

## Porter's Theory of Competitive Advantage among selected SMEs in Anambra State : An Empirical Review of its applications.



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Name of the Author:

**Dr. Peter Ositadinma Ndubuisi**

Department Of Entrepreneurship Studies

Chukwuemeka Odumegwu Ojukwu University, Igbariam,

Anambra State, NIGERIA

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### ABSTRACT

This study examines the extent of the application of porter's theory of competitive advantage among selected SMES in Anambra state. The researcher used the descriptive survey approach to gather data for this study. The population of the study comprises of 207 middle level and senior members of staff drawn from ten SMEs in Anambra state. The researcher however using convenience or purposive sampling technique selected 163 employees out of the population of study. A five point likert scale questionnaire that covered the different areas of extent of Porter's theory application in SMEs competitiveness and profitability was used to elicit response from the respondents. The statistical tool used for data analysis in this paper is the Non-Parametric Kruskalwallis test (H) using the 15.0 version of the Minitab statistical software (MSS). From the result obtained, the researcher concludes that porter's five forces model plays key role in the competitiveness and strategy decisions of SMEs in Anambra state. Sequel to the result, the researcher recommends that operators and managers of SMEs should effectively adopt the new model which contains all the parts of Porter's original model in addition to Innovation and Complementary Product.

**Keywords:** Competitiveness, SMEs, Profitability, Strategic, Porter's theory.

## I. INTRODUCTION

It is a widely held view among economist and national development policy makers that the surest route to fast and sustainable economic development is the promotion of small and medium scale enterprises (SMEs). As government makes effort to promote the competitiveness of domestic SMEs, they are challenged by the influx of imported goods that are produced in a low-cost operational environment; this places the Nigerian SMEs in a risk and the Nigerian industrialization at a fix. To adapt to the changing operational environment occasioned by a mix of globalization and rapid advancement in information and communication technology, there is need for operators and managers of small and medium scale enterprises to adopt strategies and models that will avail them with adequate market knowledge. This brings to mind the porter’s five forces theory. The theory as developed by Michael E. Porter of Harvard University in 1979 is a framework that attempts to analyze the level of competition within an industry and business strategy development. It draws upon industrial organization (IO) economics to derive five forces that determine the competitive intensity and therefore attractiveness of an Industry. Attractiveness in this context refers to the overall industry profitability. An "unattractive" industry is one in which the combination of these five forces acts to drive down overall profitability. A very unattractive industry would be one approaching "pure competition", in which available profits for all firms are driven to normal profit. This paper shall therefore investigate the extent of its application among SMEs in Anambra state.

## II. OBJECTIVES OF THE STUDY

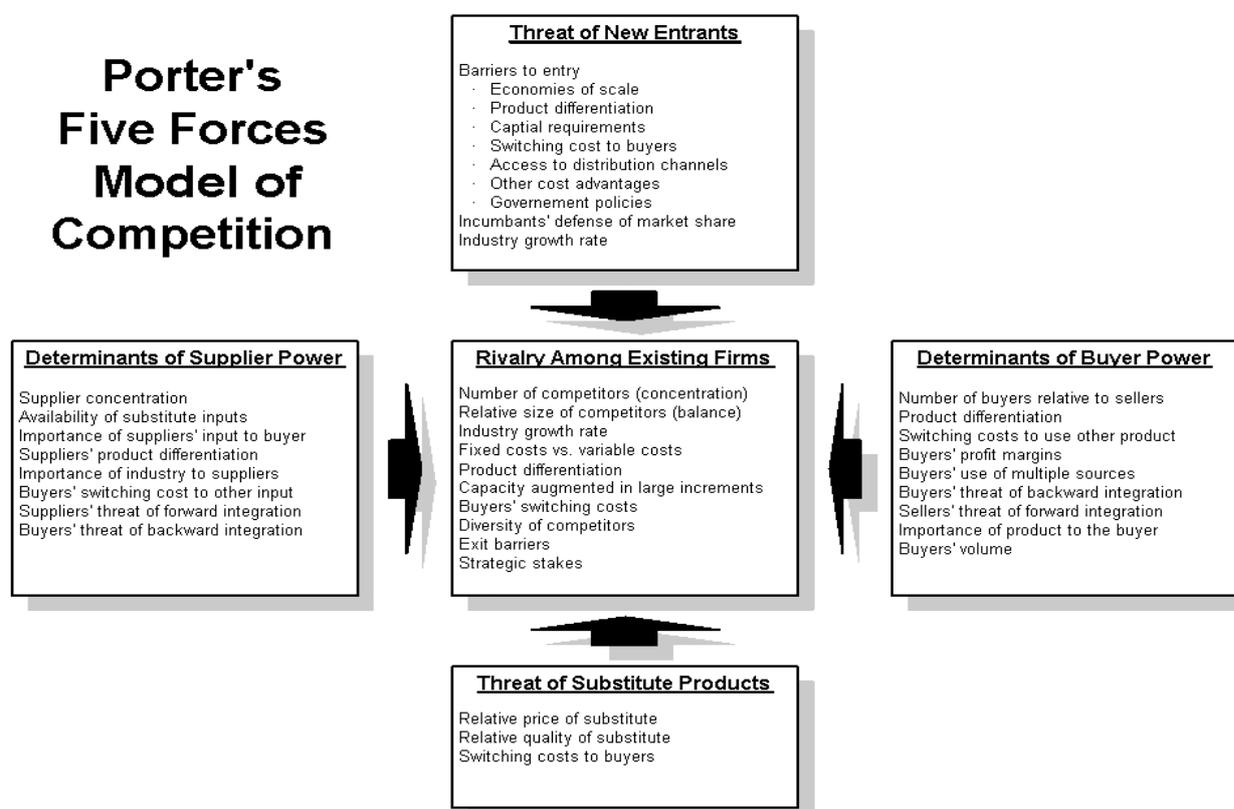
The general purpose of this study is to examine the extent of the application of porter’s theory of competitive advantage in selected SMEs in Anambra state. The following specific objectives shall however be examined;

