

Using Porter's 5 Forces to Hit the Target

Randy Richter

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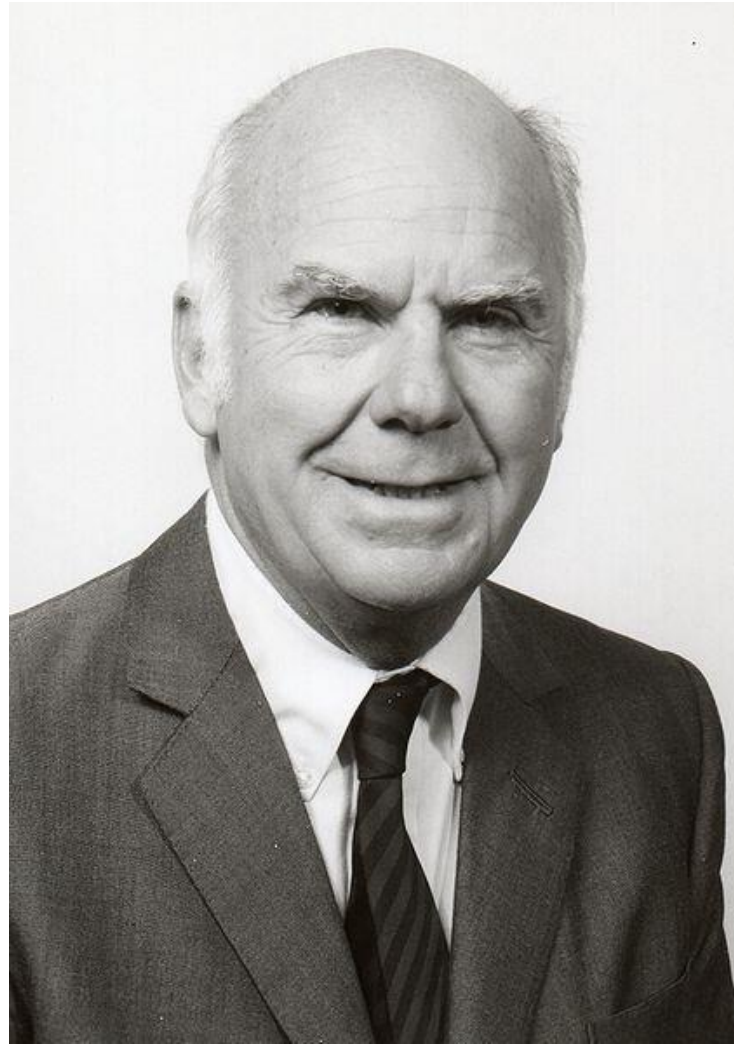
Goal of Every Business –

- Identify external threats and undue influence
- Maximize own influence
- Minimize negative influences
- Create differentiation



