A fresh look at industry and market analysis.(understanding markets beyond the Five Competitive Forces Model)

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Today's strange, new business world needs an augmented model of industry and market analysis that reflects recent developments in industry dynamics, such as globalization, entrepreneurship, technological advances, and the Internet. Here we present such an updated model, built on and expanding the basic premises that underlie Porter's Five Competitive Forces Model. And we offer suggestions for how managers can position their businesses for success in the current competitive environment.

In 1980, Michael Porter introduced the Five Forces Model of Industry Competition and forever changed how managers, consultants, and academics would view competitive environments. His basic premises were that the collective strength of five basic competitive forces determine the return on capital potential in an industry and influence the strategies available to firms in the industry. The competitive forces are: (1) threat of new entry into an industry; (2) intensity of rivalry among existing competitors; (3) pressure from substitute products; (4) bargaining power of buyers; and (5) bargaining power of suppliers.

Since the introduction of this model, a substantial body of research has been compiled that either supports or complements the basic premises set forth by Porter. However, industry dynamics have evolved in subtle and not so subtle ways over the past two decades. We have moved closer to a global marketplace in many industries; technology has advanced rapidly and in unforeseen ways; deregulation has opened the door for aggressive forms of entrepreneurship; and the Internet has created an entirely new way to do business.

How can we augment Porter's Five Forces Model to reflect these and other developments? We can begin by examining its basic underlying premises:

1. Industry is the appropriate unit of analysis.

Industries are frequently identified by two- or four-digit SIC (Standard Industrial Classification) codes. But this is too broad a definition to be valuable for meaningful analysis. Porter attempts to bring more precision to the issue of what constitutes an industry by defining it as "the group of firms producing products that are close substitutes for each other." However, this is still rather vague in that it leaves the definition of "close substitutes" open. Are minivans close substitutes for sport utility vehicles? Are frozen vegetables substitutes for fresh vegetables? Is an industrial strength adhesive a close substitute for a nut and bolt or a rivet? Porter provides us with no clear-cut way to answer these questions.

We prefer a customer-oriented, demand-side definition of industry to the more traditional, production-oriented, supply-side definition. We also prefer the term "market" to "industry." A market is where buyers and sellers meet to execute an exchange. More precisely, it is where buyers who have similar needs meet sellers who have "products" that provide benefits to satisfy this need. (For convenience here, we use "product" to represent products and/or services.) The distinction between industries and markets, though subtle, suggests different mental models for managers. Mental models shape the way we perceive and process information. Markets as a mental model are less likely to produce rigid thinking.

The first step in an analysis, then, is to define a group of buyers who have a relatively homogeneous need. Standard market research techniques such as focus groups, survey research, and conjoint analysis, among others, are appropriate for this task. The potential demand in the market must be assessed to determine whether a strategy for creating superior value for this set of buyers is economically feasible. Finally, the market must be strategically distinctive for product development and communication purposes. If a market is not determined to be strategically distinctive, it should be combined with a related market.

2. Industry factors determine the average return on capital in an industry.

This topic has been the subject of research in both economics and strategic management, and the results largely conform with Porter's position. An analysis of businesses in the PIMS (Profit Impact of Market Strategies) database by Buzzell and Gale (1987) indicated that the average pretax ROI for businesses competing in unattractive markets was 13.4 percent, compared to 31.3 percent for those competing in attractive markets. Schmalensee's (1985) analysis of FTC Line of Business data showed that industry effects accounted for about 75 percent of the difference in industry returns. Rumelt's (1991) more conservative analysis of the same data showed that industry effects still account for about 40 percent of the differences among industries.

Two influences are at work here that need to be considered. The first is that both stable and transient

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forces affect ROI. Stable forces, such as the value of brand names or patents, typically do not change rapidly. The exception might be when a catastrophic event occurs similar to what recently happened with Firestone tires. In contrast, transient forces, such as the number of potential buyers for frill-sized cars, can change dramatically from year to year based on demographic shifts or changes in fuel prices. Thus, market analysis must consider the rate and unpredictability of change because these will influence profitability, strategy formulation, and strategy content. We will return to the influence of market change when we present the augmented model.

The second influence is that the collective strength of market forces has much greater influence on average returns than on the ROI for a specific business. The research cited above shows that there is substantial variation within an industry--or market--around its average ROI. This means that even firms in unattractive markets can achieve exceptional rates of return by developing the appropriate configuration of physical assets, intangible assets, and capabilities, and by deploying them in an integrated strategy. The U.S. Forest and Paper Products Industry had a median ROI of 3.7 percent in 1999, but the ROIs for individual companies ranged from 1 percent for International Paper to 18 percent for Chesapeake.

