

MGT703: STRATEGIC MANAGEMENT

Module 2: Strategic Analysis – External Analysis

Chapter 3

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Module Overview

The Strategically Relevant Components of a Company's External Environment

Thinking Strategically About a Company's Industry and Competitive Environment

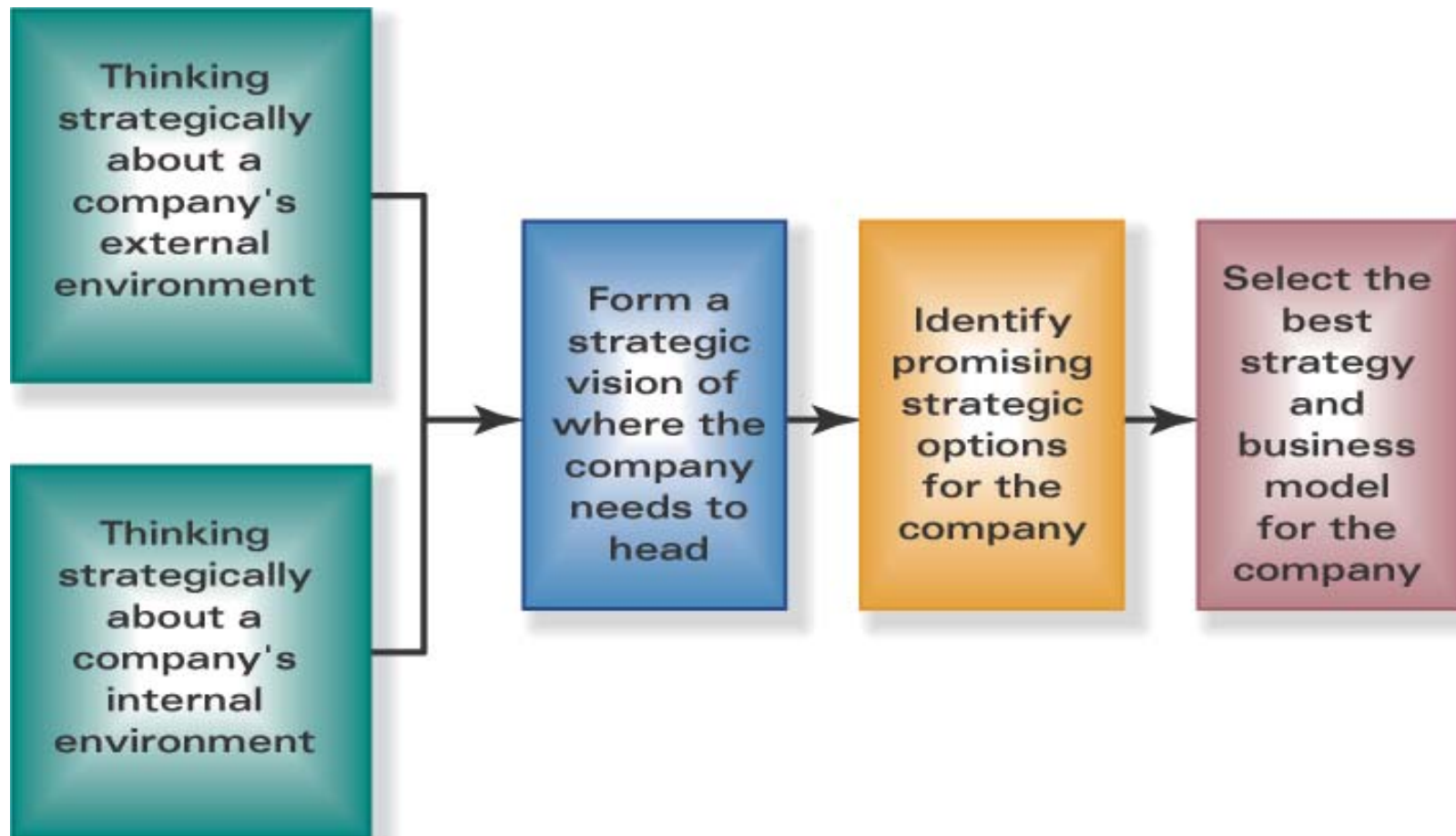
- Question 1: What Are the Industry's Dominant Economic Features?
- Question 2: What Kinds of Competitive Forces Are Industry Members Facing?
- Question 3: What Factors Are Driving Industry Change and What Impacts Will They Have?
- Question 4: What Market Positions Do Rivals Occupy—Who Is Strongly Positioned and Who Is Not?
- Question 5: What Strategic Moves Are Rivals Likely to Make Next?
- Question 6: What Are the Key Factors for Future Competitive Success?
- Question 7: Does the Outlook for the Industry Present an Attractive Opportunity?

