

# White Paper (No. 3)

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## **The Maritime Security Industry in the Market of Today and Tomorrow**

*An analysis based on Michael Porter's "Competitive Forces" Model*

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# **The Maritime Security Industry in the Market of Today and Tomorrow**

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## **ABSTRACT**

This study employs Michael Porter's famous model designed to determine how competitive forces shape strategy in order to better understand the current state of, and contemporary and future challenges faced, by Private Maritime Security Companies (PMSCs). The model used allows companies to understand that competition extends beyond their professional rivals and includes many other factors that affect the framework in which the industry operates. Those PMSCs that lack a deeper knowledge of competitive considerations will find it difficult to stay profitable.

In 1979 Michael Porter, a Harvard assistant professor, started a revolution in the business world with his *Harvard Business Review* article, "How competitive forces shape strategy." Porter's model has been up to date the most influential work in the field of business studies and has boosted strategic management into the heart of the management agenda.

Porter contends that a company is always concerned with the competition within its industry. The level of competition determines the industry's profit potential (Return On Invested Capital). According to Porter, five Competitive Forces affect competition: the threat of new entrants; rivalry among competitors; the threat of substitute products or services; the bargaining power of buyers; and the bargaining power of suppliers. Frequently the model is adjusted with a sixth force—the relative power of other stakeholders.

As Porter argues, "the awareness of the 5 forces can help a company understand the structure of its industry and stake out a position that is more profitable and less vulnerable to attack." In other words, the model is a starting point for developing a strategy and choosing a position in the industry that will enable the company to cope with competition.

The purpose of this paper is to use Porter's model to briefly analyze today's Maritime Security Industry.



## **A. DEFINING THE MARITIME SECURITY INDUSTRY**

For the purposes of this paper, the boundaries of the Maritime Security Industry include all companies worldwide that offer security services to commercial vessels that sail through High Risk Areas and are vulnerable to pirate attacks. We also assume that the existing threat of pirates in sea areas that affect international shipping will not change in the given time period of this analysis.

## **B. THREAT OF NEW ENTRANTS**

New companies that want to enter this business offer new capacities and resources and try to gain a market share from existing competitors. Their presence usually results in pressure on prices, costs and profit margins for all players. The threat of entrants depends on the power of entry barriers in the industry. In our case, we analyze these barriers as follows:

### *(1) Economies of scale*

Private Maritime Security Companies (PMSCs) with a large number of transits per month enjoy lower costs per transit by spreading their fixed costs over them. As a result, new entrants will initially have to accept a cost disadvantage. Due to the fact that the number of PMSCs with many transits per month (normally beyond 60) is relatively small, I assess the power of this barrier as LOW to MEDIUM.

### *(2) Customer switching costs*

In case a customer (shipping company and/or charterer) wants to change its security supplier, the costs that will incur are minimum. Customers are not required to invest again in new equipment / hardware / software, nor to train their personnel in new technologies / procedures. Therefore, the power of this barrier is LOW.

### *(3) Capital requirements*

New entrants do not need to invest large financial resources. The business model that the vast majority of PMSCs follow requires the purchase and storage of weapons / ammunition and the employment of trained Armed Guards, mostly on a part-time basis (paid by completed transit days). Moreover, PMSCs do not need special fixed facilities, investments in manufacturing equipment or large product inventories. Therefore, the power of this barrier is LOW.



(4) *Incumbency advantages*

Established PMSCs have some experience / quality advantages over potential entrants. The gained cumulative experience in conduction operations in various ports and on board vessels, the establishment of their brand identities in the market and the gained accreditations by various Flag States and P&I Clubs put them in a better competitive position. New comers need time in order to start operating efficiently and get the licenses to provide services to ships flying different flags. This time, usually more than one year, limits their ability to capture quickly a market share and allows their rivals to retaliate. Therefore the power of this barrier is MEDIUM.

(5) *Restrictive government policies*

As described above, Flag States, Governments and other organizations like P&I Clubs today regulate the Maritime Security Industry. Licensing requirements and due diligence / vetting procedures heighten the entry barriers and raise the needed effort of newcomers. Therefore the power of this barrier is MEDIUM.

Concluding the above brief analysis on the 1<sup>st</sup> Force of Porter's model, I assess that the threat of new entrants is MEDIUM to HIGH (the entry barriers are rather low). This can be verified by evaluating the rapid development of this industry in the last three years, during which the number of PMSCs has more than doubled worldwide. The effect of this accelerated growth is also obvious. Established PMSCs react by increased advertisement and presence in the social media and by reducing prices in order to retain their market share at any cost and in order to fill their unused capacities. Prices per transit have already dropped more than 40 percent during the past three years.

### **C. RIVALRY AMONG EXISTING COMPETITORS**

The rivalry among existing PMSCs usually limits the profitability of the industry. In the Maritime Security Industry one can identify the following signs that increase the intensity of the competition:

- The number of PMSCs is large.
- Industry growth is currently slow and competitors fight for market share.
- The provided services are nearly identical (companies differentiate only in the quality of service), with low switching costs for the customers.



