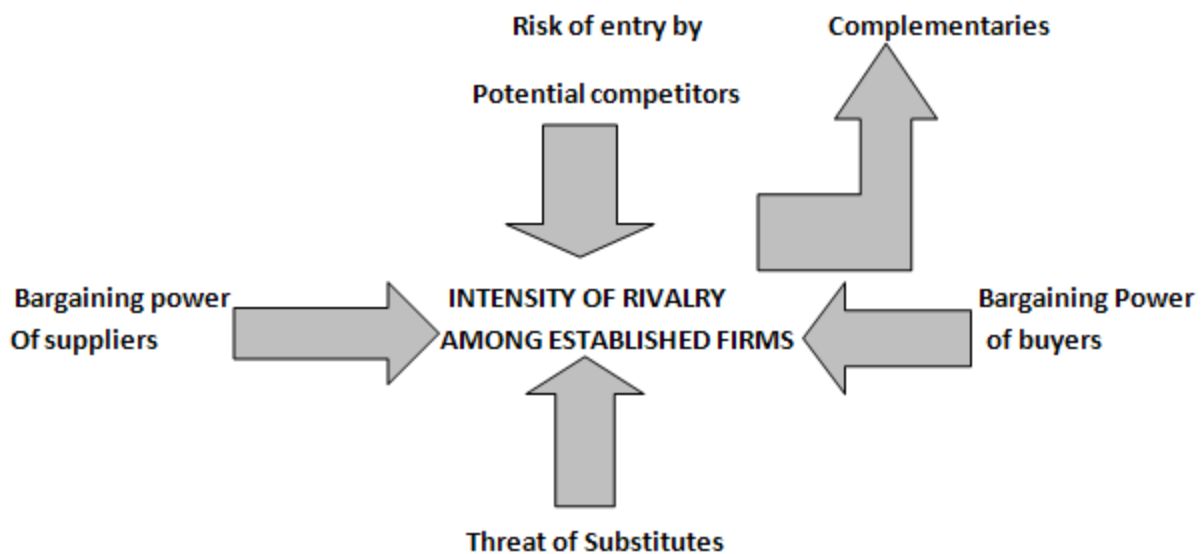


# Porter's Five Forces Model of Competition

Michael Porter (Harvard Business School Management Researcher) designed various vital frameworks for developing an organization's strategy. One of the most renowned among managers making strategic decisions is the five competitive forces model that determines industry structure. According to Porter, the nature of competition in any industry is personified in the following five forces:

- i. Threat of new potential entrants
- ii. Threat of substitute product/services
- iii. Bargaining power of suppliers
- iv. Bargaining power of buyers
- v. Rivalry among current competitors



**FIGURE: Porter's Five Forces model**

The five forces mentioned above are very significant from point of view of strategy formulation. The potential of these forces differs from industry to industry. These forces jointly determine the profitability of industry because they shape the prices which can be charged, the costs which can be borne, and the investment required to compete in the industry. Before making strategic decisions, the managers should use the five forces framework to determine the competitive structure of industry.



Let's discuss the five factors of Porter's model in detail:

1. **Risk of entry by potential competitors:** Potential competitors refer to the firms which are not currently competing in the industry but have the potential to do so if given a choice. Entry of new players increases the industry capacity, begins a competition for market share and lowers the current costs. The threat of entry by potential competitors is partially a function of extent of barriers to entry. The various barriers to entry are-
  - Economies of scale
  - Brand loyalty
  - Government Regulation
  - Customer Switching Costs
  - Absolute Cost Advantage
  - Ease in distribution
  - Strong Capital base
2. **Rivalry among current competitors:** Rivalry refers to the competitive struggle for market share between firms in an industry. Extreme rivalry among established firms poses a strong threat to profitability. The strength of rivalry among established firms within an industry is a function of following factors:
  - Extent of exit barriers
  - Amount of fixed cost
  - Competitive structure of industry
  - Presence of global customers
  - Absence of switching costs
  - Growth Rate of industry
  - Demand conditions
3. **Bargaining Power of Buyers:** Buyers refer to the customers who finally consume the product or the firms who distribute the industry's product to the final consumers. Bargaining power of buyers refer to the potential of buyers to bargain down the prices charged by the firms in the industry or to increase the firms cost in the industry by demanding better quality and service of product. Strong buyers can extract profits out of an industry by lowering the prices and increasing the costs. They purchase in large quantities. They have full information about the product and the market. They emphasize upon quality products. They pose credible threat of backward integration. In this way, they are regarded as a threat.
4. **Bargaining Power of Suppliers:** Suppliers refer to the firms that provide inputs to the industry. Bargaining power of the suppliers refer to the potential of the suppliers to increase the prices of inputs( labour, raw materials, services, etc) or the costs of industry in other ways. Strong suppliers can extract profits out of an industry by increasing costs of firms in the industry. Suppliers products have a few substitutes. Strong suppliers' products are unique. They have high switching cost. Their product is an important input to buyer's product. They pose credible threat of forward integration. Buyers are not significant to strong suppliers. In this way, they are regarded as a threat.
5. **Threat of Substitute products:** Substitute products refer to the products having ability of satisfying customers needs effectively. Substitutes pose a ceiling (upper limit) on the potential returns of an industry by putting a setting a limit on the price that firms can charge for their product in an industry. Lesser the number of close substitutes a product has, greater is the opportunity for the firms in industry to raise their product prices and earn greater profits (other things being equal).