- i. The extent of the application of Porter’s theory in the competitiveness of SMEs in Anambra state.
- ii. The extent of the application of Porter’s theory in the strategy development of SMEs in Anambra state

### Hypotheses

### Review of Literature

In most industries there is competition in one way or another, although the type varies widely depending on which industry that is examined. The degree of competition can be judged by the threat of entry to the industry or the power from suppliers and buyers to the company. Competition can also come from a substitute and together with the other ones; they will decide the profitability and attractiveness for the industry. Each of these factors has to be analyzed to find out the underlying forces and structures in the industry. Michael E. Porter developed a model for this already back in 1979 and it is widely referred to as Porter’s Five Forces. As the name implies there are five factors that describe how an industry’s environment is structured and measured. These are called Threat of New Entrants, Power of Suppliers, Power of Buyers, and Threat of Substitutes, which all contributes to the final factor Competitive Rivalry. If the conclusion is that there is a high Competitive Rivalry in the industry, it results in an unattractive environment. Significant for an unattractive environment is the low profitability level that is determined by the competitiveness (which is probably strong, if the profitability is low) amongst the companies, which results in a lower chance for a new entrant to be successful within it. In an attractive environment the situation is the opposite, which means that the risk from new entrants is bigger due to higher profit levels (Porter, 1985). The diagram below demonstrates the constituents of the Michael E. Porter five forces theory.



Source: Porter M.E, (1979), How Competitive Forces Shape Strategy. *Harvard Business Review*, pp. 3-10.

**Threat of New Entrants:** The first factor, called the Threat of New Entrants is the most obvious force and also the easiest one to measure in this model. There are several ways to measure whether the competition barriers is strong or not.

1. **Economies of scale** – In manufacturing industries this barrier is one of the most important to deal with, since large scale production is what brings down the unit cost and thereby creates profit for the company. This also means that experiences within the production is crucial, which is a big disadvantage for a newcomer in the industry (Porter, 1985). Scale advantages occur in marketing and R&D actions taken by the company and customer services are also included here. Companies that are unwilling to enter an industry with large-scale production (when necessary) probably must cope with cost disadvantage, at least in the start-up phase (Porter, 1979).
2. **Product differentiation** – This barrier can be hard to overcome in such industry where brand recognition is crucial, because the existing competitors may have strong connections to the customer. To entice the loyal customers, a new entrant may have to invest in advertising etc., which can be costly and time consuming.
3. **Capital requirements** – Some industries are capital intensive and then it is important to have enough financial resources. This can be in the start-up phase, when investments in machines, buildings, or as mentioned earlier for advertisement has to be done. Many times a company has high running-costs too, such as credits for customers, high storages and capital losses from time to time. These financial issues decrease the number of likely entrants for some industries, just because they do not have enough financial assets.
4. **Cost disadvantages independent of size** – No matter how good a company is at creating economies of scale, how well they attract customers or how strong financial power they have, it still is not enough in some situations. Sometimes there are factors that only can be attained or owned by one company; this can be in form of patents or unique assets to raw-materials. Such factors may not be available for new companies; hence, the threat of entry is decreasing considerably in those cases.
5. **Access to distribution channels** – In some cases it is not possible for new companies to use the existing distribution channels and, therefore, they have to create their own if they shall enter the industry. This situation is not the usual one; often it is possible to use the competitors' channels, but they may still need to compete for the space within these, for example through price competition.
6. **Government policy** – Sometimes an industry is protected by governmental regulations, which prohibits new entrants in the industry. Such regulation can be protection of domestic actors, laws for environmental protection and licensing requirements for industries. These are all examples of how institutional decisions can regulate an industry. When all these factors have been taken into account, it is possible to come to a conclusion about how high the threat of entry is for an industry. If the barriers can be considered as high, it basically means that it protects the active companies. If the conclusion is the opposite it is more likely for new entrants to be successful. However, new entrants should still be careful before they enter an industry, since it is likely that active companies will retaliate against newcomers.

