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RESEARCH ARTICLE

PORTER'S INDUSTRY ANALYSIS AND VALUE CHAIN MODEL.

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Abstract

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Michael Porter's Five Forces Model delivers a perfect mechanism and structure to understand the industry's competitive erection to achieve competitive advantage. According to it the Five Forces models offers pictorial representation of the Five Forces that distinguish the concentration and attractiveness of market. Also the Michael Porter's value c**hain** analysis focuses to deliver **value** to customer. It defines value as the sum a buyer is willing to pay for what a supplier delivers. Every value-generating activity involves bought-in components, human resources, some form of technology and information flow of various kinds. The purpose of this paper is to assess how the Porter's five key factors help in identifying and evaluating potential opportunities and risks. Also it focuses on the factors that determine competitive rivalry.

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Introduction:-

The concept of value chain was first introduced by Michael E.Porter. Harvard Business School's Michael E.Porter, who had also developed the Five Forces Model that many companies and businesses used to figure out how well they can perform in the existing marketplace. Porter's industry analysis was like a framework that tried to analyze the level of competition present within the industry and business strategy development.

Value Chain analysis basically relied on the economic principle of advantage i.e. businesses are best served by operating in areas/sectors where they can have a relative productive advantage over their competitor companies. At the same time, businesses should also ask themselves where they can provide best value to their customers.

Porter's Industry Analysis - Five Forces Model:-

In year 1979, Harvard Business School's Michael E.Porter identified five key forces that determined the long term fundamental attractiveness of a market or market sector. This was later recognized as Porter's Five Forces Analysis and it provided the model that enables the companies to analyze their industry in way that takes your competitors' activities in to the account. For Creating Strategies this was the vital part and it is very important that managers understand its working and how to contribute to it.

Organization's ability to define its market properly is one of the most crucial aspect of using this technique. Porter's analysis technique is often regarded as credible and practical approach as it looks at the forces that your competitors can exert on the market and how this could affect long term success of your organization. Porter's technique of analysis has become very popular with business and strategy analysts.

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For analyzing organizations industry structure in strategic processes, ‘Five Forces Tool’ has become an important method. Porter’s model is basically based on the insight that a corporate strategy should meet the threat and opportunities in the organizations external environment. Competitive strategy should be based on the understanding of the industry structures and the way they can change.

Five competitive forces were identified by Porter that shape each and every industry and attractiveness of the industry. The objectives of Corporate Strategy are to modify the competitive forces in such a way that it improves the organization’s position. Five Forces model supports analysis of the driving forces present in the industry. From the information derived from the Five Forces Analysis, management can decide how to exploit or influence particular characteristics of their industry scan.

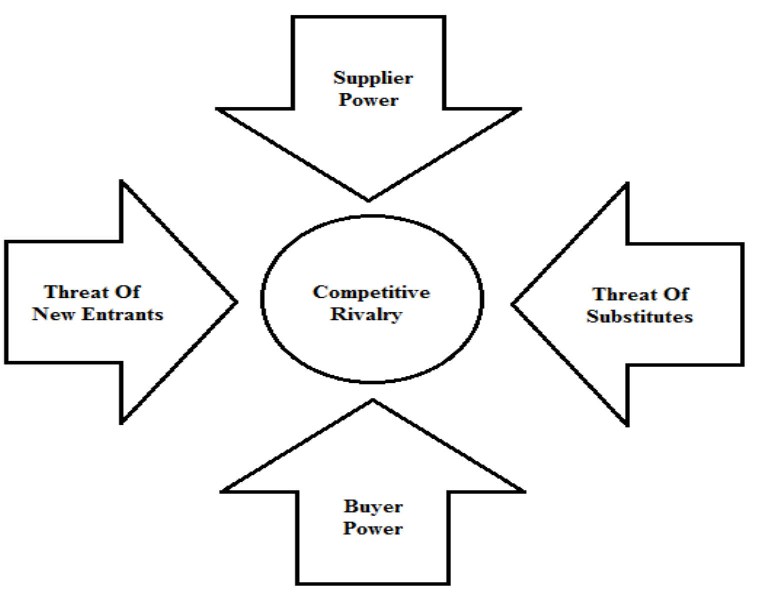
Porter’s model considered five forces that determine the attractiveness of market by carefully analyzing the competitive intensity. What Porter meant by a particular market being attractive was its overall industry profitability, which was assessed by looking at the risks and potential opportunities.

Always remember, Porter’s Five Forces was designed for use at the line of business level.

Line of business is defined as applying to a set of one or more highly related products that service a business need or a particular customer transaction.

The five key factors that this model uses to identify and evaluate the potential opportunities and risks are as following:-

- Competitive Rivalry
- Bargaining Power of Suppliers
- Threat of Substitutes
- Threat of New Entrants
- Bargaining Power of Buyers



