Five Forces Analysis

Predicting the Unpredictable

THE FIVE FORCES – PREDICTING THE UNPREDICTABLE

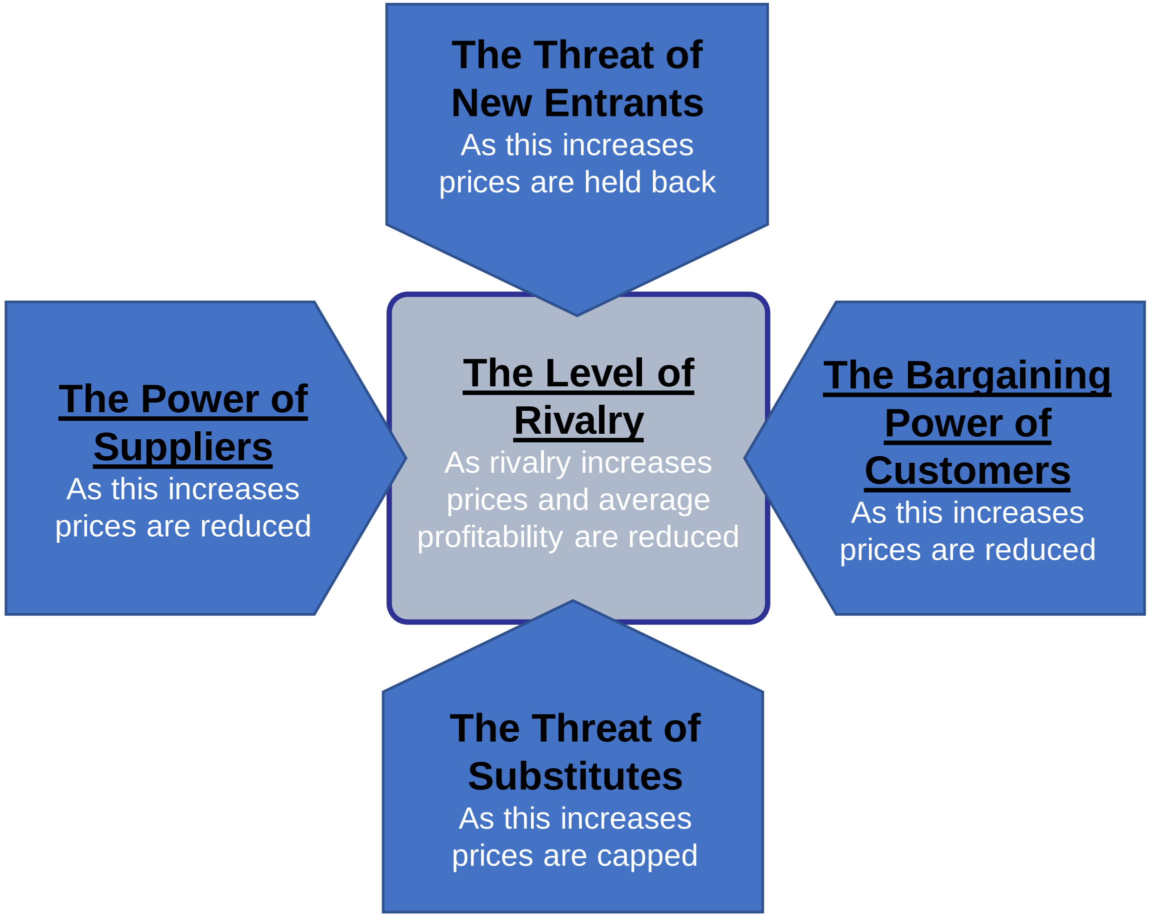
How strong or weak are the forces that shape the level of competition in your market? And how might they change in the future?

Covid-19 has rapidly shifted some of these forces. Once we understand these changes. The Five Forces framework can help predict how this will affect competition in our sector and how our strategy should change.

