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Porter's Five Forces Analysis and the Strategic Group Analysis.

The aim of this research is to critically evaluate the combination of two business strategy techniques; Porter's Five Forces Analysis and the Strategic Group Analysis.

The essay will often refer to these terms and it will be therefore pertinent to clarify these at this early stage. Current issues in the business world will also be identified and related to the theory. Limitations of these techniques will be outlined and conclusions drawn.

Porter's Five Forces Analysis is based on the concept that the key objective for any organisation should be to gain advantage over its competitors, it is not the industry that an organisation is in that counts, but where it wants to compete in terms of the nature of the competition. This competition is provided by the nature of the rivalry between existing firms, the threat of potential entrants and substitutes and the bargaining power of both the suppliers and buyers (Lowson, 2002).

Strategic groups have been defined by Finlay (2000) as groups of business that are likely to respond similarly to environmental changes and be similarly advantaged/disadvantaged by such changes. Porter (1980, taken from John et al, 1997), suggests that an industry could have only one strategic group if all the firms followed essentially the same strategy. At the other extreme, each firm could be a different strategic group.

Evaluation of analysis techniques

Porter's Five Forces model has been identified as a powerful tool for systematically diagnosing the principal competitive pressures in a market and assessing how strong and important each one is (Thompson and Strickland, 2003).

Barriers to entry, identified as one of the five forces, presents five structural determinants that affect a company's ability to enter new markets; economies of scale, product differentiation, government as with taxi licences for example, favourable access and capital requirements (Bowman, 1998). The economies of scale, which is a benefit gained from large scale production will keep costs down and ultimately low prices too. Product differentiation will allow keeping customers loyalty and switching costs and an appropriate example of this would be the new electric car introduced by Toyota.

It can also be suggested that advertising campaigns may also be considered as an entry barrier. The existing markets will be able to raise product awareness while new entrants will less likely be able to meet the costs involved in doing so. Backwards vertical integration may also be identified as a possible entry barrier. The bargaining power of both suppliers and buyers and also the threat of substitutes; the extent to which there are products/services which are close substitutes for the product/services of the industry in question, are also considered as part of the five forces. The retail industry, and in particular the food sector, is currently faced with the problem of high power of buyers and the lack of suppliers power. According to Rigby (2005), "suppliers are receiving insufficient government protection from the market power wielded by supermarkets. The failure of the Code of Practice reflects the market power that consumers have delegated to them en masse". Bowman (1998) also suggests that the Five Forces model allows firms to rate the strength of each of the five forces so that they can focus their attention on the main competitive aspects.

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As noted by Fleisher and Bensoussan (2003), Porter's fifth force, competitive rivalry, is also an element addressed by the strategic group analysis where it considers competitive rivalry and how this force both impact and it is impacted by other four forces. Porter (1980, taken from Bowman, 1998) suggests that the level of rivalry, the actual competition between existing producers, varies according to a number of factors. The market structure for example will be a major determinant in the intensity of rivalry. In a monopolistic market for example, where one firm has the total control of the market, quality, availability, price but mainly product differentiation will be a priority. In relation to this it must be noted that an article by Business World (2005) suggests that the law concerning the abuse by companies of dominant market positions will be reviewed and ultimately changed in the near future. On the other hand, firms operating under conditions of oligopoly may find considerable variation in the identity, number and size distribution of competitors internationally, as for example Burger King and McDonald (John et al, 1997). The slow growth of demand, or a declining demand, the high fixed costs involved that do not vary with the level of outputs, are also factors which will ultimately impact on the level of rivalry.

It has been noted that the Strategic Group analysis is a technique used to provide management with information in regards to the firm's position in the market and a tool to identify their direct competitors. The Five Forces industry analysis will form the first step in this process. After having identified the forces, the major competitors in the industry based on competitive variables will also be outlined. Competitors will then be divided into strategic groups based on similarities in strategies and competitive positions. As suggested by Thompson and Strickland (2003), one thing to look for is whether industry driving forces and competitive pressures favour some strategic groups and hurt others. Firms will most likely try to shift to a more favourable situated group, and how hard such a move proves to be, will depend on whether entry barriers for the target strategic group are high or low. It is also important to mention that although some companies operate in the same market they are not necessarily direct competitors as this will be determined by the size or market position for example.

