# Seminar 1 – Analysing the external environment

## 1. Understand what is meant by SWOT analysis and its purpose

## 2. Identify opportunities and threats based on an analysis of an organisation's external environment by:

- **Macro-environment** refers to those general influences that affect an industry.
  - Macro-environment issues tend to affect many industries, but we are concerned with their effect on the growth of the particular industry we are analysing.
- **Industry-environment** refers to factors within the industry that affect both its profitability and the competitive position of organisations within it.
  - Our consideration of the industry includes analysing not only the organisation, its competitors and strategic groups, but also their buyers (customers), suppliers, substitutes and potential new entrants.
- An **industry** is a group of organisations or business units producing close substitutes.

### 2.1. Analysing the macro environment using the PESTELID framework

- In analysing the macro-environment (relates to opportunities and threats), many analysts forget the purpose of the analysis. We are interested in two questions:
  1. What are the major trends affecting the *future growth* of the industry?
  2. In summary, will this industry *grow faster or slower than average* industry growth rates?

**Political Trends**

- One political trend in many countries is the issue of government debt levels.
  - This issue is not directed at any particular industry, yet it is having profound effects on many industries where government-owned authorities have been major competitors or purchasers.
- Easier to monitor are changes in specific legislation – planned or actual.
  - Governments influence not only through legislation, but also through government agencies and government administrative regulation.
  - For instance, the ACCC has been a very active enquirer into industry practices and has caused substantial changes in many industry structures and practices, as well as preventing a number of planned industry consolidations which it felt would reduce competition.

**Economic Trends**

- Economic indicators which might affect an industry could include gross national product and personal disposable income growth rates, inflation rates, unemployment levels, interest rates, exchange rates, taxation rates and wage rates.
  - For example, the demand for international airline travel is highly affected by growth in personal disposable income; that is, as individuals' disposable income increase, their demand for international airline travel increases even faster.

**Social/Cultural Trends**

- Often difficult to capture in strategic analysis, as they change almost imperceptibly.
  - Nevertheless, spotting trends and understanding new attitudes is important for future success.
  - For instance, changing marital/partner and working relationships have created new markets and new needs, such as the demand for more convenience foods, longer shopping hours/online shopping, smaller houses, increased child care and online dating.
  - The role that social media, such as FB, Twitter and LinkedIn, as well as many other online channels, play in influencing customer attitudes and decisions remains widely underestimated and misunderstood by many traditional organisations.

**Technological Trends**

- Most industries are affected by technological revolutions.
  - Online technology for purchasing and selling goods and services has changed convenience levels and expectations, introduced international/global customers, suppliers and competitors to industries, and created untold new products and services (e.g. apps, social media) that are a direct result of the technology.
  - Cloud computing, Wi-Fi, cheap global communications, global outsourcing and so on are also impacting internal operations of most organisations and changing the value chain and consequent business model.
  - Many print media sources (e.g. Harvard Business Review) publish annual lists of 'big ideas' that organisations may need to consider in their future plans.

**Environment Trends**

- Industries are facing the unsustainability of existing commercial practices in terms of their effects on the natural environment.
  - Lack of water, water quality and salinity, increasing greenhouse gas emissions, deforestation, global warming and decreasing non-renewable resources are just a few of the problems.
  - Most of the changes required will likely be forced by government or powerful single-issue lobby groups, because organisations do not include some of the social and environmental costs of their actions in their costings and because they do not want to incur extra costs when competitors in other locations do not have to follow suit.

**Legal Trends**

- Apart from specific legislation which comes from political influences, developments in the legal system can also have an important influence on an industry.
  - For instance, the increased willingness of courts to award damages against professionals for malpractice has led directly to the move by professionals away from partnership structures with unlimited personal liability towards corporate structures with limited liability.

**International Trends**

- Many organisations compete internationally as a 'normal' business strategy.
  - Suppliers have become increasingly overseas based, due to the reductions of trade barriers, changing foreign exchange rates, differential labour rates, and the increased speed, availability and low cost of international communication of new ideas and good practice.
  - Six trends that may impact on the size of international business – increasing numbers of customers in emerging economics; a shift of activities between and within regions; greater ease in obtaining information and developing knowledge; increasingly flexible international labour markets; increasing constraints in supply or usage of natural resources; and increasing communication as a result of technical innovation.

**Demographic Trends**

- Organisations assume that their market will simply grow by X% each year.
  - But key drivers are population growth, plus inflation, plus some real increase in performance.
- However, growth in the general population may not translate to growth in a specific population for a particular industry.
  - For instance, a reducing birth rate will result in less demand for primary schools (then high schools and universities) and products associated with children.
  - On the other hand, the number of elderly people is expanding as life expectancies increase. This has implications for hospitals, retirement villages and medical businesses.
- Much of the demographic data is available, so that its influence should be quite predictable.

