



# Industry Analysis: The Five Forces

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## Overview

### Assessing Your Marketplace

The economic structure of an industry is not an accident. Its complexities are the result of long-term social trends and economic forces. But its effects on you as a business manager are immediate because it determines the competitive rules and strategies you are likely to use. Learning about that structure will provide essential insight for your business strategy.

Michael Porter has identified five forces that are widely used to assess the structure of any industry. Porter's five forces are the:

- Bargaining power of suppliers,
- Bargaining power of buyers,
- Threat of new entrants,
- Threat of substitutes, and
- Rivalry among competitors.

Together, the strength of the five forces determines the profit potential in an industry by influencing the prices, costs, and required investments of businesses—the elements of return on investment. Stronger forces are associated with a more challenging business environment. To identify the important structural features of your industry via the five forces, you conduct an industry analysis that answers the question, “What are the key factors for competitive success?”

**Audience:** Business managers seeking to assess the nature of their marketplace

**Content:** Presents five forces that influence the profitability of an industry

**Outcome:** Reader should understand the forces and be able to counter them with appropriate tactics

## Using This Publication

This publication describes five forces that influence an industry. The publication includes a set of application questions that will help you evaluate the structure of the industry you are in or are considering entering. The more you understand about the strength of each force, the better able you will be to respond.

The forces affecting profitability are often beyond your control, so you must choose tactics to respond to the forces rather than try to change the business environment. This publication offers insight on specific tactics you need for success when facing competitive situations. While you may assess any one force individually, you will gain the most value by assessing all five of the forces

With each force, a “Perspective” feature illustrates the force for an Indiana wine entrepreneur by evaluating that marketplace. To avoid repetition, we use the word “product” to mean either a product or a service. Read more about the five forces in Porter’s book, *Competitive Strategy*.

## ***Bargaining Power of Suppliers***

### ***How Much Power Do Your Suppliers Have Over You?***

Any business requires inputs—labor, parts, raw materials, and services. The cost of your inputs can have a significant effect on your company’s profitability. Whether the strength of suppliers represents a weak or a strong force hinges on the amount of bargaining power they can exert and, ultimately, on how they can influence the terms and conditions of transactions in their favor. Suppliers would prefer to sell to you at the highest price possible or provide you with no more services than necessary. If the force is weak, then you may be able to negotiate a favorable business deal for yourself. Conversely, if the force is strong, then you are in a weak position and may have to pay a higher price or accept a lower level of quality or service.

### ***Factors Affecting the Bargaining Power of Suppliers***

Suppliers have the most power when:

- The input(s) you require are available only from a small number of suppliers. For instance, if you are making computers and need microprocessors, you will have little or no bargaining power with Intel, the world’s dominant supplier.
- The inputs you require are unique, making it costly to switch suppliers. If you use a certain enzyme in a food manufacturing process, changing to another supplier may require you to change your entire manufacturing process. This may be very costly to you, thus you will have less bargaining power with your supplier.
- Your input purchases don’t represent a significant portion of the supplier’s business. If the supplier does not depend on your business, you will have less power to negotiate. Of course the opposite is true as well. Wal-Mart has significant negotiating power over its suppliers because it is such a large percentage of suppliers’ business.

- Suppliers can sell directly to your customers, bypassing the need for your business. For example, a manufacturer could open its own retail outlet and compete against you.
- It is difficult for you to switch to another supplier. For example, if you recently invested in a unique inventory and information management system to work effectively with your supplier, it would be expensive for you to switch suppliers.
- You do not have a full understanding of your supplier’s market. You are less able to negotiate if you have little information about market demand, prices, and supplier’s costs.

### ***Reducing the Bargaining Power of Suppliers***

Most businesses don’t have the resources to produce their own inputs. If you are in this position, then you might consider forming a partnership with your supplier. This can result in a more even distribution of power. For instance, Dell Computer uses partnering with its components suppliers as a key strategy to be the low-cost/high-quality leader in the market. This can be mutually beneficial for both supplier and buyer if they can:

- Reduce inventory costs by providing just-in-time deliveries,
- Enhance the value of goods and services supplied by making effective use of information about customer needs and preferences, and
- Speed the adoption of new technologies.