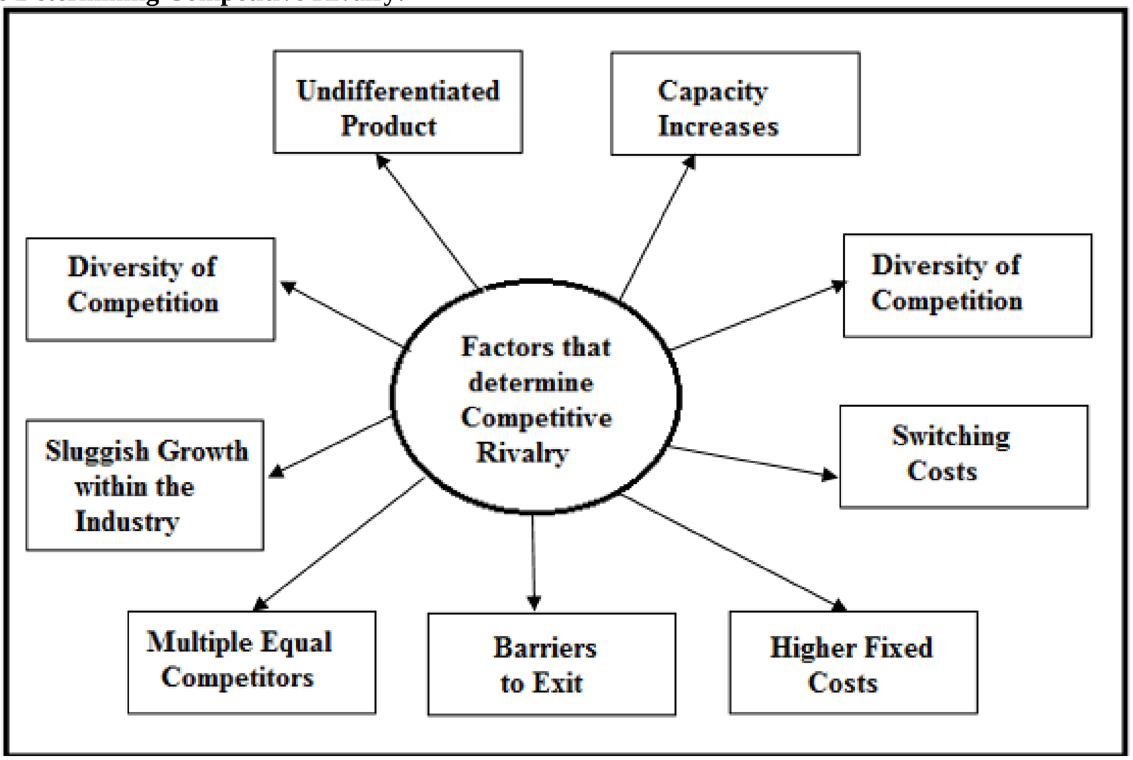
Porter's Five Forces

Competitive Rivalry:-

The competitive pressure present in the industry can manifest itself through a number of different tactics. These can include advertising wars, New Products, Competition based on the Price etc. The rivalry may also gain traction whenever a company feels pushed by a competitor or it identifies an opportunity to grow its share of the market.

Whatever be the reason, the actions of one company will definitely going to have an impact on its competitors. In turn, Competitors will also take action to retaliate against these actions. This scenario has the potential of turning into a cycle which may eventually end up harming the industry as a whole. It can become very unstable and affects the profit margin if the competition ends up being based on the price. On the other hand, advertising battles can end up raising the demand for a profit across the whole industry.

Factors Determining Competitive Rivalry:-



The nature and structure of an industry may determine the nature of the competitive rivalry that can exist in it. Some of the factors that make an industry competitive include:

Multiple Equal Competitors:-
If the industry under consideration has numerous competitors who all can operate an equal level of product or service quality, then there is a very higher threat of competition. Companies may feel the need to have more aggressive activities to gain a higher share of the market if they do not enjoy any sort of clear advantage over its competitors.

Sluggish Growth within the Industry:-
If the industry is not having a rapid growth rate, then the only way for the company to increase its market share is to take it away from its competitor. There is also going to be a higher degree of protectiveness towards the existing share in the market, as once it is lost, it will going to be hard to regain.

Higher Fixed Costs:-
If fixed costs are very high within an industry, then there is going to be more pressure to produce at full capacity in order to achieve the economies of scale. In order to make sure that stock is cleared, companies may guard their share of market aggressively and can also try to obtain more as well. In addition, Companies may have to sell at a lower rate to ensure that their stock is cleared.

Undifferentiated Product:-
If the main product of the industry is generic one and there are no grounds to base the differentiation on, then the products can be treated as a commodity. This means that choice of consumer will be based on its price and value for money. This is naturally going to lead to price based competition.

Switching Costs:-
If there is very little or no switching costs for a consumer then the industry is going to be more competitive. This scenario happens often in undifferentiated industries or the ones where the products are very similar in the feature, benefits and the Quality.

Capacity Increases:-
If the increase in Production capacity is warranted by the need for economies of scale, then there may be a short/brief disruption in the demand and supply of the market. This may further result in overcapacity of products and price cut to make sure stocks are cleared.

Diversity of Competition:-
If the industry is having different types of companies which are having differences in their origins and strategies, then there may be diverse ways to do the business. These alternate methods can change the nature of the competition and the way of doing the business.

Strategic Focus:-
Often a company may have high stakes to ensure that it stays in market/business over the long term. In this kind of scenario, the company may sacrifice their short term profitability to ensure the long term presence in the market. These companies will be focusing foremost on maintaining and growing their market share.

Barriers to Exit:-
If some barriers are present to exit within the industry, then the companies which are having low profit and growth may also need to remain active, In such cases, there is going to be competitive pressure to stay relevant and also earn profits by any means. Some of the potential exit barriers can be the result of ownership of specialized assets, fixed costs of exit and might be due to governmental regulations.

Threat of New Entrants:-
Porter believed that the possibility of having more new entrants can have a significant part to play in developing and changing the competitive dynamics of the industry. Porter's definition helped manager to see this threat as influential and substantial. According to him, this threat can change the competitive environment and it will directly impacts the profitability of an existing firm. If in any industry, there is a higher threat of new entrants, then this means that there are low barriers to entry and there is very high possibility that the industry profit potential will decrease as a whole. Same is due to the reason that competitors will going to fight more for the same amount of business. Sales and market share is going to be redistributed and there is also going to have its impact on the price and product quality.