- Exit barriers become higher. PMSCs are now required to invest more in personnel training, weapons and commercial advertisement and are not willing to abandon the market easily.

The competition is nowadays more focused on the price dimension, rather than on other service features, such as brand image and quality. The price competition is destroying the industry's profitability. PMSCs cut prices to win new customers and sustain the existing ones. The absence of market segmentation enhances this zero-sum competition.

Concluding the brief analysis of the 2<sup>nd</sup> Force of Porter's model, I assess that the rivalry among competitors is HIGH and results into the reduction of the industry's profitability in most cases.

#### **D. THREAT OF SUBSTITUTE SERVICES**

A substitute service in the Maritime Security Industry could be an alternative security solution that provides the same level of security to the vessels transiting through the High Risk Areas. So far, the only acceptable and recognized solution is the Group Transits of ships through the International Recommended Transit Corridor (IRTC) off the Somalia Coast, coordinated by the Maritime Security Center – Horn of Africa (MSCHOA). This approach provides vessels the needed security during their transit but limits the shipping companies / charterers by establishing specific time frames for the beginning of each Group Transit.

Due to the absence of substitute services, I assess the threat of the 3<sup>rd</sup> Force of Porter's model as LOW.

#### **E. BARGAINING POWER OF BUYERS**

As buyers we define the Customers (shipping companies / charterers) that use the security services of the PMSCs. Buyers can strongly affect the industry through their ability to demand lower prices and different service features. The following points indicate the power of the customers in the Maritime Security Industry:

- Shipping companies / charterers are the only clients of the majority of the PMSCs. In cases when, due to license restrictions, PMSCs can service part of the potential customers worldwide, their power becomes stronger.
- Customers can find many alternative security providers. Most PMSCs offer identical services and differ slightly in the quality of these services.



- Switching costs to other PMSCs are minimum.
- Due to the recession in the shipping industry, customers earn low profits per trip and are thus very sensitive to their costs (including security costs).
- The security service is irrelevant to the quality of service that the customers offer and does not affect their market performance.

Concluding the brief analysis of the 4th Force of Porter's model, I assess that the bargaining power of buyers (customers) is HIGH.

## **F. BARGAINING POWER OF SUPPLIES**

As suppliers in the Maritime Security Industry we can define the various agents / companies at each port that support the operations of each PMSC as well as the armed guards that offer their services to them and actually represent the heart of their activities on board the customers' vessels.

Suppliers can affect the industry through their ability to raise prices or reduce the quality of the services. The following points indicate the power of the customers in the Maritime Security Industry:

- Suppliers at each port are few and may offer services to many PMSCs. They usually offer services to a wide range of customers in the shipping business and do not rely on PMSCs for their profits. Moreover, substitutes are not readily available for their services.
- Well-trained suppliers (armed guards) can offer their services to competitors.

In the current period, the power of suppliers can be assessed as LOW. Especially in the case of armed guards, the recession and high unemployment in the European Union have in the last 3 years resulted into a large pool of available professionals with a military background who are willing to pay for a new certification / training in order to work in the Maritime Security business with reduced compensation.

## **BY WAY OF CONCLUSION ...**

In evaluating the above brief analysis, the Maritime Security Industry at present could be rated as follows:

- Rivalry among existing competitors is HIGH
- The threat of potential entrants is MEDIUM to HIGH
- The threat of substitutes is LOW
- The bargaining power of suppliers is LOW



- The bargaining power of customers is HIGH
- The industry's level of competitive intensity is HIGH

Once PMSCs understand the competitive forces in their industry and their underlying causes at a given time, they can devise a strategic plan in order to cope with competition. They may position themselves so that they can defend against rivals; they may influence or change the power or the balance of the competitive forces, and they may exploit industry changes for their own profit.

In any case, the Porter model enables companies to understand that competition extends beyond their competitors and includes many other factors that affect the industry's structure. Without deeper knowledge of competition, it will be difficult for many PMSCs in the future to stay profitable in the industry.

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## **ABOUT ADVANFORT**

A recognized global leader with ever-growing reach, AdvanFort provides high-quality, comprehensive security solutions for commercial shipping, port and terminal operations, and oil and gas industries. Our world-class reputation is a result of our laser-like priority of understanding clients' businesses in order to create security services that integrate seamlessly with your needs.

In an increasingly integrated world, we work closely with those complex networks of relationships that both need and support our state-of-the-art standards and practices, and proud history of commercial experience, thus providing the most cost-effective security possible.

The result: Unparalleled customer experiences.

Protecting lives and maritime assets against any type of threat and assuring their arrival in safe waters, AdvanFort prides itself with strategic and innovative responses to sea piracy in the Gulf of Aden and its growing reach in other places in the world. The unique quality assurance system employed by AdvanFort has proved 100 percent successful in support of our clients' vessel transits, resulting in the complete failure of pirates boarding their ships.

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