**By maximizing/minimizing influence,
and creating differentiation,
you get pricing power**

Profit



Albert S. Humphrey



SWOT Analysis

Inside
Your
Control

Strength

Weakness

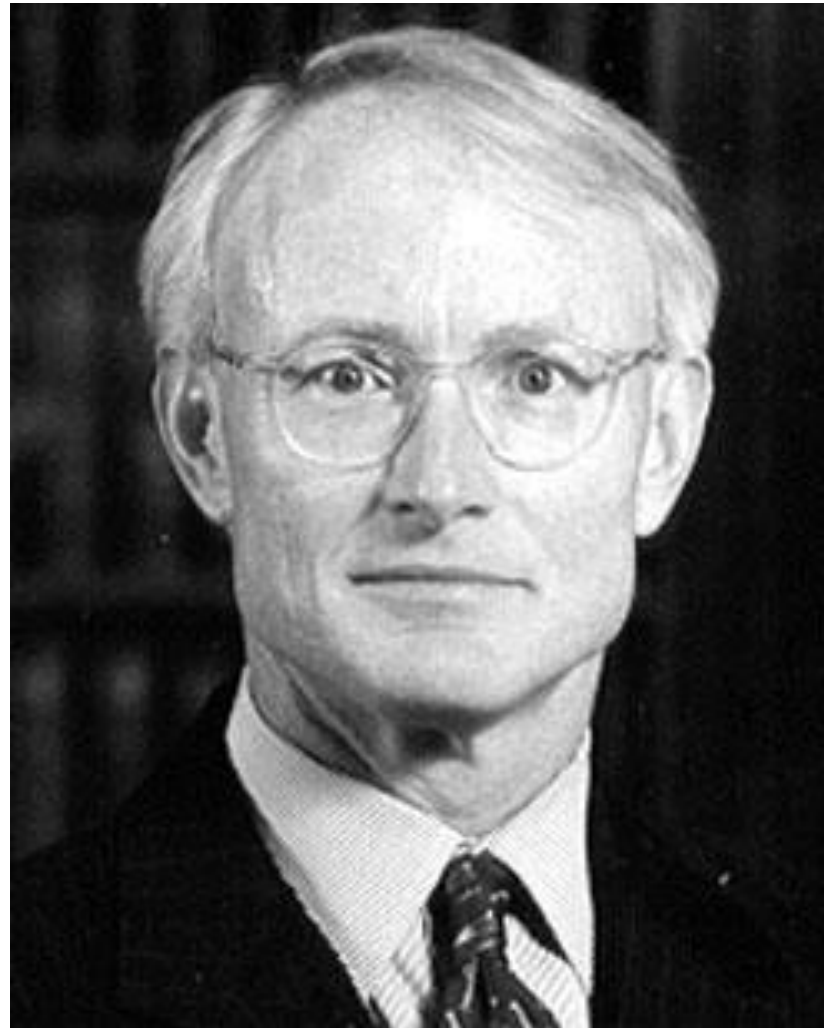
Outside
Your
Control

Opportunity

Threat

Increase pWin

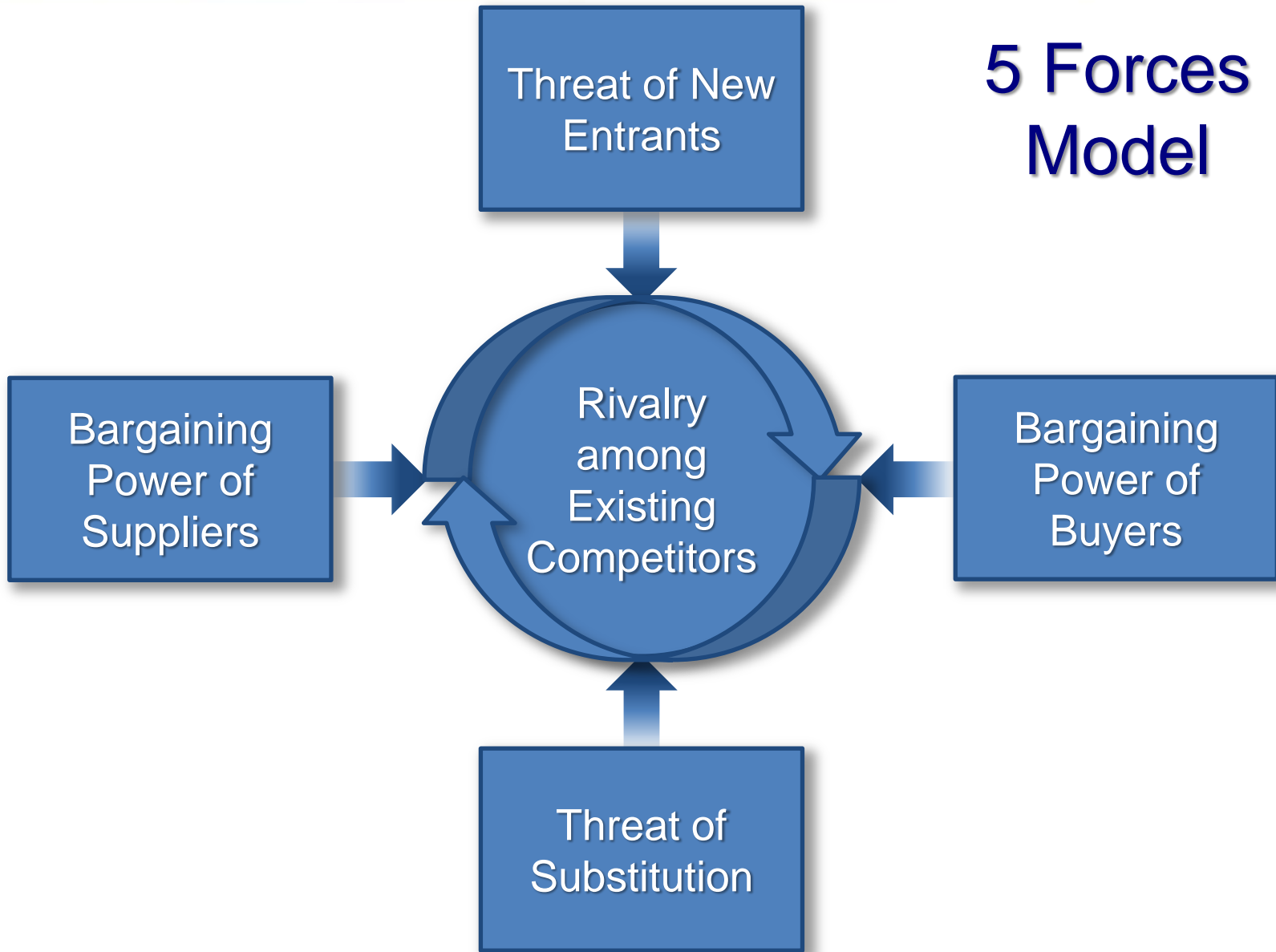
Decrease pWin



Michael Porter



5 Forces Model





Threat of New Entrants

High profit potential increases the risk that new competitors will enter an established market

Bargaining Power of Suppliers

Bargaining Power of Buyers

Barriers to entry slow – but don't eliminate - these incursions

1. Tangible barriers
2. Psychological barriers

Threat of Substitution



Threat of New Entrants

Tangible barriers

1. Customer (mindshare, switching costs)
2. Financial (capital, cash flow, shareholder)
3. Scale (high fixed costs driving need for high volume)
4. Scope (ability to share costs over adjacent markets)
5. Access (suppliers and distribution)
6. Knowledge (intellectual property, experience)
7. Legal/regulatory

Psychological barriers

1. Risk of retaliation (legal challenges, pressure on suppliers, distributors and partners, flooding market)
2. Risk of failure



**Bargaining
Power of
Suppliers**

How easy is it for
suppliers to maintain –
or even drive up – their
prices?

- Suppliers are **strong** if:
 - Their solution is unique
 - They are concentrated (i.e., limited sources)
 - Customers demonstrate a preference
 - The cost to switch suppliers is significant
 - The market or opportunity is small
 - They are able to do their customers' work themselves (forward integration)
- Suppliers are **weak** if:
 - Their product is a commodity