Another option may be to increase your power by forming a buying group of small producers to buy as one large-volume customer. If you have the resources, you may choose to integrate back and produce your own inputs by purchasing one of your key suppliers or doing the production yourself.

### Perspective on Bargaining Power of Suppliers

For an Indiana winery, one of the main supply decisions lies with the key product ingredients—winegrapes and juice. Wineries have several options, including owning the vineyard, purchasing grapes, or purchasing juice. An overabundance of winegrapes and juice from the West Coast of the U.S., for instance, enhances Indiana wineries’ negotiating power with grape and juice suppliers. However, the bargaining power of Indiana wineries is generally weakened due to lack of winegrape growing experience.

If the winery needs a specific grape variety for a particular wine, then the manager needs to be concerned about the supply and demand for the product. As supply becomes short, the manager will find that suppliers have increasing bargaining power.

Raw materials for wine production are commodity items that are very cyclical in price, quality, and availability. There are times when high-quality grapes can be bought for low prices (over supply) and other times when particular grape varieties

or juice are almost non-existent. This can have a significant effect on a winery. And it is something the manager has no control over. For example, if a late spring frost hits the New York vineyards, the tender varieties will not produce enough grapes to satisfy demand for the year.

Small wineries are particularly challenged because they do not have the leverage associated with volume that the larger wineries have. As a result, the force of suppliers on a small winery can be viewed as relatively strong. However, a manager of an Indiana winery could decrease the effect by cooperating with other small players to make collective purchases.

Contracts and positive relationships with suppliers and producers are another way a small winery can manage the uncertainty and power of suppliers. Recognizing the power of suppliers and the influence of outside factors (e.g., knowledge and weather) is an important consideration as a small winery finds a place in the market.

### Self Assessment—Bargaining Power of Suppliers

This is a short scorecard to help you assess your business’ position in the marketplace. Read each of the questions, and respond with “Yes” or “No” in the space provided. “Yes” indicates a favorable competitive environment for your business. “No” indicates a negative situation. Use the insight you gain to develop effective tactics for countering or taking advantage of the situation.

- |   |  |   |   |
|---|--|---|---|
| <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> | <p>1. Are there a large number of potential input suppliers? The greater number of suppliers of your needed inputs, the more control you will have.</p> <p>2. Are the products that you need to purchase for your business ordinary? You have more control when the products you need from a supplier are not unique.</p> <p>3. Do your purchases from suppliers represent a large portion of their business? If your purchases are a relatively large portion of your supplier’s business, you will have more power to lower costs or improve product features.</p> | <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> | <p>4. Would it be difficult for your suppliers to enter your business, sell directly to your customers, and become your direct competitor? The easier it is to start a new business, the more likely it is that you will have competitors.</p> <p>5. Can you easily switch to substitute products from other suppliers? If it is relatively easy to switch to substitute products, you will have more negotiating room with your suppliers.</p> <p>6. Are you well informed about your supplier’s product and market? If the market is complicated or hard to understand, you have less bargaining power with your suppliers.</p> |
|---|--|---|---|

## Further Assessment

Using a pencil and sheet of paper, examine in greater detail how the bargaining power of suppliers will affect your business.

| List the major inputs needed for your business. | For each input, list possible suppliers. | How can you best work with this supplier to maximize your bargaining power? |
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| 2.  |  |   |
| 3.  |  |   |
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## Bargaining Power of Buyers

### How Much Negotiating Power Do Your Buyers Have?

The power of buyers describes the effect that your customers have on the profitability of your business. The transaction between the seller and the buyer creates value for both parties. But if buyers (who may be distributors, consumers, or other manufacturers) have more economic power, your ability to capture a high proportion of the value created will decrease, and you will earn lower profits.