3. Industry factors influence competitive strategy.

A common meaning of competitive strategy is that it is the set of actions, including the development and deployment of resources, that position the business to both exploit opportunities and avoid threats in its markets. While this meaning would make the premise true by definition, there is substantial evidence that some strategies are more effective than others in particular industry environments. Several studies have found that, in turbulent environments, companies that attempt to be first to market with innovative product concepts are less successful than those with more conservative strategies. It is not our purpose here to explain these results. Rather, we merely point out that industry factors do influence the selection of strategies and their effectiveness.

Our conclusion is that Porter's basic premises are indeed valid. However, we believe the Five Forces model is an incomplete representation of the market factors that influence industry and business performance. So we turn now to the development of an augmented model.

An augmented model for market analysis

Figure 1 presents our augmented model, which reconfigures Porter's five original forces without removing any of them. For instance, we now combine substitutes and threat of new entry with traditional competitors into a single category we refer to as the "composite competitive rivalry force." There are four other major revisions of note. First, the model explicitly considers the role of "complementors." A market participant is a complementor if buyers value a company's product more highly when they have access to the complementor's product than if they do not. Second, we consider the impact of changing market conditions--specifically, market turbulence and market Growth--on profitability and strategy. Third, we now explicitly consider the impact of market structure on the risk profiles of companies competing in a market. Risk, in this context, is the variability of returns in a market. Anticipated variability of returns for a firm influences shareholder value creation. The greater the anticipated variability, the greater the risk premium investors will demand. Finally, we bring the results of recent research and thinking to bear in our discussion of the original forces.

In presenting this model, we stress that the vast majority of Porter's conclusions are as valid today as they were 20 years ago. Thus, we do not challenge the points he has made so effectively. Instead, we concentrate on forces that were not elements in the Five Forces Model, as well as on new ways of thinking about the original forces.

Composite competitive rivalry

Competitive rivalry is a force that appears to have the greatest influence on both ROI potential and business-specific risk. We include competition by producers of substitute products and the threat posed by potential entrants in our consideration of rivalry. Rather than separating them into distinctive forces, we combine them because they are so highly interrelated. Separating them could obscure the interrelationships.

Porter suggests that rivalry can be portrayed as falling on a continuum from civilized to cutthroat. Cutthroat competition is often characterized by price wars, which, though good for buyers, are very damaging to industry profitability. Because of price wars, the U.S. airline industry lost more money in the early 1990s than it had earned in the preceding five decades. In 1999, the median return on sales (ROS) for the U.S. Fortune 500 was 5 percent. A 2 percent price cut would produce an ROS of 3.5 percent (assuming a 30 percent tax rate), resulting in 30 percent less total profit if no additional sales were generated. The average company would require a 40 percent sales increase to compensate for the reduction. Because price cuts can be quickly, if painfully, invoked, they can be quickly matched, which gives the firm initiating the cut only a temporary advantage and market share increase. After

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price cuts are matched by competitors, total industry demand would have to increase by the entire 40 percent. Few in dustries have such elastic demand.

Porter characterizes nonprice-competitive tactics like product development or advertising as more civilized rivalry. This begs the question, though: How civilized is such rivalry? To answer it we must consider the firm’s objectives. The financial objective is to produce a return on capital that exceeds the cost of capital, thereby creating shareholder value. This can be done consistently only when the firm has a position of sustainable competitive advantage--creating more value for buyers than competitors can, and in a way that is difficult to imitate. However, all a firm can really hope to do is impede imitation because in the long run any product, asset, or capability can be imitated or innovated around.

Innovation, whether in products or processes, is the key to achieving and sustaining competitive advantage. There are two generic types of innovation. Disruptive innovations, according to Christensen and Bower (1996), are the stuff of which Schumpeter’s "creative destruction" is made. These innovations happen rarely but have the potential to destroy incumbent products and businesses. The advent of the compact disc player destroyed the majority of the market for turntables and many of the companies that manufactured them. Digital photography represents another disruptive innovation that poses a substantial threat to manufacturers and developers of 35 mm film, such as Kodak.

