

# **Strategic Management**

## **CA Inter: May 24**

# **Chapter 2**

I am really proud of myself. Because I'm on, realizing the dreams I set for myself. I struggled to pay fees for coaching class. Now, as I empower many of you to access the finest classes at the most affordable rates, I see the true impact of my CA Degree.

Behind the creation of these lectures and notes lie countless sleepless nights and hard work. I hope you will stay focussed and try your best to clear your exams!!

# **CA Himanshu**

## Strategic Analysis

1. Strategies should be based on analysis of external environment and internal resources.
2. **Environmental scanning** is crucial for businesses, can be informal or formal.
3. Systematic environmental assessment essential for managing risk and uncertainty.
4. Rapidly expanding organizations use strategic planning at various stages of operations.
5. Strategic analysis is systematic, helps in making resource investments and staying ahead of competition.
6. Perceptive understanding of external and internal environments crucial for decision-making.
7. Helps in setting appropriate objectives and crafting effective strategies.

### Limitations of Strategic Analysis:

There are two major limitations of strategic analysis that we need to be aware of.

1. **First**, it gives a lot of innovative options but doesn't tell which one to pick. The options can be overlapping, confusing or difficult to implement.
2. **Second**, it can be time consuming at times, hurting overall organisational functioning and also strain other efficient innovations such as developing a new product or a service.

### Importance of Strategic Analysis:

1. **Aligning Resources with Challenges:** Strategic analysis helps organizations align their internal resources (such as talent, technology, and finances) with the challenges and opportunities presented by the external environment.
2. **Unique Strategies for Success:** Each business environment is unique. Strategic analysis enables companies to tailor their strategies, ensuring they remain relevant and competitive amidst globalization, technological advancements, and market fluctuations.

## Issues to consider for Strategic Analysis

1. **Strategy evolves over a period of time:**
  - (a) Strategies develop gradually, shaped by balancing impacting and constraining factors.
  - (b) Current strategy results from numerous small choices made over time.
  - (c) Management may significantly change strategy to accelerate organizational growth.
  - (d) Strategy influenced by experience, updated based on clear results, evolving over time.

## 2. Balancing External and Internal Factors:

- (a) Strategic analysis requires balancing conflicting challenges, considering opportunities, influences, and constraints.
- (b) Decisions driven by factors like market entry opportunities and limited by constraints such as competition.
- (c) Some aspects controllable, while others beyond existing capabilities.

## 3. Managing Risks:

- (a) Importance of maintaining balance in strategic analysis.
- (b) Complexity in the environment complicates strategic balance.
- (c) Factors like competitive markets, globalization, technological advancements pose varying degrees of risk.

		Time	
		Short Time	Long Time
Strategic Risks	External	Errors in interpreting the environment cause strategic failure	Changes in the environment lead to obsolescence of strategy.
	Internal	Organizational capacity is unable to cope up with strategic demands.	Inconsistencies with the strategy are developed on account of changes in internal capacities and preferences

**Figure: Strategic Risk**

## Framework for Strategic Analysis

### Diversity in Industries:

1. Industries differ in economic characteristics, competitive situations, and profit prospects.
2. Economic traits vary based on market size, technological changes, geographic boundaries, buyer-seller dynamics, product differentiation, distribution channels, government support, etc.

### Variation in Competitive Forces:

1. Competitive forces range from moderate to intense.
2. Competition can focus on price, quality, product features, quick service, convenience, or brand reputation.

- Some industries require cooperation with suppliers, customers, and competitors for product innovations and market opportunities.

### Impact on Profit Prospects:

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- Industry and competitive conditions determine profit prospects.
- Leading companies in unattractive industries may struggle for profits, while weak companies in attractive industries can perform well.