The power of Porter's five forces varies from industry to industry. Whatever be the industry, these five forces influence the profitability as they affect the prices, the costs, and the capital investment essential for survival and competition in industry. This five forces model also help in making strategic decisions as it is used by the managers to determine industry's competitive structure.

Porter ignored, however, a sixth significant factor- complementarities. This term refers to the reliance that develops between the companies whose products work is in combination with each other. Strong complementors might have a strong positive effect on the industry. Also, the five forces model overlooks the role of innovation as well as the significance of individual firm differences. It presents a stagnant view of competition

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# Porter's Five Forces Analysis of the Airlines Industry in the United States

## Five Forces Analysis

Porter's Five Forces analysis is a useful methodology and a tool to analyze the external environment in which any industry operates. **The key aspect about using Porter's Five Forces for the airline industry in the United States is that the airline industry has been buffeted by strong headwinds from a host of external factors that include declining passenger traffic, increasing operating expenses, high fuel prices, and greater landing and maintenance costs, apart from intense competition from low cost carriers that has led to a cutthroat price war which has led the industry severely affected.** Indeed, it can be said that the airline industry globally is in a "death spiral" and more so in the United States where several prominent carriers were either forced into bankruptcy or had to merge with other airlines just to stay afloat.

## Supplier Power

The power of suppliers in the airline industry is immense because of the fact that the three inputs that airlines have in terms of fuel, aircraft, and labor are all affected by the external environment. For instance, the price of aviation fuel is subject to the fluctuations in the global market for oil, which can gyrate wildly because of geopolitical and other factors. Similarly, labor is subject to the power of the unions who often bargain and get unreasonable and costly concessions from the airlines. Third, the airline industry needs aircraft either on outright sale or wet lease basis which means that the airlines have to depend on the two biggies, Airbus, and Boeing for their aircraft needs. This is the reason the power of the suppliers in terms of the three inputs needed for them is categorized as high according to the Porter's Five Forces framework.

## Buyer Power

**With the proliferation of online ticketing and distribution systems, fliers no longer have to be at the mercy of the agents and the intermediaries as well the airlines themselves for their ticketing needs.** Apart from, the entry of low cost carriers and the resultant price wars has greatly benefited the fliers. Moreover, the tight regulation on the demand side of the airline industry meaning that passengers and fliers have been protected by the regulators means that the balance of power is tipped in their favor. All these factors make the airline industry cede power to the consumers and hence, the power of buyers is moderate to high as per Porter's Five Forces methodology. Apart from this, the buyers can engage in "price discovery" meaning that price fluctuations do not deter them as they have multiple channels through which they can book their tickets.

## Entry and Exit Barriers

**The airline industry needs huge capital investment to enter and even when airlines have to exit the sector, they need to write down and absorb many losses.** This means that the entry and exit barriers are high for the airline industry. As entry into the airline industry needs a high infusion of capital, not everybody can enter the industry, which in addition, needs sophisticated knowledge and expertise on part of the players, which is a deterrent. The exit barriers are also subject to regulation as regulators in the United States do not let airlines exit the industry unless they are satisfied that there is a genuine business reason for the same. Moreover, the airline industry leverages the efficiencies and the synergies from the economies of scale and hence, the entry barriers are high. Therefore, applying Porter's Five Forces framework, we find that the airlines pose significant entry and exit barriers, which means that the impact of this dimension is quite high.

