis showed more stark differences among the power and influence positions of the dominant firms. It even went so far as to identify a single *rule setter*: a competitor that was able, because of its share position and relationships with both suppliers and

buyers: to tactically set many of the competitive rules that other players were forced to follow.

The company also learned a thing or two about the minor players that were increasingly entering the industry. The company was worried that these players had the ability to grow share at the expense of the dominant players, mainly through price competition. Instead they discovered that minor players actually lacked the clout and power to be considered viable threats.

Lastly, the company determined that conditions were becoming more favorable for a possible acquisition among two of the dominant players. The management began to explore plans to either participate in an acquisition or develop a defensive strategy should the company be excluded.

The Five Forces exercise and subsequent analysis enabled the company's management to pursue a number of strategic options, based on

its fresh knowledge of not only its position in the industry relative to competitors, but also insights into relative influence relationships among major players along the value chain. The company began to consider specific trade and promotion tactics that would be more viable given its position within the industry. These tactics might also be effective at swiping share from a competitor now deemed to be more vulnerable.

The company also sought additional investment from its parent for further product R&D to support a longer term growth play. And it began to quietly explore acquiring one of its direct competitors.

WITH FIVE FORCES?

Some CI analysts have begun to question the continued applicability of the Five Forces model, arguing that with information overload, rapidly moving industries, and unpredictable

forces of change, the model is no longer relevant. I couldn't disagree more. Five Forces provides an immensely useful framework to evaluate industry players under just about any condition, and continues to be an effective and insightful tool. CI analysts ignore it at their peril.

Next issue: a new look at scenario analysis.

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