 - Buyers are concentrated (i.e. small market)
 - Significant competition exists
 - Customers have no preference
 - Cost to switch is low
 - The market or opportunity is large and fragmented
 - Customers establish their own sources of supply (backward integration)



Threat of New Entrants

Concentration Ratio: market share of (typically) 4 largest firms in an industry

Bargaining Power of Suppliers

How easy is it for suppliers to maintain – or even drive up – their prices?

| % | Concentration Level |
|---------|----------------------------|
| 0% | None (perfect competition) |
| 0-50% | Low |
| 50-80% | Medium |
| 80-100% | High |
| 100% | Total (monopoly) |

Weak
↑
↓
Strong

Threat of Substitution



Threat of New Entrants

Herfindahl Index: sum of squares of market share of 50 largest firms in an industry

Bargaining Power of Suppliers

| | Index Level |
|--------|--------------------|
| <1% | Highly Competitive |
| <15% | Unconcentrated |
| 15-25% | Moderate |
| >25% | High |

Weak
↑
↓
Strong

How easy is it for suppliers to maintain – or even drive up – their prices?

Threat of Substitution



- Buyers are **strong** if:
 - Their requirement is a commodity
 - Significant competition exists
 - Customers have no preference
 - Cost to switch is low
 - The market or opportunity is large and fragmented
 - Customers establish their own sources of supply (backward integration)
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 - They are able to do their customers' work themselves (forward integration)
 - Suppliers are concentrated (i.e., limited sources)

How easy is it for customers to maintain
– preferably drive down
– their costs?