### How Much Power Do Your Buyers Have Over You?

Buyers have the most power when they are large and purchase much of your output. If your business sells to a few large buyers, they will have significant leverage to negotiate lower prices and other favorable terms because the threat of losing an important buyer puts you in a weak position. Buyers also have power if they can play suppliers against each other. In the automotive supply industry, the large car manufacturers have significant power. There are only a few large buyers, and they buy in large quantities. But, when there are many smaller buyers, you will have greater control because each buyer is a small portion of your sales.

Many small customers acting as a group can create a strong force. For instance, because of their size, health maintenance organizations (HMOs) can purchase health care from hospitals and doctors at much lower cost than can individual patients.

Note that not all buyers will have the same degree of bargaining power with you or be as sensitive to price, quantity, or service. For example, apparel makers face significant buyer power when selling to large retailers like Wal-Mart or department stores, but face a much more favorable situation when selling to smaller specialty shops.

### Factors Influencing the Bargaining Power of Buyers

Buyers have more power when:

- Your industry has many small companies supplying the product and buyers are few and large. For example, you may have little negotiating power if you and several competing companies are trying to sell similar products to one large buyer.
- The products represent a relatively large expense for your customers. Customers may not price shop for a quart of oil, but they will price shop if purchasing a new vehicle.

- Customers have access to and are able to evaluate market information. You have less room for negotiation if buyers know market demand, prices, and your costs.
- Your product is not unique and can be purchased from other suppliers. If your brand is homogenous or similar to all of the others, buyers will base their decision mainly on price.
- Customers could possibly make your product themselves. Anheuser-Busch, Coors, and Heinz are examples of companies that have integrated back into metal can manufacturing to fill the balance of their container needs.

- Customers can easily, and with little cost, switch to another product. For example, IBM customers might switch to Gateway or Dell, but it may be inconvenient for them to consider Macintosh.

## ***Reducing the Bargaining Power of Buyers***

You can reduce the bargaining power of your customers by increasing their loyalty to your business through partnerships or loyalty programs, selling directly to consumers, or increasing the inherent or perceived value of a product by adding features or branding. In addition, if you can select the customers who have little knowledge of the market and have less power, you can enhance your profitability.

### **Perspective on Bargaining Power of Buyers**

Indiana wineries have three types of buyers—direct consumers, wholesalers, and retail outlets. Direct consumers are mostly tourists out for the day, weekend, or even a weeklong vacation. In this situation, competition for those buyers is actually any travel destination in the area competing for their leisure time. Would the buyers rather visit a state park or a museum than a winery? A winery can reduce the bargaining power of these customers by offering unique products and events that offer high value.

Wholesalers have a significant amount of bargaining power because they are few in number and have a considerable influence over the wines that are sold on the retail shelf. Thus, the bargaining power of small wineries is weak

compared to that of the wholesalers. In Indiana, counteracting legislation allows small wineries to sell directly to retail outlets without using a wholesaler. While the bargaining power of one of these wineries with retail outlets is still weak, the winery has the benefit of offering a local Indiana product that is in demand with consumers.

Overall for Indiana wineries, buyers have more power than the entrepreneurs. This is due to the fact that direct consumers have multiple options for entertainment, and wholesalers and retail outlets have thousands of wine brands to choose from. Therefore, a small winery owner must be creative in dealings with consumers, usually by offering loyalty programs and increasing perceived value.

## Self Assessment—Bargaining Power of Buyers

This is a short scorecard to help you assess your business' position in your marketplace. Read each of the following questions and respond with "Yes" or "No" in the space provided. "Yes" indicates a favorable competitive environment for your business. "No" indicates a negative situation. Use the insight you gain to develop effective tactics for countering or taking advantage of the situation.