## 2.2. Analysing the industry environment using the Porter's Five Forces of Competition framework

- The aim of industry analysis is to answer the following:
  - What is the *current profitability* of the industry?
  - What is the *expected future profitability* of the industry?
- **Five forces analysis** refers to the analysis of the impact of the threat of new entrants, suppliers, buyers, substitutes and rivals on profitability in an industry.

**1 Threat of new entrants**

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

- **Economies of scale**: Barrier to entering an industry is where there is a need for large-scale production in order to be cost-efficient.
- **Proprietary product differences**: Where existing products are unique in some way and these differences cannot be replicated, it is difficult to enter the industry. E.g. IP for pharmaceuticals
- **Brand identity**: If existing producers in the industry have established their brands, this can be an effective barrier to entry.
- **Buyer/customer switching costs**: If it is difficult to switch from an existing producer to a new entrant, even if the new entrant's product is superior, this can be a significant barrier to new entrants.
- **Capital requirements**: Related to the economies of scale argument, high capital requirements limit the number of potential new entrants. New entrants with good ideas but without finance are unable to break into these industries.
- **Access to distribution**: Inability to distribute the product can kill even the best products.
- **Absolute cost advantages**: Clearly, 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**: Remains a barrier in some countries. Airlines, energy utilities, water suppliers, banking and education are some industries that have either been government owned or have been highly regulated by government. Government policy on foreign investment in some countries can also prevent foreign firms entering these markets.
- **Expected retaliation**: A barrier to entry is retaliation from existing competitors.

**2 Bargaining power of suppliers**

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, supplier will have power.
- **Switching costs of suppliers and firms in industry**: Some suppliers supply their products in special containers which need to be refilled once installed in the producer's plant. Consequently, this may lock the producer into a particular supplier because only that one supplier has the equipment needed to refill the container.
- **Supplier concentration relative to industry concentration:** Small number of suppliers means that suppliers will have power.
- **Importance of volume to suppliers:** If the volume being sold to the industry is important to suppliers, they will be concerned about it and hence be willing to bargain.
- **Cost relative to total purchases in the industry:** If the supplier's cost is a small part of the total cost of supplies, the industry will not be too concerned about it, thus giving suppliers the 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 they are buying and may be wary of substitutes. This gives suppliers power relative to the situation where the industry knows exactly what it is they are buying and how it works.

- **Supplier profitability:** If suppliers are unprofitable, they will be unable to bargain and are likely to make close to their best offer at the first opportunity.
- **Decision makers' incentives:** Often, in purchasing, there are incentives for the purchasing decision maker. The aim of this, and its likely effect, is 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, then they will have considerable power.

**3 Bargaining power of buyers**

This is essentially the mirror image of the bargaining power of suppliers to it. This time the industry is the supplier, not the buyer, in the transaction.

- 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

**4 Power of substitutes**

The power of substitutes depends on the following factors:

- **Relative price/performance of substitutes**: All substitutes have a price and a performance level.
  - For instance, in the alcoholic beverage industry, non-alcoholic beverages are substitutes.
  - If the performance demanded of the alcoholic beverage is that the drinker becomes more relaxed, the performance of non-alcoholic beverages is poor. However, if the performance demanded is refreshment, the non-alcoholic beverages may perform well.
  - The non-alcoholic substitutes are quite cheap, so their price performance for refreshment is better. The picture is less clear if alcoholic performance is demanded.
- **Switching costs**: How easy is it for buyers to switch from the industry product to a substitute?
- **Buyer propensity to substitute**: It may make economic sense for buyers to switch, but in some industries, they do not.

**5 Intensity of industry rivalry**

- **Industry growth rate**: If the industry is growing fast, the amount of industry rivalry will be relatively low, because there will be room for most or all organisations to prosper. If there is no industry growth, as occurs in mature or declining industries, growth for one organisation can only come at the expense of another organisation.
- **High fixed costs**: If fixed costs are a high proportion of total costs, opportunities for marginal cost pricing (pricing below full cost) will exist and will be marginally profitable, at least in the short term.
  - Hence, high fixed costs will tend to lead to high rivalry.
- **Intermittent overcapacity**: In some industries, capacity must be added in large lumps. Such industries experience periods where demand exceeds supply, followed by expansion of capacity of many competitors simultaneously.
  - Results in severe rivalry during the period of supply exceeding demand and the industry is characterised by periods of large profits and large losses.
- **Product differences**: Rivalry between competitors can be reduced to the extent that their products are differentiated, resulting in market segmentation. On the other hand, if product differences are virtually non-existent, competition can be extreme.

