Porter’s Model: A Critical Examination

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ABSTRACT

Porter’s Five Forces model is an influential management instrument for analyzing the present industry prosperity and attractiveness by using the outside-in viewpoint. Within the most recent decades, the model has involved in some disapproval because of the rising Internet economy. Due to an growing implication of Digitalization, Globalization and Deregulation, the trade structure of the ‘Older Economy’ changed primarily. The ‘New Economy’ is not equivalent with the ‘Old Economy’, which is the establishment of the Five Forces model. Furthermore the previous decades have revealed that Information Technology became extra and more significant. Objective of this study is to critically examine The Five Forces Model of Porter and to study up to what extent industry structure changed with thought of Globalization, Deregulation and Digitalization process. The study is qualitative study based on secondary data. These days expertise is one of the most significant drivers for modify and not only important for the accomplishment of change.

Keywords— Portal, Model, Critical, Digitalization, Globalization, Deregulation.

I. INTRODUCTION

Michael E. Porter of Harvard Business School developed the Five Forces model in the delayed 1970s. The Five Forces model is a easy but powerful tool for the recognition where authority lies in a certain business circumstances by means of the outside-in viewpoint (Johnson, Scholes & Whittington, 2008). The structure identifies five forces in the microenvironment that force challenge and pressure a company’s capability to make revenue. The origin of the Five Forces structure of Porter is the engineering economics approach. The thought is that the attractiveness of marketplace and it’s on the whole productivity can mostly be distinct by the market formation (Slater & Olson, 2002). The marketplace formation in turn influences the planned behavior of organizations, e.g. market accomplishment depends on the competitive policy. Therefore the organizational achievement is therefore not directly needy on the market arrangement. According to Porter the “attentiveness of these forces can help a business stake out a place in its industry that is less vulnerable to attack” (Porter, 1979, p. 137). On the other hand it is essential to state that the Five Forces have miscellaneous degrees of impact in certain industries (Mohapatra, 2012). In addition Mohapatra (2012) said that “individual forces and their communal impact will modify as the administration policies and macroeconomic plus surroundings circumstances alter” (p. 274).

II. METHODOLOGY

Research Methodology: The study is qualitative study based on secondary data. Need for Study: This paper reveals that the three latest forces changed the industry organization but they do not restructure the model. Porter’s Five Forces cannot be considered as obsolete. The basic idea that each company is operating in a network of Buyers, Suppliers, Substitutes, New Entrants and Competitors is still convincing. The three new forces now influence every of the Five Forces. An occurrence is that the Bargaining influence of Buyers enlarged due to the right to use to much more in sequence as of the Internet. In addition the hazard of New Entrants decreased since companies have to make high reserves in Technology which has a prevention effect on new possible marketplace entrants.

Objective of Study:

- To understand the Five Forces Model of Porter for analyzing profitability of an industry.
- To study up to what extent does the Industry structure changed with contemplation of the Globalization process, Deregulation process and Digitalization process.
III. THE FIVE FORCES MODEL OF PORTER

The foundation of Porter’s Five Forces is the approach of the industrial organization theory (IO). The IO assumes that the attractiveness of an trade, in which a business operates, is determined by the marketplace arrangement due to the cause that market arrangement affects the performance of marketplace participants. The Five Forces structure is a “helpful preliminary position for tactical investigation up till now where revenue criteria may not concern”. In order to produce a strategy it is very important to have enough information regarding the trade in which the corporation operates. The factors that are influencing a business within an manufacturing can be tremendously different. So it is wise to think only those factors that are significant for all participating companies within an business. In totaling to the competition between the presented competitors, Porter’s Five Forces model identifies one more four forces that describe the strength of competition within an trade: Bargaining control of Seller, Bargaining power of Purchaser, Threat of Substitutes and Threat of latest Entrants. The communication of these Five Forces is a steady threat to the achievement of a corporation. The force ‘Rivalry between presented Competitors’ includes several forms of struggle, for example “cost discounting, fresh product introductions, promotion campaigns, and examine.