In contrast, sustaining innovations are the type of innovations we associate with continuous improvement. An example is the Iomega 250M Zip drive. The basic technology is not substantially different from that found in the company’s 100M Zip drive. However, the sustaining innovation of a 150 percent increase in storage capacity allows for the convenient backing-up of memory-hungry video files that have become more and more popular with the advent of increased PC processing power and more user-friendly video-editing software.

Innovation is at least as much of a competitive threat as price competition. Unless a competitor has developed a new process that dramatically lowers cost, price competition is easily matched. While a price cut may damage industry profitability in the short run, it is not likely to cause an industry to become irrelevant. In contrast, introducing a disruptive innovation can be very damaging or even fatal to a firm or industry’s fiscal viability. At the introduction of a disruptive innovation, incumbent firms may actually realize short-term victories as innovators find it difficult to motivate customer buying due to relatively high prices and possible switching costs. Because of their installed base and substantial investment, incumbents are highly motivated to protect their markets. However, if the innovation truly has merit, price disadvantages will be overcome. The end result for incumbents is that short-term gains will not be sustained; ultimately they will experience long-term market share and financial lo sses.

A major reason we include substitutes and new entrants here is that these market players often instigate disruptive innovation. Incumbents must be alert to the threats posed by innovations coming from outside the market. In the long run, disruptive innovations have a greater potential to destroy incumbents’ profitability, if not the incumbents themselves.

Even the development of sustaining innovations poses risks and is a substantial threat to profitability. Procter & Gamble and Unilever are currently locked in a war for increased market share in the slow-growth laundry detergent business. Brooker (2001) recently noted that "the real genius of Tide’s strategy is its relentless stream of new and improved products. Each year Procter & Gamble spends close to $2 billion on research and development, a large portion of which goes toward developing new formulations of Tide." Between the massive amounts spent on marketing and R&D, the financial performance of both firms has suffered.

Complementors

Brandenburger and Nalebuff (1996) coined the term "complementor" based on a branch of economics that is concerned with the impact of network effects on market evolution. Network effects occur when the value of or demand for a product rises with the number of complementary products and the extent of their availability. Microsoft’s Windows operating system is valuable to buyers partly because of the many applications that run on it. In this case, we have a wide variety of products that complement Windows and are readily available.

Microsoft’s symbiotic relationships with application developers and Intel are the most visible examples of positive network effects. However, network effects are important in low-tech markets as well. The demand for shaving cream is closely linked to the demand for safety razors, and the demand for safety razors is related to improvements in the quality of shaving cream. These products complement one another; the value of either is dependent on the usefulness of the other.

A subtle but important distinction can be made between complementary products and products whose demand is

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derived simply from the demand for other products. Diesel truck engines are bought largely because of new trucks. In this case, the diesel engine is a purchased component that will stimulate very little increased demand and for the final product category even if it is substantially improved. In contrast, final demand for PCs is likely to increase if an improvement in microprocessor technology enables users to perform a new task or to perform a current task much more effectively. It is important for producers to recognize these different demand situations and understand their position in the network.

Network effects can also lead to increasing returns--that is, the tendency for products that have been accepted as the standard to continue to get farther ahead. Thus, once the VHS recording system established itself as the standard over Sony's Betamax, it achieved an unassailable position. However, its position is assured only until a disruptive innovation comes along. Such an innovation may be the Personal Video Recorder (PVR), which uses large hard disks and computer circuitry inside a set-top box to digitally record anything broadcast over cable or satellite systems. As such, PVRs pose a substantial threat to VCRs and even DVD players. Network effects lead to increasing returns only to the point at which an innovative substitute is developed and introduced to the market.

Customer power

The bargaining power of customers determines their influence on the selling industry's profitability. Traditional economics tells us that customers have the greatest bargaining power when they are large, few in number, and able to switch easily to alternate suppliers. The question, then, is: How does a seller demonstrate to powerful customers why they should be willing to pay a premium price for its product? There are two common responses to this question. The first is to accept the power imbalance and the reduced profitability that accompanies it. Most firms that adopt this philosophy accept rates of return on capital that approximate their cost of capital. A second response is to find some means for raising the costs customers incur when they switch from one seller to another. Although this is a laudable objective, it is difficult for small sellers to achieve because most customers recognize that their degrees of freedom will be reduced if they become locked in to a particular seller.

