

Business Policy and Strategy

CHAPTER 3 Evaluating a Company's External Environment

Dr. Chi Zhang



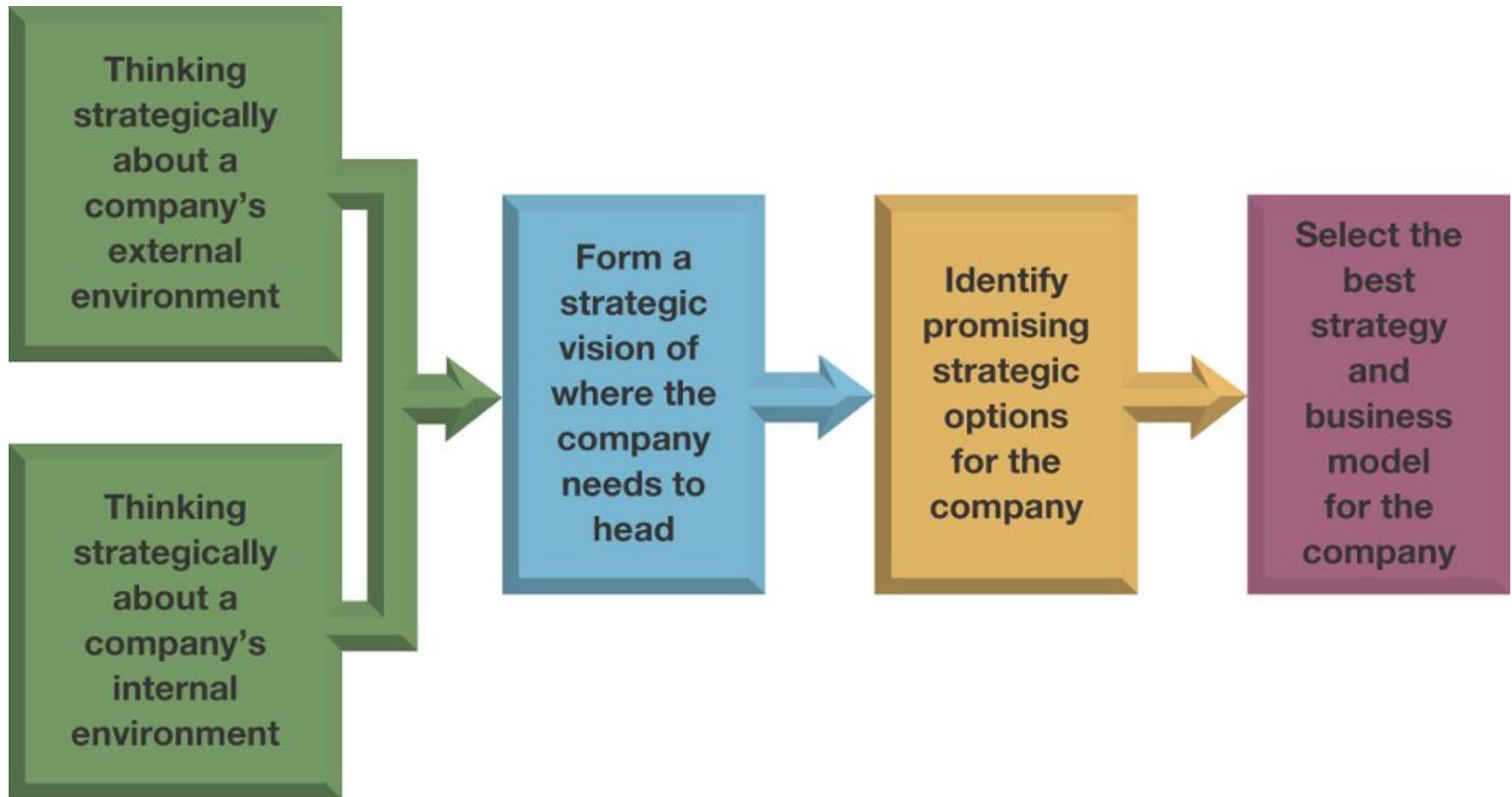
LEARNING OBJECTIVES

THIS CHAPTER WILL HELP YOU UNDERSTAND:

1. How to recognize the factors in a company's broad macro-environment that may have strategic significance
2. How to use analytic tools to diagnose the competitive conditions in a company's industry
3. How to map the market positions of key groups of industry rivals

FIGURE 3.1 From Thinking Strategically about the Company's Situation to Choosing a Strategy