Two considerations

- Company's external or macro-environment – Industry and competitive conditions
- Company's internal or micro-environment – competencies, capabilities, resource strengths and weaknesses, and competitiveness

Strategy selection

From Thinking Strategically about the Company's Situation to Choosing a Strategy

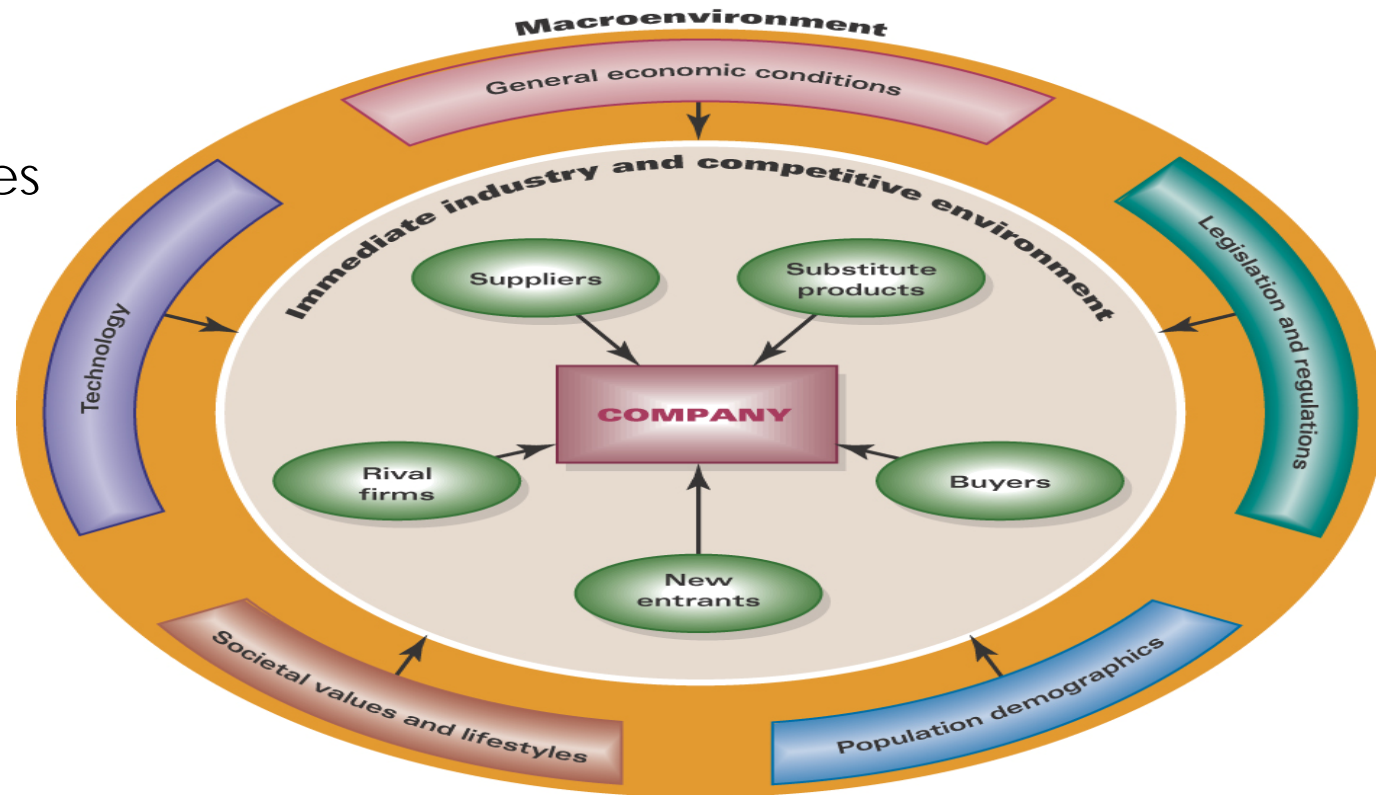


The Macro Environment

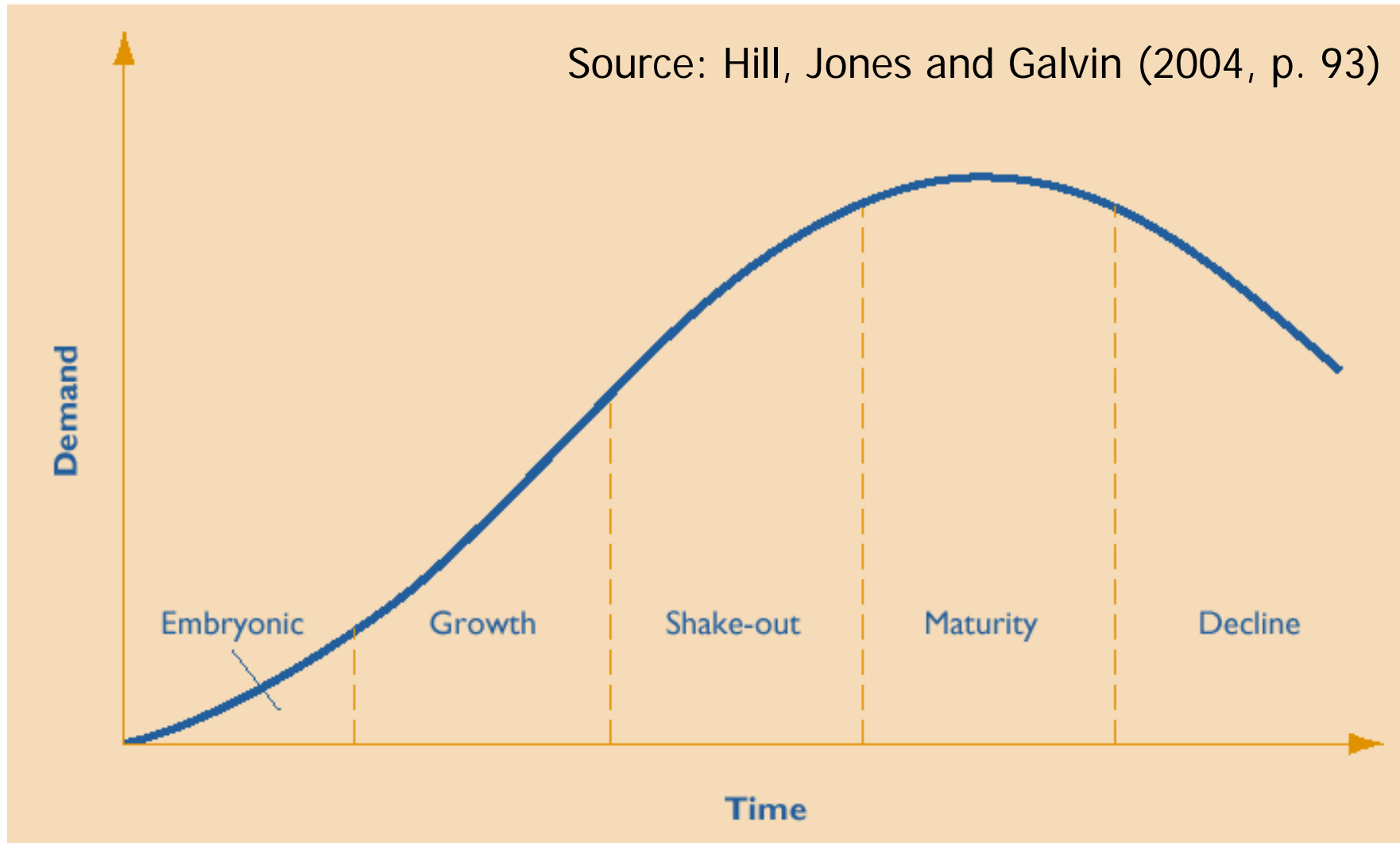
The Components of a Company's Macro-Environment, often referred to as PEST

