

# **ERM Tool**

## **Using Porter's Five Forces to Analyze Risks**

### **BRIEF DESCRIPTION OF TOOL**

Porter's Five Forces is a strategic tool used to analyze the competitive environment of an industry. Originally developed by Professor Michael Porter of Harvard Business School, this framework examines five key forces that shape competition within an industry. These forces are:

1. The threat of new entrants,
2. The bargaining power of suppliers,
3. The bargaining power of buyers,
4. The threat of substitute products or services, and
5. Competitive rivalry among existing firms.

Examining each of these Five Forces may help executives identify risks emerging in the industry that may impact their organization's business model and competitive advantage. Evaluating the five forces regularly provides a deeper understanding of the external risks and pressures that could impact profitability and growth.

### **HOW TO USE**

The tool on the next page highlights a number of questions related to each of the Five Forces that could be used by executive teams to engage in discussions about potentially important emerging risks.

The questions in the tool provide a structured way to engage in discussion and dialogue about potential shifts in root causes that may trigger new risk conditions emerging within an industry. The questions could be used in strategic planning or risk workshops, or they may be embedded in business plan guidelines as explicit elements to be addressed by business leaders as they develop business plans.

Following the template of questions, this tool provides an example of a completed assessment of risks using Porter's Five Forces, using a furniture retailer as an example. It includes an analysis of the dynamics related to each force, associated risks, and risk responses.

The questions and examples in this tool can be used to guide analysis.

## Porter's Five Forces Industry Risk Analysis Tool - Questions to Consider -

### THREATS OF NEW ENTRANTS

Questions to Guide Analysis	Risk Examples
<ul style="list-style-type: none"> <li>• What barriers protect our market position in the industry (e.g., economies of scale, brand loyalty, regulations)?</li> <li>• Are new technologies affecting barriers to entry into our industry?</li> <li>• Is the industry attractive to new entrants because it is growing or profitable?</li> <li>• Are any regulations changing that might affect industry attractiveness or barriers to entry?</li> </ul>	<ul style="list-style-type: none"> <li>• Increased pressure on pricing</li> <li>• Loss of market share</li> </ul>

### BARGAINING POWER OF SUPPLIERS

Questions to Guide Analysis	Risk Examples
<ul style="list-style-type: none"> <li>• How many suppliers do we depend on?</li> <li>• Are any suppliers particularly important to us?</li> <li>• How much control do our suppliers have over pricing?</li> <li>• How easily could we switch to alternative suppliers or sources?</li> </ul>	<ul style="list-style-type: none"> <li>• Increased input costs</li> <li>• Input shortages</li> </ul>

### BARGAINING POWER OF BUYERS

Questions to Guide Analysis	Risk Examples
<ul style="list-style-type: none"> <li>• Are any buyers particularly important to us?</li> <li>• How easily can customers switch to competitors?</li> <li>• How price-sensitive are our customers?</li> <li>• Are decision criteria for customers changing?</li> </ul>	<ul style="list-style-type: none"> <li>• Pressure to reduce prices or increase product quality</li> <li>• Loss of customers</li> </ul>

## Porter's Five Forces Industry Risk Analysis Tool - Questions to Consider -

### THREAT OF SUBSTITUTES

Questions to Guide Analysis	Risk Examples
<ul style="list-style-type: none"><li>• Are there alternative products or services our customers could use instead of ours?</li><li>• How easily can customers switch to substitutes?</li><li>• Are any substitutes becoming more attractive to our customers?</li></ul>	<ul style="list-style-type: none"><li>• Reduced demand</li><li>• Pressure to lower prices or improve products or services</li></ul>

### RIVALRY AMONG EXISTING FIRMS

Questions to Guide Analysis	Risk Examples
<ul style="list-style-type: none"><li>• Is the industry growing or shrinking?</li><li>• Are competitors changing what they are doing in terms of pricing or offerings?</li><li>• How loyal are our customers?</li></ul>	<ul style="list-style-type: none"><li>• Pressure to reduce prices or expand offerings</li><li>• Higher marketing and advertising expenses</li></ul>

# Porter's Five Forces Industry Risk Analysis Tool Example

## EXAMPLE USED: FURNITURE RETAILER

Competitive Forces	Analysis	Risks	Responses
<b>Threat of New Entrants</b>	<i>Traditional barriers to entry such as investment in inventory, logistics, and showroom space are being challenged by online-only retailers.</i>	<i>New online competitors could erode market share by offering lower prices, delivery, easy returns, and convenient virtual showrooms.</i>	<i>Enhance the physical store experience, provide financing options and quick delivery, expand online presence.</i>
<b>Bargaining Power of Suppliers</b>	<i>The large number of furniture suppliers keep bargaining power of suppliers low, but prices for raw materials are rising and there are potential supply chain disruptions.</i>	<i>Price increases or supply chain delays could reduce profit margins and cause inventory shortages.</i>	<i>Maintain diversified set of suppliers and logistics providers, negotiate long-term contracts, monitor political and climate factors affecting raw materials.</i>
<b>Bargaining Power of Buyers</b>	<i>With many purchasing options, buyers have high bargaining power and are often price sensitive.</i>	<i>Customers may switch to competitors offering discounts or greater selection.</i>	<i>Keep prices competitive and differentiate through value-added services such as extended warranties, free installation, and flexible payment plans.</i>
<b>Threat of Substitutes</b>	<i>Alternatives, such as second-hand furniture and rentals, are not a major force, but are not insignificant, especially since they are frequently low-cost options.</i>	<i>An economic downturn may increase the appeal of secondhand furniture to cost-conscious customers.</i>	<i>Offer products at a wide range of price points to provide affordable options and emphasize durability and design.</i>
<b>Rivalry Among Existing Firms</b>	<i>Competition is intense and growing as the number of general and specialty internet retailers increase and big box stores expand furniture offerings.</i>	<i>Attempts to gain market share may lead competitors to begin price wars and aggressive marketing campaigns.</i>	<i>Partner with designers and offer customizable options to differentiate from larger, low-cost competitors.</i>