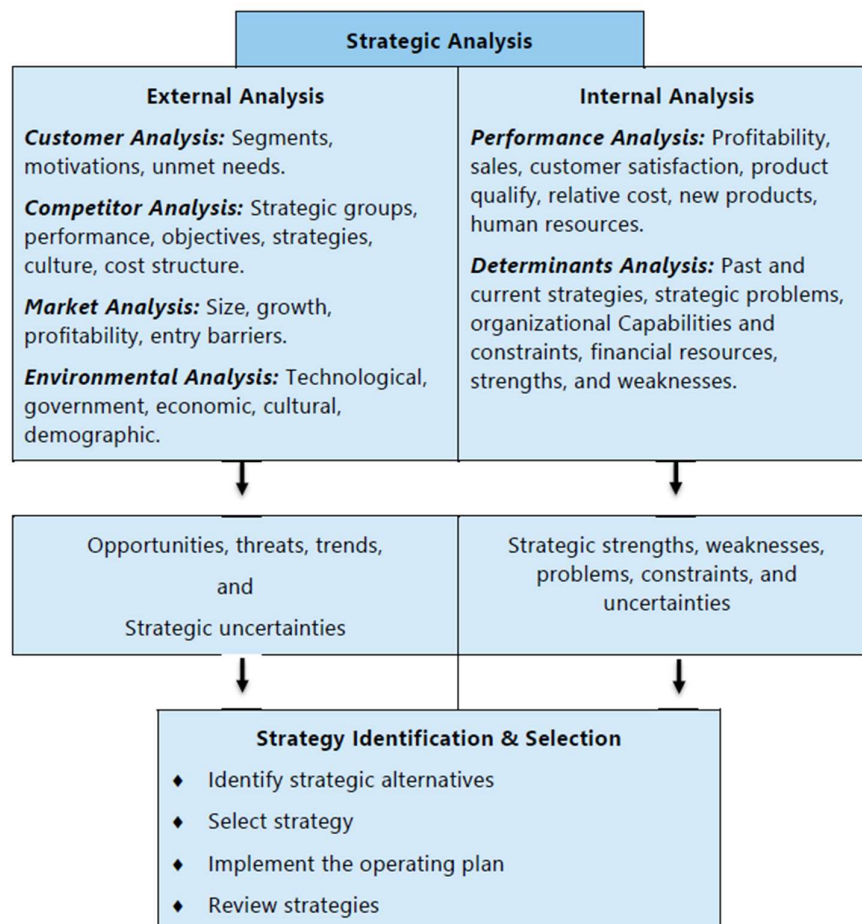


Figure: Framework of Strategic Analysis

## Strategy and Business Environment

The term "business environment" refers to all external factors, influences, or situations that in some way affect business decisions, plans, and operations. Organisational success is determined by its business environment, and even more from its relationship with it.

### Benefits of Environmental Interaction:

- Identifying Opportunities and Threats:** Understanding consumer needs, legal changes, social behaviours, and competitors' offerings helps businesses anticipate opportunities for growth and recognize potential threats.

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2. **Direction for Growth:** By analysing the external environment, businesses can identify emerging markets or areas where demand is rising. This insight enables strategic planning for successful expansion and sustainable growth.
3. **Continuous Learning:** In a rapidly changing business landscape, managers need to continuously update their knowledge and skills. Adapting to new trends and technologies ensures that the organization remains competitive and innovative.
4. **Image Building:** Businesses that show sensitivity to environmental needs, such as energy conservation or community welfare, enhance their reputation. This positive image fosters trust among customers and stakeholders, contributing to long-term success.
5. **Meeting Competition:** Analysing competitors' strategies allows businesses to assess their strengths and weaknesses. By formulating strategic responses, companies can position themselves effectively, outsmart competitors, and capture market share.

## Micro and Macro Environment

The external environment can be categorised in two major types as follows:

- ◆ Micro environment
- ◆ Macro environment

### Elements of Micro-environment

1. Micro-environment is related to small area or immediate periphery of an organization.
2. It influences an organization regularly and directly.
3. Micro environment consists of suppliers, consumers, marketing intermediaries, competitors, etc.
4. These are specific to the said business or firm and affect its working on a direct and regular basis.
5. Within the micro or the immediate environment in which a firm operates we need to address the following issues:
  - (a) The employees of the firm, their characteristics and how they are organised.
  - (b) The existing customer base on which the firm relies for business.
  - (c) The ways in which the firm can raise its finance.
  - (d) Who are the firm suppliers and how are the links between the two being developed?
  - (e) The local community within which the firm operates.
  - (f) The direct competition and their comparative performance.

## Elements of Macro Environment

The environment includes factors outside the firm which can lead to opportunities for, or threats to the firm. Although, there are many factors, the most important of the factors are socio-economic, technological, supplier, competitors, and government.