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|--|--|--|--|
| <input type="checkbox"/> YES <input type="checkbox"/> NO | 1. Do you have enough customers such that losing one isn't critical to your success? The smaller the number of customers, the more dependent you are on each one of them.  | <input type="checkbox"/> YES <input type="checkbox"/> NO | 4. Is your product unique? If your product is homogenous or the same as your competitors', buyers have more bargaining power.  |
| <input type="checkbox"/> YES <input type="checkbox"/> NO | 2. Does your product represent a small expense for your customers? If your product is a relatively large expense for your customers, they'll expend more effort negotiating with you to lower price or improve product features. | <input type="checkbox"/> YES <input type="checkbox"/> NO | 5. Would it be difficult for buyers to integrate backward in the supply chain, purchase a competitor providing the products you provide, and compete directly with you? The less likely a customer will enter your industry, the more bargaining power you have. |
| <input type="checkbox"/> YES <input type="checkbox"/> NO | 3. Are customers uninformed about your product and market? If your market is complicated or hard to understand, buyers have less control.  | <input type="checkbox"/> YES <input type="checkbox"/> NO | 6. Is it difficult for customers to switch from your product to your competitors' products? If it is relatively easy for your customers to switch, you will have less negotiating power with your customers.   |

## Further Assessment

Using a pencil and sheet of paper, examine in greater detail how the bargaining power of buyers will affect your business.

| List the types of customers that you have or expect to have. | What alternatives might these customers have for your product? | How can you build loyalty for your product or service to reduce customer bargaining power? |
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| 1.   |  |  |
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## Threat of New Entrants

### How Easy Is It for Businesses to Enter Your Market?

You may have the market cornered with your product, but your success may inspire others to enter the business and challenge your position. The threat of new entrants is the possibility that new firms will enter the industry. New entrants bring a desire to gain market share and often have significant resources. Their presence may force prices down and put pressure on profits.

Analyzing the threat of new entrants involves examining the barriers to entry and the expected reactions of existing firms to a new competitor. Barriers to entry are the costs and/or legal requirements needed to enter a market. These barriers protect the companies already in business by being a hurdle to those trying to enter the market. In addition to up-front barriers, a new competitor may inspire established companies to react with tactics to deter entry, such as lowering prices or forming partnerships. The chance of reaction is high in markets where firms have a history of retaliation, excess cash, are committed to the industry (see Rivalry Among Competitors), or the industry has slow growth.

### Unique Barriers

Entry barriers are unique for each industry and situation, and can change over time. Most barriers stem from irreversible resource commitments you must make in order to enter a market. For example, if the existing businesses have well-established brand names and fully differentiated products, as a potential market entrant you will need to undertake an expensive marketing campaign to introduce your products. Barriers to entry are usually higher for companies involved in manufacturing than for companies that provide a service because there is often a significant expense in setting up a production facility.

Another type of entry barrier is regulatory. To produce organic food there is a three-year wait before land may be certified. During the waiting period, producers must raise the crop as organic, but may not market it as organic until the three-year “cleansing process” of the land is completed.

Overcoming barriers to entry may involve expending significant resources over an extended period of time. Industries based on patentable technology may require an especially long-term commitment, with years of research and testing, before products can be introduced and compete.

### Factors Affecting the Threat of New Entrants

The threat of new entrants is greatest when:

- Processes are not protected by regulations or patents. In contrast, when licenses and permits are required to do business, such as with the liquor industry, existing firms enjoy some protection from new entrants.
- Customers have little brand loyalty. Without strong brand loyalty, a potential competitor has to spend little to overcome the advertising and service programs of existing firms and is more likely to enter the industry.
- Start-up costs are low for new businesses entering the industry. The less commitment needed in advertising, research and development, and capital assets, the greater the chance of new entrants to the industry.
- The products provided are not unique. When the products are commodities and the assets used to produce them are common, firms are more willing to enter an industry because they know they can easily liquidate their inventory and assets if the venture fails.
- Switching costs are low. In situations where customers do not face significant one-time costs from switching suppliers, it is more attractive for new firms to enter the industry and lure the customers away from their previous suppliers.
- The production process is easily learned. Just as competitors may be scared away when the learning curve is steep, competitors will be attracted to an industry where the production process is easily learned.
- Access to inputs is easy. Entry by new firms is easier when established firms do not have favorable access to raw materials, locations, or government subsidies.

