Strategic Management
The External Environment
Opportunities, Threats, Competition, and Competitor Analysis

By

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Strategic Management Process

- Is the full set of commitments, decisions, and actions required for a firm to achieve strategic competitiveness and earn above average returns.

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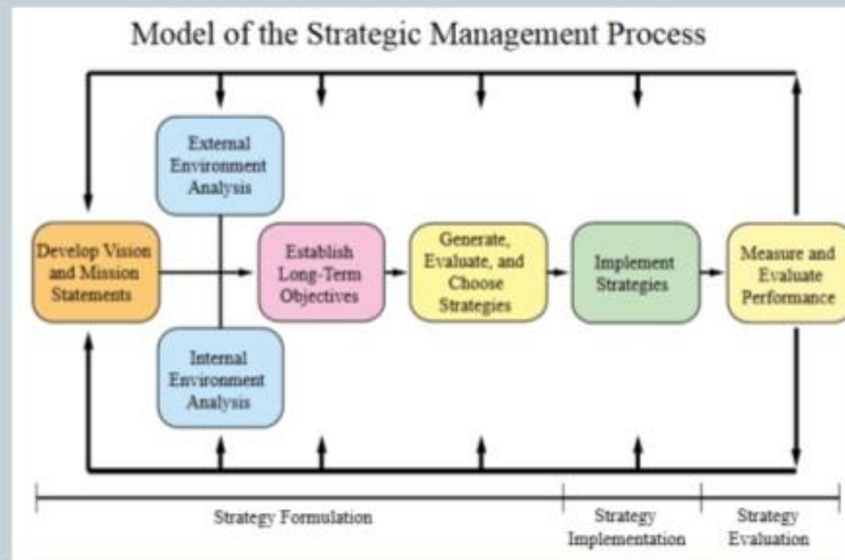
Different models of strategic management
David's model
Model of the Strategic Management Process
External Environment Analysis
Develop Vision and Mission Statements
Establish Long-Term Objectives
Generate, Evaluate, and Choose Strategies
Implement Strategies
Measure and Evaluate Performance
Internal Environment Analysis
Strategy Formulation
Strategy Implementation
Strategy Evaluation

The I/O Model of Above average returns

- From the 1960s through 1990s the external environment was thought to be the primary determinant of strategies that firms selected to be successful.
- The I/O Model of above average returns explains the external environments dominant influence on a firms strategic actions.
- The model specifies that the industry or segment of an industry in which a company chooses to compete has a stronger influence on performance than do the choices managers make inside their organizations.

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- The firms performance is believed to be determined primarily by a range of industry properties, including economies of scale, barriers to market entry, diversification, product differentiation, and the degree of concentration of firms in the industry.

- This module examines the tools and concepts needed to conduct an external strategic management audit (sometimes called environmental scanning or industry analysis).

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Five forces Model

- The five forces model of competition is an analytical tool used to help firms find the industry that is the most attractive for them.

- This model suggest that an industry's profitability is a function of interactions among five forces: Suppliers, buyers, competitive rivalry among firms currently in the industry, product substitutes, and potential entrants to the industry.

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The I/O Model of Above average returns

Study the External Environment, specially the industry environment.	The External Environment
Locate and industry with high potential for above average returns	An Attractive Industry
Identify the strategy called for by the attractive industry to earn returns	Strategy Formulation
Develop or acquire assets and skills needed to implement the strategy.	Assets and Skills
Use the firms strength (its assets and skills) to implement the strategy.	Strategy Implementation
	Superior Returns

The External Environment

- The firms strategic actions are influenced by the conditions in three parts:
  - General Environment
  - Industry Environment
  - Competitor Environment

- The General Environment is further divided into segments:
  - Demographic Segment
  - Economic Segment
  - Political Segment
  - Socio-cultural segment
  - Technological Segment
  - Global Segment
  - Physical Environment segment

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Industry Environment

- The industry environment is the set of factors that directly influences a firm and its competitive actions and responses: the threat of new entrants, the power of suppliers, the power of buyers, the threat of product substitutes and the intensity of rivalry amongst competitors.
- In total the interactions among these five factors determine an industry's profit potential; in turn the industry's profit potential influences the choices each firm makes about its strategic action.

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Competitor Analysis

- How companies gather and interpret information about their competitors is called competitors analysis.
- Understanding the firms competitor environment complements the insights provided by studying the general and industry environments.
- For example: JSW Steel needs to learn as much as it can about its two competitors – SAIL and Tata Steel – while also learning about its general and industry environments.

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Industry Environment Analysis – In Detail

- Industry is a group of firms producing products or services that are close substitutes.
- An industry's profit potential is a function of five forces of competition: The threats posed by new entrants, the power of suppliers, the power of buyers, product substitutes and the intensity of rivalry among competitors.
- Michael Porter's five forces model of competitive analysis (or industry analysis) is the widely used approach for developing strategies in many industries.

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- When studying industries firms must also recognize that suppliers can become a firms competitors (by integrating forward) as can buyers (by integrating backward).

- Example: Several firms have integrated forward in the pharmaceutical industry by acquiring distributors or wholesalers.

