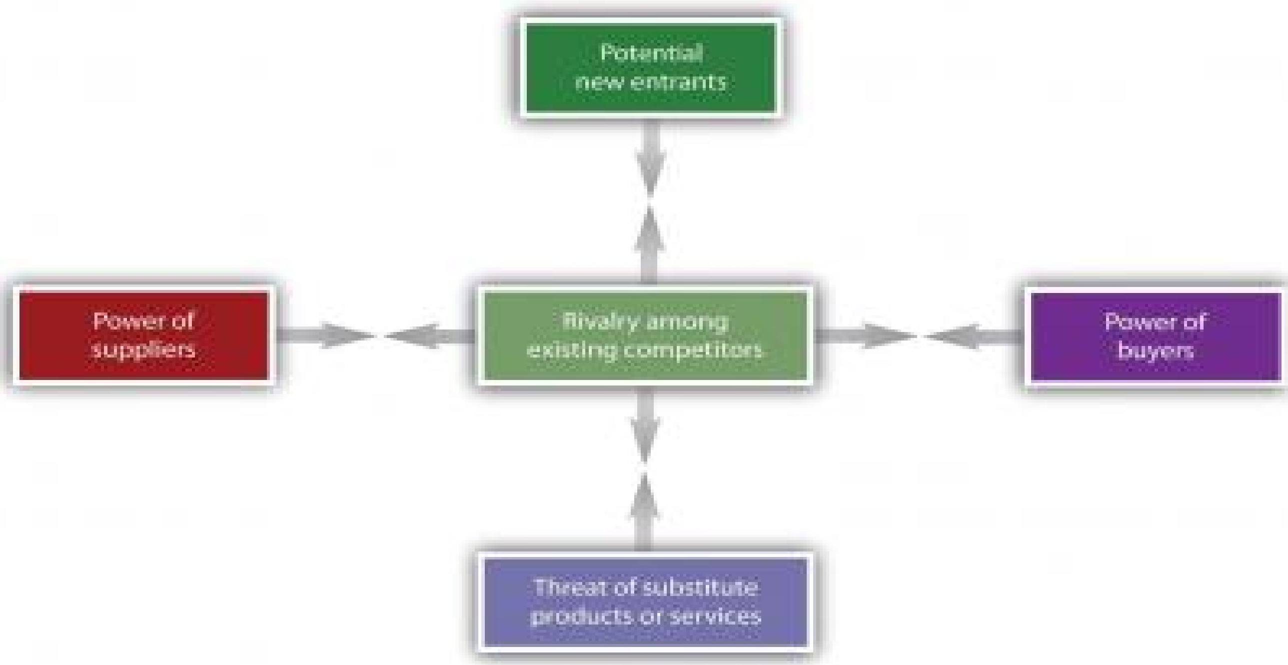
PORTER'S FIVE FORCES MODEL OF INDUSTRY COMPETITIVE ADVANTAGE

Professor and strategy consultant Gary Hamel once wrote in a *Fortune* cover story that "the dirty little secret of the strategy industry is that it doesn't have any theory of strategy creation."[79] While there is no silver bullet for strategy creation, strategic frameworks help managers describe the competitive environment a firm is facing. Frameworks can also be used as brainstorming tools to generate new ideas for responding to industry competition. If you have a model for thinking about competition, it's easier to understand what's happening and to think creatively about possible solutions.

One of the most popular frameworks for examining a firm's competitive environment is Porter's Five Forces, also known as the *Industry and Competitive Analysis*. As Porter puts it, "analyzing [these] forces illuminates an industry's fundamental attractiveness, exposes the underlying drivers of average industry profitability, and provides insight into how profitability will evolve in the future." The five forces this framework considers are (1) the intensity of rivalry among existing competitors, (2) the threat of new entrants, (3) the threat of substitute goods or services, (4) the bargaining power of buyers, and (5) the bargaining power of suppliers.