Other forces include

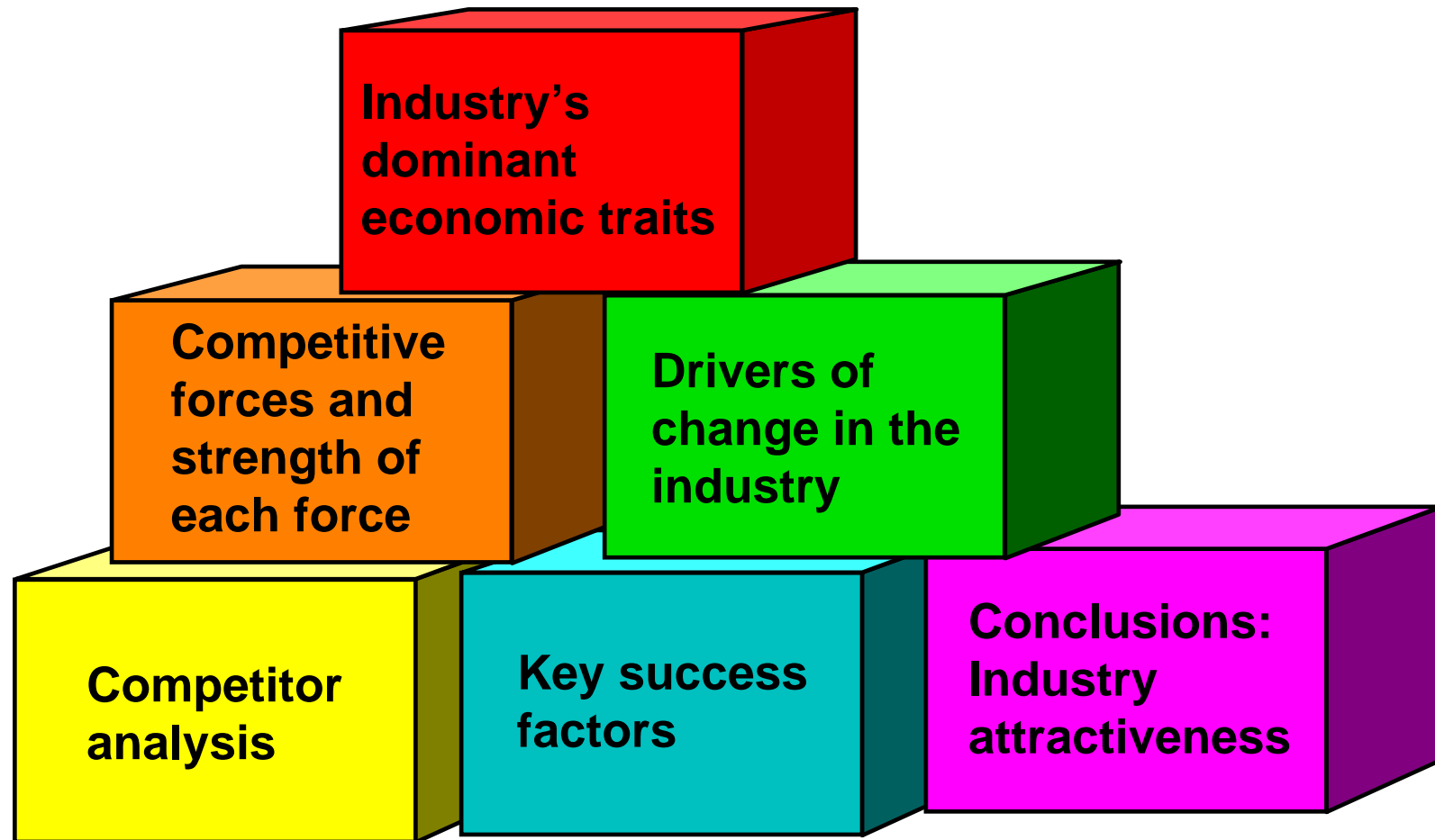
- Demographic issues
- Green issues
- Ethical issues
- Global issues



The Industry Cycle



Key Questions Regarding the Industry and Competitive Environment



Q1: Dominant economic features/traits

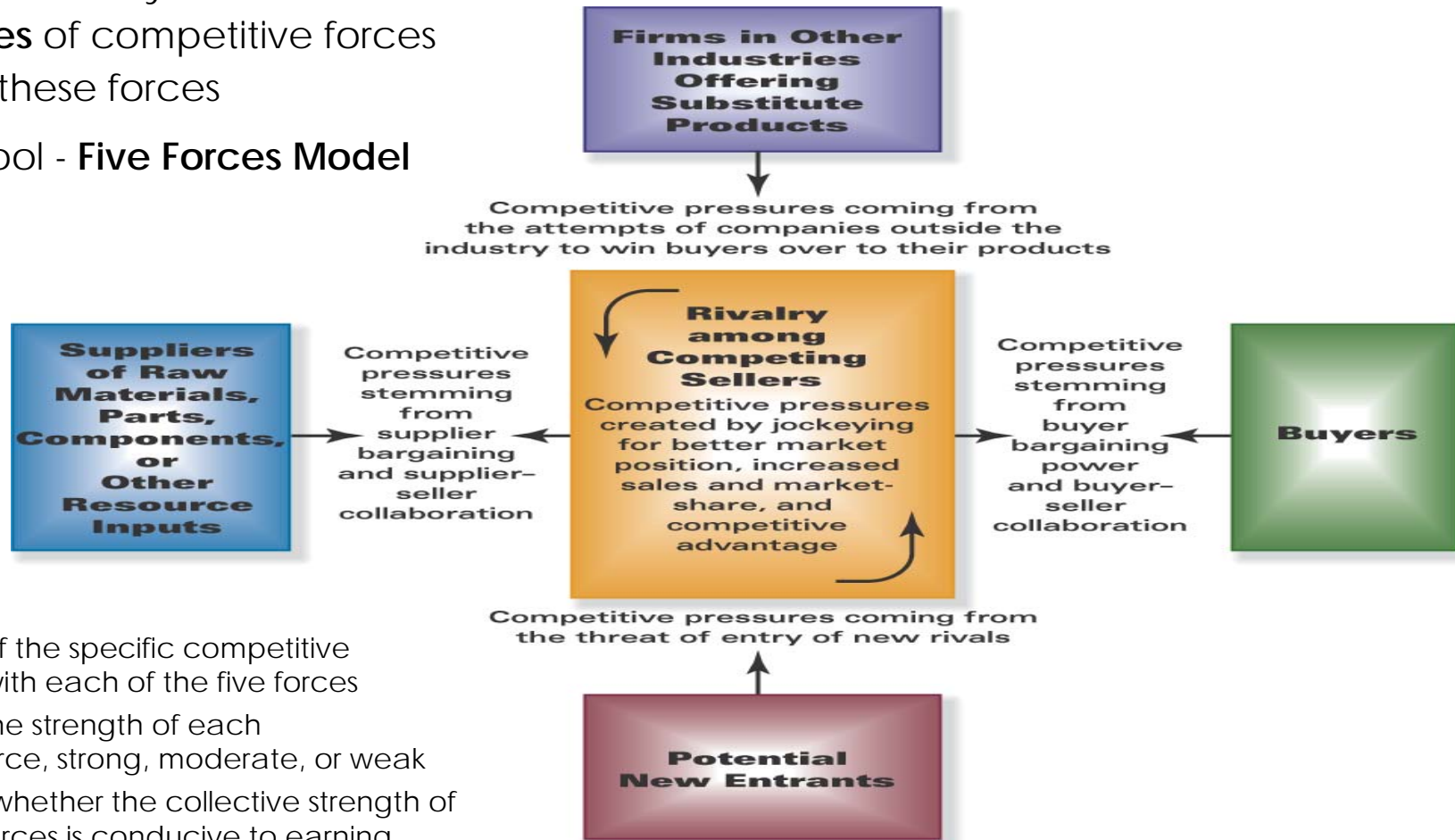
- Market size and growth rate
- Scope of competitive rivalry
- Number of rivals
- Buyer needs and requirements
- Production capacity
- Pace of technological change
- Vertical integration
- Product innovation
- Degree of product differentiation
- Economies of scale
- Learning and experience curve effects