My advice is to work through the four outer forces, starting with The Power of Customers and then working back to The Power of Suppliers. Then assess the Threat of New Entrants and the Threat of Substitutes, before assessing The Level of Rivalry.

Taking each in turn use the questions / prompts on each page to build up a picture of the relative power in each area.

Use the blank sheets provided to make notes on your sector.



MARKET FORCES – THE BARGAINING POWER OF CUSTOMERS

How Easily Could Your Customers Force You to Lower your prices?

What is the number and size of customers – fewer, larger customers = more powerful customers.

How price sensitive is the customer base? What is the historic approach to pricing / price increases? Who is the customers customer? How might they influence the purchase decision?

Price sensitivity is HIGH when you are selling a commodity product, which is a low risk purchase or inconsequential, regular and/or small purchase.

Price sensitivity is LOW when your product or service is bespoke, critical to your customers performance, has a large financial cost, a high risk and/or is an infrequent purchase.

What % of their input materials are you? – smaller % = more powerful customers

How high are customers fixed costs? If they are high customers will prioritise volume over price and may consider "contribution" to fixed costs ahead of profit.

What is the cost to customers to switch away from you as a supplier? If this is a high cost, complex and/or may take a long time the price pressure is lower.

How strong is the potential for vertical integration? If this is credible then customers may be more aggressive in demanding lower pricing

USE THE SHEET BELOW TO MAP OUT THE POWER OF YOUR CUSTOMERS…

The Bargaining Power of Customers

As this increases prices are reduced

The Bargaining Power of Customers

THE FIVE FORCES – HOW TO ASSESS THE BARGAINING POWER OF SUPPLIERS

The Power of Suppliers

As this increases prices are reduced

How easily could your suppliers put up their prices?

- Focus on any suppliers of materials, parts or services which are critical to the value you deliver to your customers (But cover all areas to avoid surprises!). Where the cost, complexity or impact on your customer of the component is high, the power of the supplier is higher. If the component

- Include your staff and any partners like colleges, professional bodies or agencies.

- Include suppliers of investment finance or working capital.

- How many and what size are your suppliers – fewer, larger suppliers are often more powerful. Many small suppliers are less powerful.

- What % of their order book are you? – if you are small relative to them you have low levels of power to stop them securing most of the value your market has to offer for themselves.

- How high are suppliers fixed costs %, if they are high you have greater leverage.

- What are the costs to you of switching suppliers? If these are high and complex, suppliers have greater power.

- How strong is the potential for suppliers to forward integrate?
- For example - Soft drinks makers can credibly threaten to make their own plastic bottles, important if you are a plastic bottle maker, but not to make their own glass or aluminium packaging. Where the threat of forward integration is high suppliers are more powerful. The reverse is true also, could you credibly reverse integrate? Then you have more power.

- Do you have alternative inputs which you could use instead?

USE THE SHEET BELOW TO MAP OUT THE POWER OF YOUR SUPPLIERS…

The Bargaining Power of Suppliers

MARKET FORCES – THE LIKLIHOOD OF NEW ENTRANTS?

How Likely are New Entrants?

- What are the up-front market entry costs faced by potential new entrants? If these are low new entrants are inevitable.
- Where are the economies of scale that might influence the size of any new entrant at the point they enter the market?
- What are the development costs for potential new market entrants?
- What are the costs, risks, advantages for prospective customers to switch to a new entrant?
- Is there a network scale effect? With subscription sales how possible is it to access the subscriber network needed for success? Do they already have a network, or a different approach that brings potential, or will they have to tolerate an unprofitable period while this network builds up?
- What are the technical, brand, IP, licensing and regulatory, land and location barriers or opportunities to new entrants?
- What would be the market reaction – aggressive or passive? How has the market reacted to previous new entrants?
- How fast or slowly is the market growth and profitability. And what is the current level of competition within the market and what is the nature of that competition – Price focused or differentiation focused? How large or small are current players?