The Five Forces of Industry Competitive Analysis



New technologies can create jarring shocks in an industry. Consider how the rise of the Internet has impacted the five forces for music retailers. Traditional music retailers like Tower and Virgin found that customers were seeking music online. These firms scrambled to invest in the new channel out of what is perceived to be a necessity. Their *intensity of rivalry* increases because they not only compete based on the geography of where brick-and-mortar stores are physically located, they now compete online as well. Investments online are expensive and uncertain, prompting some firms to partner with *new entrants* such as Amazon. Free from brick-and-mortar stores, Amazon, the dominant new entrant has a highly scalable cost structure. And in many ways the online buying experience is superior to what customers saw in stores. Customers can hear samples of almost all tracks, selection is seemingly limitless (the "*long tail*" phenomenon—see this concept illuminated in Chapter 3, *Netflix: David Becomes Goliath*), and data is leveraged using *collaborative filtering* software to make product recommendations and assist in music discovery.[80] Tough competition, but it gets worse because CD sales aren't the only way to consume music. The process of buying a plastic disc now faces *substitutes* as digital music files become available on commercial music sites. Who needs the physical atoms of a CD filled with ones and zeros when you can buy the bits one song at a time? Or don't buy anything and subscribe to a limitless library instead.

From a sound quality perspective, the *substitute good* of digital tracks purchased online is almost always inferior to their CD counterparts. To transfer songs quickly and hold more songs on a digital music player, tracks are encoded in a smaller file size than what you'd get on a CD, and this smaller file contains lower playback fidelity. But the additional tech-based market shock brought on by digital music players (particularly the iPod) has changed listening habits. The convenience of carrying thousands of songs trumps what most consider just a slight quality degradation. iTunes is now responsible for selling more music than any other firm, online or off. Most alarming to the industry is the other widely adopted substitute for CD purchases—theft. Music is available free, but illegally. And while exact figures on real losses from online piracy are in dispute, the music industry has seen album sales drop by 45 percent in less than a decade.[81] All this choice gives consumers (buyers) *bargaining power*. They demand cheaper prices and greater convenience. The *bargaining power of suppliers*—the music labels and artists—also increases. At the start of the Internet revolution, retailers could pressure labels to limit sales through competing channels. Now, with many of the major music retail chains in bankruptcy, labels have a freer hand to experiment, while bands large and small have new ways to reach fans, sometimes in ways that entirely bypass the traditional music labels.

While it can be useful to look at changes in one industry as a model for potential change in another, it's important to realize that the changes that impact one industry do not necessarily impact other industries in the same way. For example, it is often suggested that the Internet increases bargaining power of buyers and lowers the bargaining power of suppliers. This suggestion is true for some industries like auto sales and jewelry where the products are commodities and the price transparency of the Internet counteracts a previous information asymmetry where customers often didn't know enough information about a product to bargain effectively. But it's not true across the board.

In cases where network effects are strong or a seller's goods are highly differentiated, the Internet can strengthen supplier bargaining power. The customer base of an antique dealer used to be limited by how many likely purchasers lived within driving distance of a store. Now with eBay, the dealer can take a rare good to a global audience and have a much larger customer base bid up the price. Switching costs also weaken buyer bargaining power. Wells Fargo has found that customers who use online bill pay (where switching costs are high) are 70 percent less likely to leave the bank than those who don't, suggesting that these switching costs help cement customers to the company even when rivals offer more compelling rates or services.

Tech plays a significant role in shaping and reshaping these five forces, but it's not the only significant force that can create an industry shock. Government deregulation or intervention, political shock, and social and demographic changes can all play a role in altering the competitive landscape. Because we live in an age of constant and relentless change, mangers need to continually visit strategic frameworks to consider any market impacting shifts. Predicting the future is difficult, but ignoring change can be catastrophic.

Company	Business	Competitive Use of Information Systems
Circuit City	Consumer electronics	Developed sophisticated sales and inventory-control systems to deliver a consistent experience to customers
Gillette	Shaving products	Developed advanced computerized manufacturing systems to produce high-quality products at low cost
Walgreens	Drug and convenience stores	Developed satellite communications systems to link local stores to centralized computer systems
Wells Fargo	Financial services	Developed 24-hour banking, ATMs, investments, and increased customer service using information systems