Chapter 3



Chapter 4

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The Macro-Environment

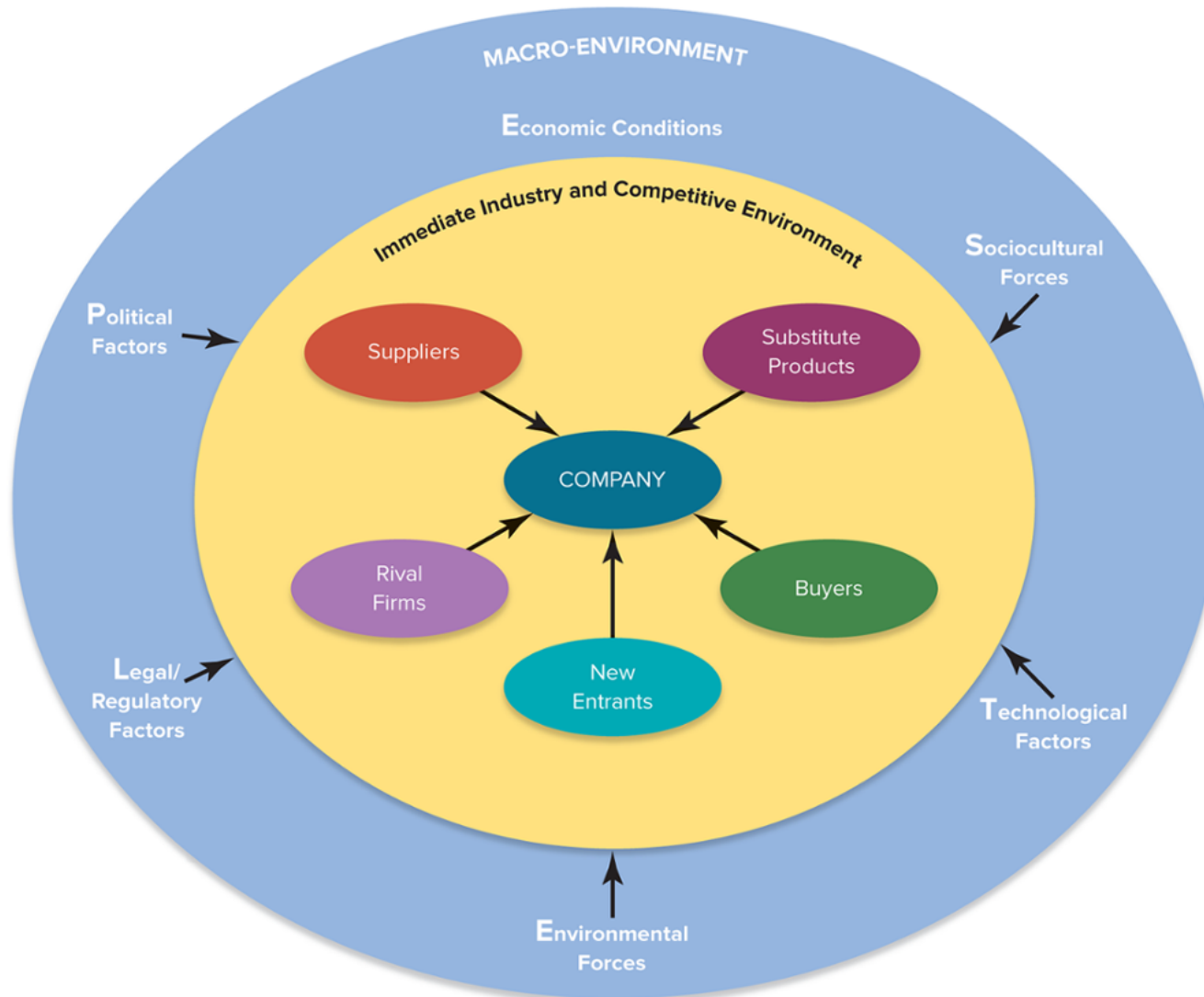
The macro-environment encompasses the **broad environmental context** in which a company's industry is situated that includes strategically relevant components over which the firm **has no direct control.**

THE STRATEGICALLY RELEVANT FACTORS IN THE COMPANY'S MACRO-ENVIRONMENT

◆ PESTEL Analysis

- Focuses on principal components of strategic significance in the macro-environment
 - ❖ Political factors
 - ❖ Economic conditions (local to worldwide)
 - ❖ Sociocultural forces
 - ❖ Technological factors
 - ❖ Environmental factors (the natural environment)
 - ❖ Legal and regulatory conditions

FIGURE 3.2 The Components of a Company's Macro-Environment



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Analytical Tools

- ◆ Thinking strategically about a company's competitive environment requires the manager to use some well validated concepts and analytical tools.
 - a. Five forces framework
 - b. The value net
 - c. Driving forces
 - d. Strategic groups
 - e. Competitor analysis
 - f. Key success factors

THE FIVE FORCES FRAMEWORK

◆ The five competitive forces

- Competition from rival sellers
- Competition from potential new entrants
- Competition from producers of substitute products
- Supplier bargaining power
- Customer bargaining power

USING THE FIVE-FORCES MODEL OF COMPETITION

Step 1

For each of the five forces, identify the different parties involved, along with the specific factors that bring about competitive pressures.