Given that the second response, though difficult, is generally considered the preferable option, the question then becomes: How do sellers increase customer commitment while preserving customer choice? The answer is to create customer loyalty, which comes from providing more value to the customer than competitors provide. This can be accomplished in one of three ways. The first is to increase benefits, such as quality or service, to the customer. The second is to reduce non-price costs for the customer, such as adopting a JIT delivery system to help reduce the customer's inventory carrying costs. A third, though potentially self-defeating, approach is to lower prices. If competitors match reduced prices, as frequently happens, this approach will only motivate short-term brand switching, fail to create customer loyalty, and ultimately result in lower profitability for the entire industry.

Supplier power

Most buyers seek a bargaining advantage relative to suppliers. The forces that lead to more supplier power are the same as those that lead to more customer power. Suppliers have the greatest bargaining power when they are large, few in number, and can sell easily to alternate customers. Traditionally, supplier power has been seen as greater when the product provided represents a low percentage of the buyer's total costs. But this last guideline is no longer true.

In recent years, most buyers have come to appreciate the substantial profitability improvement that a 1 or 2 percent reduction in the cost of purchased products or services can yield. This explains the popularity of reengineering programs. Reengineering begins with the firm's customer value proposition and aligns all internal processes to deliver this value at the lowest cost, which is achieved through efficient processes and inexpensive purchases.

There are two issues here: (1) How can firms successfully bargain with powerful suppliers? and (2) Should buyers attempt to negotiate the lowest prices from weaker suppliers? With regard to the first issue, buyers can bargain for either lower prices or additional benefits. Powerful suppliers are inclined to offer lower prices when they believe it is in their long-run best interests to do so. This may be because they see the buyer as a more important partner in the future and they want to establish a relationship today. Or the buyer may offset some of the supplier's power by entering into a long-term contract. On the other hand, suppliers may hold firm on price but provide additional benefits to buyers. This can be a win-win situation, preserving the revenue stream of the seller while providing additional value to buyers.

With regard to the second issue, powerful buyers should wield their power in a thoughtful manner. Buyers depend on suppliers that can provide high-quality and innovative raw materials, components, and professional services. Innovation requires investment derived from a strong and

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stable stream of cash flows. Such cash flows require a fair price that produces an adequate return on capital. Firms that view relations with suppliers as transactions to be exploited for maximum gain may be short-sighted. Good relationships with strong suppliers have the greatest potential for creating additional value for ultimate customers--value for which customers will be willing to pay a premium price.

Market change: Growth and turbulence

Market growth occurs as the result of growth in the number of market members, more purchases by the members, or the creation of a solution to a latent need (one that is evolving or unexpressed) in the market. An example of the latter situation is IBM's development of the Advanced Dictation System, which enabled traveling managers to relay correspondence to their secretaries. Neither managers nor secretaries found it acceptable as a dictation system, but managers did start to use it to leave messages for the secretaries. In the early 1970s, the system was modified and became the Speech Filing System, the precursor to today's voice mail.

The first two situations are not as disruptive as the development of solutions to latent needs because they can be anticipated more easily and so do not have as substantial an effect on profitability, risk, or strategy. However, the development of new solutions to needs that are not obvious has the potential to alter market structure significantly. This is where we now turn our attention.

Such growth stems from satisfying the pent-up or developing demand for a product that provides the solution to a latent need. The conventional wisdom is that such growth markets are attractive, but this may be a dangerous assumption for several reasons. At best, they represent a classic case of the risk/return trade-off. At worst, the uncertainty surrounding them leads to poor decisions that are precipitated by the desire to achieve or sustain a strong market position.

What are the threats posed by rapid market growth? Growth starts with the introduction of an innovative product that addresses a latent need. Early adopters who embrace risk to gain advantage over users of the old solution are the first to embrace innovations. They are willing to accept a partial but potentially superior solution from the seller and work closely with the seller to refine the product to meet their needs. These early adopters are often small--individually and collectively--with respect to the potential market. But they are the true lead users (customers or potential customers who have advanced needs compared to other market members and who expect to benefit significantly from a solution to those needs), so sellers expend considerable effort to identify and work closely with members of this market segment to develop and refine the concept.

This is a critical step in the product's commercialization as the solution embraced by the early adopters becomes the core of the product that will be adopted by early majority buyers. The greatest risk, says Moore (1991, 1995), lies in the ability of sellers to cross this "chasm" between the early adopters and the early majority. The latter is composed of pragmatists who require a clear understanding of how adopting the new product will create value for them. Pragmatists require the supplier to produce a whole solution that is more effective or efficient than the buyers' current solution. They often are reluctant adopters because of the cost of switching from the traditional solution to the innovation. However, industry average returns on capital are most likely to exceed the cost of capital when sellers address the needs of the early majority. Although high growth rates may have occurred during the phase when early adopters accepted and used the innovation, much of the growth will be unprofitable.