Q2: What Kinds of Competitive Forces Are Industry Members Facing?

- Objectives are to identify –
 - Main sources** of competitive forces
 - Strength** of these forces
- Key analytical tool - **Five Forces Model of Competition**

3 Steps Analysis



- Step 1:** Identification of the specific competitive pressures associated with each of the five forces
- Step 2:** Evaluation of the strength of each competitive force - fierce, strong, moderate, or weak
- Step 3:** Assessment of whether the collective strength of the five competitive forces is conducive to earning attractive profits

Threat of new entrants



Barriers to entry:

- Brand loyalty
- Customer preferences
- Absolute cost advantages
- Economies of scale
- Switching costs
- Government regulation
- Capital requirements
- Tariffs & Trade Restrictions

The higher the entry barriers the lower the threat of new competition

Companies aggressively pursue strategies that help to keep entry barriers high

The bargaining power of buyers

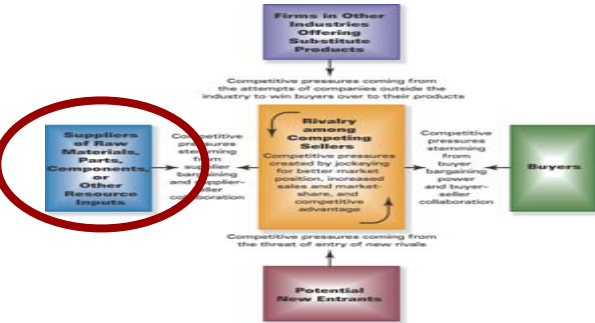


Buyers may be consumers (end-users) or distributors (dealers or wholesalers)

Buyers are most powerful when:

- There are many small sellers and few large buyers
- Buyers purchase in large quantities
- A single buyer is a large customer to a firm
- Buyers can switch suppliers at low cost
- Buyers can easily purchase from multiple sellers
- Buyers can easily vertically integrate to compete with suppliers

The bargaining power of suppliers



Suppliers have bargaining power when:

- Their products have few substitutes and are important to buyers
- The supplier industry is dominated by a few large producers
- Product (component) differentiation makes it costly for buyers to switch suppliers
- The buyer's industry is not an important customer to the supplier
- Suppliers can vertically integrate forward to compete with buyers and buyers can't integrate backward to supply their own needs

Substitute products



- The competitive threat of a substitute product increases as it comes closer to fulfilling a similar function to the original product
- The existence of substitute products may create price limits on the original products
- Many substitute products in an industry leads to increased competition
- Eyeglasses / contact lenses / laser surgery
- Sugar / artificial sweeteners
- Newspapers / TV / Internet

Rivalry among firms



- Usually the **strongest** of the five forces
- A **key factor** in determining the **strength** of the **rivalry** - How aggressively are rivals using various **weapons of competition** to improve their market positions and performance?
- **Competitive rivalry** is a **combative** contest involving:
 - **Offensive** actions
 - **Defensive** countermoves
- The intensity of competitive rivalry in an industry arises from:
 - Concentration of firms
 - Overcapacity of firms that is not matched by high demands for product or service
 - Product/service differentiation
 - Ratio of fixed costs to variable costs
 - Height of industry exit barriers
 - Diversity of competitors
 - High strategic stakes

Q3: What Factors Are Driving Industry Change and What Impacts Will They Have?