Step 2

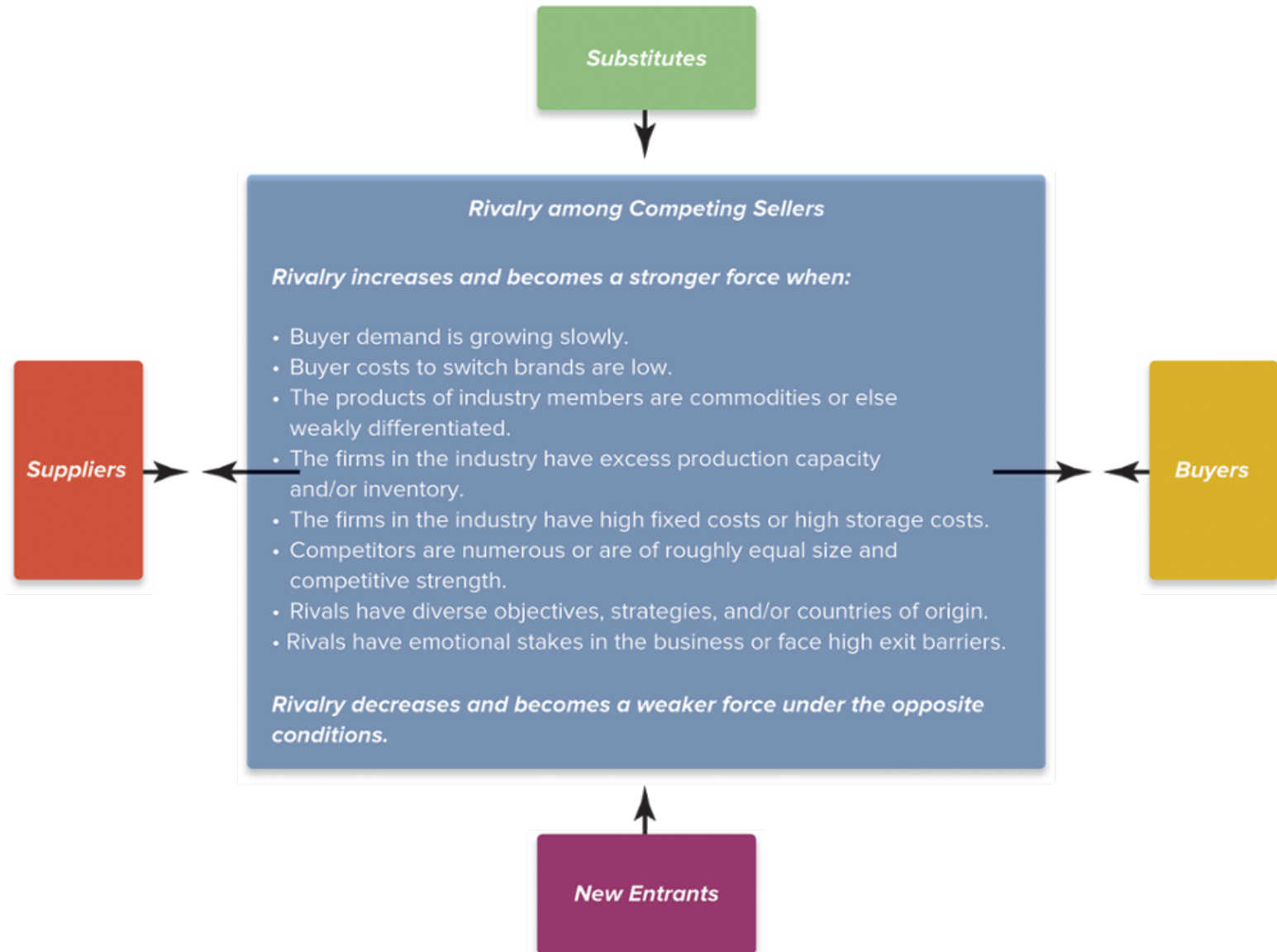
Evaluate how strong the pressures stemming from each of the five forces are (strong, moderate, or weak).

Step 3

Determine whether the five forces, overall, are supportive of high industry profitability.

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FIGURE 3.4 Factors Affecting the Strength of Rivalry



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Competitive Weapons

- ◆ With the analysis complete, rivals must select which competitive weapons to employ.
- ◆ Competitive weapons used in these highly dynamic contests will have a primary effect on price (P), cost (C), or value (V).

COMPETITIVE PRESSURES ASSOCIATED WITH THE THREAT OF NEW ENTRANTS

The competitive **threat of entry** is in a particular market depends on two classes of factors:

- the expected reaction of incumbent firms to new entry
- what are known as barriers to entry.

MARKET ENTRY BARRIERS FACING NEW ENTRANTS

- ◆ Incumbent **cost advantages** related to learning and experience, proprietary patents and technology, favorable locations, and lower fixed costs
- ◆ Strong **brand preferences** and customer loyalty
- ◆ Strong “**network effects**” in customer demand

MARKET ENTRY BARRIERS FACING NEW ENTRANTS

- ◆ **High capital requirements**
- ◆ Building a **network of distributors** or dealers and securing adequate space on retailers' shelves
- ◆ Restrictive **regulatory** and trade policies

COMPETITIVE PRESSURES FROM THE SELLERS OF SUBSTITUTE PRODUCTS

Competitive pressures are **stronger** when:

- a. Good substitutes are readily available and attractively priced
- b. Buyers view the substitutes as being comparable or better in terms of quality, performance, and other relevant attributes
- c. The costs that buyers incur in switching to the substitutes are low

COMPETITIVE PRESSURES FROM THE SELLERS OF SUBSTITUTE PRODUCTS

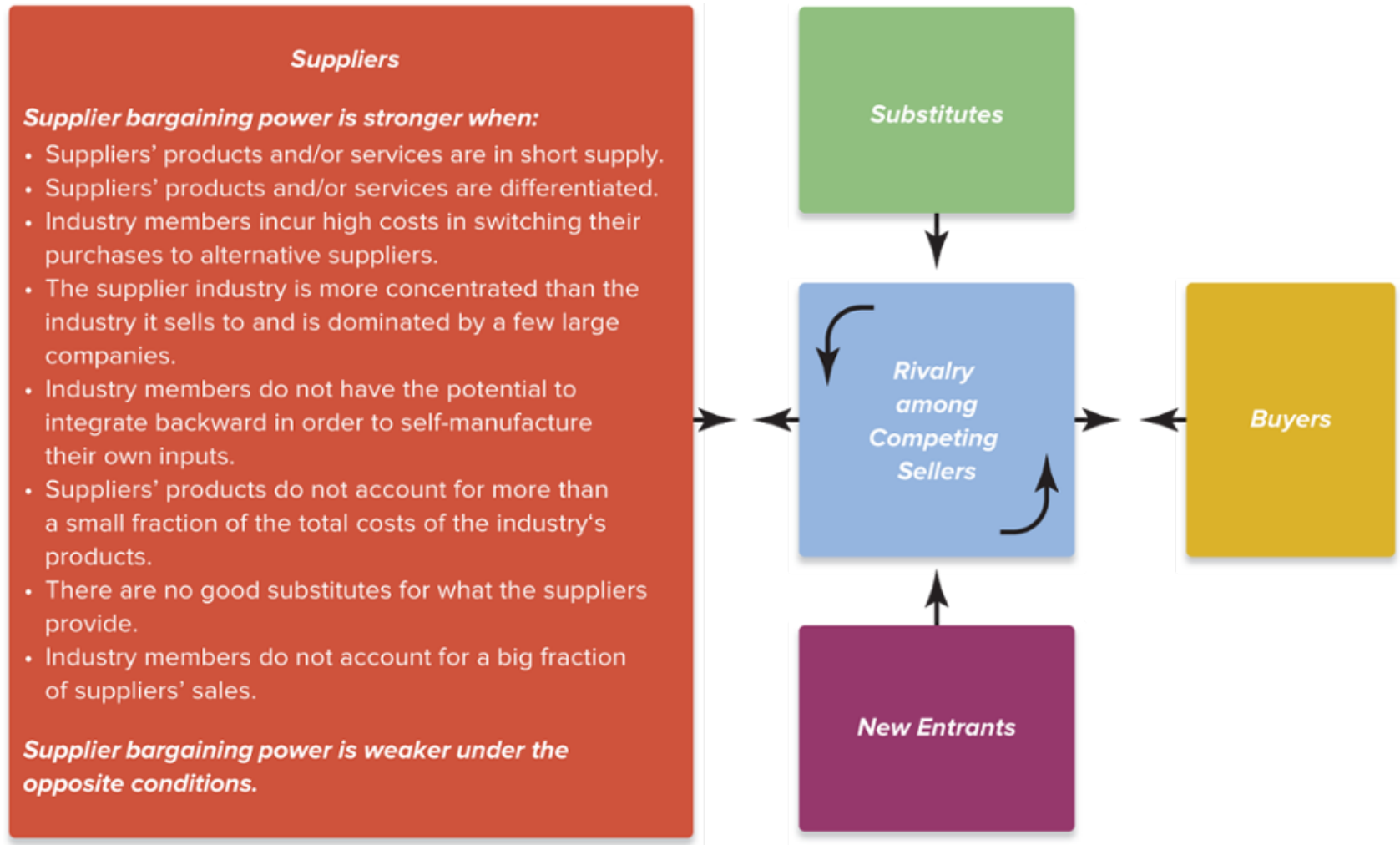
Company managers must identify the substitutes, which is less easy than it sounds since it involves:

- a. Determining where the industry boundaries lie
- b. Figuring out which other products or services can address the same basic customer needs as those produced by industry members.

COMPETITIVE PRESSURES STEMMING FROM SUPPLIER BARGAINING POWER

- ◆ Supplier bargaining power depends on:
 - Strength of demand for and availability of suppliers' products
 - Whether suppliers provide a differentiated input that enhances the performance of the industry's product
 - Industry members' costs for switching among suppliers
 - Size and number of suppliers relative to industry members
 - Possibility of backward integration into suppliers' industry
 - Fraction of the cost of the supplier's product relative to the total cost of the industry's product
 - Availability of good substitutes for suppliers' products
 - Whether industry members are major customers of suppliers

FIGURE 3.7 Factors Affecting the Bargaining Power of Suppliers



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COMPETITIVE PRESSURES STEMMING FROM BUYER BARGAINING POWER AND PRICE SENSITIVITY

- ◆ Buyer bargaining power considerations
 - Strength of buyers' demand for sellers' products
 - Degree to which industry goods are differentiated
 - Buyers' costs for switching to competing sellers or substitutes
 - Number and size of buyers relative to number of sellers
 - Threat of buyers' integration into sellers' industry
 - Buyers' knowledge of products, costs and pricing
 - Buyers' discretion in delaying purchases
 - Buyers' price sensitivity due to low profits, size of purchase, and consequences of purchase

IS THE COLLECTIVE STRENGTH OF THE FIVE COMPETITIVE FORCES CONDUCTIVE TO GOOD PROFITABILITY?