## Threat of Substitutes and Complementarities

The airline industry in the United States is not at threat from substitutes and complementarities as unlike in the developing world, consumers do not necessarily take the train or the bus for journeys. What this means is that flying is a natural phenomenon for the consumers and hence, the substitutes in terms of the train and bus is minimal in its impact. Of course, many Americans motor down (use their cars for longer travel as well) which means that there is the threat of this substitute. As for complementarities, the provision of services like free Wi-Fi, a la carte meals, and passenger amenities offered by the full service airlines does not really translate into more passengers as in the recent past; fliers have been induced more by lower fares than these aspects.

## **Intensity of Competitive Rivalry**

As mentioned in the introduction, the airline industry in the United States is extremely competitive because of a number of reasons which include entry of low cost carriers, the tight regulation of the industry wherein safety become paramount leading to high operating expenses, and the fact that the airlines operate according to a business model that is a bit outdated especially in times of rapid turnover and churn in the industry. Apart from anything else, the airline industry is regulated on the supply side more than the demand side, which means that instead of the airlines being free to choose which markets to operate and which segments to target, it is the fliers who get to be pampered by the regulators. This is the reason why low cost carriers have literally grounded the full service airlines and when combined with the intense competition that was always the case in the United States, the result is that the sector is one of the most competitive in the country

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# **Porter's Five Forces Analysis of Samsung**

## **Introduction**

Porter's Five Forces methodology is used in this article to analyze the business strategies of white goods makers like Samsung. This tool is a handy method to assess how each of the market drivers impact the companies like Samsung and then based on the analysis, suitable business strategies can be devised. Further, companies like Samsung are known to study the markets they want to approach thoroughly and deeply before they make a move and it is in this perspective that this analysis is undertaken.

## **Industry Rivalry**

This element is especially significant for Samsung as the other White Goods multinationals like LG, Nokia, and Motorola not to mention Apple are engaged in fierce competitive rivalry. Indeed, Samsung cannot take its position in the market for granted as all these and other domestic white goods players operate in a market where margins are tight and the competition is intense. Apart from this, Samsung faces the equivalent of the "Cola Wars" (the legendary fight for dominance between Coke and Pepsi) in emerging markets like India where Samsung has to contend and compete with a multitude of players domestic and global. This has made the impact of this dimension especially strong for Samsung.

## **Barriers to Entry and Exit**

The White Goods industry is characterized by high barriers to entry and low barriers to exit especially where global conglomerates like Samsung are concerned. Indeed, it is often very difficult to enter emerging markets because a host of factors have to be taken into consideration such as setting up the distribution network and the supply chain. However, global conglomerates can exit the emerging markets easily as all it takes is to handover and sell the business to a domestic or a foreign player in the case of declining or falling sales. This means that Samsung has entered many emerging markets through a step-by-step approach and has also exited the markets that have been found to be unprofitable. This is the reason why white goods multinationals like Samsung often do their due diligence before entering emerging markets.

## **Power of Buyers**

The power of buyers for white goods makers like Samsung is somewhat of a mixed bag where though the buyers have a multitude of options to choose from and at the same time have to stick with the product since they cannot just dump the product, as it is a high value item. Further, the buyers would have to necessarily approach the companies for after sales service and for spare parts. Of course, this does not mean that the buyers are at the mercy of the companies. Far from that, they do have power over the companies, as most emerging market consumers are known to be finicky when deciding on the product to buy and explore all the options before reaching a decision. This means that both the buyers and the companies need each other just like the suppliers and the companies, as we shall discuss next.

## **Power of Suppliers**

In many markets in which Samsung operates, there are many suppliers who are willing to offer their services at a discount since the ancillary sectors are very deep. However, this does not mean that the companies can exert undue force over the suppliers as once the supply chain is established; it takes a lot to undo it and build a new supply chain afresh. This is the reason why white goods makers like Samsung invariably study the markets before setting up shop and also take the help of consultancies in arriving at their decision.

## Threat of Substitutes

This element is indeed high as the markets for white goods are flooded with many substitutes and given the fact that consumer durables are often longer term purchases, companies like Samsung have to be careful in deciding on the appropriate marketing strategy. This is also the reason why many multinationals like Samsung often adopt differential pricing so as to attract consumers from across the income pyramid to wean them away from cheaper substitutes. Further, this element also means that many emerging market consumers are yet to deepen their dependence on white goods and instead, prefer to the traditional forms of housework wherein they rely less on gadgets and appliances. However, this is rapidly changing as more women enter the workforce in these markets making it necessary for them to use gadgets and appliances.

