

Porter`s Models – are they still of relevance?

by

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Abstract. The foundation for the modern strategy development was made in 1979 by Michael Porter. He developed several model like “Five Forces”, “General Strategies” or “Diamond of National Advantage”. Such models are well known around the world. Michael Porter was the founder of many other important management topics like competitive analysis or the development of competitive advantage. Our world today world should be much more complex as in 1979. Therefore we have to raise the question “Are the models which a “Harvard Professor” developed in a library more than 30 years ago still relevant in today`s business world? The “Five Forces Model” and the “Generic Strategies Model” according to Porter belong to the classics as such in strategic management. The following paper shall help to answer the question – if such models are still relevant. Therefore the initial focus is on the topic of strategy and strategy finding, followed by a detailed look at the two most important Porter Models, which are finally examined with regard to their relevance.

Key Words: Michael Porter, Strategy Models, Strategic Management, Criticism, Porters Models.

JEL classification: L10, M10, M31.

1 Introduction

In times like these, which are marked by increasing market dynamics and globalisation, companies are obliged to constantly adapt to a changing economic environment and competitive conditions in order to continue to guarantee a sustainable corporate growth. To meet these ambitious requirements, it is indispensable for them to develop a strategy, which distinguishes them from their competitors and emphasizes their uniqueness. By means of innovative products or the focus on service and extras they can stand out against competitors and create not only profitability but also sustainability.

A strategy is therefore important for the entrepreneurial awareness, i.e. not only where one would like to be now, but also in a few years` time. For a clear market positioning is, at long last, decisive for the success or failure of a company. Simultaneously it also focuses on whatever a company and its employees are concentrated on and which they would like to convince their customers of. Before creating a strategy, there is a vision, which has to be clearly formulated by the management and adequately communicated within the company. It has a

strong effect on the employees of a company, for, with the help of this vision, everybody in the company knows what they are working and standing up for. The corporate objectives are derived from this vision and they form the basis for the company strategy. The objectives have to be clearly defined, they have to be “SMART” and have to meet the following requirements:

S = Specific

M = Measurable

A = Ambitious

R = Realizable

T = Timed

Therefore they should be formulated as precisely as possible, be measurable with relatively simple aid, offer an incentive, be achievable and be timed with an exact deadline (Tiefenbacher & Neuburger 2010, 46). The company strategy states in which manner they can be achieved on the market.

The author has the target with this document to discuss if Porter`s models are still of relevance. The first part of the document includes a review of Porter`s Five Forces and Porter`s Generic Strategies explaining some details. The second part covers the examination of relevance followed by a conclusion.

1.1 The Models by Michael E. Porter

In the field of economic strategy doctrine there is a multitude of models and concepts. One of the most important economists in this field is Michael E. Porter, presently Professor at the Harvard Business School, who, at the end of the '70s resp. in the '80s of the previous century, revolutionized economics with his Five Forces Analysis and the definition of the three generic competitive strategies.

Porter's fundamental realization consisted in the fact that each strategy has to be orientated to the external environment, as a company can only succeed in the best possible positioning on the market with the help of a detailed analysis of the sector and competition.

2 Porter's Five Forces

2.1 The Five Forces Model

The Five Forces Model by Michael E. Porter, which is a classic in strategic management, has influenced not only economists, but also numerous managers in this field, as it admits conclusions as to the attractiveness of a complete industry sector, for the Five Forces have a strong influence on competitiveness and therefore, in the following, on profitability.

According to Porter the industry mix, which is mainly responsible for competition and consequently the strategy a company has to apply, in order to be successful on the market, is determined by five forces. On the basis of a detailed analysis of these five influencing factors at the current as well as a future time, the attractiveness of a complete sector can be evaluated respectively. The stronger the competitive forces are, the more difficult it will be for a company to make higher profits on a long-term basis. If the forces are weaker, then high returns can be yielded on the market. The success of a company, therefore, depends on the attractiveness of the respective branch according to Porter.

The Five Forces That Shape Industry Competition



Figure 1. The Five Forces
Source: Porter 2008

Porter's Five Forces Model is aimed at the sustainable and long-term profitability of a company in a certain sector and is not orientated to a short-term win-win situation as this can also be influenced by other factors. The results of the industry mix analysis together with the results of the internal company analysis form the basis for any further strategic planning of a company.

2.1.1 The Five Forces in Detail

As mentioned above, according to Porter, the attractiveness of a branch depends on how strongly developed the following competitive forces are in a sector. These are:

- The bargaining power of suppliers
- The bargaining power of customers
- Threat of competitors
- Threat of substitute products or services
- The rivalry among existing competitors.