Demographic	
Definition and Components of Demographics	<ol style="list-style-type: none"> <li>1. Demographics refer to population characteristics classified by criteria like age, gender, and income.</li> <li>2. Demographic analysis includes factors such as race, age, income, education, assets, house ownership, job position, region, etc.</li> </ol>
Importance of Demographics	<ol style="list-style-type: none"> <li>1. <b>Business and Economic Significance:</b> Data on demographic qualities are crucial for businesses and economists.</li> <li>2. <b>Marketing and Social Sciences:</b> Marketers and social scientists use demographic data to understand and segment populations.</li> <li>3. <b>India's Demographics:</b> India has a relatively young population, making it attractive for multinational companies due to its large population size.</li> </ol>
Relevance for Businesses	<ol style="list-style-type: none"> <li>1. <b>Market Size Impact:</b> Demographic trends influence industry market sizes.</li> <li>2. <b>Identifying Opportunities and Threats:</b> Businesses must assess demographic trends to identify opportunities and threats in the market.</li> <li>3. <b>Critical Factors:</b> Population size, age distribution, geographic dispersion, ethnic mix, and income distribution are vital considerations for organizations.</li> </ol>
Strategic Implications	<ol style="list-style-type: none"> <li>1. <b>Challenges for Strategists:</b> Identifying the implications of changing demographics is a challenge for strategists.</li> <li>2. <b>Future Competitiveness:</b> Understanding and adapting to changing demographic characteristics are crucial for ensuring future strategic competitiveness in the market.</li> </ol>

Socio-Cultural Environment	
Definition of Socio-Cultural Environment	<ol style="list-style-type: none"> <li>1. Socio-cultural environment influences enterprises universally, encompassing social traditions, values, beliefs, literacy standards, ethics, social stratification, and societal cohesion.</li> <li>2. Differs from demographics as it focuses on the behaviour and belief system of the population, not just their characteristics.</li> </ol>
Components of Socio-Cultural Environment	<ol style="list-style-type: none"> <li>1. <b>Human Relationships:</b> Relates to how people interact within society.</li> <li>2. <b>Social Attitudes and Cultural Values:</b> Impact organizational operations.</li> <li>3. <b>Beliefs, Values, and Norms:</b> Determine interrelationships between individuals and organizations</li> </ol>
Relevance for Businesses	<ol style="list-style-type: none"> <li>1. <b>Persistent Core Beliefs:</b> Core beliefs in society remain stable and are hard to change.</li> <li>2. <b>Adaptation to Social Norms:</b> Businesses must adjust their operations to align with societal norms and beliefs for successful operation.</li> <li>3. <b>Impact on Strategic Management:</b> Affects mission and objective setting, as well as decisions related to products and markets within organizations.</li> </ol>

Political-Legal Environment	
Components of Political-Legal Environment	<ol style="list-style-type: none"> <li>1. Economic environment directly impacts business strategies.</li> <li>2. Encompasses regional, national, and global economic conditions affecting resources, costs, quality, and availability</li> </ol>
Influence on Business	<ol style="list-style-type: none"> <li>1. <b>Government Policies:</b> Business operations are significantly influenced and controlled by government policies.</li> <li>2. <b>Regulatory Changes:</b> Businesses need to adapt to changes in the regulatory framework, including taxes and duties, impacting their operations.</li> </ol>

- |  |   |
|--|---|
|  | <ol style="list-style-type: none"> <li>3. <b>Understanding Laws:</b> Businesses must be aware of major laws protecting consumers, competition, and organizations.</li> <li>4. <b>Relevant Laws:</b> Knowledge of laws related to companies, competition, intellectual property, foreign exchange, and labour is essential for businesses operating in any country.</li> </ol> |
|--|---|

Technological Environment	
Importance and Impact	<ol style="list-style-type: none"> <li>1. Technology has revolutionized communication and business operations, intertwining them closely.</li> <li>2. Businesses play a key role in making technological advancements accessible to society, raising living standards.</li> <li>3. Businesses leverage technology, adapting to new discoveries and advancing society in return.</li> <li>4. Technology enables organizations to reduce paperwork, streamline payments, and coordinate inventories efficiently, cutting costs and gaining a competitive edge.</li> <li>5. Technological advancements necessitate changes in operational, production, and marketing strategies for businesses.</li> <li>6. Technology creates new business opportunities while rendering existing products and services obsolete.</li> <li>7. Technologies like artificial intelligence, machine learning, and robotic process automation offer both opportunities and threats to businesses, depending on their effective adoption and strategic use.</li> </ol>

## PESTLE– A tool to Analyse Macro Environment

The term PESTLE is often used to describe a framework for analysis of macro environmental factors. PESTEL analysis is frequently used to assess the business environment in which a firm operates.

PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.

**P- Political E- Economic S- socio-cultural T- technological L- legal E- environmental**

### Political Factors:

1. **Government Intervention:** Involves how and to what extent the government intervenes in the economy and business activities.
2. **Influence on Goods and Services:** Political factors influence the goods and services the government provides and those it restricts.
3. **Impact on Nation's Welfare:** Governments significantly impact a nation's health, education, and infrastructure.

