Chapter - 2

Strategic Analysis: External Environment

Strategic Analysis

► The strategic analysis
- is a component of business planning that has a methodical approach,
- makes the right resource investments,
- and may assist business in achieving its objective.

► **The two important situational considerations are:**
(1) industry and competitive conditions, and
(2) an organisation's own capabilities, resources, internal strengths, weaknesses, and market position.

► The strategic analysis is a continuous process with two limitations:

► 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.

► Second, it can be time consuming at times, hurting overall organisational functioning.

Issues to consider for Strategic Analysis:

(a)Strategy evolves over a period of time	- result of choices taken over a period of time - radically changes to speed up growth - influenced by experience
(b)Balance of external and internal factors	- Meeting internal strengths and weaknesses with external opportunities and threats. - No perfect match exist. - Thus, strategic analysis uses workable balance.

(c)Risk

- Identify potential imbalances or risks and assess them consequences.

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

Framework of Strategic Analysis

Strategic Analysis

External Analysis

Opportunities, threats, trends, and Strategic uncertainties

Internal Analysis

Strategic strengths, weaknesses, problems, constraints, and uncertainties

Strategy Identification & Selection

- Identify strategic alternatives
- Select strategy
- Implement the operating plan
- Review strategies

Business Environment

►It consist of all factors which have impact on business operations.

►It can be classified as internal and external environment.

►Internal environment consist of people within the organisation.

►External environment consist micro and macro environment e.g. shareholders, industry competitive forces, political factors, legal factors etc.

Strategy And Business Environment

▶Business keeps a close and continuous interaction with environment which helps in following ways:

Determine opportunities & threats	Find new needs and wants of the consumers, changes in laws, changes in social behaviours, and tells what new products the competitors are bringing in the market to attract consumers.
Give direction for growth	It helps to identify areas for growth and expansion of their activities. The business understands the changes happening around, it can plan and strategies to have successful business.
Continuous Learning	The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in the realm of business.
Image Building	Environmental understanding helps the business organizations to improve their image by showing their sensitivity to the environment in which they operate. Understanding the needs of the environment help to showcase that the business is aware and responsive to the needs. It creates a positive image and helps it to prosper and win over the competitors.
Meeting Competition	It helps the businesses to analyse the competitors' strategies and formulate their own strategies accordingly. The idea is to flourish and beat competition for its products and services.

▶Strategic analysis covering internal and external environment is highly relevant to achieve competitive advantage, as well as ensure high performance for survival and growth.

»» Micro Environment

▶It is related to small area or immediate periphery or an organization.

▶It consists of suppliers, consumers, marketing intermediaries, competitors etc.

▶These are specific to the organization and influences it on a direct and regular basis.

»»Issues to Address in Macro Environment

- The employees of the firm, their characteristics and how they are organized.
- The existing customer base on which the firm relies for business
- The ways in which the firm can raise its finance
- Who are the firm suppliers and how are the links between the two being developed?
- The local community within which the firm operates
- The direct competition and their comparative performance.

»» Macro Environment

▶It is the portion of outside world that significantly affects how an organization operates but is typically much beyond its direct control and influence.
▶It has broader dimensions as it consist of economic, socio-cultural, technological, political and legal factors.

»»Elements of Macro Environment

Demographic Environment	»Means characteristics of population. »such as race, age, income, education, possession of assets, house ownership, job position, region, and the degree of education. »Data about these are of importance to both businesses and economists. **Particularly, they need to address following issues:** o What demographic trends will affect the market size of the industry? o What demographic trends represent opportunities or threats?
Socio-Cultural Environment	»It represents a complex group of factors such as social traditions, values and beliefs, level and standards of literacy, the ethical standards and state of society, the extent of social stratification, conflict, cohesiveness and so forth. »It differs from demographics in the sense that it is not the characteristics of the population, but it is the behaviour and the belief system of that population. »Core belief of society tends to be persistent and difficult to change. »Thus, businesses have to adjust to social norms and beliefs to operate successfully.