Means of Entry into a Market:-
A new firm entering a market can happen in a number of ways:

Take-over:-
A company from outside the industry might take over an existing firm, thereby avoiding any of the traditional barriers to entry present within the firm. This firm may also bring new and innovative expertise within the industry, which is going to change the competitive dynamics for everyone.

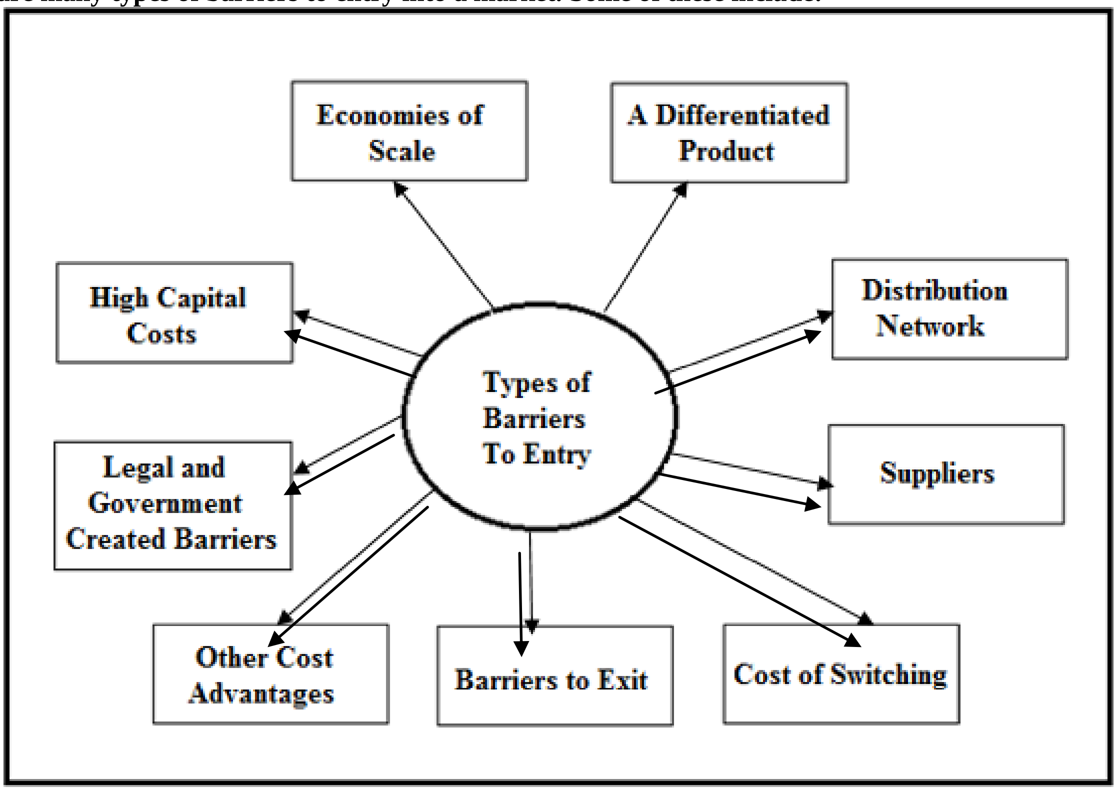
Diversification:-
Diversification of products from existing firms into other categories.

Competitive Advantage:-
Competition, through development of a specific competitive advantage over other companies can also be a threat.

Demand:-
Increase in demand may result in increase in prices which might allow a new entrant to make use of this increase and offset any high costs of the market entry.

Control:-
Existing firms may choose to control how a new firm will enter the market rather than attempting to stop any new competitors from emerging.

Types of Barriers to Entry:-
There are many types of barriers to entry into a market. Some of these include:-



Economies of Scale:-
When selling or manufacturing at a very large scale, companies are able to avail the cost advantages because per unit cost of the product decreases. So, the more the company manufactures in quantity the more will be the benefit. When existing companies are having this advantage, this can act as a barrier to entry for new entrant because a new entrant will have to try to match the scale to achieve the similar cost advantage as the existing company. This may not be possible for the new entrant at the initial stage.

A Differentiated Product:-
If the product which is being sold by the existing company or companies is highly differentiated or is enjoying a strong brand loyalty, then this can also act as a strong barrier to entry. The new entrant will have to invest in developing a product with newer and unique features and benefits that needs to surpass those offered by the existing company. In addition, there will be need for strong efforts to break the existing brand loyalties and shift them to a newer untested company.

High Capital Costs:-
If an industry requires huge capital investments at the very beginning, then this will act as a barrier to entry for many of the potential new entrants. Only those companies will attempt to enter the competitive fray who have the requisite resources to make high initial investment.

Other Cost Advantages:-
Apart from those cost benefits that come due to economies of scale, there are many other advantages that an existing firm may enjoy. These advantages include access to the best suppliers, an understanding of the existing materials and knowledge of their quality, possession of any necessary and important patents, and proprietary information and technological knowledge required. There are also learning advantages, which is achieved over years of business and experience in industry.

Cost of Switching:-
The cost which is associated with a consumer’s move from one company or product or another is called the switching cost. If the switching costs are significant, then a new entrant may not be able to create means of removing these. Or, they may need to offer significant advantages to customer to counter these switching costs at their own expense.

Distribution Network:-
Often, distribution relationships are very well established and which may prove to be a strong barrier to entry for a new company. A new entrant will obviously need access to same distribution channels but will need to invest extra in order to engage the distributors who are having established relations with existing competitors.