- Industries change because **forces** are **driving** industry **participants** to **alter** their actions
- **Driving forces** are the **major underlying causes** of changing industry and competitive conditions

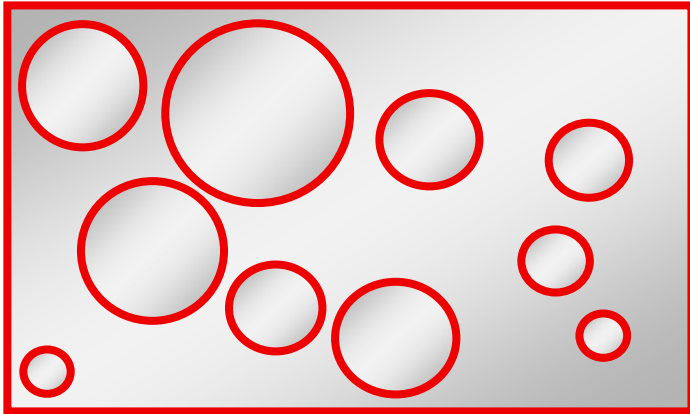
Q3: Analysis of driving forces of industry change



- Identify forces that are likely to exert the **greatest influence** over the next 1 to 3 years
 - Usually no more than 3 to 4 factors qualify as real drivers of change
- Assess the **impact**
 - Are the driving forces causing **demand** for product to increase or decrease?
 - Are the driving forces acting to make **competition** more or less intense?
 - Will the driving forces lead to higher or lower industry **profitability**?

Common types of driving forces ■ Internet and e-commerce opportunities ■ Increasing globalisation of industries ■ Changes in long-term industry growth rate ■ Changes in who buys the product and how they use it ■ Product innovation ■ Technological change/process innovation ■ Marketing innovation ■ Entry or exit of major firms ■ Diffusion of technical knowledge ■ Changes in cost and efficiency ■ Consumer preferences shift from standardised to differentiated products (or vice versa) ■ Changes in degree of uncertainty and risk ■ Regulatory policies / government legislation ■ Changing societal concerns, attitudes, and lifestyles

Q4: What Market Positions Do Rivals Occupy?