Economic Environment	»It refers to the overall economic situation including conditions at the regional, national and global levels. »It determines strength of the market. »Purchasing power depends on current income, prices, savings, circulation of money, debt availability. Income distribution determine the business possibilities. »It includes factors like GDP, per capital income, market for goods and services, interest rates, inflation etc. »High interest rate are detrimental for the business with debt.
Political-Legal Environment	»It includes factors like general level of policy development, degree of politicization, economic issues, law and order, political stability etc. »Business is highly guided and controlled by government policies and thus needs to consider changes in regulatory framework. »Taxes and duties are other critical areas that may be levied and affect the business. »Businesses prefer to operate in a country where there is a sound legal system.
Technological Environment	»Business leverages technology. »Technology has changed the way people communicate and do things. »Technology has also changed the ways of how businesses operate now. »Technology and business are linked and are interdependent on one another. »Technology act as both opportunity and threat. »Business can effectively adopts technological innovations to their strategic advantage.

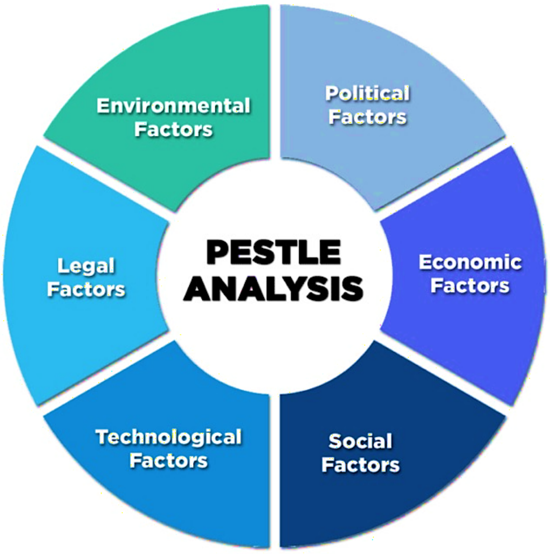
PESTLE- A tool to Analyse Macro Environment

►It is a way of scanning the macro environment factors that have influenced or are likely to affect the organisation.

►Earlier it was PEST but now legal and environment factors are included.

►It encourages management to be proactive and structured thinking in decision making.

►'PESTLE analysis is an increasingly used and recognized analytical tool, and it is an acronym for:



►**The Key Factors**

Political factors	Political factors are how and to what extent the government intervenes in the economy and the activities of business firms. Political factors may also influence goods and services which the government wants to provide or be provided and those that the government does not want to be provided.
Economic factors	Economic factors have major impacts on how businesses operate and take decisions. Example: interest rates affect a firm's cost of capital and therefore to what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy.
Social factors	Social factors affect the demand for a company's products and how that company operates.
Technological factors	Technological factors can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.

Legal factors	Legal factors affect how a company operates, its costs, and the demand for its products, ease of business.
Environmental factors	Environmental factors affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer--it is both creating new markets and diminishing or destroying existing ones.

Internationalization of Business

►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.

►A business can approach internationalisation systemically with the aid of international strategy planning.

►**Characteristics of a global business**

To be specific, 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?

- ✓ The first and foremost reason is the need to grow.
- ✓ There is rapid shrinking of time and distance across the globe.
- ✓ It is being realised that the domestic markets are no longer adequate. The competition present domestically may not exist in some of the international markets.

- ✓ There can be varied other reasons such as need for reliable or cheaper source of raw-materials, cheap labour, etc.
- ✓ Companies often set up overseas plants to reduce high transportation costs. It may be cheaper to produce near the market to reduce the time and costs involved in transportation.
- ✓ Companies find foreign markets to open up or grow big, they may naturally look at overseas manufacturing plants and sales branches to generate higher sales and better cash flow.
- ✓ The trade tariffs and custom barriers are getting lowered, resulting in increased flow of business.
- ✓ Globalization to form strategic alliances to leverage their respective comparative and competitive advantages.

International Environment

►Assessments of the international environment can be done at three levels: multinational, regional, and country.