Suppliers:-
As with distributors, suppliers are also vital to the operations of a new business. Existing suppliers might have loyalties or contracts with existing companies and may prove to be difficult to form relationships with new entrant.

Legal and Government Created Barriers:-
Government and regulatory requirements like permits and licenses can be a strong barrier to entry. There can also be laws governing ways to conduct the business that might conflict with a company’s practices in some other countries.

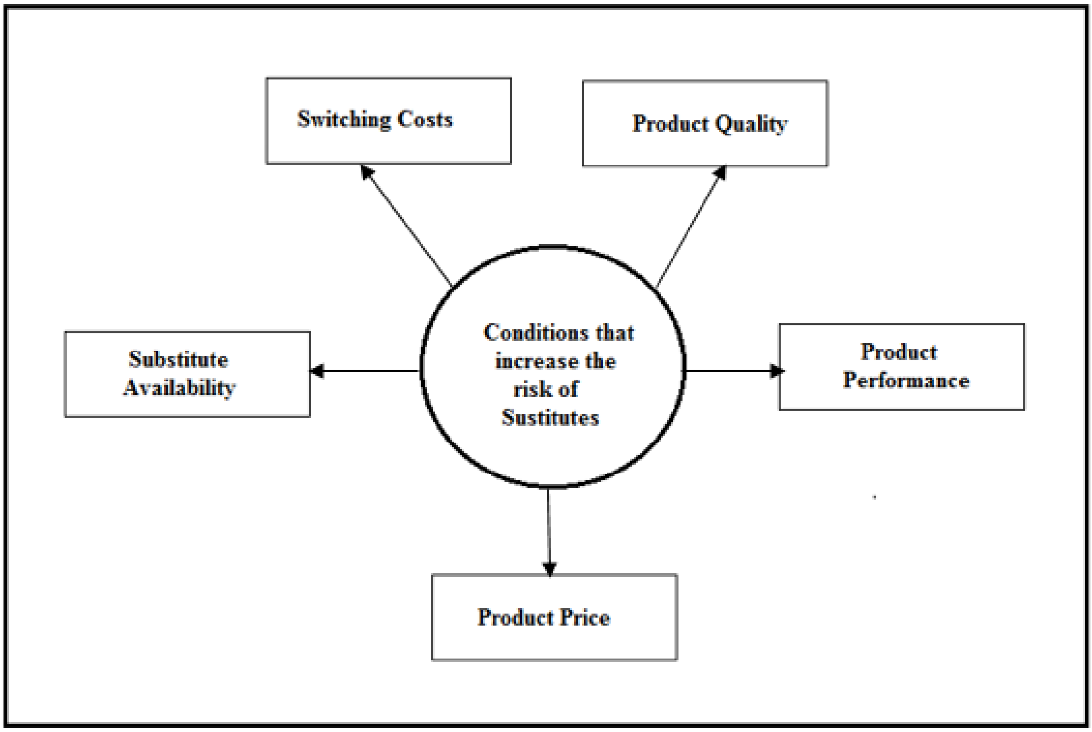
Barriers to Exit:-
Interestingly, barriers to exit may also act as a deterrent to entry by new entrants. If a company is unable to leave a competitive environment easily in case business does not work out, then it needs to stay and compete even if there is detrimental business practice. In such a case, the company may choose to not enter the market in the first place itself.

Threat of Substitutes:-
Substitute product is the one that is offering the same or similar benefits to a company as a product from another industry. Threat of a substitute is the risk level that a company faces from replacement by its substitutes. For more generic, undifferentiated products this threat is always way higher than that from more unique products. A company that is having several possible substitutes that can easily be switched has very little or no control over the prices it sets or how it chooses to sell its product.

The existence of substituted product offer different choices to customers and allows them options within the industry and beyond it to products that may fulfill the similar need. In case of more generic products, there are often more than one way to address the particular need. For Example, option to choose from different modes of transportation when going from destination Point A to Destination point B. If some taxi company operates on that route, it must compete with all other taxi companies on that route as well with any other possible routes such as airlines, buses and trains.

Analyzing the threat of substitutes can be difficult because the items being compared are not exactly alike but vary either slightly or greatly in what they offer. Customer will often base their analysis on the value offered by the product and its price.

Factors that increase the risk of Substitutes:-



There are many conditions or situations in which the threat of substitutes is stronger than usual. Some of these conditions are:

Switching Costs:-

If there is little or no switching costs for a consumer, then chances are more that they will explore and move over to a more attractive substitute. In the absence of other factors such as differentiation or brand loyalty, the choice to move will be very easier. For example, Apparel firms have very low switching cost among customers, who can easily find clothing deals and compare prices by walking from one store to another.

Product Price:-

If the price of the substitutes are more reasonable, then there may be more risk of consumers switching the products. In addition, this can act also as a barrier to how much a company can increase the prices for its own product. Any move to raise the price higher than substitutes may lead to consumer migration and loss profits.

Product Quality:-

If the substitute products quality is higher than that of any product, then there is more likelihood that consumers will want to make use of this difference and switch over.

