The key components of a successful business strategy

By Eric Britten

What are the key components of a successful business strategy? Harvard Business School Professor Michael Porter says strategy is all about escaping that model of "perfect competition," and instead creating a strong position for your product or service that allows it to garner outsized profits.

He cites five key competitive "forces" that will determine the ability of your product or service to achieve a strong strategic position:

1. Entry. How easy is it for others to enter your market? Do newcomers face significant barriers, or do they expect sharp retaliation from existing competitors? Barriers to entry can include economies of scale, a highly differentiated product, large capital requirements for new entrants, large costs for customers to switch, limited access for newcomers to distribution channels, and government regulations or subsidies.

2. Threat of substitution. Are there other products and services that can easily be substituted for yours? Consider, for instance, what the rise of corn syrup did to the sugar industry, or what the iPod did to the CD business.

3. Bargaining power of buyers. Are a small number of buyers responsible for a large portion of your sales? Do their purchases from you represent a large portion of their costs? Can they easily switch suppliers, or go into your business themselves? Is your product relatively unimportant to the quality of their product or service? If the answer to these questions is "yes," the buyer has significant leverage over you and your pricing.

4. Bargaining power of suppliers. Do you have multiple suppliers? Are there substitutes you can use? Is it easy to switch suppliers? Are you a relatively important customer? Is their product a relatively unimportant input for you? In this case, a "yes" answer means you have significant bargaining power over them.

5. Rivalry among current competitors. How intense is the rivalry among the firms you compete with? This will also affect your ability to sustain profits.

In coping with these five forces, Mr. Porter argues there are three generic strategies a firm can take to create superior profits:

– Overall cost leadership. If you keep your costs lower than anyone else's, you can sustain profits. This was the strategy of computer maker Dell Inc., for instance, or of Wal-Mart Stores Inc.

– Differentiation. If you can create something that is valued as unique – think Mercedes automobiles, or Apple computers – you can succeed in making more money than others in the industry.

– Focus. By focusing on the unique needs of a particular group of buyers, a particular geographic region, or a particular segment of the product line, you may be able to earn above-average returns.

Porter argues that it is critical that companies make clear strategic choices about their approach. The worst position, he argues, is to be “stuck in the middle,” without either clear price leadership, a clearly differentiated product, or a distinct focus.