2.1.2 The bargaining power of suppliers

A high bargaining power on the supplier side leads to the fact that they are in a better position to put through their interests and are, therefore, able to demand higher prices on the one hand, respectively offer poorer quality at the same price on the other hand. This will increasingly be

the case if suppliers, for example, have strong brands or if there are only few substitutes on the market. Furthermore, suppliers are all the more powerful the lower the purchasing volume is, or if a possible change would cause too high costs.

2.1.3 The bargaining power of customers

If customers have a strong bargaining position, they can demand lower prices respectively a better quality at the same price. This is especially the case, if a switch to another company would cause relatively low costs for the customer, or if substitutes are relatively easily available. Further indicators for a high bargaining power are, for example, a low differentiation of industry products or a monopolistic or semi-monopolistic position for the customer.

2.1.4 Threat of Competitors

Strong competition also puts prices under pressure and, therefore, leads to a disequilibrium between supply and demand, which, at last, has a negative influence on the whole sector.

Existing companies from other branches can then successfully venture into new segments, if they can use competences from their own branch in doing so. In this way, for example, Pepsi was able to establish itself successfully on the market for bottled water. (Porter 2008:21)

In addition, market entry barriers have an unfavourable effect on the attractiveness of a sector. These are:

- Scale effects, i.e. cost advantages of established companies, which result from the fixed costs per produced unit becoming lower and lower at rising quantities.
- Advantages of size by the customer, called user effects, which can be found in sectors, in which customers are prepared to pay more for a product the more users there are. (Porter 2008:22)
- Product differentiation
- Access to distribution channels
- Government regulators.

2.1.5. Threat of Substitute Products

If there is a multitude of products that meet customers' needs and that can be changed to quite easily, then this fact can also pose a threat to existing companies. A company can stand out against its competitors by means of unique products, a better image or various extras, in order to create a sustainable competitive advantage.

2.1.6 Rivalry among Existing Competitors

The higher the number of companies of the same kind there are on the market / in the sector, the stronger the rivalry among these competitors will be. Here it must be differentiated between a price competition, in which companies try to undercut each other's prices, or a performance competition, in which competitors would like to stand out against each other in view of their product quality and extra services

The intensity of competitive rivalry within a branch is strongly influenced by the number of competitors as well as by product differentiation. Capacity utilization also plays a decisive role. If capacity exceeds demand, then companies will try to sell their goods at cheaper prices, which, in turn, will weaken the attractiveness of the branch.

3 Porter's generic strategies

3.1 The generic competitive strategies

After analysing the five determining competitive forces, Porter defined three strategic approaches for the best possible market positioning respectively to achieve and preserve competitive advantage. These are the following strategies:

- Strategy of cost leadership
- Strategy of differentiation
- Concentration on niches/particular market segments

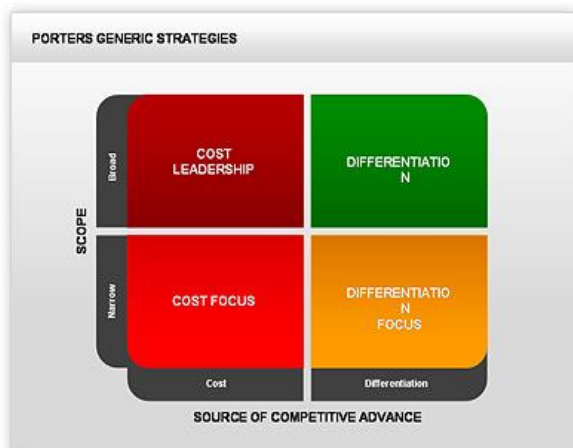


Figure 2. Porter's generic strategies
Source: PoweredTemplate.com

3.2.1 Cost leadership

The strategy of cost leadership substantially aims at offering the lowest prices on the market. Its success is mainly based on the use of scale effects and the high volumes of output. Building customer relationships and preserving existing customer relationships are more or less left out of consideration.

3.2.2 Differentiation

The differentiation strategy is orientated to a company offering a product or service, which has a unique position within the respective sector. Therefore, either the product itself, or the technology behind it or, for example, the service have a unique value, with which its customers are bound to the brand and higher prices can be achieved.

3.2.3 Concentration on niches

Being a niche leader means concentrating on distinct niche products, distinct customers or distinct market segments. Focussing on these enables companies to be more successful by means of specializing and concentrating on individual products (groups) or regions. Within a defined niche a company can again concentrate on cost leadership or differentiation.