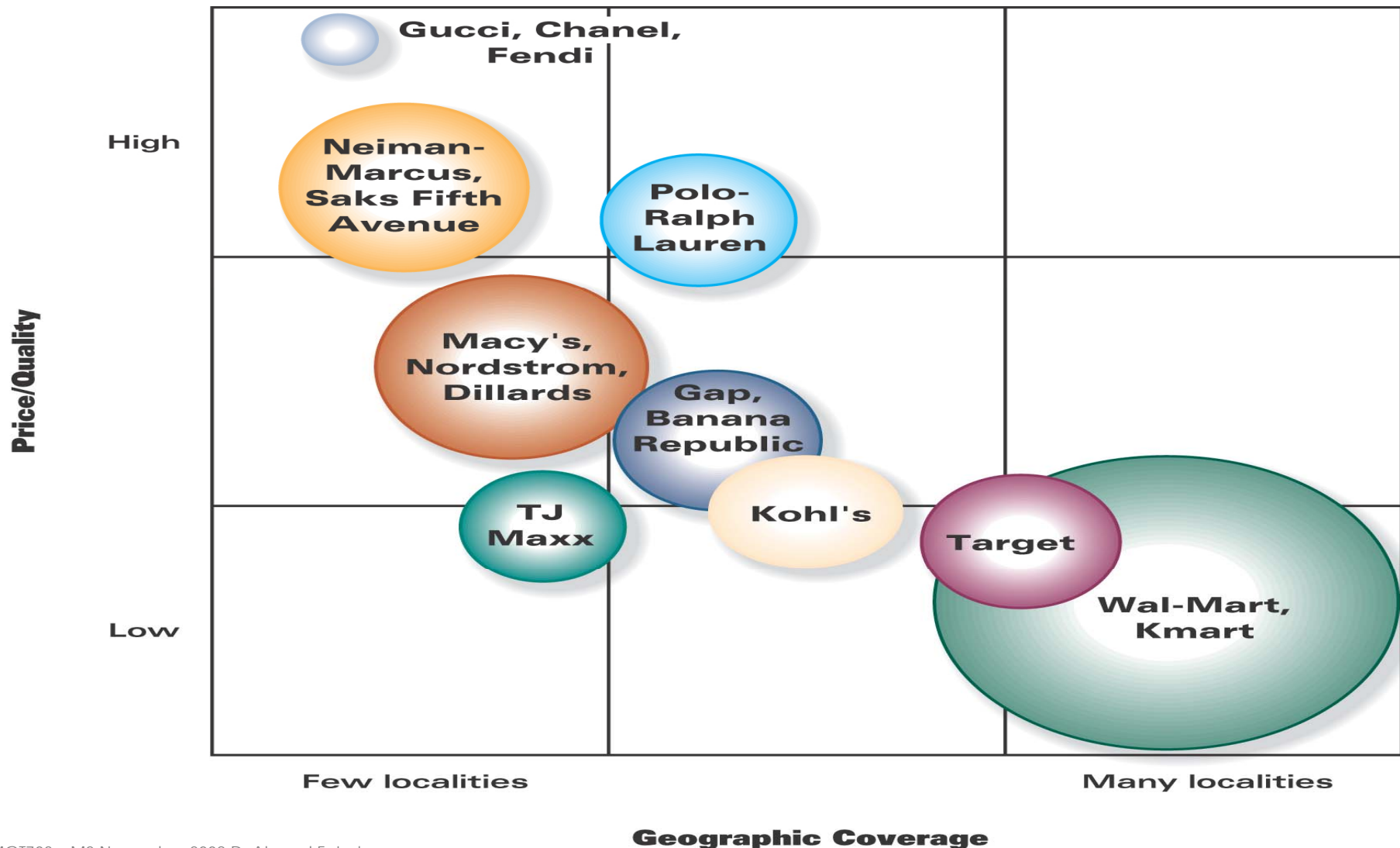
One technique to reveal **different competitive positions** of industry rivals is **strategic group mapping**

A **strategic group** is a cluster of firms in an industry with similar competitive approaches and market positions

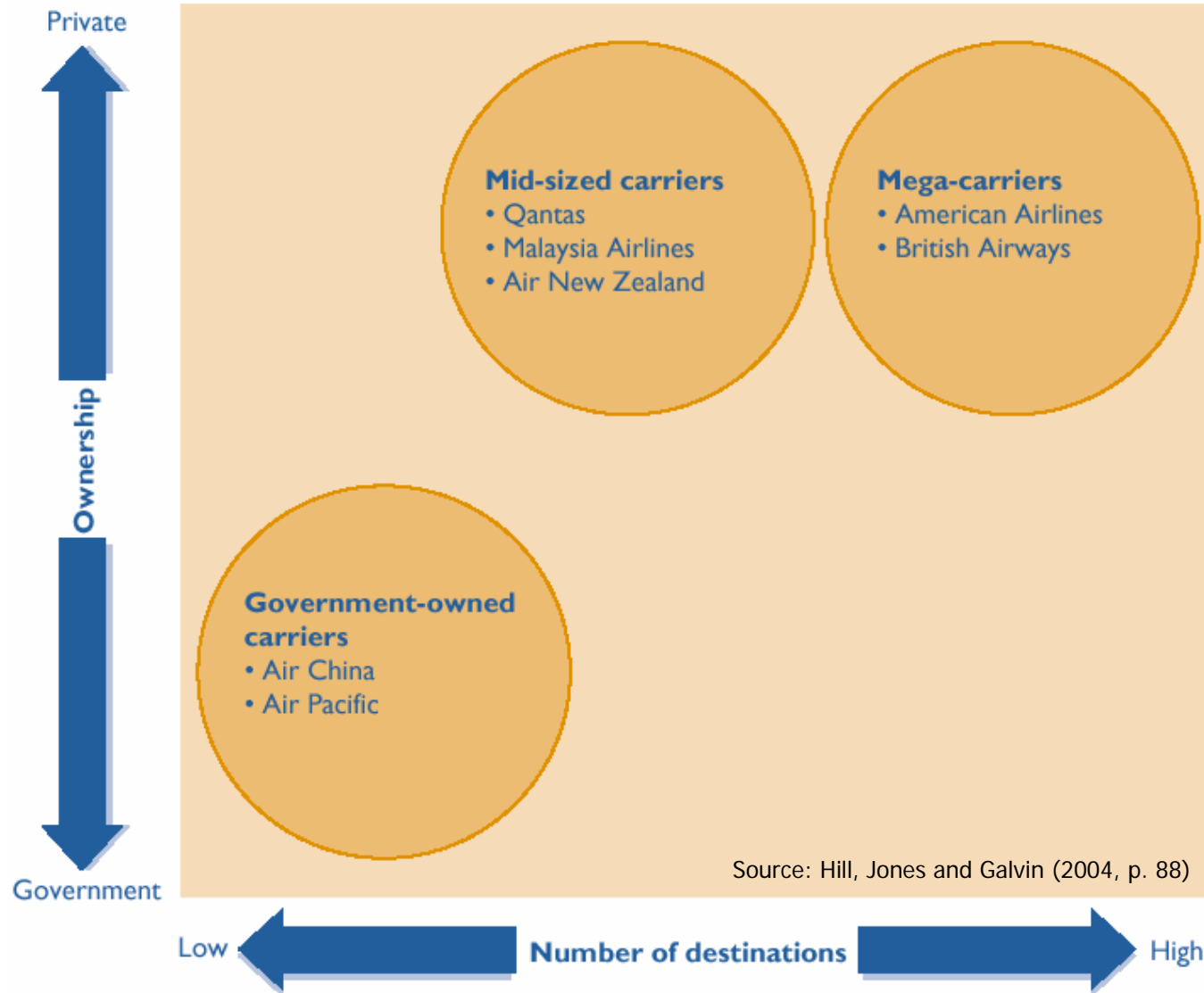
Firms in the same **strategic group** have two or more **competitive characteristics** in common