1. Intense competitive pressures from just one of the five forces may suffice to destroy the conditions for good profitability and prompt some companies to exit the business.
2. As a rule, the strongest competitive forces determine the extent of the competitive pressure on industry profitability

Class Exercise 1 Organic Food Industry

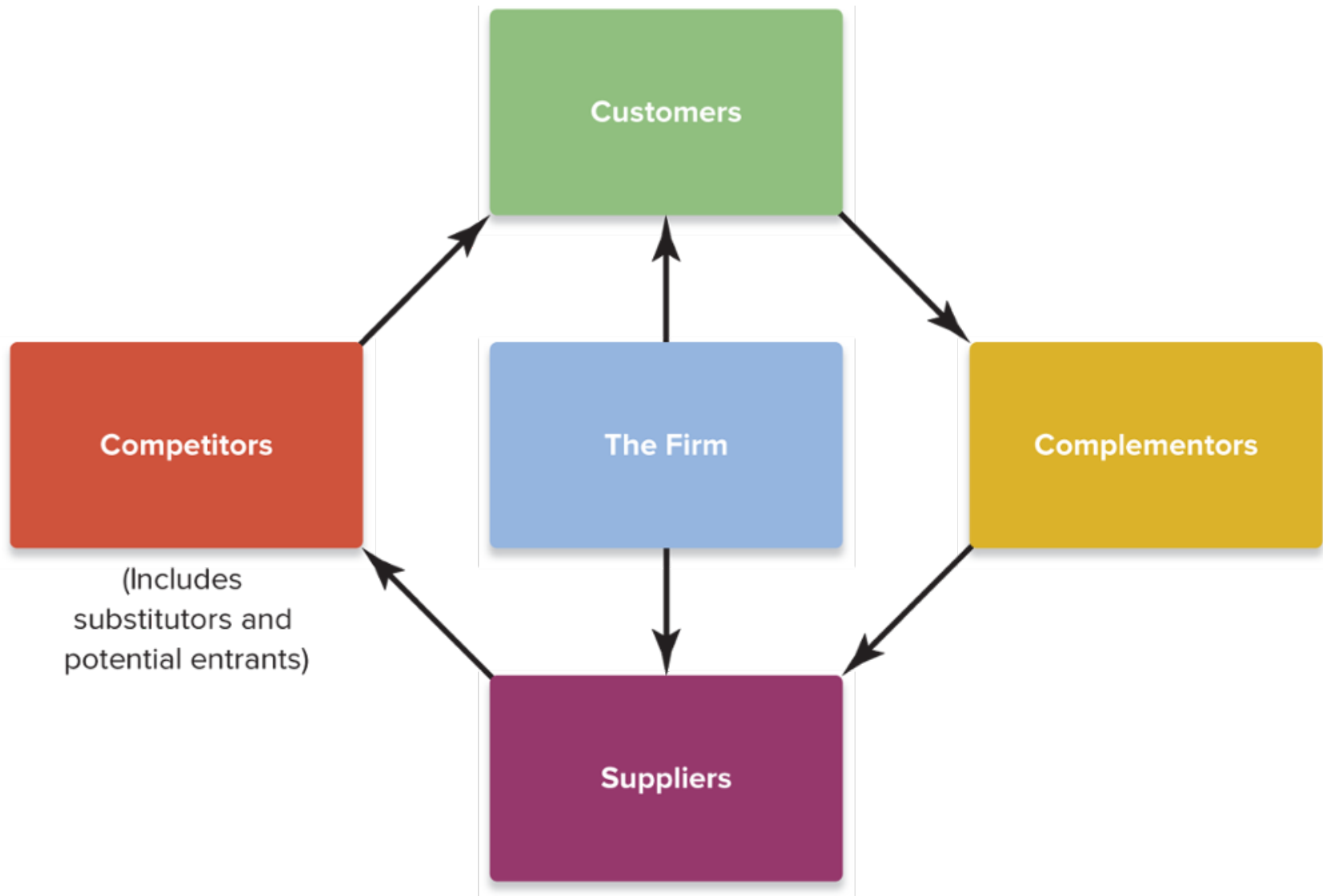
- ◆ **Draw a five-forces diagram similar to figure 3.2**
- ◆ The diagram should show that the five forces are: (1) firms in other industries offering substitute products, (2) buyers, (3) potential new entrants, (4) suppliers of raw materials, parts, components, or other resource inputs, and (5) rivalry among competing sellers in the industry.

