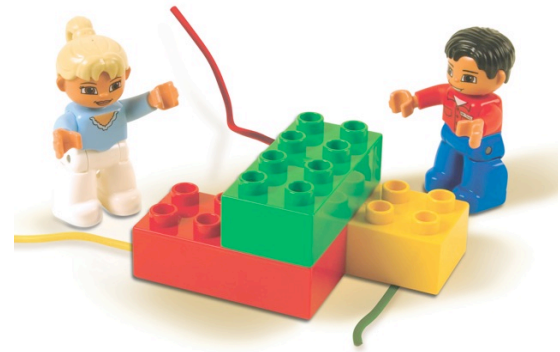


Porter's Five Forces Model



The Big Idea

Michael Porter is currently the hottest (and most expensive!) management consultant in the world. He has produced a number of 'big ideas'. But perhaps his most famous is the Five Forces model.

Essentially this is a tool that allows you – at an organisational or 'business units' level – to:

- work out the dynamics in any market or area of activity
- establish what your best competitive position is
- decide if you can successfully enter a market
- work out who you need to partner with in any enterprise
- identify what the implications are of 'exiting' a market

Fundraising is essentially all about deciding whether you can effectively operate in a market. So in many ways this model requires relatively little adaptation.

Porter says you can decide what to do in terms of market position by assessing 5 key forces:

- **new entrants:** are there many potential new entrants keen to get into this market – or are there barriers like, charity registration, to entry?
- **buyer's power:** can 'buyers' – from customers to donors – negotiate about price/donation level and so put you under pressure?
- **substitute products and services:** are there alternatives to what you do that donors or customers might use?
- **power of suppliers:** if there are relatively few suppliers they can make rules and deals which impact on fundraising.
- **current competitor:** rivalry among current competitors impacts on the attractiveness of a given market. How competitive is this market?

Origins

Five Forces comes out of Porter's work on competition at Harvard University. It has been widely used in business – but less so in the public and voluntary sector.

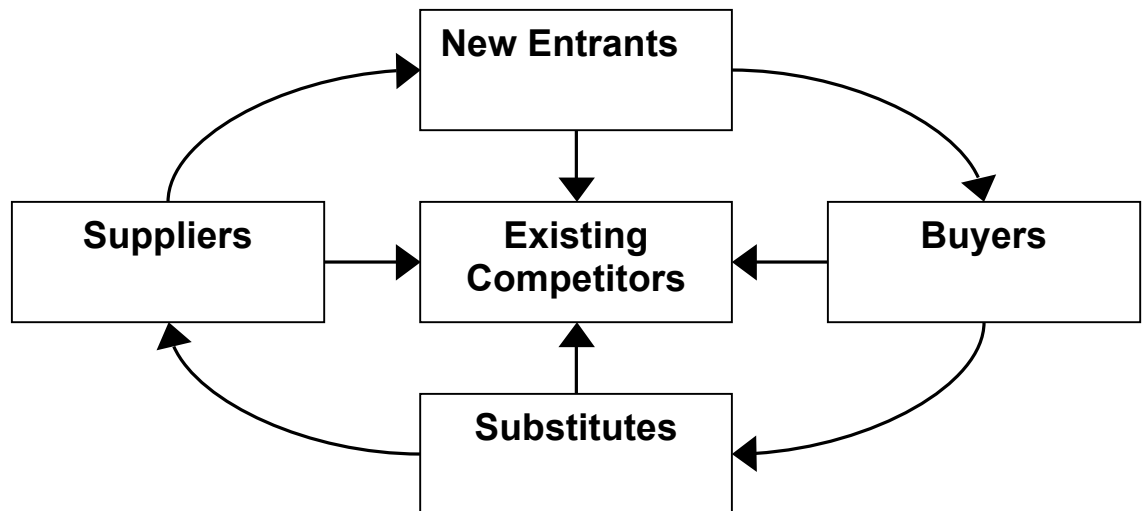
=mc has used it in a number of practical international and national charity settings:

- to help one smaller charity identify where there was a 'gap' in the market – with relatively weak competitors – that they could make a massive impact in
 - to enable a large charity with a failing retail division work out how they could most easily 'exit' from their network of underperforming shops
 - to help a charity keen to get into special events fundraising to decide which of the four key suppliers they should use to make their entry to the market

How to use it

The Five Forces model doesn't produce an answer – it still requires interpretation. So the easiest way to start is by asking yourself several key questions under each competitive force.

It might also help if you try and keep in mind this diagram.



This shows that all these forces are connected and in a dynamic relationship.