Product Performance:-

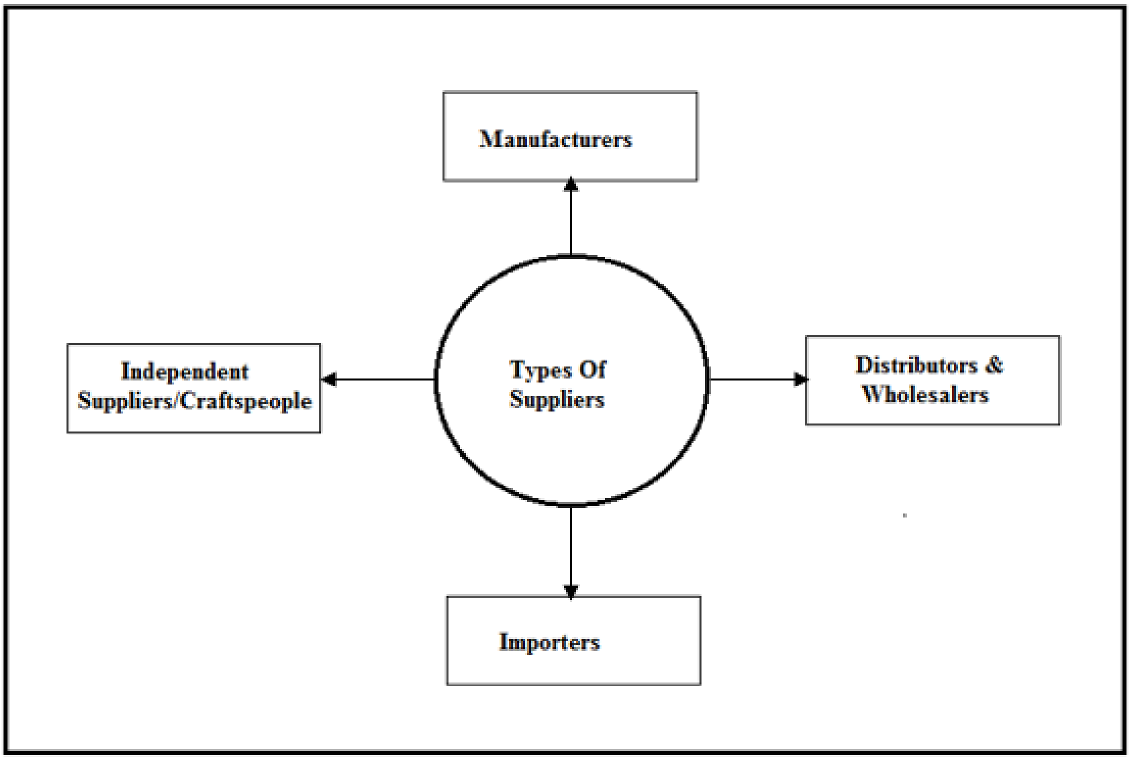
If the performance of the substitute product is better than a product then there is a chance that consumers will want to switch over. For example, in travelling short distances, if an airline’s flights are always delayed, while a bus is always on time, customers may choose to travel by road rather than wait endlessly for a plane to take off.

Substitute Availability:-

All of the above mentioned factors can only come into play if there are actually substitutes available in the market. To identify the potential threats, the company needs to be creative in its thought process and look beyond its traditional competitors.

Bargaining Power of Suppliers:-
An important force within the Five Forces model is the **bargaining power of suppliers**. The presence of powerful suppliers reduces the profit potential for an industry. Suppliers can increase the competition within the industry by threating to raise the prices or reduce the quality of goods and services.

Types of Suppliers:-



Depending on the industry, there are different types of suppliers. Some of these may be:-
Manufacturers:-
Manufactures are the producers of components that is feed into the end product manufacturing process. If the manufacturer has expertise or there is no competing producer, they will have more power. Conversely, if the supplied parts are generic and alternatives are easily available, then the manufacturer will be having less power.

Distributors & Wholesalers:-
Distributors & Wholesalers are types of suppliers who purchase the products in large quantities from different companies present in industry, store these products and eventually sell to retailers. These products are sold at higher prices than if bought directly from the manufacturers, but this also allows purchases to be made in smaller quantities than a manufacturer will not be willing to supply.

Independent Suppliers/Craftspeople:-
Unique items in small quantity are manufactured by Independent Suppliers/Craftspeople. These Products are exclusive and sold through representatives or trade shows.

Importer:-
These type of suppliers purchase the products from the international sources and then sell it to local retailers. These type of suppliers acts like domestic wholesalers for these products.
Power of Supplier Group:

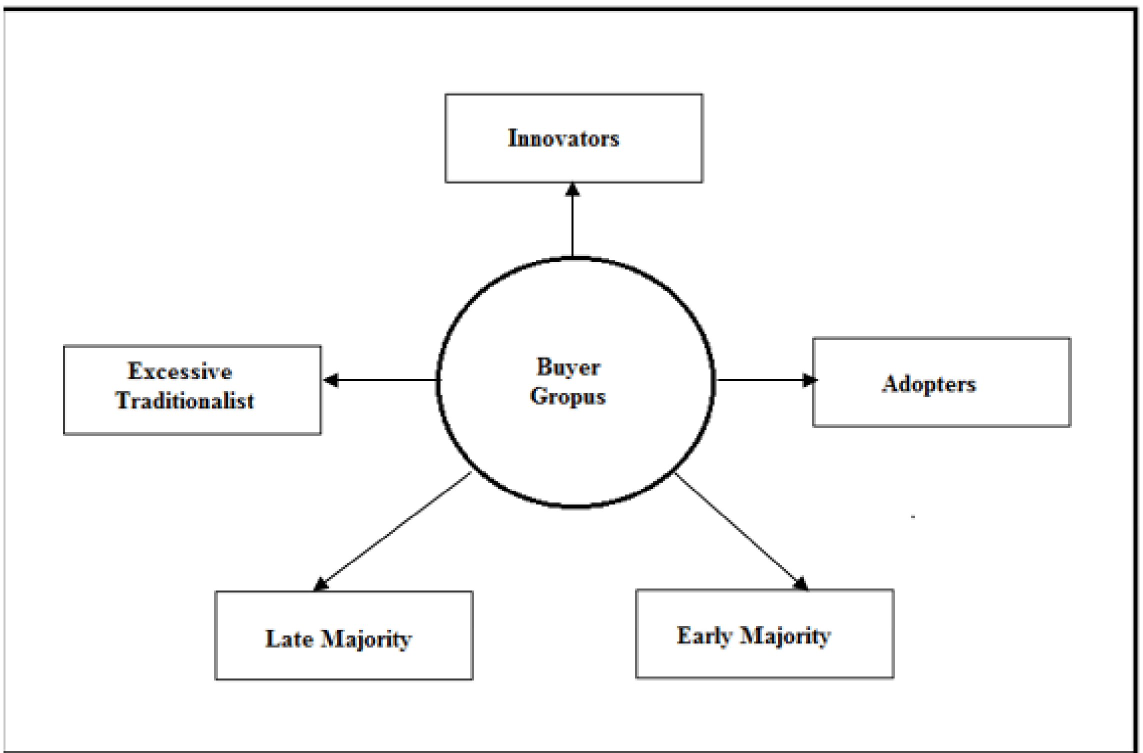
The following conditions indicate that a supplier group is powerful:
1. If suppliers are in concentrated numbers compared to the industry to which it sells.
2. If switching costs associated with a move to another supplier are high.
3. If suppliers are having ability to integrate forward or can start producing the product themselves.