Moreover, as the early majority of buyers begin to show interest in the product concept, risk-averse competitors will start to take interest in the market. These fast followers enter a market when the concept has been largely proven. They have the ability to assess the likelihood of success or failure in the market, to learn how the product concept might be improved from that market intelligence, and to rapidly develop and introduce an improved version of the product. This is one reason why only a small percentage of firms that pioneered a new product concept are still market leaders by the time late majority buyers have entered the market. Ironically, it is the entry of new competitors that legitimizes the product concept and demonstrates its acceptability to pragmatic buyers.

As new competitors enter the market during its growth stage, the market will become saturated. Most firms have a minimum efficient operating scale that is required for them to be profitable. The invalid assumption made too often is that market growth rates achieved in the early and middle stages of a market's development are sustainable. If these rates are the basis for investment in R&D or facilities, an adequate ROI may not be realized. The softness of demand in the PC market at the end of 2000, even with faster microprocessors from Intel and AMD, shows both that market growth will slow and that the market will not be able to sustain the profitable operation of all competitors. The concern in this situation is that competitors will lower prices to raise demand and reach a break-even volume. This returns us to the proposition that

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lower prices decrease margins, raise break-even volume, and, because they are easily matched, provide little hope of accomplishing the objective of substantially raising demand.

While turbulence is a common characteristic of growth markets, it is also likely to characterize slower growing markets. The discussion of turbulence can be simplified by classifying it into one of two broad types: market turbulence and competitive turbulence. Market turbulence concerns primarily the rate of change in customers' needs and preferences and in the composition of the served market. Competitive turbulence concerns the rate at which other firms change their competitive methods, including the development and introduction of technological innovations.

In growth markets, sellers quickly discover that the needs of early majority buyers differ from those of early adopters. Moreover, as the product concept matures, the requirements of early adopters evolve as well. In mature markets, late majority buyers continuously press for additional benefits at the same or lower prices. In growth markets, little is certain about buyer preferences. Thus, competitors frequently enhance the product and non-product portions of their value propositions. In mature markets, they seek to enhance their value proposition to avoid price competition.

Not all markets are equal in their susceptibility to the disruptions caused by market or competitive turbulence. The presence of durable barriers to imitation is the most powerful deterrent to destructive turbulence. These barriers include patents, strong brand names, access to critical resources, scale economies, competencies that span numerous parts of the firm, and relationships with key suppliers or customers. They protect sellers from price competition and lead to a position of sustainable competitive advantage and the superior profitability that accrues to it.

Industries may be portrayed on a continuum based on the height of the barriers to imitation. Those with high barriers, such as pharmaceuticals and the beverage industry, typically face lower turbulence and achieve consistently higher profitability. Industries with lower barriers to imitation face higher turbulence, particularly competitive turbulence, and their profitability varies more over time.

Strategic positioning in competitive markets

So how might firms reduce the pressure of the competitive forces in their markets? Several suggestions follow. Of course, no single strategy exists that is appropriate for all firms in a market. The result of strategic homogeneity will be intense, head-to-head competition. Ultimately, meaningful differentiation is the key to competitive advantage and superior performance.

Moreover, markets do not look the same to all competitors. Different firms in a market will have different levels of power, depending on their resources and capabilities. Strategy formulation must be based on a firm's market position, not on some generic assessment of market structure.

Create a market-focused organization

To stay even with or ahead of developments in their markets, firms must develop a market sensing capability, commonly referred to as a market orientation. Fundamental to such an orientation is organizational learning--a firm continuously generating knowledge about its target markets and reflecting that knowledge in its market behavior.

There are many ways by which businesses can draw useful inferences about customer needs. They can often discover latent needs by observing customers use of products or services in various contexts. They can also monitor data on customer complaints, product returns, and warranty claims--all of which may reveal information about customers product knowledge, ease of use, and product maintenance.

Market-oriented firms scan the market broadly, have a long-term focus, and work closely with lead users. Because the future is so uncertain in a turbulent market, they conduct small-scale market experiments, learn from the results, and modify their offerings based on this new knowledge and insight.