COMPLEMENTORS AND THE VALUE NET

◆ How the **value net** differs from the five forces

- Focuses on the interactions of industry participants with a particular (focal) company
- Defines the category of *competitors* to include the focal firm's direct competitors, industry rivals, the sellers of substitute products, and potential entrants
- Introduces a new category of industry participant—***complementors***—producers of products that enhance the value of the focal firm's products when they are used together

FIGURE 3.9 The Value Net



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CORE CONCEPT

Driving forces are the major underlying causes of change in industry and competitive conditions.

INDUSTRY DYNAMICS AND THE FORCES DRIVING CHANGE

- ◆ Driving forces analysis has three steps
 - Identifying what the driving forces are
 - Assessing whether the drivers of change are, on the whole, acting to make the industry more or less attractive
 - Determining what strategy changes are needed to prepare for the impact of the driving forces

THE MOST COMMON DRIVERS OF INDUSTRY CHANGE

- Changes in the long-term industry growth rate
- Increasing globalization
- Emerging new Internet capabilities and applications
- Shifts in buyer demographics
- Technological change and manufacturing process innovation
- Product and marketing innovation
- Entry or exit of major firms
- Diffusion of technical know-how across companies and countries
- Changes in cost and efficiency
- Reductions in uncertainty and business risk
- Regulatory influences and government policy changes
- Changing societal concerns, attitudes, and lifestyles

STRATEGIC MANAGEMENT PRINCIPLE

The most important part of driving forces analysis is to determine whether the collective impact of the driving forces will increase or decrease **market demand**, make **competition** more or less intense, and lead to higher or lower **industry profitability**.

Strategic Group Mapping

Strategic group mapping is a technique for displaying the different market or competitive positions that rival firms occupy in the industry.

A **strategic group** is a cluster of industry rivals that have similar competitive approaches and market positions.