### Economic Factors:



1. **Interest Rates:** Affect a firm's cost of capital, influencing business growth and expansion.
2. **Exchange Rates:** Affect costs of exporting and supply/prices of imported goods.
3. **Money Supply, Inflation, and Income:** Impact business decisions, credit flow, and per capita income, influencing business strategies.

#### Social Factors:

1. **Demand and Business Operations:** Social factors influence product demand and affect how a company operates.

#### Technological Factors:

2. **Barriers to Entry:** Determine entry barriers for businesses.
3. **Efficient Production and Outsourcing:** Influence minimum efficient production levels and outsourcing decisions.
4. **Impact on Costs and Innovation:** Technological shifts affect costs, quality, and lead to innovation in products and services.

#### Legal Factors:

1. **Operational Impact:** Affect how a company operates, its costs, and product demand.
2. **Ease of Business:** Legal factors influence the ease of conducting business operations.

#### Environmental Factors:

1. **Industry Impact:** Affect industries like tourism, farming, and insurance.
2. **Climate Change Awareness:** Growing awareness of climate change affects how companies operate, creating new markets and diminishing existing ones.

Political	Economic
♦ Political stability	♦ Economy situation and trends
♦ Political principles and ideologies	♦ Market and trade cycles
♦ Current and future taxation policy	♦ Specific industry factors
♦ Regulatory bodies and processes	♦ Customer/end-user drivers
♦ Government policies	♦ Interest and exchange rates
♦ Government term and change	♦ Inflation and unemployment
♦ Thrust areas of political leaders	♦ Strength of consumer spending
Social	Technological
♦ Lifestyle trends	♦ Replacement technology/solutions
♦ Demographics	♦ Maturity of technology
♦ Consumer attitudes and opinions	♦ Manufacturing maturity and capacity
♦ Brand, company, technology image	♦ Innovation potential
♦ Consumer buying patterns	♦ Technology access, licensing, patents, property rights and copyrights
♦ Ethnic/religious factors	
♦ Media views and perception	
Legal	Environmental
♦ Business and Corporate Laws	♦ Ecological/environmental issues
♦ Employment Law	♦ Environmental hazards
♦ Competition Law	♦ Environmental legislation
♦ Health & Safety Law	♦ Energy consumption
♦ International Treaty and Law	♦ Waste disposal
♦ Regional Legislation	



## Internationalization of Business

Internationalization has emerged as the dominant commercial trend over the last couple of decades. It enables a business to enter new markets in search of greater earnings and less expensive resources. Additionally, expanding internationally enable a business to achieve greater economies of scale and extend the lifespan of its products.

### Characteristics of a global business:

#### A global business has three characteristics:

- ◆ It is a **conglomerate of multiple units** (located in different parts of the globe) but all linked by common ownership.
- ◆ Multiple units draw on a **common pool of resources**, such as money, credit, information, patents, trade names and control systems.
- ◆ The units respond to **some common strategy**. Besides, its managers and shareholders are also based in different nations.

### Developing internationally:

The steps in international strategic planning are as follows:

- ◆ **Evaluate global opportunities and threats** and rate them with the internal capabilities.
- ◆ **Describe the scope** of the firm's global commercial operations.
- ◆ Create the firm's **global business objectives**.
- ◆ Develop distinct corporate strategies for the global business and whole organisation.

### Why do businesses go global?

1. **Need for Growth**: Organizations expand globally to fulfil their fundamental need for growth and opportunity.
2. **Shrinking Time and Distance**: Rapid advancements in communication, transportation, financial flow, and technology reduce time and distance barriers globally.
3. **Inadequacy of Domestic Markets**: Domestic markets may not suffice due to increased competition, leading companies to explore international markets.
4. **Resource Optimization**: Companies seek reliable, cheaper raw materials, cost-effective labour, and talent pools globally.
5. **Cost Reduction Strategies**: Setting up overseas plants reduces transportation costs, and producing near the market minimizes time and expenses.
6. **Market Expansion and Cash Flow**: Expanding foreign markets prompts the establishment of overseas manufacturing plants and sales branches, enhancing sales and cash flow.
7. **Rise of Services and Economic Integration**: Services sector growth and regional economic integration drive globalization efforts worldwide.
8. **Reduction of Trade Barriers**: International trade barriers like tariffs and customs are decreasing, leading to increased business flow and market competitiveness.

9. **Strategic Alliances and Competitive Advantage:** Companies form global strategic alliances to combat economic and technological threats, leveraging their comparative and competitive advantages.

