

Porter's added value: High indeed!

Academic Commentary by Adam Brandenburger

Published in 1980, Michael Porter's *Competitive Strategy* continues today to exert enormous influence on the field of business strategy.¹ Both the teaching of business strategy in business schools and the practice of business strategy in the business community carry the stamp of Porter's ideas. This brief commentary lays out the reasons I see for the continued importance of Porter's *Competitive Strategy*, in particular. I also say something about the influence of Porter's ideas on my own work.

A Picture of the Landscape

The Five Forces Model is surely the most widely known and widely used idea from *Competitive Strategy*.² What is the reason for the power of this model? In my view it is that it gives a clear image of the essential activity of business. It depicts the whole vertical chain of economic activity running from suppliers (i.e., owners of resources) through businesses and on to customers. It highlights the central role of business in creating value but also emphasizes how businesses are interdependent with their suppliers and customers. Porter's model gives us an image of a 'value pie' being created by firms together with buyers and suppliers, and of this pie getting divided up among the different players.

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When teaching, I explain the five forces exactly this way. To get going, I draw the diagram depicted in Figure 1.³ The first step is to say that the potential for profit arises when the maximum that the buyers will pay (their willingness-to-pay) ex-

ceeds the minimum that the suppliers will accept (their opportunity cost). The next step is to ask who captures this pie. Porter's model helps us in both these steps. His *threat of substitutes* is an indicator of what is capping the value created by the supplier-firm-buyer chain; it affects the willingness-to-pay of buyers. The other four forces (*threat of new entrants*, *bargaining power of buyers*, *bargaining power of suppliers*, and *rivalry among existing competitors*) all relate to how the value created is divided up and down the chain of players.

Let's compare Porter's model with another "picture of the landscape" that students learn—the traditional supply-and-demand diagram of economics. Here, we imagine a large number of small buyers and small sellers, each of whom responds to market prices. But many business contexts involve a small number of large players. This is the world of 'big businesses' doing business with one another. It is the case of a business selling to a mass consumer market but selling through a small number of large distributors. It is also the case of a business that sources from a small number of large suppliers. And so on.⁴ Moreover, these big players are often active negotiators over prices and other terms and do not simply respond to the prices they find. In short, business strategy is very often interested in games made up of small numbers of significant and active players, rather than large numbers of small, non-strategic players. By design, Porter's model is tailor-made for thinking about precisely these kinds of games.

This, then, is my explanation of the success of Porter's Five Forces Model. It gives us a memorable mental picture of the business landscape—one that reflects what real-world business strategists actually think about.

How Many Strategies?

A second very influential idea from *Competitive Strategy* is Porter's generic strategies. Porter argues that, while the way firms succeed in making