- Have comparable product line breadth
- Sell in same price/quality range
- Emphasise same distribution channels
- Use same product attributes to appeal to similar types of buyers
- Use identical technological approaches
- Offer buyers similar services
- Cover same geographic areas

Q4: Strategic group map of selected retail chains



Q4: Strategic group map of selected international airlines



Q4: Strategic groups within industries

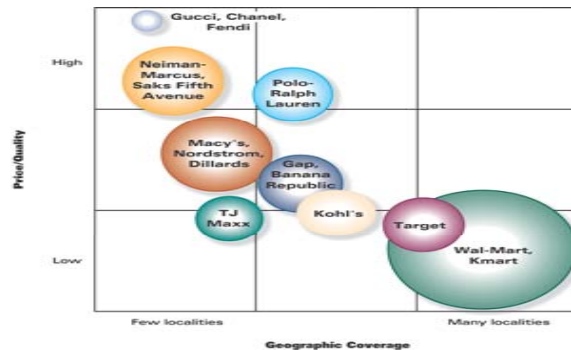
Strategic blocks

- Groups of companies within an industry that exhibit strategic links via alliances or other cooperative arrangements
- Strategic blocks are less likely to compete with each other than strategic groups

Coopetition

- Strategic block members can benefit from the exchange of information and expertise (Tsai 2002)

Limitations of the five forces model and strategic group mapping



- Both models are static and ignore the role of innovation
- Their focus is on industry and group structures rather than individual companies
- Successful innovation creates change in industry structures altering the competitive environment

Source: Hill, Jones & Galvin (2004)

Q5 : What Strategic Moves Are Rivals Likely to Make? – Competitive intelligence

A firm's **best strategic moves** are affected by

- Current strategies of competitors
- Future actions of competitors

Profiling key rivals involves gathering **competitive intelligence** about

- Current strategies
- Most recent actions and public announcements
- Resource strengths and weaknesses
- Efforts being made to improve their situation
- Thinking and leadership styles of top executives



Q6: What Are the Key Factors for Competitive Success?



Key success factors are those competitive factors that affect **every industry member's** ability to prosper

- Specific strategy elements
- Product attributes
- Resources
- Competencies
- Competitive capabilities

They are attributes that indicate the **difference** between

- Profit and loss
- Competitive success or failure

Q7: Does the Outlook for the Industry Present an Attractive Opportunity?



Involves assessing whether the industry and competitive environment is **attractive** or **unattractive** for earning good profits

Under certain circumstances, a firm **uniquely** well-situated in an otherwise **unattractive** industry can still earn unusually good profits

- Attractiveness is relative, not absolute
- Conclusions have to be drawn from the perspective of a particular company

Q7: Assessing industry attractiveness



- Industry's market size and growth potential
- Whether competitive forces are conducive to rising/falling industry profitability
- Whether industry profitability will be favourably or unfavourably impacted by driving forces
- Degree of risk and uncertainty in industry's future
- Severity of problems facing industry
- Firm's competitive position in industry against their rivals
- Firm's potential to capitalise on the vulnerabilities of weaker rivals
- Whether firm has sufficient resources to defend against unattractive industry factors

References

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- Tsai, W, 2002, Social structure of coopetition within a multiunit organisation, Organisation Science, vol. 13, no. 2, pp. 179-190.