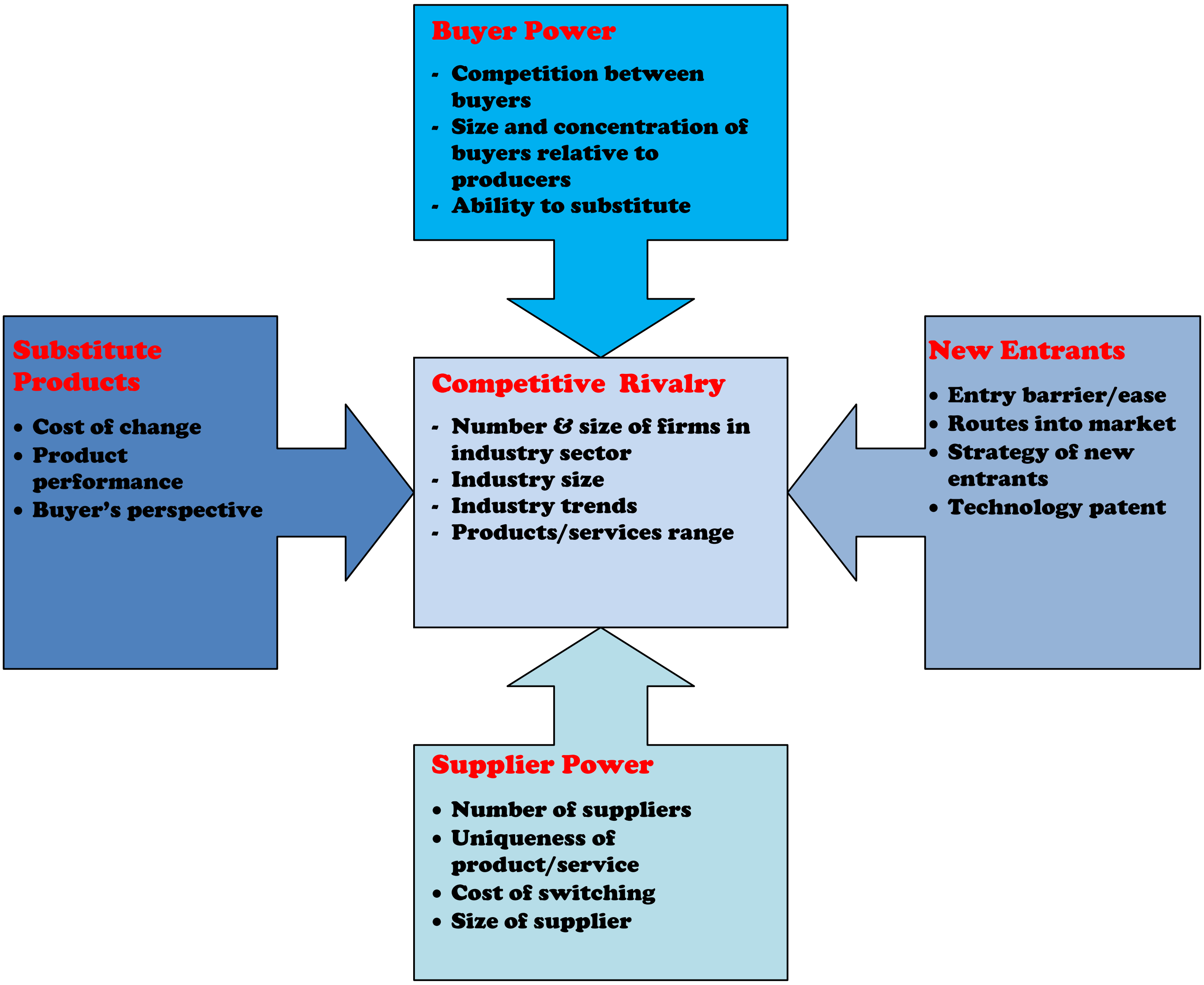
Porter's Five Forces Analysis

A business's potential for profitability can be analysed using Professor Michael Porter's Five Analysis. Just because a market sector is growing does not mean that a business can make money from it.

Porter's Five Forces are as follows:

- Threat of new entrants
- Bargaining power of suppliers
- Bargaining power of buyers
- Threat of substitute products
- Degree of competitive rivalry



1. Threat of New Entrants

A very profitable industry will attract new firms. If a lot of firms enter the industry then the competition will drive down profits for all firms in that industry. This will deter other firms from wanting to enter this market, but it will also encourage firms in this industry to exit. Low profits will create an entry barrier. Other types of entry barrier may also exist, e.g.

- Legislation compliance to operate in the industry;
- Patents and special know-how;
- Capital requirements, which could relate to specialist equipment.

2. Supplier Bargaining Power:

The ability of supplier(s) to drive up costs will affect a firm's competiveness. Suppliers bargaining power will depend upon, for example,:

- Number of suppliers that can supply key materials or services required by a firm to produce its goods/services;
- The uniqueness of the product or service offered by the supplier;
- The cost of switching from one supplier to another;

3. Buyer Bargaining Power:

A firm's competitive position is also affected by the number of buyers requiring the firm's products/services. If the firm is reliant on a few powerful buyers then the buyers will have greater power to dictate terms. Buyer bargaining power is influenced by, for example:

- Ratio of concentration of buyers to firms supplying the product;
- Price sensitivity of buyers (if any);
- Availability of substitute products;
- Switching cost for buyer;

4. Threat of substitute products:

If a firm's product can be substituted by an alternative product which may be available from a competitor, then buyers may consider switching based on price and performance of the other products.

5. Competitive Rivalry:

The number of firms competing in the marketplace will affect a business's prospects. If, however, the firm's product is unique then it is in a powerful position to dictate price and achieve a higher profit-margin.

As the diagram shows, the threat of new entrants, the bargaining power of suppliers and buyers and substitute products all impact on the firms within an industry which influences the level of competitive rivalry that exists between them.