Multinational environmental analysis	- Involves identifying, anticipating, and monitoring significant components of the global environment on a large scale. - Analyse macro environment, Govt. intervention etc. - Government may have free or interventionist tendencies in economies that needs to be carefully considered. - These characteristics are evaluated based on their present and expected future impact.
Regional environmental analysis	- It is a more in-depth evaluation of the critical factors in a specific geographical area. - The emphasis would be on discovering market opportunities for a goods, services, or innovations in the chosen location.
Country environmental analysis	- It has to take a deeper look at the important environmental factors. - Study of economic, legal, political and cultural dimensions is required to be successful. - The analysis must be customised for each of the countries to develop effective market entrance strategies.

Understanding Product And Industry

Business products have certain characteristics as follows:

1. Products are either tangible or intangible.
   a. A tangible product can be handled, seen, and physically felt.
   b. An intangible product is not a physical good, such as telecom services, banking, insurance, or repair services.

2. Product has a price.
   a. The market price is the price at which quantity provided equals quantity desired.
   b. In the present competitive world price is often given by the market and businesses have to work on costs to maintain profitability.

3. Products have certain features that deliver satisfaction.
   a. Products should provide value satisfaction to the customers.
   b. It is distinguish it in terms of its function, design, quality and experience.

4. Product is pivotal for business.
   a. It is at the centre of business around which all strategic activities revolve.
   b. It is the driving force behind business activities.

5. A product has a useful life.
   a. Every product has a usable life after which it must be replaced, as well as a life cycle after which it is to be reinvented or may cease to exist.

Product Life Cycle

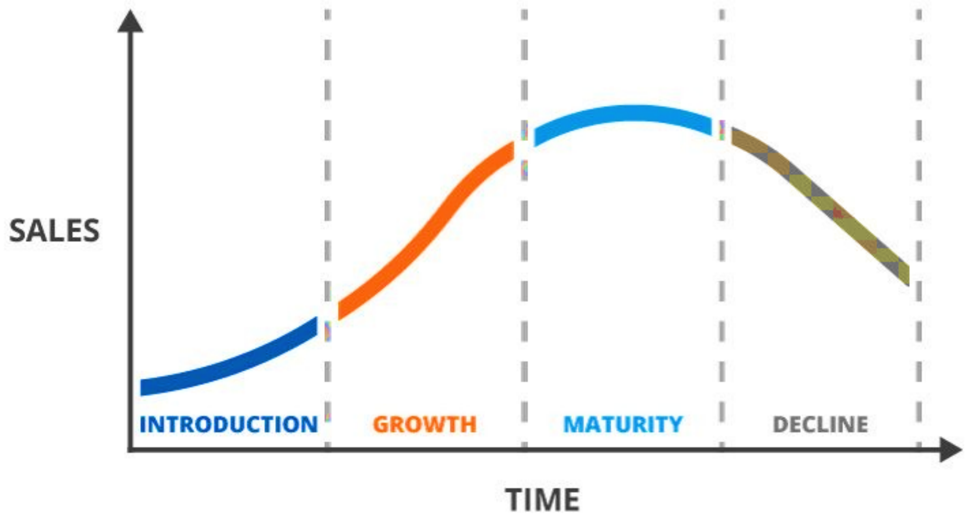
»»An important concept in strategic choice is that of product life cycle (PLC).

»»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.

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.
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.

Third phase: - of PLC is maturity stage where there is slowdown in growth rate. In this stage, the competition gets tough, and market gets stabilized. Profit comes down because of stiff competition. At this stage, organisations have to work for maintaining stability.

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.



»»The main advantage of PLC approach is that it can be used to diagnose a portfolio of products (or businesses) in order to establish the stage at which each of them exists.

»»Depending on the diagnosis, appropriate strategic choice can be made.

- For instance, expansion may be a feasible alternative for businesses in the introductory and growth stages.
- Mature businesses may be used as sources of cash for investment in other businesses which need resources.
- A combination of strategies like selective harvesting, retrenchment, etc. may be adopted for declining businesses.