## Stakeholders

This is an added element for analysis as the increasing concern over social and environmentally conscious business practices means that companies like Samsung have to be careful in how they do business as well as project themselves to the consumers. For instance, white goods makers are known to decide after due deliberation on everything from choosing their brand ambassadors to publicizing their CSR (Corporate Social Responsibility) initiatives.

## Conclusion

As the diagram above indicates the relative strengths and the weaknesses of each element, we can now conclude this analysis with the theme that as the global economy integrates and more emerging markets open up, companies like Samsung are at an advantage because they have already established themselves in many markets. However, it must also be noted that each market is unique and hence, Samsung must not adopt a one size fits all strategy and instead, must approach each market differently. In conclusion, Samsung can take pride from the fact that being an Asian conglomerate, it has managed to break into and hold its own against many western multinationals that have been in this business for decades

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# Porter's Five Forces Analysis of Virgin Atlantic

## Introduction

To introduce the article, it would suffice to say that each of the five forces that are discussed subsequently differ in their impact on Virgin Atlantic as the dynamics underlying them vary and the strategy employed by the airline is subject to the fluid and the changing external environment. Virgin Atlantic is a pioneer in the low cost business model though in recent years, many of its competitors have successfully incorporated its strategies in their operations.

## Entry and Exit Barriers

The entry and the exit barriers for the aviation industry are quite high as can be seen from the fact that it takes a lot of capital to enter the sector. Further, airlines cannot exit the sector when they choose as the regulators often insist that they fulfill their contractual obligations towards their stakeholders in case they want to exit the venture. Apart from this, the airline industry is characterized by tight regulation and many rules, which means that the regulators have to be satisfied about the safety aspect in addition to the airworthiness and the financial stability of the carriers. This means that the entry barriers are formidable and hence, Virgin Atlantic faces an external environment that is relatively tough for newer entrants to entrench themselves. Having said that, it must be remembered that once a carrier enters the industry, the situation is different as it can then engage in all out price wars and a race to the bottom.

## Industry Rivalry

It is a known fact that the airline industry is saturated with more and more carriers entering the sector in search of profits. Though it is a separate matter that most airlines do not manage to make profits consistently, this has not deterred the carriers from setting shop and entering the industry. Therefore, it can be said that the industry rivalry is quite high and something that affects Virgin Atlantic very much. Further, as far as the global aviation industry is concerned, there is a race to the bottom as ever-increasing carriers vie for a shrinking passenger pie leading to fare wars and cutthroat competition. Apart from this, the rivalry between airlines is leading to more consolidation as the mantra of bigger is better and lack of profitability is driving the airlines towards mega mergers.

## **Power of Suppliers**

The suppliers for carriers like Virgin Atlantic are the aircraft makers like Boeing and Airbus in addition to the aviation fuel companies and the ground support and handling vendors. Further, the suppliers also include those who make spare parts to the airlines. Considering the fact that the airline industry is characterized by the presence of a few carriers and many suppliers vying for business, it comes as no surprise that the power of the suppliers is low and the airlines have the upper hand in their interactions with the suppliers. Further, even in cases such as the supply of jet fuel, the carriers like Virgin Atlantic have a distinct advantage, as this fuel is expensive and a premium product meaning that there are not too many buyers for it making Virgin Atlantic a favored customer for the aviation fuel companies.

## **Power of Buyers**

If there is one force that has the maximum amount of impact on Virgin Atlantic, it is the power of buyers because the airline industry is essentially a buyers' market because of a plethora of choices, intense fare wars, and the ever looming threat of low cost carriers eating into the market share of established rivals. Of course, Virgin Atlantic is itself a low cost carrier though the fact that in recent years, many airlines have successfully imitated its business model means that they are taking away fliers from it. Further, with regulators choosing to lean on the side of the buyers rather than the airlines, Virgin Atlantic has to kowtow to the fliers and defer to them as otherwise it would lose out on market share. Apart from this, the increase in the distribution channels through which fliers can buy tickets and the removal of the intermediary layer with the proliferation of online booking direct from the airlines means that the buyers are spoilt for choice.

## **Threat of Substitutes**

People in the West most often travel by air and hence, the threat of substitutes is not that high for Virgin Atlantic. Having said that, it must be remembered that due to the ongoing recession, many business fliers who hitherto used to fly are now considering other options like Teleconferencing, virtual meetings, and such things to reduce the need to fly down to the customer and the partner locations for business meetings. Apart from this, another noticeable trend in recent years has been the paring down of leisure travel and substituting it with cheaper options like budget cruises and slow tourism that entail less dependency on air travel.