**Bargaining
Power of
Buyers**



Threat of New Entrants

- Risk is **high** if:

- The cost to switch suppliers is low
- The substitute is less expensive
- The substitute's performance is the same or better
- The substitute's quality is the same or better

- Risk is **low** if:

- The cost to switch suppliers is high
- The substitute is more expensive
- The substitute's performance is inferior
- The substitute's quality is inferior
- No substitute is available

Threat of Substitution

How is a product or service's demand likely to be affected by the price change of a similar product or service?



Rivalry is a measure of **aggression**; good rivals share a market, while bad rivals cut throats

What factors increase rivalry?

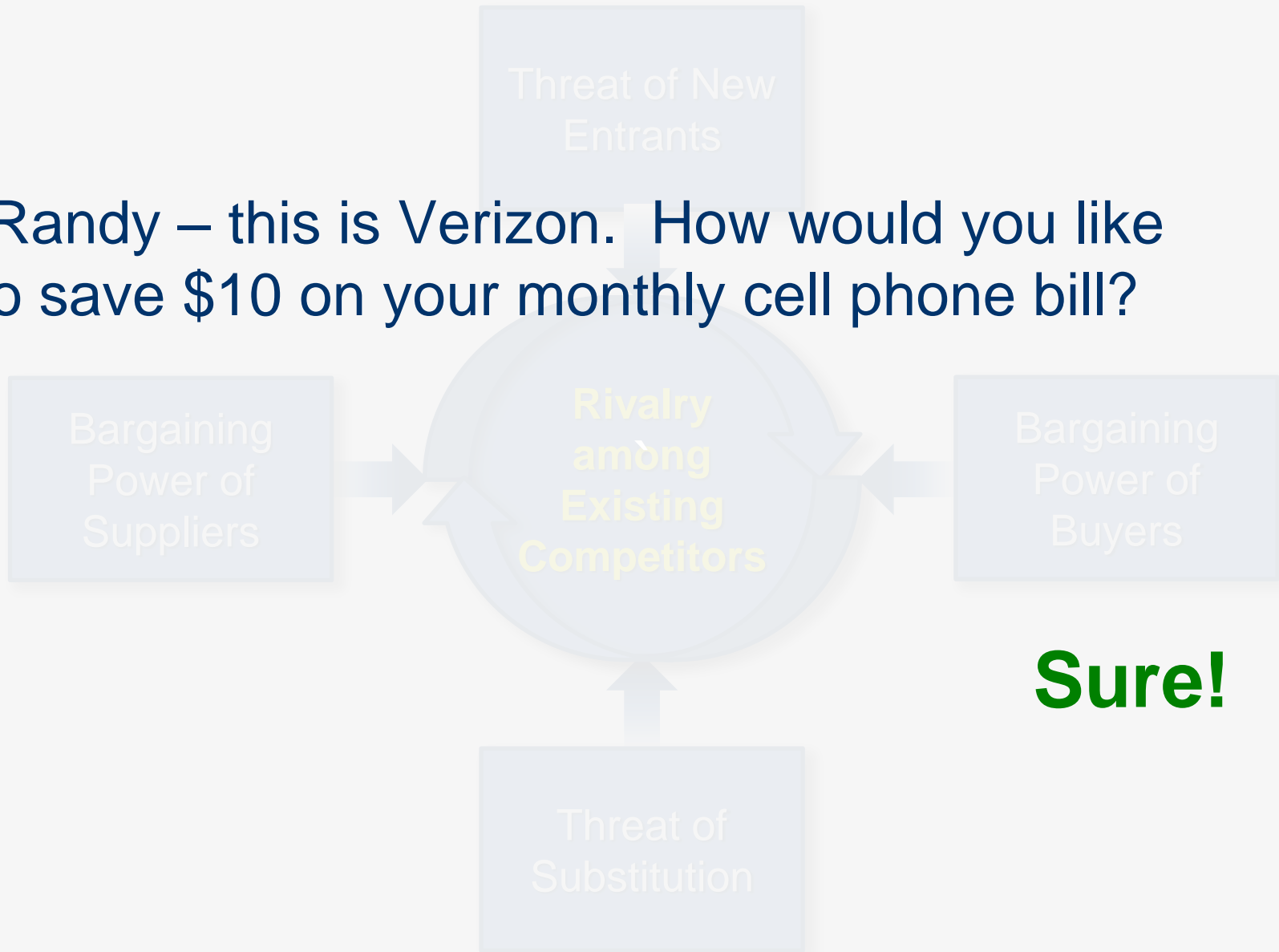


- More players in market
- Slow market growth
- High fixed costs
- High storage costs
- Low switching costs
- Low differentiation
- High strategic value
- High exit barriers
- High competitor diversity
- Industry shakeout

Other four forces!