## International Environment

Assessments of the international environment can be done at **three levels**:

1. Multinational
2. Regional
3. Country

### Multinational Environmental Analysis:

1. Involves identifying, anticipating, and monitoring significant components of the global environment on a large scale.
2. Understanding global economic and macro elements is crucial.
3. Consideration of governments' tendencies, whether free or interventionist, is necessary, evaluating their present and expected future impact.

### Regional Environmental Analysis:

1. Focuses on evaluating critical factors in a specific geographical area.
2. Emphasizes discovering market opportunities for goods, services, or innovations in the chosen location.

### Country Environmental Analysis:

1. Requires a deeper examination of important environmental factors within specific countries.
2. Involves studying economic, legal, political, and cultural dimensions for effective market entrance strategies.
3. Customized analysis is essential for planning successful market strategies tailored to each country's unique characteristics.

## Understanding Product and Industry

Business products have certain characteristics as follows:

1. Products are either tangible or intangible.
2. Product has a price.
3. Products have certain features that deliver satisfaction.
4. Product is pivotal for business.
5. A product has a useful life.

### Types of Products:

- Tangible products (e.g., cars, books) are physical.

- Intangible products (e.g., telecom services, insurance) are not physical.

### Pricing and Market Influence:

- Supply and demand impact product pricing.
- Quality, marketing, and target audience affect the market price.
- Competition requires cost reduction to maintain profitability.

### Product Features and Satisfaction:

- Features meet consumer needs and affect pricing.
- Adjusted during development to improve user experience.
- Products must deliver value and satisfaction to customers.

### Central Role of Products:

- Products drive all business activities, including production, quality, sales, marketing, and logistics.

### Product Lifecycle:

- Products have a usable life and a lifecycle.
- Innovation or replacement occurs at the end of the lifecycle (e.g., mobile phones replacing fixed-line telephones).

## Product Life Cycle

Product Life Cycle is a useful concept for guiding strategic choice. PLC is an S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages of introduction, growth, maturity and decline.

1. The **first stage** of PLC is the **Introduction stage** with slow sales growth, in which competition is almost negligible, prices are relatively high, and markets are limited. The growth in sales is at a lower rate because of lack of awareness on the part of customers.
2. The **second phase** of PLC is **Growth stage** with rapid market acceptance. In the growth stage, the demand expands rapidly, prices fall, competition increases, and market expands. The customer has knowledge about the product and shows interest in purchasing it.
3. The **third phase** of PLC is **Maturity stage** where there is slowdown in growth rate. In this stage, the competition gets tough, and market gets stabilised. Profit comes down because of stiff competition. At this stage, organisations have to work for maintaining stability.
4. In the **fourth stage** of PLC is **Declines** with sharp downward drift in sales. The sales and profits fall down sharply due to some new product replaces the existing product. So, a combination of strategies can be implemented to stay in the market either by diversification or retrenchment.

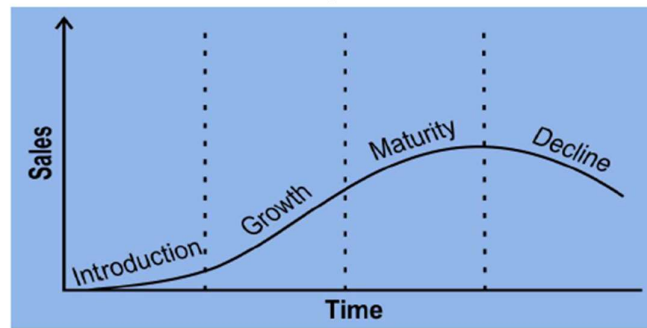


Figure: Product Life Cycle

## Value Chain Analysis

Value chain analysis is a method of examining each activity in value chain of a business in order to identify areas for improvements. When you do a value chain analysis, you must analyse how each stage in the process adds or subtracts value from the end product or service.

The primary activities of the organization are grouped into **five main areas**:

1. **Inbound logistics** are the activities concerned with receiving, storing and distributing the inputs to the product/service. This includes materials handling, stock control, transport etc. Like, transportation and warehousing.
2. **Operations** transform these inputs into the final product or service: machining, packaging, assembly, testing, etc. convert raw materials in finished goods.
3. **Outbound logistics** collect, store and distribute the product to customers. For tangible products this would be warehousing, materials handling, transport, etc. In the case of services, it may be more concerned with arrangements for bringing customers to the service, if it is a fixed location (e.g., sports events).
4. **Marketing and sales** provide the means whereby consumers/users are made aware of the product/service and are able to purchase it. This would include sales administration, advertising, selling and so on. In public services, communication networks which help users' access a particular service are often important.
5. **Services** are all those activities, which enhance or maintain the value of a product/service, such as installation, repair, training and spares.