Value Chain Analysis

»»It was introduced by Michael Porter.

»»Value chain analysis is a method of examining each activity in value chain of a business in order to identify areas for improvements.

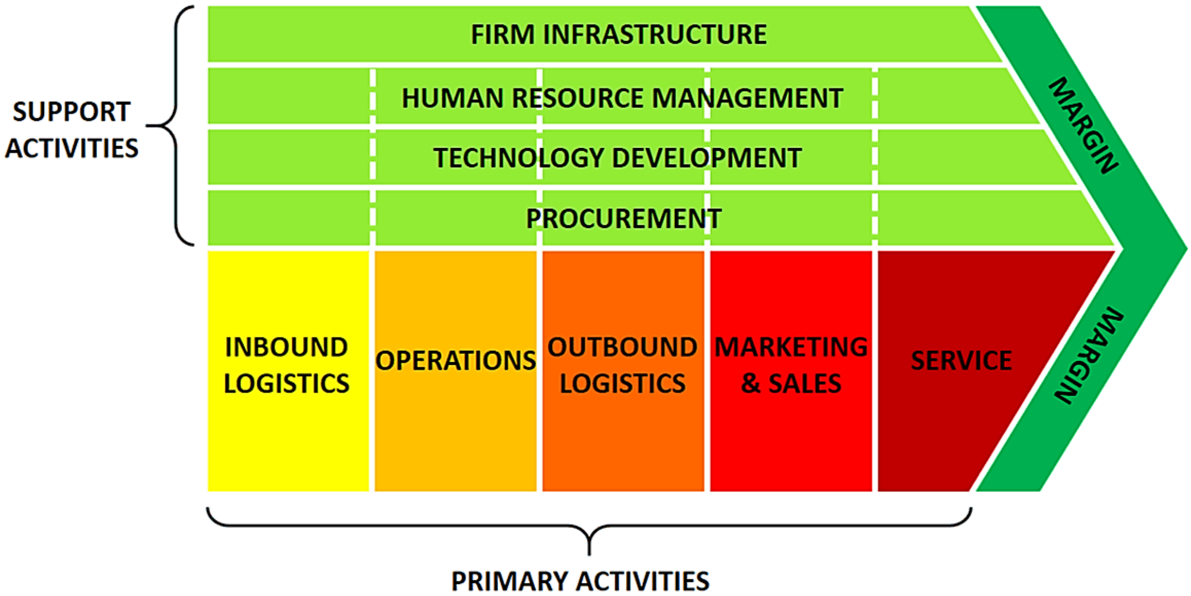
»»Value chain analysis has been widely used as a means of describing the activities within and around an organization and relating them to an assessment of the competitive strength of an organization.

»»Value chain analysis was originally introduced as an accounting analysis to shed light on the 'value added' of separate steps in complex manufacturing process, in order to determine where cost improvements could be made and/or value creation improved.

»»Two basic steps of

- ✓ identifying separate activities and
- ✓ assessing the value added from each.

»»There are two type of activities i.e. Primary and Secondary.



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

Inbound logistics	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.
Operations	Operations transform these inputs into the final product or service machining, packaging, assembly, testing, etc. convert raw materials in finished goods.
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).
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.
Service	Service 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	The processes for acquiring the various resource inputs to the primary activities (not to the resources themselves).
Technology development	All value activities have a 'technology', even if it is simply know-how. The key technologies may be concerned directly with the product (e.g. R&D product design) or with processes (e.g. process development) or with a particular resource (e.g. raw materials improvements).
Human resource management	It is an area which transcends all primary activities. It is concerned with those activities involved in recruiting, managing, training, developing and rewarding people within the organization.
Infrastructure	The systems of planning, finance, quality control, information management, etc. are crucially important to an organization's performance in its primary activities.

Industry Environment Analysis

► It analyse whether industry is a lucrative or not.

► Estimate the amount of competitive pressures the business is presently facing and is expected to face in the near future.