- We now examine five forces the firm analyses to understand the profitability potential within the industry in which it competes or may choose to compete.

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Porter's Five Forces

- Threat of new entrants
- Bargaining Power of suppliers
- Bargaining Power of buyers
- Threat of substitute products
- Intensity of rivalry among competitors

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Threat of New Entrants

- The likelihood of firms will enter an industry is a function of two factors:
  - Barriers to entry
  - Retaliation expected from current industry participants.
- Entry barriers make it difficult for new firms to enter an industry and place them at a competitive disadvantage.
- Incumbents who are competing successfully want to maintain high entry barriers in order to discourage potential competitors form deciding to enter the industry.

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- When the threat is high, incumbents must hold down their prices or boost investment to deter new competitors.
- Example: In specialty coffee retailing, relatively low entry barriers mean that Starbucks must invest aggressively in modernizing stores and menus.
- Other examples we can think off…….

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Barriers to entry

- Entry barriers are advantages that incumbents have relative to new entrants. There are seven major sources:
  1. Economies of scale.
  2. Product differentiation
  3. Capital requirements
  4. Switching costs
  5. Access to distribution channels
  6. Cost disadvantages Independent of scale
  7. Restrictive government policy

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Economies of scale

- These are derived from incremental efficiency improvement through operating larger plants and systems as firm grows larger.
- Example: Maruti and Bajaj have attained unbeatable cost positions through their scale of production.
- Reliance is an example where management consciously went in for very large plant sizes comparable to global companies, making it nearly impossible for other Indian producers to compete on costs.

Product Differentiation

- Overtime customers may come to believe that a firms product is unique.
- Example: Companies like HUL, Proctor and Gamble and Infosys spend a great deal of money on advertising and marketing to convince potential customers of their products distinctiveness and of the value buying their brands provides.
- Customers valuing a products uniqueness tend to become loyal to both the company and products/service.

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- New entrants have often allocate many resources to overcome existing customer loyalties.
- To combat the perception of uniqueness, new entrants frequently offer products at lower prices.
- Example: Nirma detergent challenging HULs brands notably Surf, and Promise brand of toothpaste challenged the dominance of Colgate.

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Capital Requirements:

- Competing in a new industry requires a firm to have resources to invest.
- In addition to physical facilities, capital is needed for inventories, marketing and other business functions.
- Even if industry is attractive the capital required for entry may not be available.
- Example: Steel, Oil exploration, airlines are industries that need large capital

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Switching costs:

- Switching costs are the one time costs customers incur when they buy from a different supplier.
- If switching costs are too high, a new entrant must offer either a substantially lower price or a much better product to attract buyers.
- Example: ERP is an example of a service with very high switching costs. Once a company has installed SAPs ERP, for example, the costs of moving to a new vendor are astronomical.

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Access to Distribution Channels:

- Over time industry participants develop effective means of distributing products.
- Once a relationship with its distributors has been built, a firm will nurture it, this creating switching costs for the distributors.
- Access to distribution channels can be a strong entry barrier for new entrants, particularly in consumer nondurable goods.

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Cost disadvantages Independent of scale:

- Sometimes established companies have cost advantages that new entrants cannot duplicate.
- Example: Favorable access to raw materials, desirable location.
- New entrants have to reduce the strategic relevance of these factors.

Government Policy:

- Through licensing and permit requirements, governments can also control entry into an industry.
- Liquor retailing, radio and TV broadcasting are examples of industries in which government actions affect entry possibilities.

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Expected Retaliation:

- Companies seeking to enter an industry also anticipate the reactions of firms in the industry.
- Vigorous retaliation can be expected when the existing firm has major stake in the industry, when it has substantial resources, and when industry growth is slow or constrained.
- Example: Any firm entering the Airline or Mobile phone industry at the current time can expect significant retaliation.

2. Bargaining Power of Suppliers

- Increasing prices and reducing the quality of their products are potential means suppliers use to exert power over firms competing within an industry.

A supplier group is powerful when:

- Satisfactory substitute products are not available.
- Suppliers goods are critical to buyers marketplace success.
- It poses a credible threat to integrate forward into the buyers industry.
- It is dominated by few large companies and is more concentrated than the industry to which it sells.
- Example: In steel industry, firms that do not have captive mining facilities such as JSW steel, are at the mercy of mining companies that supply iron ore.

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3. Bargaining Power of Buyers

- Buyers want to buy products at the lowest possible price – the price at which the industry earns the lowest acceptable rate of return on the invested capital.

Customers are powerful when:

- They purchase large portion of an industry's total output.
- The sale of the product being purchased account for significant portion of the sellers annual revenues.
- The industry products are undifferentiated or standardized, and the buyers pose a credible threat if they were to integrate backward into the sellers industry.

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4. Threat of substitute products

- Substitute products are goods or services from outside a given industry that perform similar or the same functions as a product that the industry produces.
- Newspaper firms have experienced significant decline in circulation over the past decade or more.
- The declines are due to substitute outlets for new including Internet sources, cable television news channels, and email and cell phone alerts.