3.2.4. The risks of these strategies

According to Porter every company should decide on one of the strategies mentioned, in order to take up the best possible market position, respectively to achieve sustainable competitive advantages. A company should not try, under any circumstances, to pursue several competitive strategies at the same time, as it would then get stuck in the middle, for a missing distinguishing is regarded as the greatest risk. Companies with cost leadership or differentiation strategies therefore, have a better position on the market than other companies, according to Porter. (Harfield 2012)

4 Examination of the Relevance

4.1 The Porter Models in a time wise context

The Porter Models certainly belong to the most significant approaches in strategy planning, however, at the same time, they are among the most criticized. The '80s of the previous century were marked by classical markets, strong competition with relatively stable structures and a cyclical economic development. However, the internet has revolutionized and changed almost all sectors of the economy in the new millennium and has, therefore, required for additional competitive strategies. (Recklies 2001).

This dramatic economic change did not, however, suddenly lead to the fact that Porter's strategies became unusable from one day to the next. They just have to be applied in a different way to virtual markets like these, whether open or closed, on which suppliers and consumers actively meet on the internet and use their platforms to exchange information and knowledge.

Even if the individual sectors have different structures, the previously mentioned Five Forces still continue to be of relevance for all of them, as each structure can be differentiated with the help of this model. But the five determining forces may by no means be confused with other competitive forces, such as a rapid sectorial growth, for example. For too rapid growth attracts the attention of other competitors,

therefore fosters rivalry among competitors and, as a result, is not necessarily a guarantee for sustainable profit maximization. Creative ideas and an innovative technology alone are not sufficient either, in order to be lastingly successful, respectively increase the attractiveness of a sector. Sectors with simple technologies and price-insensitive customers can be by far more profitable. (Porter 2008:23)

4.2 Increasing Globalisation due to the Internet

The increasing dynamics on global markets lead to growing requirements also in the field of strategy finding. Promising markets and constantly new product innovations rapidly spread with the help of the internet and the social media platforms, however, new technologies and the increasing globalisation do not only offer a lot of opportunities, but also hold multiple dangers. Existing, so far successful company strategies have to be adapted to these different general conditions, for, compared with the '80s of the previous century, the market has fundamentally changed.

Porter's strategies as a model for the recognition of structural sectorial changes still continue to be relevant, however the changed external basic conditions call for hybrid methods, which take the changed supply, respectively demand as well as shorter product life cycles and new technologies into consideration. Successful competitive strategies in e-commerce achieve the furthest-possible range on the web by means of differentiated online strategies. The fundamental change of paradigm, caused by the dynamics on digital markets, now requires for companies not only to pursue economic objectives, but also to pay attention to how they are taken aware of on the individual social media platforms, for a high awareness level is a good indicator for the success of a brand or a company, leads to a changed consumer behaviour and, therefore, directly to the profitability of a company.

And yet, besides increasing their awareness level, these companies also concentrate on the strategy of cost leadership or that of

differentiation by putting the uniqueness of their brand to the fore, as with Porter.

4.3 The Strategic Approach according to Larry Downes

Larry Downes' much-cited article „Beyond Porter“ is a critique of Porter's Five Forces Model. It is Downes' opinion that Porter's approach was relevant for the '80s and '90s of the previous century, but that the assumptions are no longer applicable in the new millennium, which is marked by a revolutionary technological change, as competition is much tougher than it was at that time. For this reason, he defined the following three forces, which stand above Porter's Five Forces and, in his opinion, reflect today's competitive situation much better (Downes 1997):

- Digitalization
- Globalisation
- Deregulation.

4.3.1 Digitalization

A digital world, that is becoming stronger and stronger, allows its users easy and fast access to information, either via the social media, or by means of other internet platforms. This new access henceforth gives companies the possibility to get into contact with customers in a relatively easy manner, to establish and build relationships. Digitalization, therefore, fosters rivalry among competitors stronger than in Porter's times.

4.3.2 Globalisation

The digital markets inevitably lead to dynamics in globalisation and, therefore, enable companies to act on the next higher global level. As the global purchasing world is, however, also opening on the demand side and customers have worldwide access to products and services, it is not sufficient any more to establish oneself as a price or quality leader. Downes therefore suggests a link-up of far-reaching partner networks, in order to reach more mobile

customers better and to bind these (see Recklies 2001).

4.3.3 Deregulation

Furthermore, the ease of government regulations in certain branches leads to a reorientation in these sectors. These changes cause a restructuring of traditional companies, either by entering into new alliances, or giving up old, unprofitable ones, and concentrating on more profitable areas of operation (see ebd.)