Hi Randy – this is Verizon. How would you like to save \$10 on your monthly cell phone bill?



Sure!



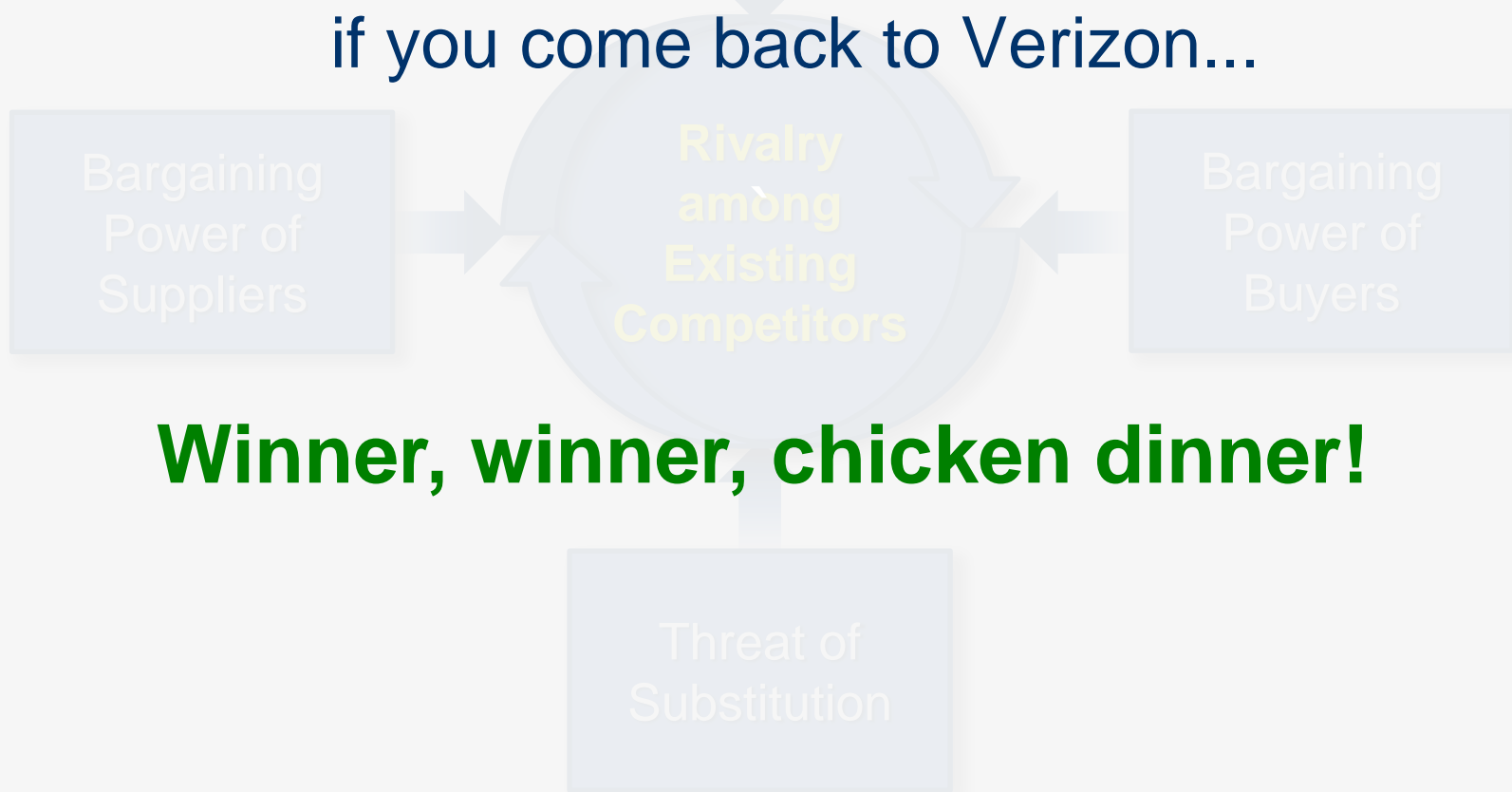
Randy – it's your old friends at AT&T. We see you accidentally switched to Verizon. We'll cut \$15 from their bill if you'll come back to us!





