

Competitive Strategy and Industry Analysis

a la Michael Porter

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In his book, *Competitive Strategy* (Free Press: 1980), Michael Porter identifies three fundamental competitive strategies and lays out the required skills and resources, organizational elements and risks associated with each strategy. The table below is a shorthand way of referring to what Porter has to say.

Competitive Strategy	Required Skills and Resources	Organizational Elements	Associated Risks
<i>Overall Cost Leadership</i>	<p>Sustained capital investment and access to capital</p> <p>Process engineering skills</p> <p>Intensive supervision of labor</p> <p>Products designed for ease of manufacture</p> <p>Low-cost distribution system</p>	<p>Tight cost control</p> <p>Frequent, detailed reports</p> <p>Structured organization and responsibilities</p> <p>Incentives based on meeting strict quantitative targets</p>	<p>Technological change that nullifies past investments or learning</p> <p>Low-cost learning by industry newcomers or followers through imitation, or through their ability to invest in state-of-the-art facilities</p> <p>Inability to see required product or marketing change because of the attention placed on cost</p> <p>Inflation in costs that narrow the firm's ability to maintain enough of a price differential to offset competitors' brand images or other approaches to differentiation</p>
<i>Differentiation</i>	<p>Strong marketing abilities</p> <p>Product engineering with creative flair</p> <p>Strong capability in basic research</p> <p>Corporate reputation for quality or technological leadership</p> <p>Long tradition in the industry or unique combination of skills drawn from other businesses</p> <p>Strong cooperation from channels</p>	<p>Strong coordination among functions in R&D, product development, and marketing</p> <p>Subjective measurement and incentives instead of quantitative measures</p> <p>Amenities to attract highly skilled labor, scientists, or creative people</p>	<p>The cost differential between low-cost competitors and the differentiated firm becomes too great for differentiation to hold brand loyalty. Buyers thus sacrifice some of the features, services, or image possessed by the differentiated firm for large cost savings.</p> <p>Buyers' need for the differentiating factor falls. This can occur as buyers become more sophisticated.</p> <p>Imitation narrows perceived differentiation, a common occurrence as industries mature.</p>

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Competitive Strategy	Required Skills and Resources	Organizational Elements	Associated Risks
<i>Focus</i>	Combination of the above policies directed at the particular strategic target	Combination of the above policies directed at the particular strategic target	<p>The cost differential between broad-range competitors and the focused firm widens to eliminate the cost advantages of serving a narrow target or to offset the differentiation achieved by focus.</p> <p>The differences in desired products or services between the strategic target and the market as a whole narrows.</p> <p>Competitors find submarkets within the strategic target and outfocus the focuser.</p>

Porter is of course the undisputed guru of competitive strategy. In the same book he identifies five forces that drive competition within an industry:

1. The threat of entry by new competitors.
2. The intensity of rivalry among existing competitors.
3. Pressure from substitute products.
4. The bargaining power of buyers.
5. The bargaining power of suppliers.

One obvious application of all this is to would-be entrants and the problem of entering new markets. Another is to the current competitors and the ongoing task of staying competitive in markets where they already operate.

Perhaps the most important thing to keep in mind is the inverse relationship between profit margins or returns and the intensity of competition: as the intensity of competition goes up, margins and returns are driven down. This can require changes in competitive strategy to remain in an industry and, under some circumstances it can occasion the decision to exit a business or an industry.

The diagram in Figure 1 on the next page is a handy way of depicting the five forces Porter identifies and providing some elaborating detail. The diagram is no substitute for reading what Porter has to say.

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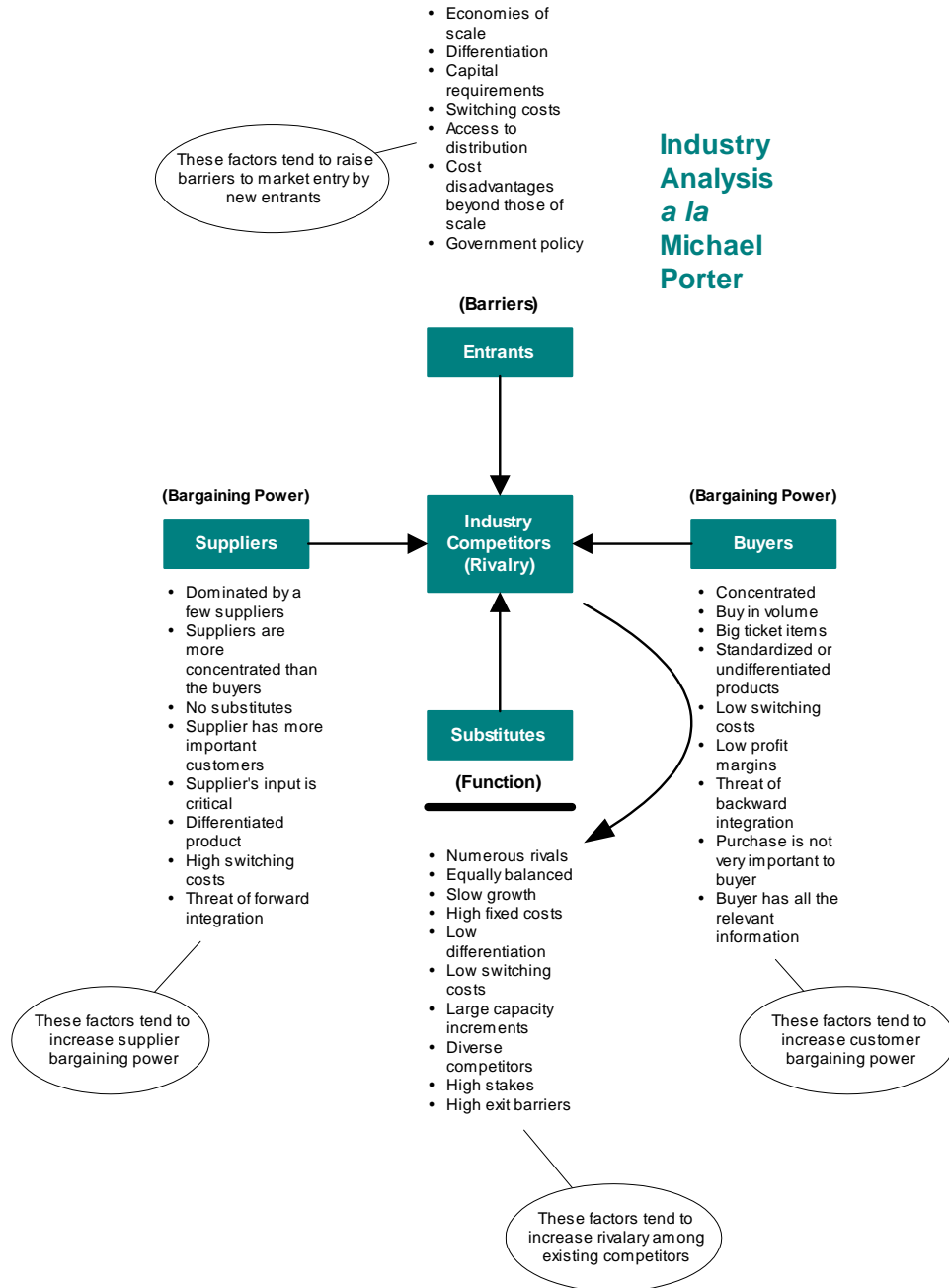


Figure 1 - Michael Porter's Five Forces

Contact the Author

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