A high level of competition involving existing competitors can pressure the productivity of an business. It depends on the “strength with which companies struggle and, next, on the foundation on which they struggle”. This strength can be prejudiced by manufacturing expansion rate, permanent costs/ storeroom costs, number of firms/contestant balance, switching costs between competitors, discrimination, or way out barriers. “New entrants to do business hold new aptitude, the want to gain market share, and frequently considerable resources.” The continued existence of access barriers limit the amount of companies in the trade and consequently pressure the ‘Rivalry Among Existing’. In addition companies who leave into a accessible market straight influence the competitive advantages. The extra supply for the same demand decreases the revenue of the market participants. The lesser the barriers to access are, the higher the danger of new entrants is. “The altitude of barriers to entrance has been originated again and again to be the most important predictor of business efficiency” Porter distinguishes amongst six important barriers to go into the marketplace:

(1) Economic of Scale
(2) Manufactured goods Differentiation,
(3) Capital Necessities
(4) Price Disadvantages
(5) Right to use to Distribution Channels
(6) Government Strategy

Bargaining authority of dealer defines the danger that dealer threatens companies with rising prices for goods or services. “Influential suppliers can thereby press profitability out of an trade unable to get better cost increases in its own prices”. There are diverse factors which are determined as indicators for high bargaining authority of suppliers: For instance the industry is conquered by a small number of companies and is consequently more determined than the business it sells to, or the trade is not the most vital purchaser of the supplier collection. The Bargaining authority of Suppliers can be prejudiced by the dimension of the dealer, the number of suppliers, and the convenience of substitute clients. The power of customers can be able to be described as the “turn over side of authoritative suppliers”. If the buyers have a high market control they are competent to move forward prices descending, prevail better fineness or they can force extensive services. These also reduce the productivity of the business. The Bargaining power of Buyer is high if the buyers are vast, they are able to organize easily to a dissimilar dealer and they are small in numbers. In the broadest sense all competitors within a business struggle with industries that generate substitutes. Alternate products and services limit the probable income of a trade by defining a cap for the prices of their products or services. The recognition of substitutes is a investigate for products or services that can fulfill the identical purpose as products of the industry of the measured industry. There are quite a lot of factors that pressure the Threat of Substitutes, e.g. switching expenses between substitute products/services plus manufacturing product or buyers’ addiction to purchase substitutes.

Porter Five Force Model

Source (Porter, 2008, p.27) (FIGURE1.1)
IV. LIMITATIONS AND CRITICISMS OF THE FIVE FORCES MODEL

As the Five Forces model is one of the majorities recognized and broadly spread management models in practice these days, the disapproval became more and more severe in the recent years (O’shaughnessy, 1984; Speed, 1989; Dulčić, Gnjidić & Alfirević, 2012). The majority detractors demonstrate that economic circumstances chanced basically in the previous decades (Conklin & Tapp, 2000). One of the initial criticisms is the fact that Porter (1979) has no explanation for the alternative of the five ecological forces, which show the strength of his option (O’shaughnessy, 1984; Speed, 1989). A additional disapproval is that the model only generates snap-shots. According to Thyrlby (1998), the Five Forces model of Porter is motionless and does not take account of instance. Thus it is much trickier to determine markets with higher rivalry dynamic because they can change very rapidly. This demands a steady creation of new models. Dulčić et al. (2012) are extremely critical in regard to the use of this model. In their opinion taking the dimension time into account might be beneficial for managers. If they take care about the ‘time dimension’, managers are better able to consider market trends and changing environment. Furthermore making use of the Five Forces framework does not assurance a cutthroat benefit that is unbreakable and continued (Aktouf, 2004). The reason for this lies in the reality that Five Forces framework is a fixed model, which does not contain again and again changes of the competitive surroundings (Karagiannopoulos & Nikolopoulos, 2005). According to Hill and Jones (2008). Industry factors are able to justify business performance variations. Those factors can only motivate 20 per cent of the variations in terms of market share, growth and industry profitability (Grant, 2011). Today’s goal is not only to protect against the Five Forces, it becomes more and more important to start collaboration and maintain innovation due to the increasing power of the Internet and other information technologies (Karagiannopoulos et al., 2005; Holm, Eriksson & Johanson, 1996). Flower (2004) and Downes (1997) criticise Porter’s model because of the missing attention to ‘Digitalization’, ‘Globalization’, and ‘Deregulation’. Those three factors are one reason why the industry structures changed during the last decades. In addition Grundy (2006) notes that the framework not refers to the ‘PEST’ factors or to the ‘dynamics of development’ for a definite business or marketplace. The Five Forces model does not evaluate the resources and capabilities of a company, which are also appropriate for analyzing on the whole effectiveness (Rivard, Raymond & Verreault, 2006)

