Porter's Five Forces

Porter's Five Forces is a strategy tool that explains **how attractive an industry is and how much profit a company can keep**. It was introduced in 1979 by **Michael Porter**, a professor of business strategy. Porter showed that competition does not come only from direct rivals: five forces together shape the pressure on every business. They are **competitive rivalry, the threat of new entrants, the bargaining power of suppliers, the bargaining power of buyers and the threat of substitutes**. Rivalry sits at the center, and the other four forces push on it from every side.

Why the Model Matters

Many leaders look only at their direct competitors and miss the wider forces that decide profits. Two companies can be equally well managed, yet one earns strong profits and the other struggles, simply because they operate in industries with very different pressures. The Five Forces help leaders understand where the pressure comes from, where their business is most exposed, and where opportunities exist. They are especially useful before major decisions, such as entering a new market or launching a new product.

1. Competitive Rivalry

Rivalry is the **intensity of competition among companies already in the market**. It is high when there are many competitors of similar size, when the market grows slowly, when products look very similar, and when leaving the industry is difficult. Strong rivalry leads to price wars, heavy advertising and lower profits.

Example: mobile phone operators in a saturated market often compete mainly on price and promotions.

2. Threat of New Entrants

When it is easy for new companies to enter a market, profits are shared among more players. **Barriers to entry** protect existing firms: high start-up costs, strong brands, strict regulations, economies of scale, access to distribution channels and customer loyalty.

Example: opening a new café is relatively easy, while building a new airline requires huge investment and licences.

3. Bargaining Power of Suppliers

Suppliers are powerful when **there are only a few of them**, when their inputs are unique or critical, or when switching to another supplier is expensive. Powerful suppliers can raise prices or reduce quality, squeezing a company's margins.

Example: a few companies build aircraft engines, which gives them strong power over airlines.

4. Bargaining Power of Buyers

Customers gain power when they **buy in large volumes**, when there are many alternatives, when products are standardized, and when switching costs are low. Powerful buyers push prices down and demand more quality and service.

Example: large supermarket chains can negotiate hard with small food producers.

5. Threat of Substitutes

A substitute is a **different product that meets the same need**. When good substitutes are available at a lower price, companies cannot raise their prices freely.

Example: video calls can replace business travel, and trains can replace short flights.

Reading the Result

When all five forces are weak, companies can earn strong profits. When they are strong, even excellent companies find it hard to make money. The model also shows which force is the biggest threat, so leaders know where to act first.

Industry example: the airline industry faces intense rivalry, powerful suppliers (aircraft and engine makers), price-sensitive buyers who compare fares online, and substitutes such as trains and video calls. No wonder many airlines struggle to stay profitable.

Applying the Model at Work: Four Steps

- **Map each force** for your industry and rate it as high, medium or low, using facts rather than opinions.
- **Find where the pressure is strongest** and where your business is most exposed.
- **Build a strategy to reduce it**, for example by building customer loyalty, working with several suppliers, raising barriers to entry or creating unique value that is hard to copy.
- **Review the forces regularly**, because markets, technology and regulations change.

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Common Mistakes to Avoid

- Looking only at direct competitors and ignoring the other four forces.
- Analyzing the whole economy instead of one clearly defined industry.
- Treating the analysis as a one-time exercise.
- Rating forces based on feelings instead of data.
- Describing the forces without turning the findings into actions.

Measuring and Monitoring

- **Rivalry:** number of competitors, market growth rate and price trends.
- **New entrants:** number of new companies entering each year.
- **Suppliers:** number of alternative suppliers and cost of switching.
- **Buyers:** share of sales from the largest customers and their price pressure.
- **Substitutes:** growth of alternative products and their relative price.

Example: A Regional Coffee Chain

A regional coffee chain used the Five Forces before opening in a new city. Rivalry was high, with many cafés; the threat of new entrants was also high, because opening a café is easy. Suppliers had moderate power, buyers had high power because they could walk next door, and substitutes such as office coffee machines were growing. The chain decided not to compete on price. Instead, it built customer loyalty with a rewards app, signed long-term contracts with two coffee suppliers, and focused on premium locations near universities. Within two years, its stores in the new city were among its most profitable.

Quick Checklist

- Have we clearly defined the industry we are analyzing?
- Have we rated each of the five forces with evidence?
- Which force puts the most pressure on our profits?
- What actions can reduce that pressure?
- When will we review the analysis again?

Key Takeaways

- Five forces shape industry attractiveness and profits: rivalry, new entrants, suppliers, buyers and substitutes.
- Competition comes from much more than direct rivals.
- Weak forces allow strong profits; strong forces make profits hard to achieve.
- Use the model to find where your business is most exposed and act on it.
- Review the forces regularly, because markets change.

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