# Who do you have to battle to make a profit?

## The five forces that really shape your business and its performance

By Professor Colin Tourick


Asked the above question, most businesspeople produce a long list of their competitors. However, in 1979, Michael E. Porter of Harvard University produced a paper that revolutionised the way businesses began to answer it. He said apart from competitors, a business must deal with four forces to make a profit: the bargaining power of suppliers, the bargaining power of customers, the threat of new market entrants and the threat of substitute products and services.

Professor Porter went on to become one of the leading economists of his generation. He has written 18 books on strategy, won numerous awards, been honoured by the US government for his contribution to economic development and his ideas are taught globally. His updated paper is at: hbr.org/2008/01/the-five-competitive-forces-that-shape-strategy.

Porter's 'Five Forces model' applies across all industries and market sectors, but the relative strength of each force differs between industries. He says to understand the roots of its current profitability, and defend it, a company must understand the forces and their underlying causes.

In this article, we will try to apply the 'Five Forces model' to the fleet leasing industry.

> 'To understand the roots of its current profitability, and defend it, a company must understand the five forces and their underlying causes'

### 1. The threat of new entrants

New entrants bring new resources into a market and add to competitive pressures for existing players.

There have been new entrants to the leasing sector in recent times – not just the smaller players who have emerged in the bottom right-hand corner of the FN50, but also organisations with solid financial backing such as HG Capital (which acquired Leasedrive and Zenith) and Maxxia (part-owned by Australia's McMillan Shakespeare), which acquired CLM.

There are barriers to entry to the leasing market, but they are not particularly high compared with some industries. Even if, unlike HG or Maxxia, new entrants are small and relatively under-resourced and cannot instantly deliver the richness of products and services offered by the FN10, they can compete for mid-market and SME business, where many customers' needs are relatively straightforward.

## 2. The power of suppliers

Powerful suppliers can keep more of the value of a transaction to themselves by charging more.

Leasing companies buy products and services from a plethora of suppliers. Where there is choice of suppliers, Porter would certainly advocate shopping around.

## 3. The power of buyers

Powerful customers drive down prices and demand more services for little or no extra money, squeezing profitability. Every leasing firm will have experienced this.

The way to lessen this pressure is clear: differentiate your products and services from your competitors'.

However, to do this you need a lot of detailed knowledge about your competitors. Salespeople often know little about their company's competitors, with information gleaned from personal contacts, urban myths or 'war stories'. "ABC Leasing is particularly cheap on Ford product." (Really? All Ford product? For all periods? And all mileages? Both with and without maintenance?)

## 4. The threat of substitutes

If customers can switch to save money, they will. Bank loans and outright purchase are potential substitutes for contract hire, video conferencing for business travel, cash allowances and mobility solutions (car clubs, car share, journey share, tighter management of pool cars) for business cars.

Historically, the threat of substitutes has been modest in the leasing sector, although it is clear there are fewer company cars on the road now than some years ago.

Some companies are addressing the threat of substitutes by offering their own. BMW, for example, has moved into the mobility and ancillary solutions markets, with offerings such as DriveNow (car sharing), ParkNow (a mobile app that helps find parking spaces), ChargeNow (to locate and use public car charging spaces) and Life360 (family-locating and linking via mobile apps).

Some substitutes are less obvious. Someone shopping for a new company car may opt for a cash allowance instead. How much work does the leasing industry do to combat the threat of this particular substitute? How can it get the chance to extol the virtues of leased company cars, or salary sacrifice, when an employee is considering opting out?

## 5. Rivalry among existing competitors

Rivalry limits the profitability of an industry and individual companies. Rivalry is intense in the leasing sector because there are lots of competitors, the overall market isn't growing, everyone wants to grow and many end-user clients don't differentiate between suppliers.

The cost of change is one of the few factors stopping clients defecting to another supplier, but lessors can't rely on this, particularly in multi-supply situations where the costs of change are small. This leads to intense price competition. It also drives the need to innovate; producing more products, more services, adding more features to existing services and investing in better client-focused technology and quality management systems.


So, when considering these five forces, what would Professor Porter have you do?

First, he would ask you to find out the average profitability of your competitors to see how you measure up.

Then he'd ask you to consider how each of the five forces combines to make the industry's profits what they currently are.

Then he'd ask you to look at how the five forces affect your business, to see how each one helps to mould your results and how they are likely to do so in the future. This would identify areas for you to focus on to deliver sustained improvement in your profitability.

Finally, he would invite you to build defences against the strongest forces and to work out where the forces are weakest, so you can be more assertive in trying to overcome them.

● **Management consultant Professor Colin Tourick is director of Dynamic Lease Pricing, visiting professor at Buckingham University Business School and author of *Managing Your Company Cars.* www.tourick.com**