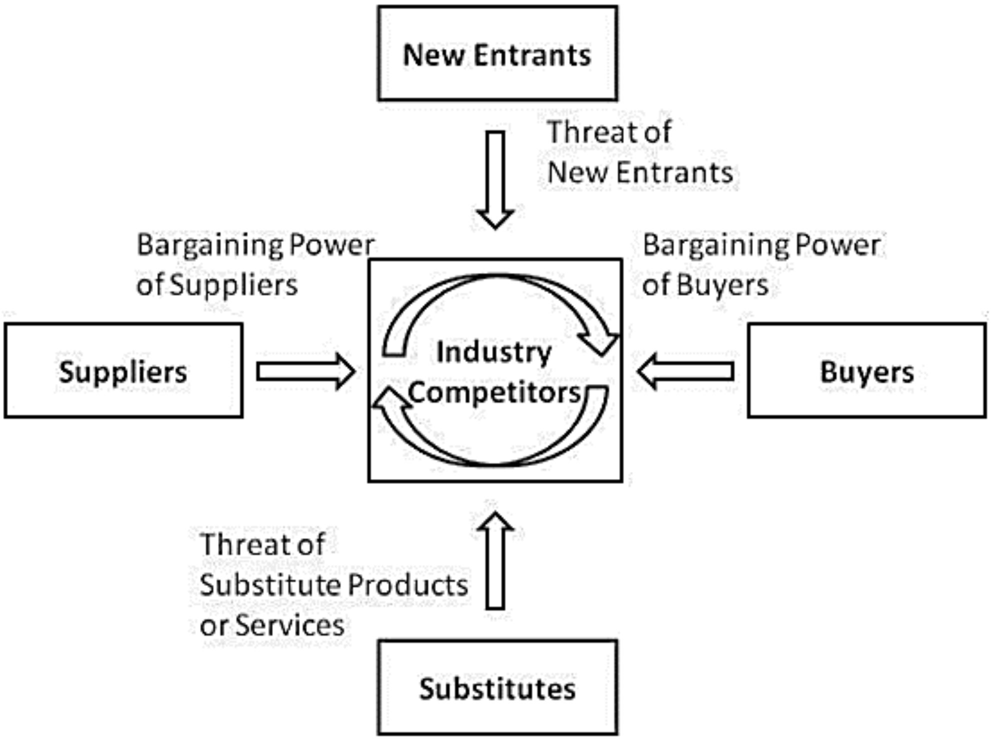
► Analysing these elements enhances knowledge of surrounding and serves as the foundation for aligning strategy with changing industry circumstances and realities.

Porter's Five Forces Model

»»Porter's Five Forces analysis is a simple but efficient way for determining the key sources of competition in business or industry.

»Understanding the variables that affect industry helps to adapt strategy, boost profitability and stay ahead of the competition.

»It states the competitive pressure operating in five areas of overall market. competitive pressures operating in five areas of the overall market:



Steps for Competitive Analysis

The strategists can use the five-forces model to determine what competition is like in a given industry by undertaking the following steps:

- Identify the specific competitive pressures associated with each of the five forces.
- Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak).
- Determine whether the collective strength of the five competitive forces is conducive to earnings attractive profits.

(I)The Threat of New Entrants

›New entrants can reduce industry profitability because they add new production capacity leading to an increase supply of the product even at a lower price and can substantially erode existing firm's market share position.

›The bigger the new entrant, the more severe the competitive effect.

›A firm's profitability is higher when other firms are blocked from entering.

›To discourage new entrants, existing firms can try to raise barriers to entry which are:

Capital requirement	When large amount of capital is required to enter an industry, firms lacking funds are effectively barred from industry, thus enhancing profitability of existing firms.
Economies of scale	- It refers to the decline in the per unit cost of production (or other activity) as volume grows. - A large firm that enjoys economies of scale can produce large volumes at lower costs. This discourages new entrant.
Product differentiation	- It refers to physical or perceptual differences or enhancements that make a product special or unique in eyes of customers. - Differentiation is an entry barriers as cost of creating genuine product differences may be high for the new entrants.
Switching costs	- To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch of its products. - To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, & train personnel to use the equipment or modify facilities for product use.
Brand identity	- Brand identity of products or services offered by existing firms can serve as another entry barrier. - It is particularly important for infrequently purchased products that carry a high unit cost to buyer.
Access to distribution channel	- The unavailability of distribution channels for new entrants poses another significant entry barrier. - Despite 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.
Possibility of aggressive retaliation	Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry.

