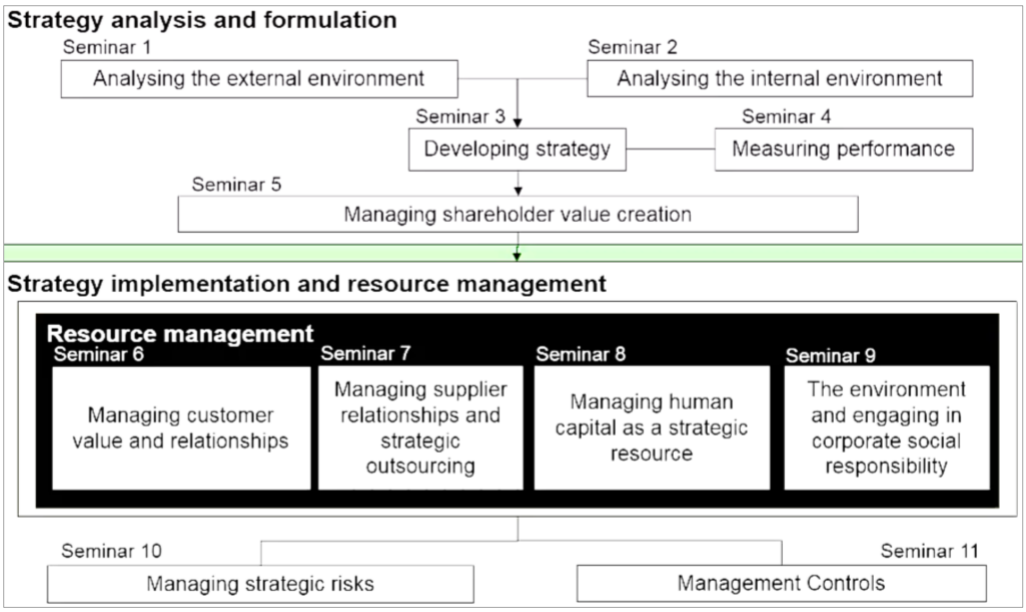
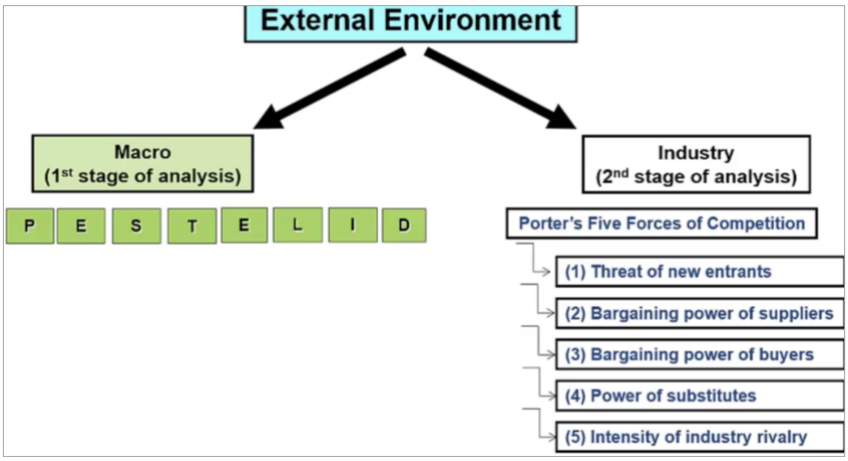


Seminar 1 – Analysing the External Environment

- A company's external environment can be viewed as comprising of three layers:
  1. Macro environment (broadest layer)
  2. Industry environment
  3. Competitor's environment

  FOCUS



Defining the industry

- Industry: A group of organisations or business units producing close substitutes
- Generally, the industry definition should include a *geographic* element
  - e.g. 'Sydney girls schools' vs 'Eastern Suburbs girls schools' industries may yield different outcomes even though a similar analysis is being conducted
- A narrow definition makes it easy to analyse the industry but runs the risk of missing new trends, which often come from new entrants or substitutes
- A wide definition makes it harder to analyse because it is easy to become lost in the mass of data
- The definition is neither right nor wrong, it simply determines what information is analysed under a particular heading
  - Under a narrow definition, competing products from outside the narrow definition are not ignored but are handled as substitutes or new entrants in the industry analysis framework
- If an organisation competes internationally, defining the industry geographically (e.g. 'the international xx' industry) often creates a problem, as different countries have different environments and cannot be generalised
  - Solution: Conduct country- or regional-specific analyses