Factors That Lead to Attainment of a Competitive Advantage	Alter Industry Structure	Create New Products and Services	Improve Existing Product Lines and Services
Rivalry among existing competitors	Netflix changes the industry structure with its use of online ordering for DVDs.	Apple, Dell, and other PC makers develop computers that excel at downloading Internet music and playing the music on high-quality speakers.	Food and beverage companies offer "healthy" and "light" product lines.
Threat of new entrants	HP and Compaq merge to form a large Internet and media company.	Apple Computer introduces an easy-to-use iMac computer that can be used to create and edit home movies.	Starbucks offers new coffee flavors at premium prices.
Threat of substitute products and services	Ameritrade and other discount stockbrokers offer low fees and research on the Internet.	Wal-Mart uses technology to monitor inventory and product sales to determine the best mix of products and services to offer at various stores.	Cosmetic companies add sunscreen to their product lines.
Bargaining power of buyers	Ford, GM, and others require that suppliers locate near their manufacturing facilities.	Investors and traders of the Chicago Board of Trade (CBOT) put pressure on the institution to implement electronic trading.	Retail clothing stores require manufacturing companies to reduce order lead times and improve materials used in the clothing.
Bargaining power of suppliers	American Airlines develops SABRE, a comprehensive travel program used to book airline, car rental, and other reservations.	Broadcom develops a chip for wireless computing used in notebook PCs from Apple, Dell, Hewlett-Packard, and Gateway.	Hayworth, a supplier of office furniture, has a computerized-design tool that helps it design new office systems and products.

Altering the Industry Structure

Altering the industry structure is the process of changing the industry to become more favorable to the company or organization. The introduction of low-fare airline carriers, such as Southwest Airlines, has forever changed the airline industry, making it difficult for traditional airline companies to make high profit margins. To fight back, airline companies such as Delta are launching their own low-fare flights.[38] Delta claims that its Song airline will be one of the first “all digital” airlines. The approach will include a host of services on the flights, including entertainment, satellite TV, and many similar services.

A company can also attempt to create barriers to new companies entering the industry. An established organization that acquires expensive new technology to provide better products and services can discourage new companies from getting into the marketplace.

Creating strategic alliances can also have this effect. A **strategic alliance**, also called a **strategic partnership**, is an agreement between two or more companies that involves the joint production and distribution of goods and services. Samsung Electronics and Echelon Corporation, for example, signed a strategic alliance agreement to develop and market electronic devices that can be connected to each other and the Internet.[39] The alliance is oriented to the home networking market.

Creating New Products and Services

Creating new products and services is always an approach that can help a firm gain a competitive advantage, and it is especially true of the computer industry and other high-tech businesses. If an organization does not introduce new products and services every few months, the company can quickly stagnate, lose market share, and decline. Companies that stay on top are constantly developing new products and services. A large U.S. credit-reporting agency, for example, can use its information system to help it explore new products and services in different markets. Delta Airlines created a new service by installing hundreds of self-service kiosks to reduce customer check-in times. The new kiosks allow Delta customers to check in, get boarding passes, change seats, and sign up for standby flights or upgrades. On average, the kiosks save flyers from 5 to 15 minutes for each check-in at an airport terminal.[40]

Improving Existing Product Lines and Services

Improving existing product lines and services is another approach to staying competitive. The improvements can be either real or perceived. Manufacturers of household products are always advertising new and improved products. In some cases, the improvements are more perceived than real refinements; usually, only minor changes are made to the existing product.

Many food and beverage companies are introducing “Healthy” and ”Low-Carb” product lines. Some companies are now starting to put radio-frequency ID (RFID) tags on their products to identify them and track their location as they move from one location to another.

[41] Customers and managers can instantly locate products as they are shipped from suppliers, to the company, to warehouses, and, finally, to customers. In another case, Metro, the third largest retail store in Europe, used portable computers to show shoppers where products are located in the store and to display discounted prices and any specials.[42]

Using Information Systems for Strategic Purposes

In simplest terms, competitive advantage is usually embodied in either a product or service that has the most added value to consumers and that is unavailable from the competition or in an internal system that delivers benefits to a firm not enjoyed by its competition.

Although it can be difficult to develop information systems to provide a competitive advantage, some organizations have done so with success. A classic example is SABRE, a sophisticated computerized reservation system installed by American Airlines and one of the first information systems recognized for providing competitive advantage. Travel agents used this system for rapid access to flight information, offering travelers reservations, seat assignments, and ticketing. The travel agents also achieved an efficiency benefit from the SABRE system. Because SABRE displayed American Airline flights whenever possible, it also gave the airline a long-term, significant competitive advantage. Today, SABRE is aggressively seeking a competitive advantage by investing heavily in e-commerce technology and developing Internet travel sites. It invested more than $200 million in technology recently. Much of the investment was in the company’s Travelocity.com site (the second largest online travel agency) and GetThere.com.[43]

Increasingly, companies are using e-commerce as part of a strategy to achieve a competitive advantage. Table 1.5 lists several examples of how companies have attempted to gain a competitive advantage.