- Access to customers is easy. For instance, it may be easy to rent space to sell produce at a farmer's market, but nearly impossible to get shelf space in a grocery store. You are more likely to find new entrants in the food business using the farmer's market distribution system over grocery stores.
- Economies of scale are minimal. If there is little improvement in efficiency as scale (or size) increases, a firm entering a market won't be at a disadvantage if it doesn't produce the large volume that an existing firm produces.

## **Reducing the Threat of New Entrants**

Enhancing your marketing/brand image, utilizing patents, and creating alliances with associated products can minimize the threat of new entrants. Important tactics you can follow include demonstrating your ability and desire to retaliate to potential entrants and setting a product price that deters entry. Because competitors may enter the industry if there are excess profits, setting a price that earns positive but not excessive profits could lessen the threat of new entry in your industry.

### **Perspective on Threat of New Entrants**

The threat of new entrants has a unique twist in the winery business. A winery is not an easy business to start because it is capital intensive and market entry can take multiple years due to licensing requirements and initial production time for vineyards and wine. A strong knowledge base is also required in order to make high-quality wine and understand the complexities of the industry. Thus, there are significant barriers to entry.

However, in at least one respect, competitors are complementary for Indiana wineries. When several wineries exist in close proximity, it becomes beneficial

for all wineries involved. People may not travel an hour from home to visit only one winery, but they would view the trip as worthwhile if they had the opportunity to visit four wineries. This clustering effect enhances the attractiveness and profitability of all wineries involved.

Barriers to entry in the local wine market are high due to capital investments, licensing, and knowledge requirements. However, having competition close to a business does not necessarily have a negative effect on the bottom line. Therefore, some industries may actually encourage and support new entrants up to a point.

### Self Assessment—Threat of New Entrants

This is a short scorecard to help you assess your business' position in your marketplace. Read each of the following questions and respond with "Yes" or "No" in the space provided. "Yes" indicates a favorable competitive environment for your business. "No" indicates a negative situation. Use the insight you gain to develop effective tactics for countering or taking advantage of the situation.

- |   |  |   |  |
|---|--|---|--|
| <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> | <p>1. Do you have a unique process that has been protected? For example, if you are a technology-based company with patent protection for your research investments, you enjoy some barriers to entry.</p> <p>2. Are customers loyal to your brand? If your customers are loyal to your brand, a new product, even if identical, would face a formidable battle to win over loyal customers.</p> <p>3. Are there high start-up costs for your business? The greater the capital requirements, the lower the threat of new competition.</p> <p>4. Are the assets needed to run your business unique? Others will be more reluctant to enter the market if the technology or equipment cannot be converted into other uses if the venture fails.</p> | <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> | <p>5. Is there a process or procedure critical to your business? The more difficult it is to learn the business, the greater the entry barrier.</p> <p>6. Will a new competitor have difficulty acquiring/obtaining needed inputs? Current distribution channels may make it difficult for a new business to acquire/obtain inputs as readily as existing businesses.</p> <p>7. Will a new competitor have any difficulty acquiring/obtaining customers? If current distribution channels make it difficult for a new business to acquire/obtain new customers, you will enjoy a barrier to entry.</p> <p>8. Would it be difficult for a new entrant to have enough resources to compete efficiently? For every product, there is a cost-efficient level of production. If challengers can't achieve that level of production, they won't be competitive and therefore won't enter the industry.</p> |
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### Further Assessment

Using a pencil and sheet of paper, examine in greater detail how the threat of new entrants might affect your business.

|   |  |
|---|--|
| 1. How would a new entrant affect your business?                                  |  |
| 2. What will your competitors do if there is a new entrant into your marketplace? |  |
| 3. How will you respond to a new competitor?                                      |  |

## **Threat of Substitutes**

### **What Products Could Your Customers Buy Instead of Yours?**

Products from one business can be replaced by products from another. If you produce a commodity product that is undifferentiated, customers can easily switch away from your product to a competitor's product with few consequences. In contrast, there may be a distinct penalty for switching if your product is unique or essential for your customer's business. Substitute products are those that can fulfill a similar need to the one your product fills.