Strategic group analysis allows managers to identify direct competitors that are of a similar size and range and focus on remaining competitive in order to survive in the ever changing market. At the same time, BMI British Midland, according to an article by Done (2005), will be entering the long-haul market from London Heathrow for the first time, becoming the third UK long-haul carrier out of Heathrow, intensifying competition with British Airways and Virgin Atlantic. These three airlines are competing "head to head" to win more traffic rights to different destinations and those that are in the same market and not looking at options will more likely be left behind.

The Five Forces analysis and Strategic Group analysis are very useful business tools however they both present some limitations that will now be considered. Lynch (2003) suggests that although Porter's five forces model is a useful early step in analysing the environment, it has been subject to critics. The model assumes a classic perfect market and it assumes that organisation's own interest come first. This however may not be appropriate if applied to charitable institutions or government bodies. The assumption that buyers and suppliers power is a threat to the organisation might also be incorrect as some companies have recently seen the benefits in working closely with suppliers. The analytical framework is essentially static, whereas the competitive environment in practice is constantly changing.

In relation to this, it may be added that a PEST and SWOT analysis may also be useful tools to use when analysing an organisation. PEST analysis considers the external political, economic, social and technological factors that will have

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an impact on the organisation, encouraging thinking more broadly about environmental influences on the firm, while the SWOT analysis considers the internal strengths and weaknesses and external opportunities and threats (Bowman, 1998).

As also noted by Recklies (2001) the model is best applicable for analysis of simple market structures. A comprehensive description and analysis of all five forces gets very difficult in complex industries however a too narrow focus on particular segments of such industries, on the other hand bears the risk of missing important elements. Another limitation of Porter's model is that it assumes that companies try to achieve competitive advantages over other players in the markets as well as over suppliers or customers. With this focus, it does not really take into consideration strategies like strategic alliances that in today's market are very common. As suggested by Thompson and Strickland (2003), not only can alliances offset competitive disadvantages or create competitive advantage but they can also allow firm's to concentrate more on the mutual rivals than towards one another.

The strategic group analysis provides a good framework for management to be aware of their direct competitors and one analytical tool that is useful for comparing the market positions of each firm separately or by grouping them into positions is the Strategic Group Mapping. This tool however does not as such, show how in reality an organisation can maintain or even gain competitive advantage over its rivals (Thompson and Strickland, 2003). It would be therefore suggested that Porter's Three Generic Strategies, whereby organisations can gain competitive advantage over their rivals either by offering lower prices than competitors for equivalent products or providing unique benefits that more than offset a higher price, should also be adopted to complement other organisational analysis. Porter also suggests that firms should pursue a generic strategy and only concentrate on one of these, instead of trying to pursue all of them risking failure (Porter, 1985:3).

An example of a successful company adopting cost leadership is Ryanair that has clearly prioritised the strengthening of its strategic position in the market over short-term profit maximisation. It is using its cost leadership position to drive prices even lower so as to increase the financial pain on higher cost competitors (Mattimoe, 2004).

The combination of these two strategy techniques is fundamental for a business looking ahead in the future and trying to remain competitive in the ever changing external environment. Other analysis techniques such as PEST and SWOT, Three Generic Strategies could also be used to compliment the two discussed business tools.

Conclusion

It can be construed that Porter's Five Forces analysis and the Strategic Group analysis are very useful business tools that allow management to identify their position in the market. It was noted that Porter's Five Forces analysis assumes that the key objectives for any organisation is to gain competitive advantage over its rivals, while Strategic Groups were defined as groups of business that are likely to respond similarly to environmental changes. The Five Forces presented some structural determinants such as the economies of scale, which are the result of large scale production, government intervention as with patents and licences, and product differentiation. In a monopolistic market, price, quality, availability and product differentiation are the priority, while in an oligopoly market price tends to be the main determinant. It was also noted that these two techniques for analysis are very useful business tools however they both present some limitations. The Five Forces model could be used for simple market structure however a comprehensive

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description and analysis for complicated markets may not be ideal. The model also regards buyers and suppliers power as a threat for the organisation, however it was noted that companies have recently seen the benefits in working closely with suppliers. It was also suggested that an organisational analysis should include a PEST and SWOT analysis to consider with a broad view the external and internal factors that may affect the business future performance. Finally it was also suggested that a firm, as per Porter's view, should aim to follow one of the Three Generic Strategy, and in particular either cost leadership as per Ryanair's example or product differentiation.

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