4. If suppliers are having specific expertise or technology required to manufacture goods.
5. If the product supplied is highly differentiated
6. If no substitutes are available for the products supplied
7. If many buyers are present but none of them make up significant portion of sales
8. If end users are strong enough to exert power over the organization in favor of the supplier. (This can happen in the case of labor situations)

In all of these cases, the bargaining power of supplier is high, Supplier can set their own timelines or demand premium prices,

Bargaining Power of Buyers:-
Buyers have bargaining power whenever they are strong enough to exert collective pressure on the companies producing a product or a service. Their power is highest whenever buyers group is concentrated and purchases large volume relative to the producer's sales. The presence of powerful buyers reduces the profit potential in an industry.

Types of Buyers:-



Companies need to understand the different types of buyers before trying to create strategies to handle different types of buyers. Different types of buyers need to be treated in consideration of their unique behavior.
Inside each market segment, there are following five different group of buyers:

Innovators:-
Smallest group of early purchasers is called Innovators. They stay updated on the current, upcoming trends and newest technologies present in the industry. They have high degree of self-confidence and always look forward to experiment with new things. If a new product turns them on, they will use it and influence other possible innovators to use the product as well. However, the usage and acceptance of a product by innovators may not lead to a widespread trend.

Adopters:-
The next type of buyers are the early adopters. These people set an example for others by their decision and are true opinion leaders of a particular market segment. If a new Products offers them significant benefit, they will definitely

try out the product. Being an agents of change, they will understand the benefits of the product and seek reference from other satisfied users before they adopt it and this leads credibility to their references.

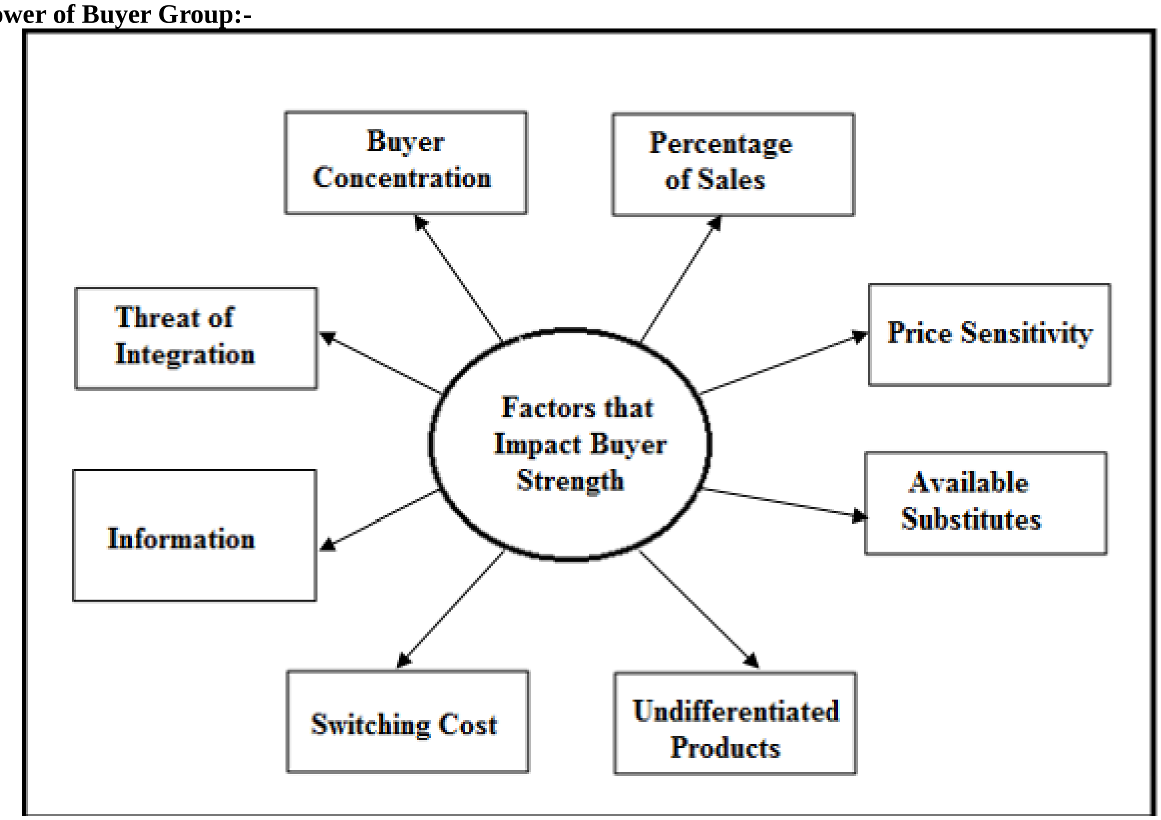
Early Majority:-
The next group of buyers is called early majority. The early majority group is relatively slower in adopting or trying a new product offering. They will usually embrace a new product only after it is accepted by their peers and strong references are received from them. This is a more practical group of people who are less technology driven and are not necessarily excited by the new or innovative.