As an example, a family restaurant may prefer to buy the packaged poultry produced at your plant, but if given a better deal, they may go to another poultry supplier. If you grow free-range organically grown chickens, though, and you are selling to upscale restaurants, they may have few substitutes for the product that you are providing.

### **Substitutes Can Come in Many Forms**

Be aware that substitute products can come in many shapes and sizes, and do not always come from traditional competitors. Pork and chicken can substitute in consumer diets for beef or lamb. Aluminum beverage cans battle in the market against glass bottles and plastic containers. Cotton competes with polyester from the petroleum industry. Barnes and Noble retail bookstores compete with Internet retailer Amazon. Postal services compete with e-mail and fax machines.

When developing a business plan, it is critical to assess the other options your customers have to satisfy their needs. To do this, look for products that serve the same function as yours. A threat exists if there are alternative products with lower prices or better performance or both.

### **How Substitutes Affect the Marketplace**

Substitutes essentially place a price ceiling on products. Market analysts often talk about "wheat capping corn." This occurs because wheat and corn are substitutes in animal feed.

If wheat prices are low, corn prices will also be low, because, as corn prices rise, livestock feeders will quickly shift to wheat to keep ration costs low. This reduces the demand and ultimately the price of corn.

It's more difficult for a firm to try to raise prices and make greater profits if there are close substitutes and switching costs are low. But, in some cases, customers may be reluctant to switch to another product even if it offers an advantage. Customers may consider it inconvenient or even risky to change if they are accustomed to using a certain product in a certain way, or they are used to the way certain services are delivered.

### **Factors Affecting the Threat of Substitution**

Substitutes are a greater threat when:

- Your product doesn't offer any real benefit compared to other products. What will hold your customers if they can get an identical product from your competitor?
- It is easy for customers to switch. A grocer can easily switch from paper to plastic bags for its customers, but a bottler may have to reconfigure its equipment and retrain its workers if it switches from aluminum cans to plastic bottles.
- Customers have little loyalty. When price is the customer's primary motivator, the threat of substitutes is greater.

### **Reducing the Threat of Substitutes**

You can reduce the threat of substitutes by using tactics such as staying closely in tune with customer preferences and differentiating your product by branding. In some cases, the advertising required to differentiate is more than one firm can bear. In that case, collective advertising for an industry may be more effective.

### Perspective on Threat of Substitutes

In the wine business, there's a common misconception. When considering substitutes, many would make the easy assumption that the substitute for wine is beer. There are many other options that need to be considered, however. In addition to selling an alcoholic beverage, a winery is a destination, an entertainment and educational source, and a part of world history and culture.

There's a saying in the wine-making business, "Taste the experience of Indiana wine"—taste the wine, taste the events, taste the education, etc.

Due to the diversification of offerings in addition to wine, substitutes must be carefully considered and evaluated. Competing against the other travel destinations for limited customer leisure time is one of the biggest challenges.

In order to decrease the threat of substitutes in the market and encourage customers, managers of Indiana wineries must carefully consider these alternatives and strategically address all the other options facing a prospective buyer.

### Self Assessment—Threat of Substitutes

This is a short scorecard to help you assess your business' position in your marketplace. Read each of the following questions and respond with "Yes" or "No" in the space provided. "Yes" indicates a favorable competitive environment for your business. "No" indicates a negative situation. Use the insight you gain to develop effective tactics for countering or taking advantage of the situation.

YES  NO  1. Does your product compare favorably to possible substitutes? If another product offers more features or benefits to customers, or if their price is lower, customers may decide that the other product is a better value.

YES  NO  2. Is it costly for your customers to switch to another product? When customers experience a loss of productivity if they switch to another product, the threat of substitutes is weaker.