5 Conclusion

Downes is very convincing with his arguments, as there are forces at work on the global and digital markets, which make new demands on a successful competitive strategy. As a result, a strategy may not only be orientated to Porter's ideas. The hybrid requirement calls for a combination of multiple management concepts in one strategy and a consideration of all of these. In times of the internet and an increasing globalisation, Porter's approach partly comes up against limiting factors. Every company is still confronted with the Five Forces and, therefore, has to deal with its suppliers, customers, substitute products and competitors, however a successful strategy approach has to take other influences into consideration besides these competitive forces. The current forces on the market require a new strategic framework, an approach, in which internal strengths and weaknesses still have to be analysed just as well as the structures of a sector, but in which different and differentiated methods are applied. In spite of the fact that companies have to combine a lot of management approaches and models in one strategy in modern market activities, they must commit themselves to a clear strategic position. A strategy has to be based on uniqueness. Increasing globalisation involves that barriers to competition are falling and that processes respectively products are copied or imitated. For this reason, companies are forced to react quickly and more flexibly to changes on the market and in competition. In

order to create really sustainable competitive advantages and to preserve these, they have to distinguish themselves permanently from others, for only by doing this can they communicate their Unique Selling Proposition (USP) to their customers. The USP Strategy is an effective differentiation strategy, with which a company can emphasize its uniqueness by its particular product quality, its strong brand, a favourable price or interesting extra services. A clear positioning with the help of Porter's generic strategies of cost leadership, differentiation or niches strategy is, therefore, an absolutely essential approach, in order to be successful in the long term. Porter distinguishes here:

- A variety-related positioning for defined products, which a company, for example, can produce better than others.
- A needs-related positioning tailored to the needs of the customers.
- An access-related positioning, which is orientated to the best way to reach and target a customer on the market. (Porter 2008:5)

In order to create sustainable competitive advantages, according to Porter each company must try to occupy this unique competitive position within its sector. As a result, all of the activities within the company have to be tailored to this strategy. It is, therefore, not sufficient any more, as it used to be, to do benchmarking or to apply best practice. Nowadays a clear competitive advantage is based on uniqueness and a synchronized value-added chain. The current credo is "from competition to added value". (Porter 1996:17)

Operational effectiveness is by no means sufficient either to increase corporate success at long term, for there is less and less difference between companies and their strategies also become more and more alike. This competition, based on operational excellence, leads to a destructive rivalry among the companies in the long term and, in this way, it is harmful to the success of the companies, even more of the whole sector (Porter 2008 in: Harvard Business Manager).

Alternative Views of Strategy

The Implicit Strategy Model of the Past Decade

- One ideal competitive position in the industry
- Benchmarking of all activities and achieving best practice
- Aggressive outsourcing and partnering to gain efficiencies
- Advantages rest on a few key success factors, critical resources, core competencies
- Flexibility and rapid responses to all competitive and market changes

Sustainable Competitive Advantage

- Unique competitive position for the company
- Activities tailored to strategy
- Clear trade-offs and choices vis-à-vis competitors
- Competitive advantage arises from fit across activities
- Sustainability comes from the activity system, not the parts
- Operational effectiveness a given

Figure 3. Sustainable competitive advantages

Source: Porter 1996:17

According to Porter, companies can, however, influence the competitive forces to their benefit, for example, by trying to reapportion the profits. They can possibly succeed in doing this by deducting shares in the profits, which previously flowed to suppliers, customers and sub-agents, or by trying to be better than the others and to offer extra services, respectively place the uniqueness of their products to the fore. It is, however, by far the better strategy, as stated by Porter, to increase the general demand or improve the present quality. A broadening of the customer range or a cooperation with suppliers with the objective to improve the coordination or cost structure of a sector, leads to a win-win situation for all market participants according to Porter. (Porter 2008:26) In conclusion it can therefore be said, that a hybrid strategy approach is necessary in times of a strong global competition, in order to take up a lasting successful competitive position. Porter's models are still of relevance, however the optimal strategy ideally combines multiple other concepts besides Porter's Five Forces Model, which enable an internal company analysis as well as an external environmental analysis. A

Authors description

Marco Pister has worked in the IT industry since 1995 and has concentrated on product development and selling software products for Business-to-Business needs. Currently he works for SEEBURGER AG a German software provider and one of the leading companies for integration technology software. He completed in 2010 a MBA with Liverpool John Moores University and started September 2011 a PhD program at the Slovak University of Agriculture in Nitra. His current research topics are strategic management for Business-to-Business companies, innovation and organizational changes for the further growth from SME businesses to multinational enterprises.

detailed analysis of the five competitive forces to determine the attractiveness of a sector is still recommended. Concentrating on one of the generic competitive strategies in further succession with a focus on uniqueness can additionally contribute to the fact that a company can distinguish itself positively from its competitors and put its USP on the fore. However, it is necessary to align all the functions in a company to the strategy. This strategy has to be clearly communicated within the company for everybody to act in concert and be motivated.

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