Late Majority:-
Next group is late majority group.This group will only become consumers of a particular product much later in the product's life cycle, when stronger buyers might have already discovered the next new product. Their motivation is to wait for prices to fall and the product to become established in the market with proof of reliability and longevity.

Excessive Traditionalists:-
This is the last buyer group to come onboard regarding the product. This group wait till the price of product have reached their lowest point, competitors have entered the market and established themselves and the product has become an absolute need. The product may have become close to obsolete by this time. They represent only five percent of any market.

Each of the mentioned buyer groups has a different potential power over the producer and need to be managed accordingly.

Power of Buyer Group:-



There are several different types of market conditions that will determine whether the buyers will have power or not. Some of these factors are:

Buyer Concentration:-
Whenever buyers are limited in number and are more concentrated, then they have a higher power over the producer. The sales revenue of the producer will be completely dependent on those few customers and they will not be able to ignore any demands. Conversely, if the buyers are large in number and widespread, then producer can easily ignore the demand.

Percentage of Sales:-
Another bargaining chip for a buyer or buyer group is the amount of business they provide to a producer. If the buyer or buyer group is purchasing large volume relative to the seller's sale, then the producer will not want to risk losing their business.

Undifferentiated products: -
If the producer sells undifferentiated or standard product, then they will have the potential threat of a buyer switching producers. If there are more than one producers supplying the similar type of product, a buyer will have the option of exploring possibilities.

Switching Cost:-
If switching costs are low for a buyer i.e. little or no penalty for moving to another supplier, then any dissatisfaction with a producer or a product will lead to loss of business as the buyer will be able to find an alternate with minimum hassle and inconvenience.

Threat of Integration:-
Sometimes buyers pose a threat of backward integration. This means that they may engage in tapered integration by producing some components in-house and purchasing the rest from other suppliers.

Information:-
If buyers have full information regarding the producers operations, demand, market prices and supplier costs then they will be able to demand better prices from the producer.

Price Sensitivity:-
If the buyers are sensitive to changes in price of product and may stop purchase, the producer will not be able to ignore their demands.

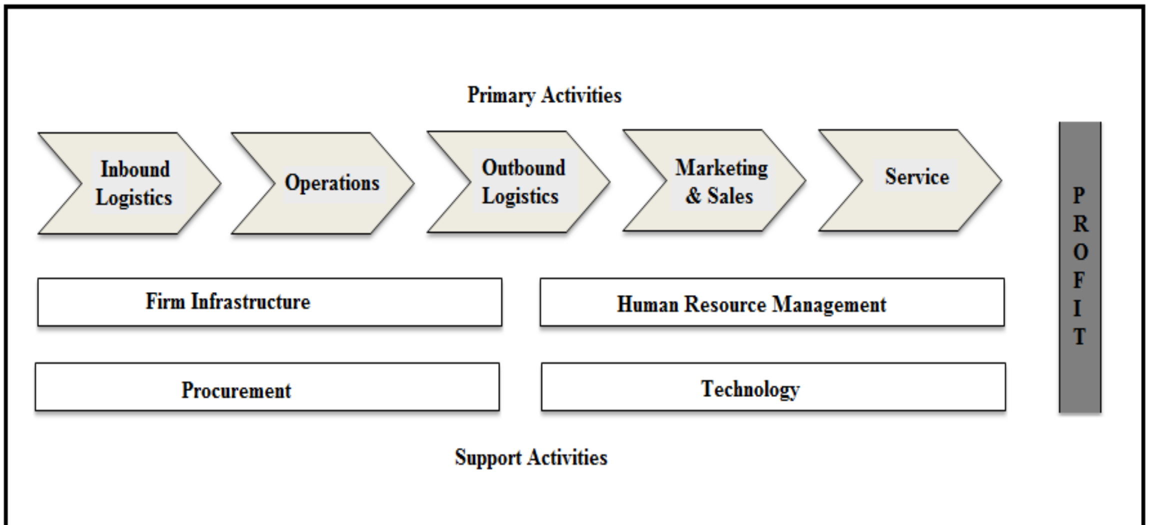
Available Substitutes:-
If substitutes or alternatives are easily available in the market, then the buyers will have options to switch and shop around, making their power over the producers substantial.

Porter's Value Chain Analysis:-
The value chain is easily recognizable in the Production industry, where a company takes raw material and perform a set of activities in order to deliver a valuable product which it sells to customers. Value chain is difficult to be identified in other industries. Any Company who wish to find ways to optimize processes while also creating an advantage in the marketplace must study the value chain first. The value chain can be used to find potential competitive advantages.

The goal of this strategy is to first identify the most valuable activities for the company and then take action on the activities that can be improved to add competitive advantage. Differentiation and Cost are two advantages within the value chain. Cost advantage demonstrate that the company is performing business activities at a lower cost which leads to greater profit. Differentiation Advantage demonstrates that a company is performing the business activities better than its competitor companies.