Each of these groups of primary activities are linked to support activities. These can be divided into four areas:

### Procurement:

- Involves acquiring resources for primary activities.
- Happens in various parts of the organization.

### Technology Development:

- Involves product design, process development, and resource improvements.
- Includes know-how and technical advancements.

### Human Resource Management:

- Focuses on recruiting, managing, training, and rewarding employees.
- Essential for all primary activities in the organization.

### Infrastructure:

- Includes planning, finance, quality control, and information management systems.
- Sustains the organization's culture and performance in primary activities.

## Industry Environment Analysis

The goal of the industry environment analysis, which is typically an important step of strategic analysis, is to estimate the amount of competitive pressures the business is presently facing and is expected to face in the near future.

### Porter's Five Forces Model:

- Systematically identifies competitive pressures and their strength.
- Guides strategy adaptation, profitability improvement, and competitive edge.
- Michael Porter focuses on competitors in the same industry.

### Competitive Pressure operating in Five Areas:

1. Competitive pressures associated with Rival sellers compete for buyers' attention and loyalty.
2. Competitive pressures associated with the threat of new entrants into the market.
3. Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
4. Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
5. Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

### Use of Five Step model by Strategist:

**Step 1:** Identify the specific competitive pressures associated with each of the five forces.

**Step 2:** Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak).

**Step 3:** Determine whether the collective strength of the five competitive forces is conducive to earning attractive profits

### The Threat of New Entrants:

New entrants place a limit on prices and affect the profitability of existing players. The new capacity and product range the new entrants bring increases competitive pressure. bigger the new entrant, the more severe the competitive effect. New entrants can limit prices and impact the profitability of existing companies.

To deter new entrants, existing firms can create barriers like high capital requirements, economies of scale, unique products, brand identity, and access to distribution channels. These are explained as follows:

1. **Capital Requirements:** Needing a lot of money to start in an industry keeps out firms that lack funds, making existing companies more profitable.
2. **Economies of Scale:** Economies of scale leads to decline in the per-unit cost of production (or other activity) as volume grows. A large firm that enjoys economies of scale can produce high volumes of goods at successively lower costs. This tends to discourage new entrants.
3. **Product Differentiation** Production differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers. Firms in the personal care products and cosmetics industries actively engage in product differentiation to enhance their products' features. Differentiation works to reinforce entry barriers because the cost of creating genuine product differences may be too high for the new entrants.
4. **Switching Costs:** To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products. To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, and train personnel to use the equipment, or modify facilities for product use. Buyers often incur substantial financial (and psychological) costs in switching between firms. When such switching costs are high, buyers are often reluctant to change.
5. **Brand Identity:** Existing companies' strong brand identity is hard for new entrants to match, requiring substantial time and resources.
6. **Access to Distribution Channels:** The unavailability of distribution channels for new entrants poses another significant entry barrier. Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals. Often, existing firms have significant influence over the distribution channels and can retard or impede their use by new firms.
7. **Possibility of Aggressive Retaliation:** Existing companies might lower prices and increase advertising to counter new competitors, deterring entry.

### Bargaining Power of Buyers

The bargaining power of the buyers influences not only the prices that the producer can charge but also influence costs and investments of the producer. This force will become heavier depending on the possibilities of the buyers forming groups or cartels, particularly in case of industrial products.

Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when:

1. Buyers have full knowledge of the sources of products and their substitutes.

2. They spend a lot of money on the industry's products i.e. they are big buyers.
3. The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

### Bargaining Power of Suppliers

Often suppliers can exercise considerable bargaining power. If the suppliers are also limited in number they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, can affect industry attractiveness and profitability.

Suppliers can influence the profitability of an industry in a number of ways. Suppliers can command bargaining power over a firm when:

1. Their products are crucial to the buyer and substitutes are not available.
2. They can erect high switching costs.
3. They are more concentrated than their buyers.

### The Nature of Rivalry in the Industry:

The intensity of rivalry in an industry is a significant determinant of an industry's attractiveness and profitability. The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus, can directly affect the profitability. "The more intensive the rivalry, the less attractive is the industry".

The level of competition in an industry affects its attractiveness and profits. Intense competition can increase costs and make the industry less profitable.