USING STRATEGIC GROUP MAPS TO ASSESS THE MARKET POSITIONS OF KEY COMPETITORS

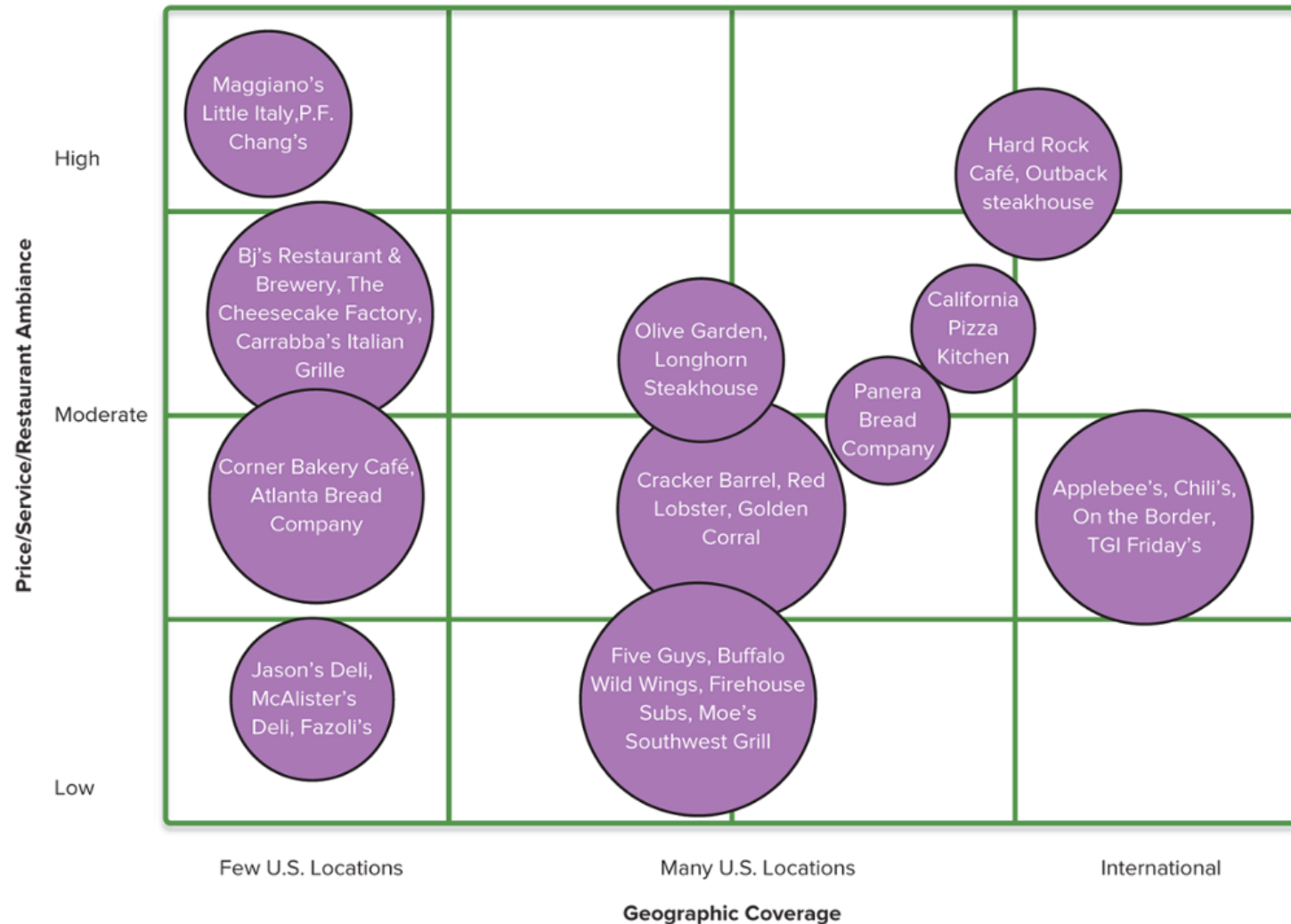
◆ Constructing a strategic group map

- Identify the competitive characteristics that delineate strategic approaches used in the industry.
- Plot the firms on a two-variable map using pairs of competitive characteristics.
- Assign firms occupying about the same map location to the same strategic group.
- Draw circles around each strategic group, making the circles proportional to the size of the group's share of total industry sales revenues.

TYPICAL VARIABLES USED IN CREATING GROUP MAPS

- ◆ Price and quality range (high, medium, low)
- ◆ Geographic coverage (local, regional, national, global)
- ◆ Product-line breadth (wide, narrow)
- ◆ Degree of service offered (no frills, limited, full)
- ◆ Distribution channels (retail, wholesale, Internet, multiple)
- ◆ Degree of vertical integration (none, partial, full)
- ◆ Degree of diversification into other industries (none, some, considerable)

Illustration Capsule 3.1 Comparative Market Positions of Selected Firms in the Casual Dining Industry: A Strategic Group Map Example



Footnote: Circles are drawn roughly proportional to the sizes of the chains, based on revenues.

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Class Discussion

- ◆ According to the diagram, which companies comprise the strategic group of firms to which Olive Garden belongs?
- ◆ Why is the circle containing Olive Garden bigger than the one containing Panera Bread?

Class Exercise 2

- ◆ According to the diagram, which are Applebee's closest competitors?
- ◆ With which strategic group does California Pizza Kitchen compete the least, according to this map?
- ◆ Why do you think no casual dining chains are positioned in the area above the Olive Garden's group?

Examining the Comparative Market Positions of Strategic Groups in the Casual Dining Industry

- ◆ Which strategic group is located in the least favorable market position? Which group is in the most favorable position?
- ◆ Which strategic group is likely to experience increased intragroup competition?
- ◆ Which groups are most threatened by the likely strategic moves of members of nearby strategic groups?

THE VALUE OF STRATEGIC GROUP MAPS

- ◆ Maps are useful in identifying which industry members are close rivals and which are distant rivals.
- ◆ Not all map positions are equally attractive
 1. Prevailing competitive pressures from the industry's five forces may cause the profit potential of different strategic groups to vary.
 2. Industry driving forces may favor some strategic groups and hurt others.