(II) Bargaining Power of Buyers

›This force will become heavier depending on the possibilities of the buyers' forming groups or cartels.

›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:

- Buyer have full knowledge of product and their substitutes
- They are big buyers
- Product is not critical to the buyer and they can easily switch to the substitutes available.

(III) Bargaining Power of Suppliers

›The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, affect industry attractiveness and profitability.

›It happens when:

- Their products are crucial and substitutes are not available
- They can incur high switching costs
- They are more concentrated than their buyers.

(IV) Threat of Substitutes

›Substitutes are those which perform the same function or nearly the same as that of existing products.

›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.

›More substitute available leads to less attractive and profit industry will earn.

(V) The Nature of Rivalry in the Industry

›The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus directly affect the profitability.

›The more intensive the rivalry, the less attractive is the industry.

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

Industry Leader	A strong industry leader can discourage price wars by disciplining initiators of such activity. Because of its greater financial resources, a leader can generally outlast smaller rivals in a price war.
Number of Competitors	Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult.
Fixed Costs	When rivals operate with high fixed costs, they feel strong motivation to utilize their capacity and therefore are inclined to cut prices when they have excess capacity.
Exit Barriers	Rivalry among competitors declines if some competitors leave an industry. Exit barriers come in many forms. Assets of a firm

	considering exit may be highly specialized and therefore of little value to any other firm. Such a firm can thus find no buyer for its assets. This discourages exit. When barriers to exit are powerful, competitors desiring exit may refrain from leaving. Their continued presence in an industry exerts downward pressure on the profitability of all competitors.
Product Differentiation	Firms can sometimes insulate themselves from price wars by differentiating their products from those of rivals. As a consequence, profitability tends to be higher in industries that offer opportunity for differentiation. Profitability tends to be lower in industries involving undifferentiated commodities.
Slow Growth	Industries whose growth is slowing down tend to face more intense rivalry. As industry growth slows, rivals must often fight harder to grow or even to keep their existing market share. The resulting intensive rivalry tends to reduce profitability for all.

Attractiveness of Industry

▶ The industry analysis culminates into identification of various issues and draw conclusions about the relative attractiveness or unattractiveness of the industry, both near-term and long-term.

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

- ✓ The industry's growth potential, is it futuristically viable?
- ✓ Whether competition currently permits adequate profitability and whether competitive forces will become stronger or weaker?
- ✓ Whether industry profitability will be favourably or unfavourably affected by the prevailing driving forces?
- ✓ The competitive position of an organisation in the industry and whether its position is likely to grow stronger or weaker.
- ✓ The potential to capitalize on the vulnerabilities of weaker rivals (perhaps converting an unattractive industry situation into a potentially rewarding company opportunity).
- ✓ Whether the company is able to defend against or counteract the factors that make the industry unattractive?
- ✓ The degrees of risk and uncertainty in the industry's future.
- ✓ The severity of problems confronting the industry as a whole.

Experience Curve

›››Experience curve akin to a learning curve which explains the efficiency increase 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.

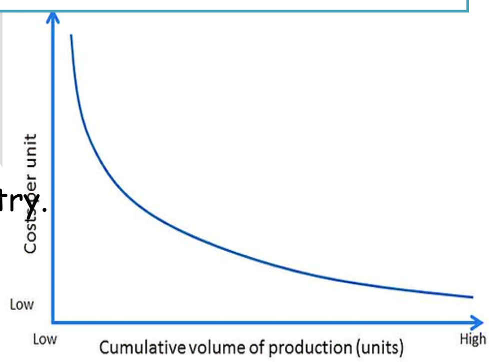
›››It is based on the concept, "we learn as we grow".

