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The Five Competitive Forces That Shape Strategy

Key ideas from the [Harvard Business Review](#) article By Michael E. Porter

The Idea in Brief

You know that to sustain long-term profitability you must respond strategically to competition. And you naturally keep tabs on your **established rivals**. But as you scan the competitive arena, are you also looking *beyond* your direct competitors? As Porter explains in this update of his revolutionary 1979 HBR article, four additional competitive forces can hurt your prospective profits:

Savvy **customers** can force down prices by playing you and your rivals against one another.

Powerful **suppliers** may constrain your profits if they charge higher prices.

Aspiring **entrants**, armed with new capacity and hungry for market share, can ratchet up the investment required for you to stay in the game.

Substitute offerings can lure customers away.

Consider commercial aviation: It's one of the least profitable industries because all five forces are strong. **Established rivals** compete intensely on price. **Customers** are fickle, searching for the best deal regardless of carrier. **Suppliers**--plane and engine manufacturers, along with unionized labor forces--bargain away the lion's share of airlines' profits. **New players** enter the industry in a constant stream. And **substitutes** are readily available--such as train or car travel.

By analyzing all five competitive forces, you gain a complete picture of what's influencing profitability in your industry. You identify game-changing trends early, so you can swiftly exploit them. And you spot ways to work around constraints on profitability--or even reshape the forces in your favor.

The Idea in Practice

By understanding how the five competitive forces influence profitability in your industry, you can develop a strategy for enhancing your company's long-term profits. Porter suggests the following:

Position Your Company Where the Forces Are Weakest

In the heavy-truck industry, many buyers operate large fleets and are highly motivated to drive down truck prices. Trucks are built to regulated standards and offer similar features, so price competition is stiff; unions exercise considerable supplier power; and buyers can use substitutes such as cargo delivery by rail.

To create and sustain long-term profitability within this industry, heavy-truck maker Paccar chose to focus on one customer group where competitive forces are weakest: individual drivers who own their trucks and contract directly with suppliers. These operators have limited clout as buyers and are less price sensitive because of their emotional ties to and economic dependence on their own trucks.

For these customers, Paccar has developed such features as luxurious sleeper cabins, plush leather seats, and sleek exterior styling. Buyers can select from thousands of options to put their personal signature on these built-to-order trucks.

Customers pay Paccar a 10% premium, and the company has been profitable for 68 straight years and earned a long-run return on equity above 20%.

Exploit Changes in the Forces

With the advent of the Internet and digital distribution of music, unauthorized downloading created an illegal but potent substitute for record companies' services. The record companies tried to develop technical platforms for digital distribution themselves, but major labels didn't want to sell their music through a platform owned by a rival.

Into this vacuum stepped Apple, with its iTunes music store supporting its iPod music player. The birth of this powerful new gatekeeper has whittled down the number of major labels from six in 1997 to four today.

Reshape the Forces in Your Favor

Use tactics designed specifically to reduce the share of profits leaking to other players. For example:

To neutralize **supplier power**, standardize specifications for parts so your company can switch more easily among vendors.

To counter **customer power**, expand your services so it's harder for customers to leave you for a rival.

To temper price wars initiated by **established rivals**, invest more heavily in products that differ significantly from competitors' offerings.

To scare off **new entrants**, elevate the fixed costs of competing; for instance, by escalating your R&D expenditures.

To limit the threat of **substitutes**, offer better value through wider product accessibility. Soft-drink producers did this by introducing vending machines and convenience store channels, which dramatically improved the availability of soft drinks relative to other beverages.

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Further Reading

Article

What Is Strategy?

Harvard Business Review

February 2000

by Michael E. Porter

By analyzing the five competitive forces, you uncover opportunities to position your company strategically; that is, to gain a sustainable advantage over rivals by preserving what's distinctive about your company. Your strategic position hinges on performing *different* activities from competitors or performing *similar* activities, but in different ways. It emerges from three sources: 1) serving few needs of many customers (for example, Jiffy Lube provides only auto lubricants), 2) serving broad needs of few customers (Bessemer Trust targets only very high-wealth clients), or 3) serving broad needs of many customers in a narrow market (Carmike Cinemas operates only in cities with a population under 200,000).

Books

Redefining Health Care: Creating Value-Based Competition on Results

Harvard Business School Press

May 2006

by Michael E. Porter and Elizabeth Olmsted Teisberg

In this book Porter and Teisberg analyze the competitive forces responsible for the current crisis in U.S. health care. The authors argue that participants in the health care system have competed to shift costs, accumulate bargaining power, and restrict services rather than create value for patients. This zero-sum competition takes place at the wrong level--among health plans, networks, and hospitals--rather than where it matters most: in the diagnosis, treatment, and prevention of specific health conditions. *Redefining Health Care* lays out a breakthrough framework for redefining health care competition based on patient value. With specific recommendations for hospitals, doctors, health plans, employers, and policy makers, this book shows how to move to a positive-sum competition that will unleash stunning improvements in quality and efficiency.

On Competition

Harvard Business School Press

September 1998

by Michael E. Porter

Porter's work, which began with his original formulation of the five forces, has defined our fundamental understanding of competition and competitive strategy. This book is a compilation of a dozen Porter articles: two new articles and ten of his articles from *Harvard Business Review*. Together, these essays provide a complete picture of Porter's perspective on modern competition. Organized around three primary categories: Competition and Strategy: Core Concepts, The Competitiveness of Location, and Competitive Solutions to Societal Problems, these articles develop the building blocks that define competitive strategy.

About the Author

Michael E. Porter is the Bishop William Lawrence University Professor at Harvard University, based at Harvard Business School in Boston. He is a six-time McKinsey Award winner, including for his most recent HBR article, "Strategy and Society," coauthored with Mark R. Kramer (December 2006).

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