Rivalry among competitors tends to be cutthroat and industry profitability low under various conditions explained as follows:

1. **Industry Leader:** A strong leader can prevent price wars due to financial strength, making smaller rivals hesitant to start conflicts.
2. **Number of Competitors:** More competitors make it harder for the leader to control prices, leading to challenges in communication.
3. **Fixed Costs:** High fixed costs drive rivals to cut prices to utilize excess capacity, reducing industry profitability.
4. **Exit Barriers:** Rivalry decreases if competitors leave the industry, leading to higher profitability in industries with few exit obstacles.
5. **Product Differentiation:** Unique products shield companies from price wars, increasing profitability in differentiated industries.
6. **Slow Growth:** Industries with slow growth face intense rivalry as competitors fight for market share, lowering profitability for all.

### Threat of Substitute



Substitute products are a **latent** source of competition in an industry. In many cases they become a major constituent of competition.

Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden.

A final force that can influence industry profitability is the availability of substitutes for an industry's product. To predict profit pressure from this source, firms must search for products that perform the same, or nearly the same, function as their existing products.

## Attractiveness of Industry

The important factors on which the management may base such conclusions include:

1. **Industry Growth:** Is the industry likely to grow in the future?
2. **Current Competition:** Can businesses make profits now, and will competition increase or decrease?
3. **Driving Forces:** How will industry profitability be affected by ongoing trends?
4. **Competitive Position:** Is the company in a strong position, and will it get stronger or weaker?
5. **Exploiting Weaknesses:** Can the company benefit from weaker rivals in the industry?
6. **Defending Against Challenges:** Can the company handle or counter industry challenges?
7. **Risk and Uncertainty:** How risky and uncertain is the industry's future?
8. **Industry Problems:** How severe are the overall problems faced by the industry?
9. **Strategic Importance:** Does participating in this industry contribute significantly to the company's overall success?

**Attractiveness is relative, not absolute.**

1. An industry may be deemed attractive if overall profit prospects are above average.
2. This attractiveness doesn't apply uniformly to all firms; it depends on their strengths and weaknesses.
3. Strong competitors in an unattractive industry may find ways to protect their competitiveness and profitability.
4. They might invest cautiously and consider acquisitions to strengthen their market position.
5. Weaker companies in unattractive industries may merge with rivals to bolster market share and profitability.
6. Alternatively, they may explore diversification opportunities outside the industry for better prospects.

## Experience Curve

Experience curve is similar to learning curve which explains the efficiency gained by workers through repetitive productive work. Experience curve is based on the commonly observed

phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production.

The implication is that larger firms in an industry would tend to have lower unit costs as compared to those of smaller organizations, thereby gaining a competitive cost advantage.

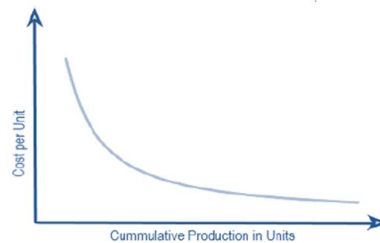
Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production

This means bigger companies tend to have lower costs, giving them a competitive edge. Various factors like learning, economies of scale, product improvements, and technology contribute to this cost reduction.

**Experience curve has following features:**

- As business organisation grow, they gain experience.
- Experience may provide an advantage over the competition. Experience is a key barrier to entry.
- Large and successful organisation possess stronger "experience effect".

**A typical experience curve may be depicted as follows:**



**Figure: Experience curve**

## Value Creation

Value creation means offering products and services that customers find valuable. It includes features, quality, durability, and performance that customers are willing to pay for. Businesses also consider value for stakeholders, expanding the concept beyond just customers.

Value creation is about a company making products, services, or business processes more valuable. Businesses aim to create value for customers and stakeholders, enhancing their investment. This strategy provides a competitive advantage and boosts profits.

**Three factors affect a company's profitability:**

1. The value customers find in the products,
2. The price charged, and
3. The production costs.

The concept of a value chain helps analyse different functions within organizations, revealing sources of differentiation and cost behaviour. Ultimately, value creation occurs when consumers value a product more than its cost, leading to increased profits for businesses.

## Market and Customer

1. "Customers" and "consumers" are similar terms, but customers buy products, while consumers use them.
2. Customer analysis is a vital part of business planning. It helps identify target customers, understand their needs, and show how the product meets those needs.
3. This process involves studying customer surveys, data, market strategies, and segmentation techniques.
4. By analysing this information, businesses can create customer profiles, which include details like age and preferences. Many parties, such as buyers and sellers, help gather this data.