Thus, a market orientation is reflected in behaviors that enable the business to learn from current and potential customers about their existing and latent needs, and to act in an entrepreneurial manner to create superior customer value. The capabilities inherent in a market orientation enable the business to discover customer need opportunities in unserved markets as well as in the markets it serves.

Establish relationships with key customers and suppliers

The development of strong relationships with key customers and suppliers follows naturally as a firm becomes market-focused. The most valuable and enduring relationships are built on a foundation of trust and common interest. Obviously, not all buyers and sellers are similarly

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inclined toward establishing relationships. Buyers of commodity-like products, for example, may not see much value in it because they have many suppliers from which to choose. On the other hand, buyers of specialized or customized products will tend to seek sellers with whom they can work comfortably for a long period of time. They make substantial investments of time, information, and money, and they want to see a return on that investment.

The challenge, then, is to be able to demonstrate the value of a relationship, even if the seller's product is commodity-like. One natural resource-based firm we have worked with has been able to accomplish this by providing services that augment the value of its products. Sophisticated, key customers are willing to pay premium prices for the seller's products and accompanying services. Its competitors target price-sensitive customers, charge lower prices, and earn lower returns--business in which the seller is not interested.

Create new market space

One way to avoid head-to-head competition is by finding new market space that represents a new opportunity to create customer value. This is accomplished by closely examining all the key influences in the market's structure for hidden opportunities, influences such as strategic groups, buyer networks, complementors, substitute industries, and time.

Strategic groups are clusters of firms that have similar value propositions. There are generally four to six groups competing in a market. The challenge is to identify a value proposition that none of these groups has adopted. Home Depot slipped in between traditional hardware and building supply stores that catered to do-it-yourselfers with some expertise and buyers with little expertise who hired contractors to do their remodeling. It did this by providing classes for novice, would-be remodelers.

Buyer networks include actual purchasers, users, and other important influencers. Chuck E Cheese Restaurants assembled a value proposition that was fun for kids, took some of the burden off parents, and was reasonably priced. For more than 30 years gas stations have sold a wide variety of drinks, snacks, and other appropriate impulse items.

Barnes & Noble booksellers enhanced the buying experience for their customers by having coffee shops on the premises to encourage longer browsing.

Is there a member of the buying network in your market whose needs are not being adequately addressed? Looking at your business from a buyer's perspective, what are natural complements to your offering that you could provide within the scope of your core competencies?

Maybe the key priority is to develop a sense of the future. What trends are taking place that have the potential to be the foundation for new value propositions? In many cases this requires the ability to anticipate which disruptive technologies have the greatest potential to alter the value equation. In many electronics markets, innovations that enable a seller to make the product smaller, faster, or less expensive will often have substantial potential. Often, however, they will make the seller's current product obsolete as well.

Conceive of strategy as a series of real options

It is incumbent on managers to invest in innovative strategic initiatives that create substantial opportunities for future growth and profitability and that balance the created opportunity with the underlying risk. Traditional approaches to financial analysis have placed too great an emphasis on risk reduction. Consequently, many businesses invest primarily in incremental product modifications and market expansion. Although the initial results from this investment strategy may be acceptable, these initiatives do little to position the firm for the long term.

Strategic options analysis takes a broader and more realistic view of the investment decision. It recognizes that investments may be delayed or reconfigured as conditions change or new information becomes available. More important, it recognizes that managers are active decision-makers both when a project is authorized and as it is implemented. Combining the qualitative insights from strategic options analysis with the quantitative outputs from a discounted cash flow analysis gives managers a rich body of information upon which to make decisions. There will be times when the results from the two analyses will conflict. This should be expected and should be viewed as an opportunity for frank discussions of the direction to take. In the quest for competitive advantage, innovative strategy development driven by adaptability and flexibility is probably the most critical activity for all businesses, and should not be hampered by improper use of the standard analytical and evaluation techniques in use today.

Most scholars and consultants agree that the effective creation and deployment of company-specific resources and capabilities has greater influence on company profitability than does industry membership. However, this should not be interpreted to mean that an understanding of

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market forces should be relegated to secondary importance. Market forces determine which resources and capabilities have the potential to be a source of competitive advantage. The current and anticipated actions of competitors, customers, suppliers, and complementors should shape the actions of the seller firm. Our goal here has been to complement, not replace, Porter's Five Forces Model. We suggest that, taken together, these works provide a framework for market analysis and the development of a strategy for competitive advantage.

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