## **Conclusion**

The preceding discussion has highlighted the impact of each of the five forces as detailed in the Porters framework on Virgin Atlantic. The clear implications that one can draw from this is that Virgin Atlantic faces a competitive and a challenging external environment that directly affects its operations as it has to innovate and be lean and mean in its operational capacities and capabilities if it has to survive the onslaught of competition. Before concluding this article, it would be pertinent to point that the global airline industry is in a death spiral and hence, Virgin Atlantic has to be ahead of the curve if it has to remain profitable

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# **Porters Five Forces Analysis of China Mobile**

## **Introduction**

China Mobile operates in a monopoly like market in the domestic Chinese telecom sector and hence, the application of the five forces model reveals that it need not yet worry about the external environment, which is protected and heavily regulated. Having said that, as the succeeding discussion makes it clear, it cannot take its current comfort zone for granted, and as the recent strategic moves made by it reveal, it indeed taking steps to ensure that it continues to thrive and prosper even when the Chinese Telecom market is thrown open to foreign competition. However, its status as a SOE or a State Owned Enterprise guarantees it a lead over competitors even in this scenario, as the Chinese government is known to handhold its SOEs even in the face of competition.

## ***Industry Rivalry***

As China Mobile operates in a heavily regulated market where the government limits competition, the power of this element is not high. Indeed, it can be said that this element exerts the lowest force, as there are very few domestic or international competitors for China Mobile. Further, the fact that China Mobile is a monopoly player coupled with the large market share it has means that it faces little or no competition from existing or as we shall discuss, new players. Finally, the large industry size with a sizzling growth rate in the volumes of subscribers means that China Mobile does not have to worry too much about Industry Rivalry. However, this is set to change in the future because of the gradual opening up of the Chinese market to foreign firms even in telephony, which is enough for China Mobile to take it seriously. As has been mentioned elsewhere, many of the future trends

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point to China Mobile having to discard its legacy business model and indeed, current evidence suggests that it is in the process of doing so.

### ***Entry and Exit Barriers***

The Telecom sector anywhere in the world has high sunk costs, which means that prospective firms seeking to enter the market have to invest a lot of capital. This is further exacerbated in the Chinese market where the need of a strong distribution network given the size of the country coupled with the lack of advanced technology available to newer players means that this force is medium to low in its strength. Apart from this, the Chinese market as mentioned earlier is tightly regulated with a maze of rules and regulations that govern the market making it difficult for smaller and lesser-known players to enter the market. Therefore, China Mobile has very few reasons to worry about the threat of new players though this seems likely to change in the future with the government deciding to open up the Chinese telecom sector to international competition.

### ***Power of Suppliers***

The power of suppliers is virtually nonexistent as there is a single technology standard and given the lack of technological sophistication of the Chinese telecom market, suppliers cannot exert the power of technology on China Mobile. Moreover, as the market is tightly regulated, the suppliers (many of them government owned SOEs or State Owned Enterprises) have no choice but to do business with China Mobile. Of course, this works the other around as well since China Mobile has to rely on the few suppliers for its needs though the government plays the mediating role to ensure that neither side holds the other to ransom.

### ***Power of Buyers***

As with the other forces, the power of buyers is limited because of the presence of very few players in the Chinese Telecom sector. Coupled with the fact that there is low price sensitivity and low dependency on customization, China Mobile has a near stranglehold on the market as can be seen from the way it has acquired a large customer base within the span of a decade. This large customer base also gives China Mobile the power to set prices though the government intervenes now and then. Further, because of the premium that the Chinese place on owning a mobile handset and a connection, they are willing to endure the waiting period and the necessary adjustments, which mean that China Mobile has the free run of the market.

### ***Threat of Substitutes***

Given the fact that China is still a primarily agrarian country where the hinterland continues to languish though the cities are world class, the substitutes to mobile telephony are very few. With China being like other emerging markets where the transition from postal communication to telephony did not go through the landline phase and instead, leapfrogged into the mobile phase, China Mobile need not bother about landline substitution though the gradual adoption of the internet has made it wary of potential substitutes from internet telephony. Apart from this, China Mobile is also actively expanding into the internet based communications so that it retains its market share in the online realm as well.

### **Conclusion**

The preceding analysis has revealed the theme that China Mobile needs to start preparing for the future as soon as possible because of the trends like allowing competition, upgrading technology, opening up to foreign firms, and most importantly, the advent of internet telephony that threatens the cozy market leadership, which China Mobile has. In conclusion, the future seems to be arriving faster than expected for China Mobile and hence, it is the case that it needs to prepare for the future as though it has arrived yesterday

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