Threat of New Entrants

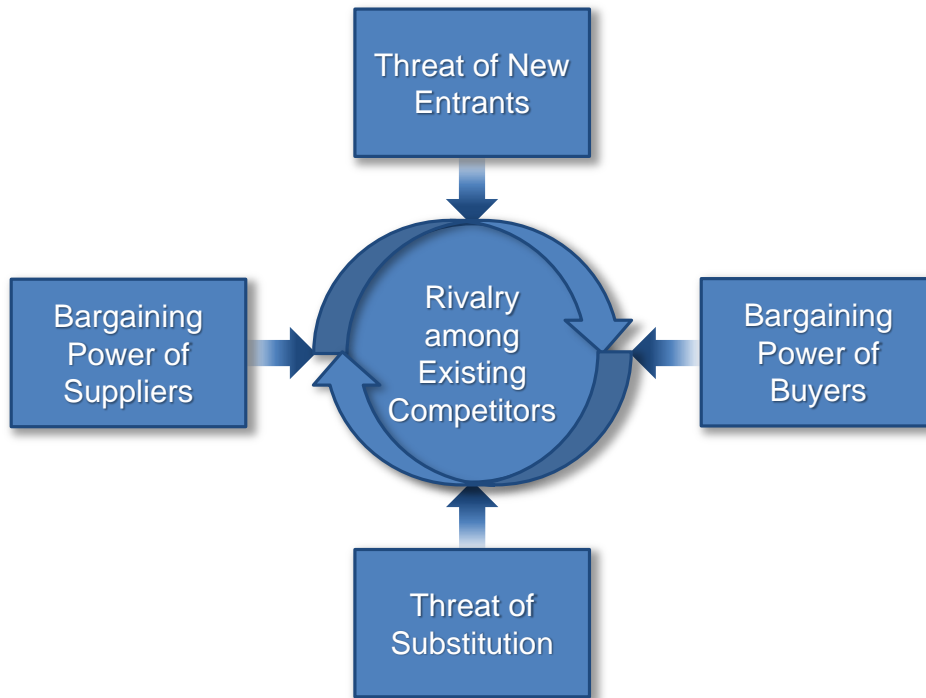
Randy, Randy, Randy. We'll increase your monthly data limit AND throw in a free puppy if you come back to Verizon...



Winner, winner, chicken dinner!



Context and Point of View



Incumbent's Point of View

- ++ Strongly favors current player(s)
- + Favors current player(s)
- Neutral
- Favors new player(s)
- Strongly favors new player(s)

Insurgent's Point of View

- ++ Strongly favors new player(s)
- + Favors new player(s)
- Neutral
- Favors current player(s)
- Strongly favors current player(s)

- Best practices

- Perform assessment independent of capture team
- Assess from your point of view
- Clearly define context before beginning assessment
- Remember: your goal is to define strategy, not produce a pretty picture!



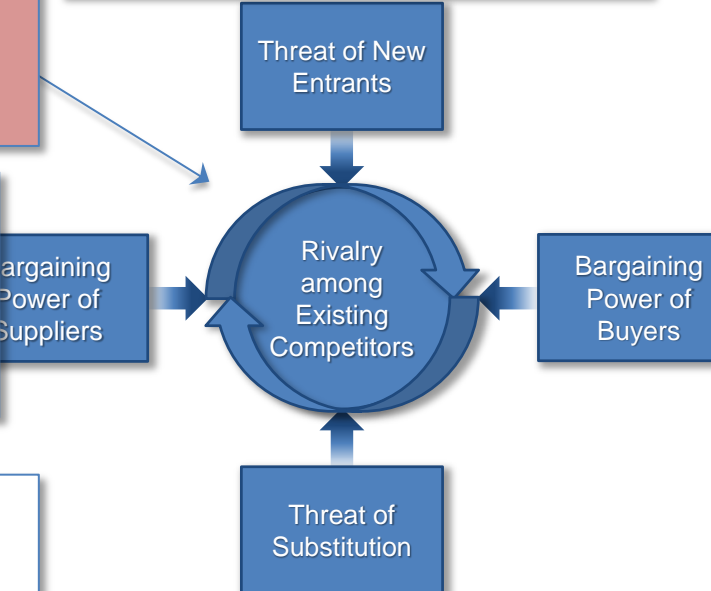
An Example UAS Training

Context: **Incumbent**

- ++ We are known to defend IP
- + Significant transition costs
- Few quality differences between "name" teams
- LPTA; no customer loyalty