COMPETITOR ANALYSIS

◆ Competitive intelligence

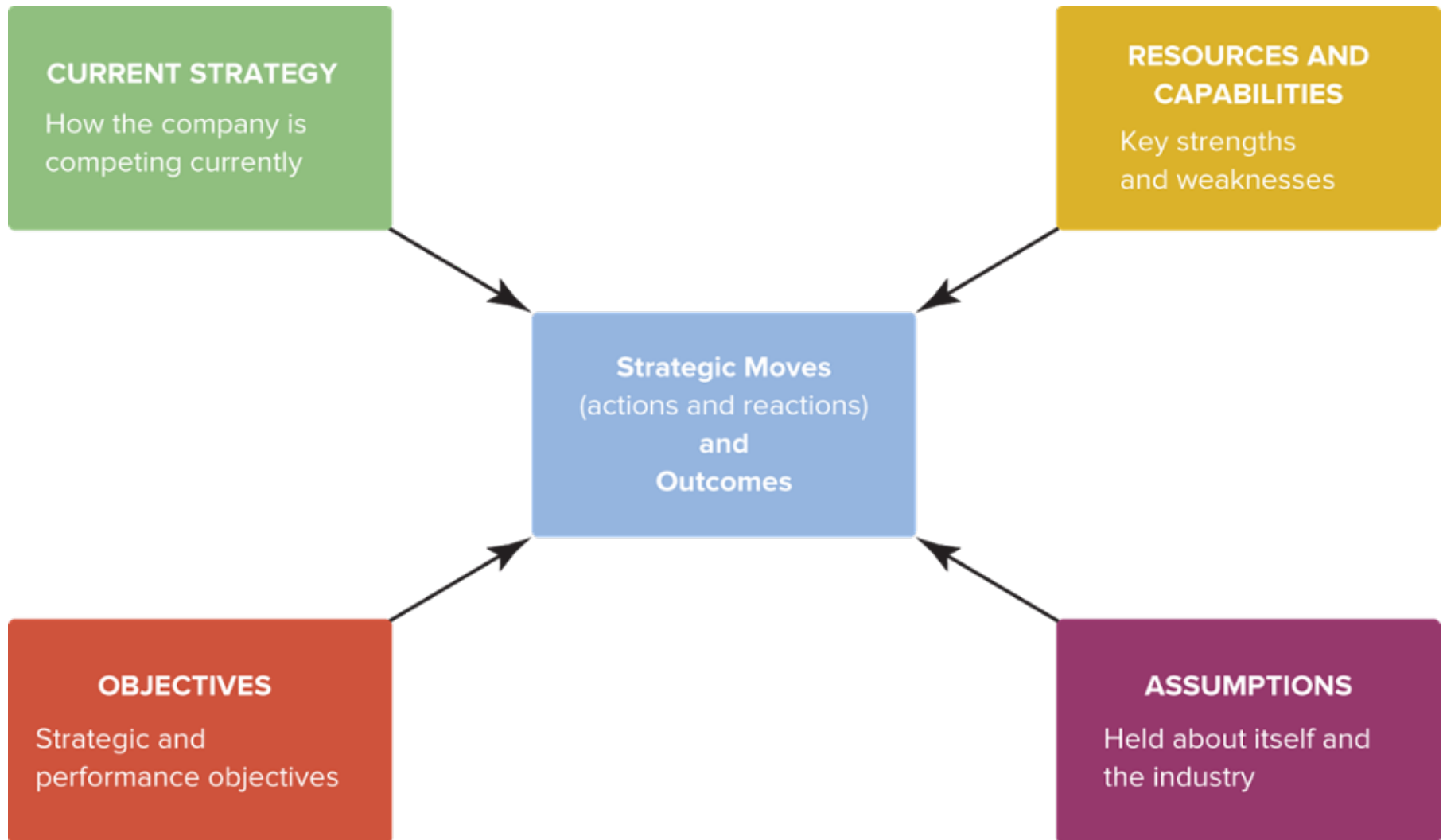
- Information about rivals that is useful in anticipating their next strategic moves

Studying competitors' **past behavior and preferences** provides a valuable assist in anticipating what moves rivals are likely to make next and outmaneuvering them in the marketplace.

A FRAMEWORK FOR COMPETITOR ANALYSIS

- ◆ Indicators of a rival firm's likely strategic moves and countermoves
 - The rival firm's current strategy
 - The rival firm's objectives
 - The rival firm's capabilities
 - The rival firm's assumptions about itself and its industry

FIGURE 3.10 A Framework for Competitor Analysis



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CREATING A STRATEGIC PROFILE OF A RIVAL COMPETITOR FIRM

◆ Current strategy

- **How is the competitor positioned in the market?**
(Simulation Practice Question)
- What is the basis for its competitive advantage?
- What kinds of investments is it making (as an indicator of its expected growth trajectory)?

◆ Objectives

- What are its financial performance objectives?
- What are its strategic objectives?
- How well is it performing in meeting its objectives?
- Is it under pressure to improve its performance?

CREATING A STRATEGIC PROFILE OF A RIVAL COMPETITOR FIRM (2 of 2)

◆ Resources and capabilities

- What is the competitor's current set of resources and capabilities?
- What weaknesses does it have?
- Which capabilities is it making efforts to obtain?

◆ Assumptions

- What do the competitor's top managers believe about their strategic situation?
- How will their beliefs affect the competitor's behavior in the market?

CORE CONCEPT

Key success factors are the strategy elements, product and service attributes, operational approaches, resources, and competitive capabilities that are essential to surviving and thriving in the industry.

KEY SUCCESS FACTORS

◆ Key success factors (KSFs)

- Are the strategy elements, product and service attributes, operational approaches, resources, and competitive capabilities that are necessary for competitive success by any and all firms in an industry.
- These vary from industry to industry, and over time within the same industry, and in importance as drivers of change and competitive conditions change.

IDENTIFICATION OF KEY SUCCESS FACTORS

- ◆ On what basis do buyers of the industry's product choose between the competing brands of sellers? What product attributes and service characteristics are crucial to competitive success?
- ◆ Given the nature of competitive rivalry prevailing in the marketplace, what resources and competitive capabilities must a firm have to be competitively successful?
- ◆ What shortcomings are almost certain to put a firm at a significant competitive disadvantage?

THE INDUSTRY OUTLOOK FOR PROFITABILITY

- ◆ An industry environment is fundamentally attractive if it presents a company with good opportunity for above-average profitability.
- ◆ An industry environment is fundamentally unattractive if a firm's profit prospects in the industry are unappealingly low.

INDUSTRY ATTRACTIVENESS IS NOT THE SAME FOR ALL PARTICIPANTS

- ◆ Industry outsiders may conclude that they have the resources to easily hurdle the barriers to entering an attractive industry while other outsiders may find the same industry unattractive because they do not want to challenge market leaders and have better opportunities elsewhere.
- ◆ A particular industry's attractiveness depends in large part on whether a company has the resources and capabilities to be competitively successful and profitable in that environment.