To help make this tool more relevant and useful we've used two different examples after each force:

- a commercial example that contains some insights – these examples vary by market. (Note that not every 'force' is relevant in every situation.)
- an example based on a mythical childcare charity interested in

bidding for a local authority contract to provide respite care for parents of disruptive children

Children Charity Co. (CCC):

CCC is currently a small provider of 'relief' services for parents of children with behavioural difficulties. They have heard that the local authority in the area where they work will be considering whether to continue using the NSC (National Society for Children) to provide residential childcare for children who are in care/looked after. This contract could be worth £5M and could lead to a national series of contracts for CCC. The CEO and senior team are trying to decide what to do.

The easiest way to use the model is to ask some key questions under each force:

1. New Entrants

- is it easy to enter the market or are there economic or legal barriers to entry?
 - *Does it cost a lot to set up in competition?* e.g. it's expensive to start a railroad, and you need a license. For a CCC, it's expensive to set up a *nationwide* network of childcare centres – and they would need *licenses/local authority approval*.
 - *Is it difficult to persuade consumers/users to switch from existing providers* – because of brand loyalty, cost of switching, or length of contract. e.g. competing against Coca Cola or persuading people to switch from PCs to Macs is a challenge. If the local authority has a 3-year contract with NSC – the *existing* charity supplier – to provide support for 'difficult' children then CCC getting the contract from that other charity could be very expensive and challenging.
 - *Do existing providers have a 'scale-independent' costs advantage?* e.g. in a commercial setting, this a unique advantage like a copyright such as Windows has, or a broadcast licence like ITV which no-one else can have. In the case of CCC, if they or their rivals have an accredited training programme for care workers, or the ability to use funds from their general fundraising to support local childcare, then these would be similar advantages.

2. Buyer Power

- *is scale or volume important in this transaction?* For example Walmart can buy in bulk more cheaply than your local corner store and so has a massive advantage. In our charity example, NSC – the current provider – may be able to provide a very good deal if it is providing many places for many local authorities. Or the authority itself may be seen as the buyer and able to demand large discounts or conditions in exchange for providing a large contract.

- *how is the cost of supplying the service made up?* If a large part of the cost is profit, then a buyer who knows this will bargain hard. Some fundraising consultants often discount heavily to secure work since much of their fee is profit. Is our charity using local authority contracts as ‘cash cow’ to fund other work that isn’t available to contract? If so this might lead the local authority to want to negotiate on price.

- *is there the potential for the buyer to become a provider themselves?* – this is technically known as ‘backwards integration’. For example, a mobile phone manufacturer might set up their own phone network.

Or in our care example, the local authority might decide to set up their own provision and create an in-house bid through the social work department.

3. Substitution

- *how readily available and cost comparable are substitutes?* In the mobile phone industry the big providers are all very similar and the cost of switching very small – except for the contract! For our childcare charity this might be more of a challenge if, for example, the local authority was comparing fostering as an alternative proposition – or even giving out Ritalin to kids in schools...

4. Supplier Power

To some extent the power of suppliers is complementary to the power of sellers.

- *what's the ‘relationship’ of buyers to sellers?* This is important if there are relatively few suppliers compared to buyers since it will give them lots of say on cost and form of supply e.g. directory enquiries before deregulation to 118 numbers meant it was more or less a monopoly. *Equally*, if the suppliers don’t need to use you as a channel then this can create problems e.g. when companies like Dell decide to sell direct this causes challenges for computer resellers.

For our childcare charity they could consider whether many other organisations are actually in competition for this contract. If not, they have a better position. Also, do they *need* the authority to provide this service? Could they instead ‘sell’ direct to parents *or* could they persuade private donors to pay for this service?

5. Current Competitors

- *is there significant rivalry among existing competitors?* This rivalry can take a number of forms:

- if there are lots of competitors generally
- slow growth in the market so competitors fight for ‘share’
- high fixed costs so competitors have to improve usage rates

The UK mobile telecom market is a good example of all three of these kinds of competition.

For our childcare charity they again might want to consider: how many competitors are there? Are there likely to be many more of these contracts that make it worth bidding? Will they be able to use any newly-trained staff or newly-acquired buildings?

- *is it difficult to compare competitors?* In a way, it's more difficult if competitors are very different. For example you could agree that trains compete with buses in terms of getting from A to B. But actually they are very different in terms of who uses them and why. Equally for our charity, if a competitor came along who said disruptive child behaviour is a *medical* problem – i.e. that the children should stay at home and be given medicine that would change this from a social care challenge to a medical one. This makes it difficult for the childcare charity to decide what to do. (Back to Ritalin?)

- *are there very high 'exit barriers'?* 'Exit barriers' mean that it is difficult – economically, emotionally and legally – to leave the market. In a commercial example there may be a contract, or the redundancy costs may be high.

For our childcare charity these concerns may also exist – but many charities also have a high emotional commitment to their work. This may exist long after that work has ceased to be relevant.

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