- ++ Incumbent (us!) owns key IP
- ++ High cost for new entrants
- Low/moderate cost/time for other established offerors

- ++ We are known to defend IP
- Moderate # of supplier
- Mix of large/small suppliers
- Suppliers can leverage other programs



- + Significant (not huge) transition risk
- Sim costs "reasonable"
- Few customers (now)

- ++ We own key IP
- + We influenced requirements
- + "Equivalence" rules thorough and difficult to achieve

- Overall Assessment**
- Our IP is our strength – but customer believes we are too expensive
 - Other known players (with existing sims) will jump in
 - New players (without existing sims) may jump in, but will need to invest heavily



Porter's Generic Strategies

| | | Lower Cost | Differentiated Offer |
|-------------------|-----------------------------|-------------------------|-----------------------|
| Competitive Scope | Broad Target (Market) | Overall Cost Leadership | Broad Differentiation |
| | Narrow Target (Opportunity) | Cost Focus | Differentiation Focus |

1. Be the cost leader

- Produce same/better quality at lower cost
- Enjoy greater profits or reduce prices to drive out competitors

2. Differentiate

- Produce products and services that are both desired by customers and different from competitor offerings
- Requires intimate knowledge of customer and current knowledge of competitor capabilities and strategies

3. Focus on a niche rather than market as a whole

- “Hit ‘em where they ain’t”
- Move into adjacent segments when it makes business sense



Lower Cost

Major Strategies and Tactics

- Leverage purchasing power and production capacity to achieve optimal economies of scale
- Focus on improvement to maximize learning and experience curve effects
- Share opportunities with other business units within the enterprise; minimize intra-company competition and “not invented here”
- Integrate with suppliers and buyers when practical (also a great way to increase size of your business!)
- Explore geographic benefits (right-to-work states, tax credits, energy costs)
- Look for regulatory loopholes (offshoring)

Nobody, but NOBODY, can make it for less!



Differentiated Offer

Major Strategies and Tactics

- Achieve technical superiority (and ghost lesser solutions)
- Assure high quality – and quantify customer benefits it provides
- Offer a long-term solution to demonstrate lower cost over lifecycle
- Quantify and prove how you will offer more value for the money

Nobody, but NOBODY, can make a better product!