V. DEVELOPMENT OF DIGITALIZATION, GLOBALIZATION

AND DEREGULATION

In order to determine whether the Five Forces are still applicable, this section analyses the Industry in general concerning structural changes because of increasing significance of ‘Digitalization’. Due to the Digitalization two further forces gain more and more importance and also significantly affect the competition: Globalization and Deregulation. Formerly locally operating companies have built an international business environment because of the technological progress and the improvement of communication and transport routes. On the other hand, the affects of globalization are visible in almost each area of a company and at each stage of the product life cycle. Just as important as Globalization is Deregulation. Good examples for Deregulation are the Airline Industry, the Communication Industry or the Energy Industry. Innovation and Information Technology reconstructed the traditional industry structure and allowed the existing company to reorient its activities. Likewise, new companies enter existing markets. Further outcomes, such as outsourcing, rejection and assimilation of business units, or forming alliances led to a restructuring of some industries.

The Impact of Globalization on the Industry structure

Nowadays companies, that are regionally focused, have to integrate in a global environment, even if they do not import or export goods. The advanced progress in the field of logistics’ distribution and communication enable global collaborations and products purchases. However the customers also benefit from the Globalization process due to the reason that they are able to compare global prices much easier and faster. This increases the strategic requirements that go beyond pure price and quality considerations. The main focus should be, in this regard, on customer loyalty and partner networks. Globalization still has an increasing impact on business organization and practice. He describes today’s Globalization, which began in the year 2000, as ‘Globalization 3.0’: political and social factors are the primary forces that shape the ‘Globalization-Process’. These factors decrease for instance the trade barriers or the economic reforms. Identified five main drivers of Globalization:

1. Lower Trade Barriers
2. Lower Communication Costs
3. Lower Transportation Costs
4. Spread of Technology
5. Information and Communication Technology (ICT) Development

The Impact of Deregulation on the Industry structure

Nowadays governments withdraw from business areas. The outcome is an increasing deregulation. Deregulation describes the removal of controls raised by the government on the operation of industries. During the process of liberalization, residual risk is dissolved and thus allows a restructuring of the affected areas. This can cause
an incorporation of business relationship, rejection, or outsourcing. In order to explain the consequences of Deregulation, the next part comes up with an example of the airline industry. The Airline industry is enormously dynamic and intriguing. Even other industries are affected by the airline industry, for example the ‘travel and tourism’ trade, which is one of the major industries international. This agreement influenced the market by introducing entry and exit barriers; control the competition for routes; and regulation price competition and fusions/ alliances.

The consequences of the deregulation are structural changes in the business that have to be considered. The airlines had to change their strategies in order to face the new competitive environment. Further implications are a strong development of the ‘hub-and spoke-system’, tougher competition among the existing competitors, and decreasing prices. Furthermore most airlines were owned by the state. Therefore the intensity of rivalry among the existing competitors was low.