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5. Intensity of Rivalry Among Competitors

- Because an industry's firms are mutually dependent, actions taken by one company usually invite competitive responses.
- Firms within industries are rarely homogeneous, they differ in resources and capabilities and seek to differentiate themselves from competitors.
- Common dimensions on which rivalry is based include price, service after the sale, and innovation.

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- The most prominent factors that, according to experience, affect the intensity of firms rivalries are discussed here, they are:
  - Numerous or Equally Balanced competitors
  - Slow Industry Growth
  - High Fixed Costs or High Storage costs
  - Lack of Differentiation or Low Switching Costs.
  - High Strategic Stakes

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- Numerous or Equally Balanced Competitors
- With multiple competitors, it is common for a few firms to believe they can act without eliciting a response.
- However evidence suggests that other firms generally aware of competitors actions, often choosing to respond to them.
- At other extreme industries with only a few firms of equivalent size and power also tend to have strong rivalries.
- Example: Competitive battle between Pepsi and Coca-coal exemplify intense rivalry between relatively equal competitors.

Slow Industry Growth

- Growing markets reduce pressure to take customers from competitors.
- However, rivalry in no-growth or slow-growth markets becomes more intense as firms battle to increase their market share by attracting competitors customers.
- Typically battles to protect market share are fierce
- Example: In the case of airline and the soft drinks industry companies try to win each others customers.

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High Fixed Costs or High Storage Costs

- When companies have high fixed costs they tend to maximize their productive capacity and thereby spread costs across large volume of output.
- When firms do this excess capacity is created, and to then reduce inventories companies typically try to cut the price of product and offer discounts to customers.

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Lack of Differentiation or Low Switching Costs

- When buyers find a differentiated product that satisfies their needs, they frequently purchase the product loyalty over time.
- Industries with competitors that have differentiated products have less rivalry, which results in lower competition.
- When buyers view products or services as commodities, rivalry intensifies.
- In this instance buyers purchasing decisions are based o price.
- Example: Rivalry between Dell and HP is strong and these companies are always trying to differentiate their offerings.

High Strategic Stakes:

- Competitive rivalry is likely to be high when it is important for several of the competitors to perform well in the market.
- Example: Although diversified and is a market leader in other businesses, Samsung has targeted market leadership in the consumer electronics market and is doing well.
- This market is quite important to Sony and other major competitors, such as Hitachi, NEC and Mitsubishi, suggesting that rivalry among these companies will remains strong.

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High Exit Barriers:

- Sometimes companies continue competing in an industry even though the returns on their invested capital are low or negative.
- Firms making this choice in all likelihood face high exit barriers, which include economic, strategic and emotional factors causing them to remain in an industry when the profitability of doing so is questionable.
- Example: Exit barriers are especially high in the airline industry.
- Due to government regulations on closing down firms, exit barriers are high in all industries in India.

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Interpreting Industry Analysis

- The stronger the competitive forces are, the lower the profit potential for an industry's firm.
- An unattractive industry has low entry barriers, supplier and buyers with strong bargaining positions, strong competitive threats from product substitutes, and intense rivalry among competitors.
- An attractive industry has high entry barriers, suppliers and buyers with little bargaining power, few competitive threats from product substitutes, and relatively moderate rivalry.

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Competitor Analysis

- Competitor analysis focuses on each company against which a firm directly competes.
- Example: Airtel, Vodafone, Reliance and BSNL
- Example: Coca-cola and Pepsi
- Example DHL and Fedex
- All the above companies are keenly interested in understanding their competitors objectives, strategies, assumptions and capabilities.

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In a competitor analysis, the firm seeks to understand the following:

- What drives the competitor, as shown by it future objectives.
- What the competitor is doing and can do, as revealed by its current strategy.
- What the competitor believes about the industry, as shown by its assumptions.
- What the competitors capabilities are, as shown by it strengths and weaknesses

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Competitor Intelligence:

- Useful data and information combine to form Competitor Intelligence: the set of data and information the firm gathers to better understand and better anticipate competitors objectives, strategies, assumptions and capabilities.

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Competitor Analysis Components

Future Objectives

How do our goals compare with our competitors goals?
Where will emphasis be placed in the future?
What is the attitude toward risk?

Current Strategy

How are we currently competing?
Does their strategy support changes in the competitive structure?

Assumptions

Do we assume the future will be volatile?
Are we operating under a status quo?
What assumptions do our competitors hold about
the industry and themselves?

Capabilities

What are our strengths and weaknesses?
How do we rate compared to our competitors?

Response

What will our competitors do in the future?
Where do we hold an advantage over our competitors?
How will this change our relationship with our competitors?

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Complementor's:

- When gathering competitive intelligence, firms must also pay attention to the complementor's of its products and strategy.
- Complementor's are companies or network of companies that sell complementary goods or services that are compatible with the firms goods or service.
- Example: Intel and Microsoft are the widely recognized complimentors (Microsoft slogan “Intel inside”)
- Example: Alliances among airline operator’s (Ex: Star Alliance and SkyTeam Alliance) find these companies sharing their route structures and customer loyalty programs as a means of complementing each other’s operations.

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