Analysing the macro-environment

- Time frame of analysis: Long term for the particular industry (generally, 3-5 years)
- 8 macro-environment trends that may have an impact on the industry:

1. **P**olitical	Industries in smaller economy (e.g. Australia, NZ and Singapore) are affected intimately by political influence and legislation. Some major government issues for the future: • Debt/income levels • Immigration policy and management • Worker/retiree ratios • Free trade vs national workforce support • Pension funding • Healthcare funding • Climate change adaption • Old age/end-of-life medical and ethical mgmt
2. **E**conomic	Economic indicators that affect an industry could include: • Gross national product • Personal disposable income growth rates • Inflation rates • Unemployment levels • Interest rates • Exchange rates • Taxation rates
3. **S**ocial/cultural	Spotting trends and understanding new attitudes is critical for future success. Some major sociocultural issues:

	• Aged care • Environmentalism • Flexibility of employment conditions • Global issue mobilisation • Growth/size of population • Immigration management • Labour/people mobility • Obesity • Social networking
4. Technological	Most industries are affected. Some important technologies of the future: • 3D printing • AI • Cloning and bioengineering • Fast broadband/mobile communications • Genetic engineering • Holographic radiation • Nano technology • Voice-activated computed
5. Environmental	Increasingly, industries are facing the unsustainability of existing commercial practices in terms of their effects on the natural environment. Some major problems affecting most industries: • Lack of water • Water quality and salinity • Increasing greenhouse gas emissions • Deforestation • Global warning • Decreasing non-renewable resources There will be increasing pressure on individual organisations and industries to improve their environmental impacts.
6. Legal	Apart from specific legislation which comes from political influences, developments in the legal system can also have an important influence on an industry. E.g.: • The responsibility of the fast food industry for the obesity epidemic, US EPA decision that CO_2 is a health hazard and introduction of the carbon tax are recent examples of emerging legal issues the industry level
7. International	Organisations compete internationally as 'normal' business strategy. Therefore, it is therefore to consider international trends. 6 trends that are likely to impact the size of international business 1. Increasing numbers of customers in emerging economies 2. A shift of activities between and within regions 3. Greater ease in obtaining information and developing knowledge 4. Increasingly flexible international labour markets 5. increasing constraints in supply or usage of natural resources 6. Increasing communication due to technical innovation
8. Demographic	Organisations assume that their market will simply grow by x% each year. But, the key drivers are population growth, inflation and some real increase in performance. Note, growth in the general population may not translate to growth in a specific population for a particular industry. Some demographic trends in Australia by 2020: • Australia's population is expected to increase to 27 million • Life expectancy of males (at birth) will be 81, and 86 for females • More than 1 in 5 Australians will be aged over 60 • % of Gen Y (born between 1980 – 1994) in the workforce will increase from 21% to 35% • % of Baby Boomers in the workforce will have decreased from 33% to 15%

Example: Discuss the Macro Environment of Qantas

Step 1 – Identify a general trend using the PESTELID framework		**Step 2** – Explain the trend by conducting research	**Step 3 and 4** – Is the trend an opportunity or a threat? Justify
Trend	**Example**	**Explain the trend**	**O or T? Justify**
Social/ cultural	Obesity epidemic	According to news.com.au (2014), "The largest increase in adult obesity in the world occurred in Australasia in the past 30 years, according to the damning new league table of world fat rates. Half of Australians who are overweight are now classified as obese (a BMI over 30) a new study by The Institute for Health metrics and Evaluation at the University of Washington shows. 34 years ago Australia ranked 63rd in the world for obesity, by 2000 we were 41st in the world and by last year we ranked 25th." *Ensure that the identified trend affects **most** industry – not just the industry that Qantas is in. Obesity epidemic can affect various industries (e.g. retail, manufacturing, aviation, etc.)*	Threat. Current aircraft seat dimensions are unable to cope with larger body frames and may lead to increased customer complaints. In addition, research has found that heavier passengers burn additional gallons of fuel per year. Increases operating and capital expenses. *A trend can be both an opportunity and a threat to a company. In MA2, take a position and justify.*