There is a direct relationship between the competitive advantage and sales of a product or service. Higher the competitive advantage, the more likely people are going to purchase the product or service. A close scrutiny and analysis of a company's processes can lead to superior product quality, higher profits and a greater market share through the value chain analysis.

Components of the Value Chain Strategy:-
According to the Value Chain Strategy, there are two main components: **primary activities** and **support activities.** Within these two categories there are additional processes that helps to narrow down the specific areas that add values to a company.



Porter's Value Chain Model

Primary Activities within Value Chain:-
The primary value activities are directly linked with the creation, sale, support and maintenance of the product or service. These primary activities are going to vary depending on the industry or business. Primary value activities add value directly to the production process but they are not necessarily more important than the support activities.

Inbound Logistics:-
The Inbound Logistics component focuses on all methods which are used to bring raw materials, or company inputs, into the business. This can include arranging the inbound movement of material from suppliers to assembly plants, warehouses, distributing material internally.

Operations:-
As the raw material makes it way though the company, Operations adds value by transforming the input (raw material, labor, energy) into outputs (in the form of goods and/or services). This is the stage of value chain that produces a product for customers.

Outbound Logistics:-
Once the product development has been completed, the process of moving it from the end of the production line to the consumers is called Outbound Logistics. Collecting, storage and distributing products, as well as preparing the company for additional growth is part of this stage.

Marketing and Sales:-
The methods which are used to convince consumers to purchase products or services over another's business are called marketing and sales. Value can be found by the addition of benefits and the success of communicating those benefits to customers, clients and partners.

Service:-
Service component in a value chain considers the value in maintaining their product/service working effectively for the buyer after it is sold and delivered.

Support Activities within Value Chain:-
In addition to the primary value activities, the value chain also considers support activities. Support activities are the behind the scenes aspect of a company that indirectly add value to products or services. There are four major components within support activities.

Firm Infrastructure: -
This includes the control systems and the overall structure of the organization. Firm Infrastructure consists of the activities such as legal, finance, public relations, quality assurance, accounting and general management.

Human Resource Management:-
Concerned with the human element of the company, this section of the value chain accounts for employee interactions. It encompasses recruiting, hiring, developing, training, compensating and laying off personnel and is one of the largest components in the value chain.

Technology Development:-
An important feature of the value chain, the technology development component pertains to the hardware, software, equipment, technology costs, managing information and maintaining current technology standards.

Procurement:-
This component studies how the company acquires the needed resources like goods, services or works from outside external source to operate. It also includes vendor and supplier negotiations.

Using the Value Chain Strategy:-
If value chain strategy is not followed by analysis and planning of action steps, then it is a worthless exercise. Depending on the advantage type desired by the company to focus on, the resulting analysis and action plan will going to have different strategies.

Differentiation Strategy:-
Value Chain Analysis is done differently when a firm competes on differentiation rather than costs. The source of differentiation advantage comes from the production of superior products, availability of more features and satisfying varying customer demands. To accomplish this type of advantage, company may require a higher cost structure, but can ultimately pay off in higher profits if managed correctly by the firm. The Value Chain Analysis focus primarily on identifying and optimizing the activities in the process chain that contribute the most to creating customer value. Additionally, the company should also focus on adding more features to their products, while maximizing the customer service experience and increase the potential for customization. The ultimate goal of the value chain strategy for the company desiring differentiation is to pursue sustainable differential advantage.

Cost Strategy:-
A company that wishes to compete in the marketplace on the basis of cost advantage must evaluate the value chain data from a different perspective. This type of approach is used when firms try to compete on costs and wants to understand the source of their cost advantage or disadvantage and what factors drive these costs.

- An exhaustive study to identify the primary and support activities of the company must be done and detailing how the work is completed at each step of the process.
- Establish the relative importance of each primary and support activity in the total cost of the product. This allows companies to identify inefficiently performed activities or large sources of cost activities to be analyzed and evaluated.
- Evaluation of the cost drivers for each activity must be performed. Determining what is driving the costs allows the company to identify ways of reducing the costs at each stage of the production.
- Identification of the links between the parts of the processes can help the company in the understanding of how cost changes in one part of the process may affect a different part of the process.
- Identify the opportunities for reducing costs. When the company knows its inefficient activities and cost drivers it can plan to improve on them. Reduction of cost through the identified areas will generate the opportunity for a successful value chain creation.

After completing a Value Chain Analysis, it can be overwhelming or tempting to consider the dozens of areas that can be improved. Select several easy-to-implement opportunities first and put them into motion immediately. This will going to create excitement and buy-in by the employees who will be enthused with the quick amount of success that can be had. Analyze the list of action steps and prioritize them according to feasibility, cost of implementing and necessity. Then begin to implement changes according to the strategy type desired. As the dynamic marketplace changes, additional evaluation of the value chain may be necessary to maintain a competitive edge.

Conclusion:-

- Michael Porter provided a framework that models an industry as being influenced by five forces. This framework should ideally be applied at all levels of the organization. This is sometimes difficult with mid or low level managers. A way to combat this is to make it intuitive in the company and should be emphasized in day to day activities.
- The strategic business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm operates.
- Helps the organization to look at all of the five forces concurrently when conducting an industry analysis. When a strategist loses sight of the big picture, they are more likely to let things slip through the cracks.
- Differentiating your product or service based on customer service can put you ahead of the competition in most industries.
- The Value Chain framework of Michael Porter is a model that helps to analyze specific activities through which firms can create value and competitive advantage.

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