USE THE SHEET BELOW TO MAP OUT THE LIKELIHOOD OF NEW ENTRANTS…

The Threat of New Entrants
As this increases prices are potentially held back

The Threat of New Entrants

MARKET FORCES – THE THREAT OF SUBSTITUTES

How Likely are Substitutes Products to be Used by Your Customers?

- Is there a potential price/value disruptive substitute?
- What technologies or new business models? eg Uber, Block buster video stores vs Redbox then vs Netflix mail order while developing streaming technology.
- Can be observed in good environmental analysis (PEST STEEPLE etc) but often unexpected or unpredictable
- Can shift the economics of a market, but still relatively rare. Technology shifts such as internet streaming of video present the same opportunity to all players in a market. Therefore it is in the company’s potential, or lack of potential, to recognize the potential shift in their market that the crux lies.
- Horizon scanning and formal ‘open’ innovation programmes can present a defense against this threat.
- How many features or how much service level reduction will your customers accept for a lower price? Many sectors come to be over served by existing suppliers and a niche for a low service, low feature, low cost alternative can be exploited (eg budget airlines).

USE THE SHEET BELOW TO MAP OUT THE EFFECTIVE OF SUBSTITUTES…

The Threat of Substitutes
As this increases prices are potentially capped

The Threat of Substitutes

MARKET FORCES – THE LEVEL OF RIVALRY

How Intense is the Rivalry Between Players in the Sector?

Rivalry or "competition" is created by the 4 external forces already assessed. The stronger these forces the greater the rivalry and therefore pressure on prices in the sector and the lower the average profit. The lower these forces the lower the level of rivalry within the sector.

Rivals where external pressures are high must be constantly focused on keeping customers as profits will be low and the consequences high.

The level of rivalry is also created by the nature of the sector itself. The average size of competitors, the market share of the largest players and the type of companies involved, ie local, owner managed vs international corporate organisations.

However, the level of rivalry is also created by the strategies adopted by each player in the sector. Players often have less resources with which to compete and branding or product development, any investment in fact, becomes more difficult.

In some sectors competition of this nature focus's only on price and the sector reaches a stalemate or "zero sum end".

If one or more of the players in a sector adopt a different competitive strategy the forces can be reduced, and profits can be increased.

Within the sector a series of activities is required to turn the inputs to the sector into the products needed by customers. This 'value chain' can be mapped for each sector.

Competitive strategy choices also decide in which of these activities each player will engage. Some will choose to undertake all activities some might specialist in just one

It is this interplay between the external forces and the choices competitors make that can make strategy so seemingly complex.

The Level of Rivalry
As this increases prices and average profitability are reduced

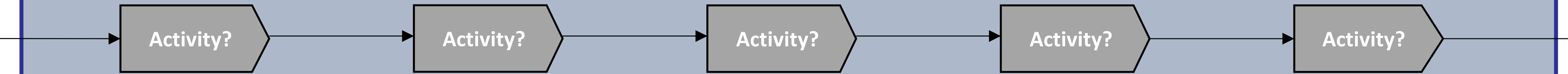
Use the sheet below to:

1. Describe the forces that most strongly influence the level of rivalry.
2. What is the average level of profit and how do you compare?
3. Map out the main activities in the generic value chain for your sector
4. Map out the main activities in your approach to the value chain
5. List your main competitors and assemble them into groups which broadly describe their competitive strategy
6. Map these competitive strategies onto the value chain for your sector
7. Taking the 5 forces framework as a whole (and this is the key benefit of the 5 forces analysis):
   - Where is competition greatest?
   - What changes in the 5 forces might create more/less pressure
   - What alternative or changes in your competitive strategy might bring greater success.

The Level of Rivalry – Your Sector Definition

The Level of Rivalry – Your Sector Definition

The Series of Activities Needed in Your Sector



Your Series of Activities