### Customer Behaviour:

Customer behaviour goes beyond knowing who the customers are; it delves into how they buy products. It looks at how often they shop, what they like, and how they perceive your marketing and services. This understanding helps businesses talk to customers effectively. Knowing these behaviours helps create successful marketing campaigns, offer products that customers want, and keep them coming back for more purchases.

Consumer behaviour may be influenced by a number of things. These elements can be categorised into the following Three conceptual domains:

### Influence:

1. External influences such as advertisements and peer recommendations, impact consumers' decision-making processes. These influences are divided into marketing efforts and environmental factors.
2. Internal influences involve psychological factors within individuals, including motivations and attitudes, which also affect consumer behaviour. Both internal and external factors play a role in shaping customers' choices and preferences.

### Decision Making:

A rational consumer gathers information, considers pros and cons, and then makes a decision based on their findings and existing knowledge.

The stages of decision-making process can be described as:

- ▲ Problem recognition, i.e., identify an existing need or desire that is unfulfilled
- ▲ Search for desirable alternative and list them
- ▲ Seeking information on available alternatives and weighing their pros and cons.
- ▲ Make a final choice

### Post-decision Processes:

After making a decision and purchasing a product, the final phase in the decision-making process is evaluating the outcome.

The consumer's reaction may vary depending upon the satisfaction. While a happy customer may make repeat purchase and recommend to others, customer with dissonance will neither purchase the product again nor recommend it to others.

## Competitive Strategy

The competitive strategy of a firm within a certain business field is analysed using two criteria:

- Creation of competitive advantage and
- Protection of competitive advantage.

### Competitive Landscape:

Competitive landscape analysis helps businesses identify and understand their competitors, including their goals, values, and strengths. Understanding of competitive landscape requires an application of "competitive intelligence".

An in-depth investigation and analysis of a firm's competition allows it to assess the competitors' strengths and weaknesses in the marketplace and helps it to choose and implement effective strategies that will improve its competitive advantage.

### Steps to understand the Competitive Landscape:

**Identify the competitor:** The first step to understand the competitive landscape is to identify the competitors in the firm's industry and have actual data about their respective market share.

This answers the question:

- ▲ Who are the competitors and how big are they?

**Understand the competitors:** Once the competitors have been identified, the strategist can use market research report, internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by them in different markets.

This answers the question:

- ▲ What are their product and services?

**Determine the strengths of the competitors:** What are the strengths of the competitors? What do they do well? Do they offer great products? Why are consumers liking their product/service? Do they utilize marketing in a way that comparatively reaches out to more consumers? Why do customers give them their business?

This answers the questions:

- ▲ What are their financial positions?
- ▲ What gives them cost and price advantage?
- ▲ What are they likely to do next?
- ▲ How strong is their distribution network?
- ▲ What are their human resource strengths?

**Determine the weaknesses of the competitors:** Identify the areas where the competitor is lacking or is weak. Weaknesses (and strengths) can be identified by going through consumer reports and reviews appearing in various media. Financial strength and weakness can always be learnt from annual reports.

This answers the question.

- ⬆ Where are they lacking?

**Put all of the information together:** At this stage, the strategist should put together all information about competitors and draw inference about what they are not offering and what the firm can do to fill in the gaps. The strategist can also know the areas which need to be strengthened by the firm.

This answers the questions:

- ⬆ What will the business do with this information?
- ⬆ What improvements does the firm need to make?
- ⬆ How can the firm exploit the weaknesses of competitors?

## Competitive Strategy

Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the market place – the particular strategy elements, product attributes, resources, competencies, competitive capabilities and business outcomes that spell the difference between profit & loss and ultimately, between competitive success or failure.

Key success factors are the prerequisites for industry success or, to put it another way, KSFs are the factors that shape whether a company will be financially and competitively successful.

- ⬆ Identifying industry key success factors (KSFs) is crucial for strategic analysis.
- ⬆ Managers must understand which factors are most important for competitive success.
- ⬆ Organizations gaining insight into industry KSFs can achieve sustainable competitive advantage.
- ⬆ Excelling at one or more KSFs offers an opportunity for competitive advantage.
- ⬆ Key success factors differ between industries and can change over time.

**The answers to three questions help identify an industry's key success factors:**

1. On what basis do customers choose between the competing brands of sellers? What product attributes are crucial to sales?
2. What resources and competitive capabilities does a seller need to have to be competitively successful, better human capital, quality of product or quantity of product, cost of service, etc.?
3. What does it take for sellers to achieve a sustainable competitive advantage, something that can be sustained for long term?