Before the deregulation process there was no Bargaining Power of Buyers because of only a few alternatives to travel. The Threat of Substitutes Products/ Services was high due to the competition of train, car or bus. The order of aircrafts depends on the airline nationality. Due to the Deregulation Agreement, the entry barriers disappeared and new airlines, predominantly low-budget airlines, were entering the market. Thus the competition between the existing Competitors increased. The Deregulation led to number of benefits. For example, the Buyers get more alternatives to travel and also the ticket prices became cheaper due to price wars among competing airlines

**The Impact of Digitalization on the Industry structure**

One of the most important aspects which is not considered by, is the ‘Digitalization’. Due to the spread of the Internet and technological innovation, the global economy undergoes a fundamental structural change. This structural change is mainly driven by innovative-, and technology-oriented companies, whose business models are based on the possibilities of the Internet. This process of change is generally described by the term “Internet-Economy”. The increasing importance of digital products and the “Internet-Economy” put Porter’s Five Competitive Forces into question. The Internet and the Digitalization have almost influenced and changed the dynamic of all industries. Based on the dynamic evolution as well as the complex process of transformation of some industries, it is quite difficult to create a comprehensive situation analysis of the competition and the industry attractiveness. The last years have seen the impact of new driving forces, which include Porter’s theories inadequate. Today’s marketplace is strongly affected by the progress of Information Technology (IT).

Furthermore digital information goods are gaining more and more importance within the economic cycle. As already mentioned in the Introduction part, Porter considers IT as a tool for implementing strategies and changes. But today it is even more important to consider IT as a driving force for change. Looking towards the future, IT will restructure branches of trade and industrial sectors through continuous technological innovation. Due to increasing power of IT, all market participants have access to extensive information resources. This leads to a conception of new business models of companies from other industries. In addition, this changes the basis for competition substantially. In the course of the new development of the economy (induced by digitalization), more and more companies use the Internet as an information-, communication-, and sales medium. On the one hand the established companies have the possibility to expand their business areas or implement new business segments. On the other hand it creates a cost basis for the implementation of new business ideas for new companies. Organizations are able to build a large customer base very easily and quickly due to the vast reach of the Internet and the low financial costs. If the companies adapt accordingly, they are able to benefit from the high market dynamics and technological innovations. Today almost all business and operational transaction is bound by information components. At the same time the Digitalization reduced the transaction-costs for the acquisition and the use of information. Due to low transaction-costs, the use of information resources is more intensive and more comprehensive than before. This leads to higher profits for the companies. Similarly traditional regularities for products and services are not valid anymore for digital information products. The reason is that product development, operational processes and planning changed over the time. As a result the Digitalization boosts the trend towards virtualization of business structures, markets and workflows. Furthermore Digitalization displaces the “traditional sale” due to a faster and cheaper distribution method such as Internet sales. From this it follows the tendency towards dematerialization. This means a resolution of physical objects to electronic information. In recent years especially mobile technologies were established successfully on the market. It also reinforces the factors mentioned above, due to the reason that the access to digital products is independent of time.

But to what extent does Information Technologies, such as the Internet influence each of Porter’s Five Forces? If the number of competitors increases within an industry the intensity of competition will be atrocious. In order to survive and gain a competitive edge, companies are requested to make use of Information Technology. Through the use of IT, they are able to differentiate their products and services and thus create more value for the customer, create new products, or improve production efficiency and cost advantage. Good examples are the introduction of ‘Online-Banking’ or


‘Airline- Booking System’. Whenever a company makes use of a new technology in order to gain a competitive edge, the competitors try to introduce a similar technology in order to ensure that they do not lose market share. No matter where you are, the implementation of those. Nevertheless it is necessary to invest in new technologies, human resources and training in order to guarantee the proper function of ‘online-banking systems’ or ‘online-booking systems’. Due to the required high investments, the market entry barriers increased and deter companies from entering new markets. If companies act according to these requirements, they can get a competitive advantage against the competitors. The Bargaining Power of Buyers is also affected by Information Technologies. Information Technology such as the Internet shifts the power to the end consumers and reduces the switching costs. This is because of the amount of available information. On the one hand, price transparency increases. Buyers are able to compare prices and quality and to collect information about competitive products very quickly and easily.