YES  NO  3. Are customers loyal to existing products? Even if switching costs are low, customers may have allegiance to a particular brand. If your customers have high brand loyalty to your product you enjoy a weak threat of substitutes.

## Further Assessment

Using a pencil and sheet of paper, examine in greater detail how the threat of substitutes will affect your business.

| List possible substitutes that your customers could use in place of your product. | How easy would it be for your customer to consider this alternative? | How can you differentiate your products or build customer loyalty to manage the threat of substitutes? |
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| 1.  |  |  |
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## Rivalry Among Competitors

### How Intense Is Your Competition?

Competition is the foundation of the free enterprise system, yet with small businesses even a little competition goes a long way. Because companies in an industry are mutually dependent, actions by one company usually invite competitive retaliation. An analysis of rivalry looks at the extent to which the value created in an industry will be dissipated through head-to-head competition.

### Intensity of Rivalry Among Competitors

Rivalry among competitors is often the strongest of the five competitive forces, but can vary widely among industries. If the competitive force is weak, companies may be able to raise prices, provide less product for the price, and earn more profits. If competition is intense, it may be necessary to enhance product offerings to keep customers, and prices may fall below break-even levels.

Rivalries can occur on various “playing fields.” In some industries, rivalries are centered on price competition—especially companies that sell commodities such as paper,

gasoline, or plywood. In other industries, competition may be about offering customers the most attractive combination of performance features, introducing new products, offering more after-sale services or warranties, or creating a stronger brand image than competitors. In some cases the presence of more rivals can actually be a positive—for instance in a shopping area, where attracting customers may hinge on having enough stores and attractions to make it a worthwhile stop.

### Factors Influencing Rivalry Among Competitors

The most intense rivalries occur when:

- One firm or a small number of firms have incentive to try and become the market leader. In some cases, an industry with two or three dominant firms may experience intense rivalry when these firms are battling to achieve market leader status. In other situations, when competitors with diverse strategies and relationships have different goals and the “rules of the game” are not well established, rivalry will be more intense.
- The market is growing slowly or shrinking. When the potential to sell products is stagnant or declining,

existing firms are unable to grow their market without taking market away from competitors. In this situation rivalry is more likely.

- There are high fixed costs of production. When a large percentage of the cost to produce products is independent of the number of units produced, businesses are pressured to produce larger volumes. This may tempt companies to drastically cut prices when there is excess capacity in the industry in order to sell greater volumes of product.
- Products are perishable and need to be sold quickly. Sellers are more likely to price aggressively if they risk losing inventory due to spoilage or if storage costs are high.
- Products are not unique or homogenous. Undifferentiated products (commodities) compete mainly on price, because consumers receive the same value from the products of different firms. Because firms do not experience any insulation from price competition, there is more likely to be active rivalry.

- Customers can easily switch between products. Intense rivalry is likely when customers in a given industry can easily switch to other suppliers. In these situations, the businesses in the industry will be vying for market share.
- There are high costs for exiting the business. If liquidation would result in a loss, businesses that invested heavily in their facilities will try hard to pay for them and may resort to extreme methods of competition.

### ***Reducing the Threat of Rivals***

Threats of rivals can be reduced by employing a variety of tactics. To minimize price competition, distinguish your product from your competitors' by innovating or improving features. Other tactics include focusing on a unique segment of the market, distributing your product in a novel channel, or trying to form stronger relationships and build customer loyalty.

#### **Perspective on Rivalry Among Competitors**

Head-to-head competition is rivalry. For a winery, the various interactions with competition create a dynamic, multifaceted situation. It boils down to "how does a winery compete for business." Porter's argument is that the more businesses compete on price, the lower the profit of the market.

The Indiana wine industry is similar in scope to other industries. There are a handful of large wineries with the majority of market share and many smaller wineries rounding out the industry. There are currently 31 wineries in the state selling 1.8 million bottles of wine per year. A small winery would sell approximately 7,500 bottles per year.