Industry Analysis

To examine the industry environment, use **Porter's Five Forces of Competition**, which can be described as **low or high**

Threat of new entrants

Factors that influence the threat of new entrants to the industry include:

- ***Economies of scale*** – barrier to entry due to the need for large-scale production to be cost-efficient
- ***Proprietary product differences*** – where existing products are unique in some way and these differences cannot be replicated (e.g. if something is patented)
- ***Brand identity*** – if existing producers in the industry have established their brands. Usually, brand identity is related to proprietary product differences that have created the brand
- ***Buyer/customer switching costs*** – it is difficult to switch from an existing producer to a new entrant, even if the new entrant's product is more superior
- ***Capital requirements*** – related to the economies of scale, high capital requirements limit the number of potential new entrants
- ***Access to distribution*** – inability to distribute the product can kill even the best product
- ***Absolute cost advantages*** – if existing organisations have absolute cost advantages over new entrants, new entry is difficult. Such cost advantages may be built up through:
  - Production experience
  - Resulting in efficiencies that are difficult to replicate
  - Control over cheap raw materials and/or low-cost design, operation or distribution
- ***Government policy*** – a barriers in many small-economy or developing countries, such as China and India.
  - Airlines, post, radio, TV, telephones, energy utilities, water supplies, banking and education are some of the industries that have been owned or highly regulated by the government
  - Government policy on foreign investment can prevent foreign firms entering these markets
- ***Expected retaliation*** – retaliation from existing competitors

Bargaining power of suppliers

To identify the important suppliers, look at the industry cost structure and determine the % of different costs.

Factors that influence the power of suppliers to the industry include:

- ***Differentiation of inputs*** – if a supplier's input is crucial to the final product, that supplier will have power to maintain their prices
- ***Switching costs of suppliers and firms in the industry*** – e.g.:
  - Some suppliers supply their products in special containers which need to be refilled once installed → lock the producer into a supplier because only one supplier has the equipment to refill the container
  - Use of long-term contracts for maintenance or service; formation of strategic alliances with suppliers
- ***Supplier concentration relative to industry concentration*** – small no. of suppliers → more power for suppliers
- ***Importance of volume to suppliers*** – if the volume being sold to the industry is important to suppliers → more willing to bargain (e.g. supermarket chains have a great deal of power over suppliers)
- ***Cost relative to total purchases in the industry*** – if the supplier's cost is a small part of the total cost of supplies, it gives the suppliers power to raise prices and increase margins without experiencing retaliatory action
- ***Information about supplier's product*** – if the supplier's product is complex, intangible or unique, the industry may have difficulty understanding just exactly what it is the are buying and may be wary of substitutes
  - E.g. suppliers of pharmaceutical products have power
- ***Supplier profitability*** – unprofitable suppliers will be unable to bargain. Vice versa for profitable suppliers
- ***Decision maker's incentives*** – often, there are incentives for the purchasing decision maker (e.g. free tickets, free trips, conferences in exotic locations to learn about the supplier' product). This is likely to give power to the supplier over the decision maker, regardless of the relative merits of the individual supplier's product
- ***Threat of forward integration*** – if suppliers are large organisations relative to those in the industry and/or if suppliers have the power to enter the industry, they will have considerable power
  - E.g. petrol refiners are able to operate their own petrol retailing outlets, giving them a role in setting retail price benchmarks and also providing them with information on the cost structures of retailers

Bargaining power of buyers

Essentially the mirror image of the bargaining power of suppliers to it. Factors include:

- Differentiation of outputs
- Switching costs of buyers
- Industry concentration relative to buyer concentration
- Importance of volume to buyers
- Cost relative to total buyer purchases
- Buyer information about the industry output
- Buyer profitability
- Decision makers' incentives
- Threat of backward integration

Power of substitutes

The "power of substitute" refers to products or services substitute from another industry, not within the industry that you are analysing. E.g. Virgin Airline is not a substitute for Qantas, but a train and bus can be substitute. The power of substitutes depends on the following factors:

- ***Relative price/performance of substitutes*** – all substitutes have a price and a performance level, as these changes relative to products within the industry, the threat of each substitute will change
- ***Switching costs*** – how easy is it for buyers to switch from the industry product to a substitute?
- ***Buyer propensity to substitute*** – if it makes economic sense for buyers to switch