**Threat of Substitutes:** A substitute can be a similar product or service that fills the need for the customer in almost the same way as the original one. To distinguish a substitute companies need to look on the shift in technology. It is also crucial for the business strategists to not only look at the own industry and the direct substitutes for a product (Fahy, 1992).

1. **Price/performance ratio** – To measure how big threat a substitute possess for an industry there are some aspects to keep in mind. First of all it is important to judge a product/service from its price/performance ratio, which is connected to how the customer perceives the company's offer. Often the difference in monetary levels for products/service has a big impact on the ratio.
2. **Extra industry effects** – Another factor to consider is related to the extra-industry effects the substitutes generate, which is the most important concept about substitutes. It means that managers have to expand their view outside of their own industry and then judge what a substitute for their product is. The goal can be to discover a specific segment that is particularly invulnerable from substitutive competition or how to defend an industry from substitutes (Porter, 1985).
3. **Learning curve** – Even if there are many direct substitutes for a product/service, it may not be that easy for a customer to switch to a substitute. Many technical products have a high learning-curve that makes them time-consuming and costly to make beneficial, which leads to the anticipation that it lowers the Threat of Substitutes in some industries. However, industries who are going through a harmonization process sets a technical standard in the industry, which means that the learning curve will be lowered and the change to a substitute easier.

**Power of Buyers:** The third force is focused on the power that the immediate buyer has, which can have a big impact on the industrial environment. Industries with high fixed costs are dependent on large-scale orders, which increases the buyers bargain power since the company is dependent on these buyers. There are three different sections that help to measure this force and those are described below (Porter, 1979).

1. **Concentrated buyers** – If the buyers are very few or concentrated within some sort of alliance they could easily gain large power and control their suppliers more or less. The most important determinants of buyer's power are the size and the concentration of customers, fewer buyers means decreasing bargain power for the company (Karagiannopoulos, *et al.*, 2005).
2. **Low switching cost** – If the product or service differentiation between the competitors is low, this could lead to that the buyers have a strong negotiating position, from which they could create a one side win situation. The possibilities for the buyers to play their alternatives against each other are better, since a change to a new alternative may be less painful when the differentiation is low (Porter, 1979).
3. **Buyer competition threat** – If the buyers have the possibility to acquire the product or service themselves, it could lead to a strong negotiation position for them. This action is referred to as backward integration (Swaan & Waalewijn, 1999). It is often useful to distinguish potential buyer power from the buyer's willingness or incentive to use that power, willingness that derives mainly from the "risk of failure" associated with a product's use (Karagiannopoulos, *et al.*, 2005). Sometimes a company can decrease their buyers bargain power by strategically choose customers that have limited power. Even if a company has a larger target group, there are segments within it that are more important for the company than others.

**Power of Suppliers:** Generally the situation for most industries is that the Power of Suppliers is high due to their ability to provide unique benefits for the buyers (Karagiannopoulos, *et al.*, 2005). The term suppliers refer to many types of sources, for example it can be banks, labourer or raw material distributors and so on. To measure their individual power towards the industry, Porter's Five Forces Model examines how concentrated the buyers are, if there are high switching costs and assess the threat of competition amongst the suppliers (Swaan & Waalewijn, 1999). Below the three features in the Power of Buyer force are described:

1. **Concentrated suppliers** – The suppliers for an industry can have big power if there are a few concentrated suppliers, which can put pressure on their customers. When this is the cases with few suppliers, it results in that the industry's bargain power weakens. It can be somewhat limited if the industry cooperate against those concentrated suppliers.
2. **Switching costs** – In some cases it is possible for the suppliers to raise the switching costs for their customer. Often this is the case in technical industries, where it can be hard and costly to change the supplier quickly.
3. **Competition threat** – As earlier mentioned the actors in an industry can have the opportunity to leap-frog a distribution channel and come closer to the end-customer. If the suppliers have this opportunity their power can increase, since they do not have to deal with intermediaries. When creating this type of direct connection to the ultimate buyer it is called forward vertical integration. Raw material suppliers are important for many companies, since they pose a significant part of the input costs for a company. Hence, it can be very dangerous for a company to underestimate their suppliers' bargain power, since a raise of the input costs will lead to decreasing profit-margins for the company (Porter, 1985). The situation can also be the opposite, which occurs if the industry is important for the supplier. Instead of becoming increasingly demanding and force the buyers to price cuts, the supplier can help the industry by providing R&D resources and other protective activities for the industry.

**Competitive Rivalry:** The fifth and last force in Porter's original model is called Competitive Rivalry. This force is the outcome of the four other forces and is dependent on the analysis of these. Competitive rivalry describes the direct rivalry between an organization's most immediate rival. To assess how hostile the actions amongst the existing companies are, there are several factors to consider and those are described underneath (Swaan & Waalewijn, 1999)

1. **Competitor balance** – This section focuses on the balance between the different competitors within the industry. If all the competitors are roughly the same size it creates an intense competition, while if there are many small competitors, it might indicate niche target groups (Porter, 1979).
2. **Industry growth rate** - In an industry with a strong growth rate the competition diminishes since the industry is growing and, therefore, new market shares are created and are up for grab for new entrants. While on the other hand, if it is a stagnating industry the competitors are fighting each other for the market shares. This can be done through price wars or increased qualities for the product/service.
3. **High fixed cost** – If the industry requires high fixed cost, for example in machinery or large amount of personnel, it tends to be highly competitive. This is because scale advantage comes into play and the way to diminish those costs is by spreading them out in large scale production.
4. **High exit barriers** – It can be highly challenging to compete in an industry with high exit barriers if there is a downturn in

demand from customers. This leads to overcapacity in the production for the whole industry and the competition increases. A maturing industry with high disinvestment costs tends to be even more competitive, since the competitors are fighting for their survival. It is cheaper to continue to compete against strong competitors, instead of withdraw from the industry to high costs (Porter, 1979). In some industries joint venture companies are an usual business form and this may raise the exit barriers, as all partners have to agree to the decision to leave the industry (Porter, 1985).

5. **Low differentiation** – Rivalry tends to be high in industries where the product or service that is provided is equal to the competitors. In these industries price wars often occur, since only the price distinguishes between the companies (Porter, 1979).

### III. OTHER FORCES

Porter's Five Forces model is widely regarded as the best analytical model. However, it is often criticized for being too static (Bose, 2007). The model does not suite rapid growing industries or fast changing environments. Therefore, new forces and add-ons need to be implemented to Porter's model. This helps the analysis to become better suited for SMEs in a globalized economy.

**Innovation Force:** This theory attempts to evolve Porter's Five Forces into the modern era and to put focus on the importance of innovation. The theory describes innovation as an add-on to Porter's Five forces, sixth force (Karagiannopoulos, *et al.*, 2005). Innovation in this meaning can be defined as product- or process innovation, market innovation and organization innovation. In order to survive companies must try different innovations and renew them (Johansson and Hjalmarsson, 2003). Many modern industries change rapidly and cannot be seen in an Ad-hoc state. The aspect of innovation is extremely important, both when examining industry environment and in order to survive long-term in a competitive industry. According to Karagiannopoulos *et al.* (2005) a faulty assessment of innovation probably ruins a company's competitiveness and can also turn an entire industry into an outdated sector.

Due to technological progress new ways of developing and implementing innovation has emerged. This has made innovation easier to use as a competitive advantage as it is a process that create fresh solutions and encourage diversity within an organization (Rajiv and Kuruna, 2006). This innovating process can be enhanced and measured through a couple key factors, which are as follows:

1. **Flexibility in an organization's structure** – A flexible organization provides ways for a company to pursue innovation and allows for adaptability to changing circumstances (Goold & Campbell, 2002).
2. **Competitive pressures within the industry** – Competitive pressure creates a need for innovation within the industry. In order to ensure future profits and survival, a company must create and embrace innovation to gain competitive advantages. Hence, competitive pressure is an important driver for innovation (Karaev, 2006).
3. **within a cluster** – As said before clusters enroll companies that are working close together within a certain area. This involves both competition and cooperation between the actors. So the fact states that companies within a cluster region are more encouraged and able to embrace innovation. Clusters have been widely recognized as one of the ways of overcoming the size limitations of SMEs and as an important instrument for improving their productivity, innovativeness and overall competitiveness.