This can lead to a full automation of business processes in which all interaction processes and all phases of service provision (including payment and delivery of goods) can be made via electronic networks. A further outcome of the Digitalization is that especially the value-chains of the company changes. The service companies, but also companies who are producing physical assets are faced with information intensive value-chains that also change the competition in a radically way. But how does Information Technology or Knowledge Management (KM), as an enabling technology of Digitalization, affect Porter’s Five Competitive Forces? Most of the industry forces are negatively affected by the listed developments. This means that the potential profit of the companies is decreasing. New technologies change the competitive environment significantly. It is also more complicated to make a prediction only on the basis of the Five Forces framework. The economic and social basic conditions change increasingly fast due to the Digitalization, Globalization and Deregulation. Information Technology changed the rules of competition in three ways:

1. Due to new technologies, existing business models are affected. In turn, this leads to changes in industry characteristics
2. New Strategies are being formulated due to the use of IT. It is important to ensure that the ambition of all stakeholders has been secured. Companies can benefit from an early adoption of new technologies. Furthermore they can maintain their competitive edge “and remains as top-of-mind recall for potential customers”
3. New Technology leads to reinvention of new business models.

On the other hand, the companies are able to make use of information technologies as well. They can make use of automated order processing system or ‘Customer-Relationship Management’ and therefore obtain information about the buying behaviour and customers’ needs. Many suggest that if the Bargaining Power of the Buyers increases, the Bargaining Power of the Suppliers will decrease as well. This is true for some industries but not for all. For example this statement is valid for the car industry. Furthermore there are two different views how the Internet altered the Bargaining Power of Suppliers: On the one side, the Bargaining Power over suppliers increases due to a new channel for supplier selection. On the other side, the Bargaining Power of Suppliers increases because of the reason that suppliers are able to have access to more customers. Therefore they are able to decide about collaboration with an organization and can have a look which harmonises best with their own philosophy. Due to the Internet, the suppliers but also the buyers and financial analysts are well informed about company’s strategy and about the quality of their products/services. Nowadays, there are many forums or WebPages where the products have been evaluated concerning the price performance ratio.

The implementation of Information Technology affects on the one side the transparency of the overall business process and on the other side relationships among customers and sellers. A good example is the introduction of the ‘Enterprise Resource Planning’ system (ERP). In the past it was quite difficult for buyers and sellers to gain insight into the production planning process. The existing confidence of buyers and sellers was enough. Today ERP makes the production planning process much more transparent and therefore buyers and sellers are able to plan accordingly. By linking different Information Technologies and manufacturing processes, companies can produce new products within a very short time of processing. Just to mention a few examples of combining IT and manufacturing processes, ‘computer-aided design’, ‘computer-aided manufacturing’ or the ‘computer integrated manufacturing system’ “greatly enhanced the scientific production, and agility and adaptability of production in enterprises, make the product’s features added expeditiously, provide the products with high performance more rapidly, simply and inexpensively, and thereby reduce the threat of substitute products or services”. Furthermore IT reduces the lead time for manufacturing new products.

VI. CONCLUSION

In the end, the Five Competitive Forces model cannot be considered as outdated. Of course there was or still is a revolution, but this does not challenge the validity of the whole model. The basic idea is that all companies are operating in a micro-network of Buyers, Suppliers, Substitutes, Competitors and new market actors. This idea is valid for each competition-based economy. Today, as in the past, companies are required to offer products and services that are competitive enough concerning price and
quality and ‘after-sales service’. It does not matter if we talk about ‘Old Economy’ or ‘New Economy’. However a strategist should not rely only on this model. Nowadays it is important to think additional factors as well and make use of more managing tools. The Five Competitive Forces are still applicable, but it is necessary to know the limitations of the model. Globalization, Deregulation and Digitalization have an impact on the accessible forces except they do not expand a new one. As already mentioned in the previous parts, the three forces changed the industry structure as well as the attractiveness of an industry. If the Entry Barriers are low due to the Deregulation process and therefore the Threat of New Entrants is high, the industry is not that attractive for companies than industries with high Entry Barriers and low Threat of New Entrants. Digitalization can affect the attractiveness of an industry as well. Because of the Internet, firms are able to reproduce products of their competitors. This increases the Threat of Substitutes and consequently impacted the attractiveness of the industry negatively.

REFERENCES