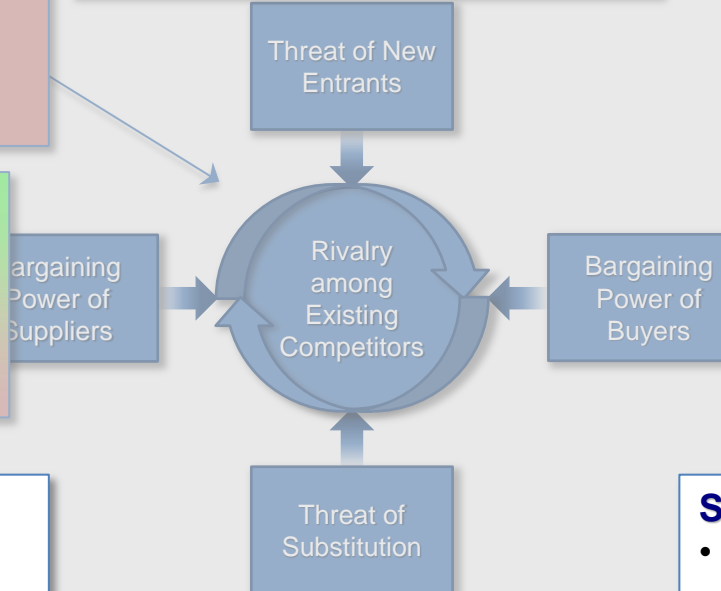


Turning Your Assessment into Your Strategy

- ++ We are known to defend IP
- + Significant transition costs
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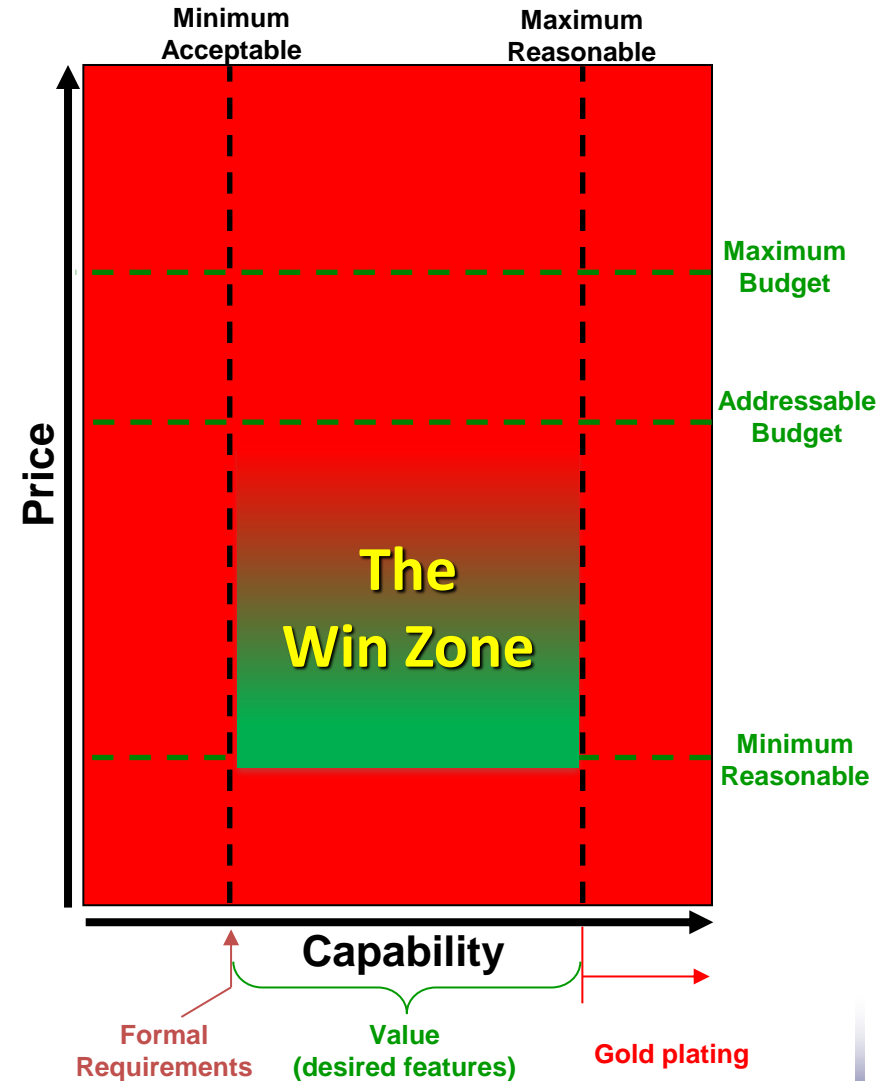
Strategy

- Differentiate by highlighting quality of our IP (ghosting transition risk of all others)
- Publicly refile infringement lawsuit against XXX to demonstrate resolve
- Negotiate lower costs from suppliers; use commonality with other sims to scale volume



The Price/Capability Tradeoff

- Capabilities have associated costs
- Solutions reflect understanding of the customer's funding
- Pricing reflects strategy, and strategy gets you at the table – but it's how you execute that enables you to win!





Key Point to Emphasize



- Profitability is at its peak when:
 - Rivalry is low;
 - Barriers to entry are high;
 - Risk of substitution is low;
 - Customer bargaining power is low;
 - Supplier bargaining power is low
- For a successful business, profitability is a strategic requirement – but not always a tactical one

Price = Cost + Strategy



Today's Takeaways

The 5 Forces model is a good generic framework; it can be as detailed as you want to make it

Originally developed to assess drivers in the context of a market, the model may also be used in the context of an opportunity – making it strategic or tactical

By itself, it does not tell you how to exploit a market or opportunity

It's a great tool to have in your toolbox, but keep in mind...



If all you have is a
hammer, everything
looks like a nail.



Keep your toolbox
diverse!



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