**Complementary products & Cooperation Force:** Complementary products can be seen as another force that influences the business environment. In some industries customers buy complementary products that are worth more together than separately and are more prices worthy when bought in a package (Yadav & Monroe, 2003). Software and hardware in the computer industry are classical examples of such complementarity, since software programs benefit from improvements in hardware performance. The customers’ eagerness to purchase advanced software programs increases if there are hardware products that can use the full potential of the software (Brandenburger & Nalebuff, 1995). Complementary products often arise within industry clusters that extend downstream to channels and customers. These clusters also move laterally to manufacturers of complementary products and to companies in industries related by skills, technologies or other common inputs (Porter, 1998). Porter’s Five Forces Model ignores this fact of Cooperation between companies. Cooperation between organizations within the industrial environment is important since it helps to achieve sustainable competitive advantage, such as lower production costs and more innovative solutions for creating new business opportunities (Karagiannopoulos *et al.*, 2005). The information above shows that Cooperation in the development of Complementary products can be crucial for a company’s survival. Some companies are dependent of the success of another company and the mutual benefits from Cooperation can be huge. However, this dependency can create problems with these types of connections, since a complementary partner at the same time can be a competitor (Brandenburger *et al.*, 1995).

#### IV. METHODOLOGY

This study in its nature is qualitative. The researcher therefore used the descriptive survey approach to gather data for this study. The population of the study comprises of 207 middle level and senior members of staff drawn from ten SMEs in Anambra state. The researchers however using convenience or purposive sampling technique selected 163 employees out of the population of study a five point likert scale questionnaire that covered the different areas of extent of Porter’s theory in SMEs competitiveness and profitability was used to elicit response from the respondents. The statistical tool used for data analysis in this paper is the Non-Parametric Kruskalwallis test (H) using the 15.0 version of the Minitab statistical software (MSS). kruskawalis which is a non-parametric equivalent for one-way ANOVA is described thus:

$$T = H = \frac{12}{N(N+1)} \sum_{i=1}^k \frac{R_i^2}{n_i} - 3(N+1)$$

The decision rule is to reject the null hypothesis if  $H \geq \chi^2_{(k-1)}$ , where k is the degrees of freedom

#### V. DATA PRESENTATION AND ANALYSIS

Aham (2000) defined data analysis as the conversion of raw data into usable information. Below is the data generated from a five point likert scale questionnaire administered on selected SME operators and managers in Anambra state.

**Table 1. Questionnaire Responds Distribution According to Respondents Option**

S/NO	OPTIONS				
	SA	A	U	D	SD
1.	30	55	26	28	24
2.	31	51	23	30	28
3.	38	54	23	29	19
4.	29	53	27	27	27
5.	30	49	28	27	29
6.	31	50	25	30	27
7.	31	47	33	28	24
8.	27	55	24	32	15
9.	38	48	29	27	21
10.	29	45	40	28	21
11.	36	43	30	29	25
12.	28	44	33	36	22

Source: field Survey 2017

#### Results for the Two Research Questions Kruskal-Wallis Test on C1

C2	N	Median	Ave Rank	Z
1	12	31.00	42.1	1.35
2	12	49.00	63.5	5.76
3	12	27.50	28.6	-1.41
4	12	28.00	31.4	-0.85
5	12	23.50	11.9	-4.85
Overall	60		35.5	

H = 48.91 DF = 4 P = 0.000  
H = 49.13 DF = 4 P = 0.000 (adjusted for ties)

From the Minitab output, the p-value 0.000, is less than the level of significance (0.05), therefore we reject the null hypothesis and conclude that SMEs in Anambra state give due consideration to the application of the Porter’s five forces theory in their competitiveness and strategy development.

**VI. CONCLUSION AND RECOMMENDATIONS**

From the result obtained above, the researcher concludes that porter’s five forces model plays key role in the competitiveness and strategy decisions of SMEs in Anambra state. Since Porter’s Five Forces Model is not enough to analyze a changing industry, the researcher recommends that operators and managers of SMEs should effectively adopt the new model which contains all the parts of Porter’s original model; Power of Buyers, Power of suppliers, Threat of entry, Threat of Substitutes and Competitive Rivalry in addition to Innovation and Complementary Product.

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**Corresponding Author :**

**Dr. Peter Ositadinma Ndubuisi\***  
 Department Of Entrepreneurship Studies  
 Chukwuemeka Odumegwu Ojukwu University, Igbariam,  
 Anambra State, NIGERIA

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