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

›››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:



›››It acts as a barrier for new firms entering in industry.

›››It is used to build market share and discourage Competition.

Value Creation

›››The concept of value creation was introduced primarily for providing products and services to the customers with more worth.

›››Value is measures by product features, quality, availability, durability, performance and its service for which customers is willing to pay.

›››Thus, value creation is an activity or performance by the firm to create value that increases the worth of goods, services, business processes or even the whole business system.

›››This concept gives business a competitive advantage in the industry and helps them earn above average profits/returns.

›››Profitable a company becomes depends on three factors:

a) the value customers place on the company's products;
b) the price that a company charges for its products; and
c) the costs of creating those products.

›››Companies are ultimately aiming to achieve sustainable competitive advantage, which enables them to succeed in the long run.

›››Michael Porter argues that a company can generate competitive advantage in two different ways, either through differentiation or cost advantage.

Market And Customer

► A market is a place for interested parties, buyers and sellers, where items and services can be exchanged for a price.

► The market might be physical, such as a departmental store where people engage in person.

► They may also be virtual, such as an online market where buyers and sellers do not meet in person but tools of technology to strike a deal.

► Example: it might be used to describe the stock exchange, where securities are traded.

► The term "marketing" encompasses a wide range of operations, including research, designing, pricing, promotion, transportation, and distribution.

► Often market activities are categorised and explained in terms of four Ps of marketing - product, place, pricing, and promotion.

Customer

›››A customer is a person or business that buys products or services from another organisation.

›››The terms customer and consumer are practically synonymous and are frequently used interchangeably. There is, a thin distinction.

›››Individuals or businesses that consume or utilise products and services are referred to as consumers. Customers are the purchasers of products and services in the economy, and they might exist as consumers or only as customers.

Customer Analysis

›››Customer analysis is an essential marketing component of any strategic business plan.

›››It identifies target clients, determines their wants, and then defines how the product meets those needs. Thus, it involves the examination and evaluation of consumer needs, desires, and wants.

›››Customer analysis includes the administration of customer surveys, the study of consumer data, the evaluation of market positioning strategies, development of customer profiles, and the selection of the best market segmentation techniques.

Customer Behaviour

»It examines elements like shopping frequency, product preferences and the perception of your marketing, sales and service offerings.

»It enables businesses to establish effective marketing and advertising campaigns, provide products and services that meet their needs, and retain customers for repeat sales.

»Consumer behaviour may be influenced by a number of things which are:

External Influences	- External influences, like advertisement, peer recommendations or social norms which have an impact on customers - These aspects are divided into two groups - the company's marketing - efforts and the numerous environmental elements.
Internal Influences	Internal processes are psychological factors internal to customer and affect consumer decision making.
Decision Making	- A rational consumer, as decision maker would seek information about potential decisions and after weighing the advantages and disadvantages of each option they would make a decision. 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.

Competitive Strategy

»The competitive strategy of a business is concerned with how to compete in the business areas in which the organization operates.

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

- the creation of competitive advantage
- the protection of competitive advantage.

Competitive Landscape

›››Competitive landscape is a business analysis which identifies competitors, either direct or indirect.

›››It is about identifying & understanding competitors & at same time it permits comprehension of their vision, mission, core values, niche market, strengths & weaknesses.

›››Understanding of competitive landscape requires an application of "competitive intelligence".(ability to gather & use info collected about competitors, to gain advantage in industry).

›››Steps to understand the Competitive Landscape:

- Identify the competitor
- Understand the competitor
- Determine the strength of competitor
- Determine the weakness of competitor
- Put all the information together

Key Factors For Competitive Success

›››An industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace

›››KSFs help to share whether a company will be financially and competitively successful.

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

On what basis do customers choose between the competing brands of sellers? What product attributes are crucial to sales?

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.?

What does it take for sellers to achieve a sustainable competitive advantage, something that can be sustained for long term?

›››Generally there are 3 to 4 KSFs in an industry.

›››The purpose of identifying KSFs is to make judgments about what things are more important to competitive success and what things are less important.