On a global scope, the wine industry is very competitive. Wineries compete for shelf space and "share of mouth" with regard to consumer tastes. In the state, however, competition at the local level is important to the industry's success. A small winery competes for customers

through the winery tasting room, rather than on the external retail shelf. This means the winery competes against all other tourism destinations in the state offering similar entertainment, not just the other Indiana wineries.

As a result, the overall quality offered to customers is very important. The first purchase is generally based on the look of the wine package and customer service. To retain these customers for the long-term, product quality is essential. Future purchases are based on consumers' perception of taste, not just how nice the bottle looks or the friendliness of the staff. A winery manager needs to offer a total package that goes above and beyond what others in the state are offering.

The Indiana industry is not saturated at this point. There is still room for wineries to grow without having to capture customers from direct competitors. The demand is growing, offering opportunities for industry growth without extreme rivalry. However, staying ahead of the game—the rivals—is the key for future success.

## Self Assessment—Rivalry Among Competitors

This is a short scorecard to help you assess your business' position in your marketplace. Read each of the following questions and respond with "Yes" or "No" in the space provided. "Yes" indicates a favorable competitive environment for your business. "No" indicates a negative situation. Use the insight you gain to develop effective tactics for countering or taking advantage of the situation.

- |   |  |   |
|---|--|---|
| <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> | <p>1. Is there a small number of competitors? Often the greater the number of players, the more intense the rivalry. However, rivalry can occasionally be intense when one or more firms are vying for market leader positions.</p> <p>2. Is there a clear leader in your market? Rivalry intensifies if companies have similar shares of the market, leading to a struggle for market leadership.</p> <p>3. Is your market growing? In a growing market, firms are able to grow revenues simply because of the expanding market. In a stagnant or declining market, companies often fight intensely for a smaller and smaller market.</p> <p>4. Do you have low fixed costs? With high fixed costs, companies must sell more products to cover these high costs.</p> <p>5. Can you store your product to sell at the best times? High storage costs or perishable products result in a situation where firms must sell product as soon as possible, increasing rivalry among firms.</p> | <p>YES <input type="checkbox"/> NO <input type="checkbox"/></p> <p>6. Are your competitors pursuing a low growth strategy? You will have more intense rivalries if your competitors are more aggressive. In contrast, if your competitors are following a strategy of milking profits in a mature market, you will enjoy less rivalry.</p> <p>7. Is your product unique? Firms that produce products that are very similar will compete mostly on price, so rivalry is expected to be high.</p> <p>8. Is it easy for competitors to abandon their product? If exit costs are high, a company may remain in business even if it is not profitable.</p> <p>9. Is it difficult for customers to switch between your product and your competitors'? If customers can easily switch, the market will be more competitive and rivalry is expected to be high as firms vie for each customer's business.</p> |
|---|--|---|

## Further Assessment

Using a pencil and sheet of paper, examine in greater detail how rivalry among competitors affects your business.

| List your major competitors. | What business and growth strategies does this competitor use? | How will this competitor affect your business? | What actions will you take in response to your competitors' actions? |
|------------------------------|---|--|--|
| 1.                           |   |  |  |
| 2.                           |   |  |  |
| 3.                           |   |  |  |
| 4.                           |   |  |  |
| 5.                           |   |  |  |
| 6.                           |   |  |  |
| 7.                           |   |  |  |
| 8.                           |   |  |  |

## Final Comment

Not all of these forces are equally important when assessing the overall attractiveness of an industry. In some industries, it is easy to gain entry, but very difficult to get out. Not surprisingly, these industries tend to be mediocre investments.

A full-fledged industry analysis would require extensive research, talking with customers, suppliers, competitors,

and industry experts. However, as a general overview, the five forces concept provides entrepreneurs with an excellent tool to examine the profit potential in a particular industry. Gaining an understanding of the way in which each of the five forces influences your profitability will provide you with tactics for countering the strength of the forces.

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