- **Brand identity**: If brands are important, it generally reflects perceived product differences between competitors and this assists in reducing competition within the industry.
- **Switching costs**: If it is easy for buyers to switch from one competitor's product to another, industry rivalry will be increased.
- **Informational complexity**: If products in the industry are complex, buyers will find it difficult to understand product differences and may not be willing to invest the time to understand those differences, thus reducing rivalry.
- **Concentration and balance**: If there are relatively few competitors (i.e. concentrated) and each competitor is satisfied with its position in the industry (i.e. balance exists), industry rivalry will be relatively low.
- **Diversity of competitors**: If competitors have different backgrounds and interests, they are likely to view the industry differently. Understanding the backgrounds of competitors (e.g. key stakeholders, corporate strategy, history) is important in understanding why they compete in the way they do and in predicting how they are likely to compete in future.
- **Corporate stakes**: A related issue is the commitment of competitors to the industry.
  - Some organisations are divisions of diversified conglomerates, and their parents may not be committed to the industry, if financial results are poor.
  - However, single-business firms may be prepared to live through poor results, because this is their only reason for existing and the productive resources of the company are unable to be utilised elsewhere.
- **Exit barriers**: If it is difficult or costly to withdraw from an industry, competitors may decide to stay, even if they are making losses.

# Seminar 2 – Analysing the internal environment

## 1. Understand what is meant by SWOT analysis and its purpose

## 2. Recognise strengths and weaknesses based on an analysis of an organisation's internal environment by:

<u>The nature of competitive advantage</u>

- For any company, the creation and sustainability of competitive advantage is a main consideration when it formulates its strategy.
  - Competitive advantage is displayed by superior performance and value created for the organisation's customers.
- **Competitive advantage** refers to a characteristic, feature or opportunity that an organisation possesses that will make it more attractive than its competitors.
- **Value** refers to a product's performance characteristics and attributes for which customers are willing to pay.
- The ability of organisations to develop a competitive advantage depends on their ability to position their business system in the business environment.
- **Business system** refers to the resources (inputs), activities (throughputs) and product/service offerings (outputs) intended to create value for customers.

<u>Product/service offerings</u>

- **Market segmentation** is the process that clusters people with similar needs into identifiable groups.
  - The most common characters on which customers' needs vary include demographic factors (e.g. age and income), socio-economic factors (e.g. stage in the family life cycle and social class), geographic factors (e.g. national and regional differences), psychological factors (e.g. lifestyle

- A target establishes the level of performance or rate of improvement required for a measure.
- By comparing current performance to the target performance, employees and managers can determine whether the company is achieving its desired level of performance.
- Thus, performance measures serve multiple purposes: communication, clarification, motivation, feedback and evaluation.

### 3.3. Creating a Strategy Map

- Companies use a picture, called a **strategy map**, to illustrate the causal relationships among the strategic objectives across the four BSC perspectives.
- Developing a strategy map follows a logical process:
  - First, identify the long-run financial objectives, the ultimate destination for the strategy.
  - Then, in the customer perspective, select the targeted customers that will generate the revenues for the new strategy and the objectives for the value proposition offered to attract, retain and grow the business with these customers.
  - In the process perspective, select objectives that create and deliver the customer **value proposition** and also improve productivity and efficiency to improve financial performance measures.
  - Finally, identify the employee skills, information needs, and company culture and alignment that will drive improvement in the critical processes.

**Financial Perspective**

- The BSC's **financial perspective** contains objectives and measures that represent the ultimate success measures for profit-seeking companies.
  - Financial performance measures, such as operating income and ROI, indicate whether the company's strategy and its implementation are increasing shareholder value.
- The company's financial performance improves through two basic approaches: **productivity improvements** and **revenue growth**.
- Productivity improvements have TWO components.
  - First, companies reduce costs by lowering direct and indirect expenses.
    - ❖ Such cost reductions enable a company to produce the same quantity of outputs while spending less on people, materials, energy and supplies.
  - Second, by utilising their financial and physical assets more efficiently, companies reduce the working and fixed capital needed to support a given level of business.
    - ❖ For example, companies can reduce the inventory levels required to support a given level of sales by implementing JIT production processes. They can support a higher level of sales with the same investment in plant and equipment by reducing unexpected shutdowns and unscheduled downtime on equipment.
- Revenue growth has TWO components.
  - First, companies can generate more revenue and income from existing customers, such as by selling them additional products and services beyond the first product or service they purchase.
  - Second, companies generate additional revenues by introducing new products, selling to new customers and expanding operations into new markets.

*Exhibit: Financial Perspective Objectives*

| Increase shareholder value | | | |
|---|---|---|---|
| **Achieve productivity improvements** | | **Generate revenue growth** | |
| **Improve cost structure** | **Increase asset utilisation** | **Enhance existing customer value** | **Expand revenue opportunities** |
| Lower unit costs<br>Reduce general and administrative expenses | Achieve higher capacity utilisation<br>Reduce working capital requirements | Grow sales with existing customers<br>Improve customer profitability | Generate sales from new products, new customers and new markets |

*Exhibit: Financial Objectives and Measures*

| Objectives | Measures |
|---|---|
| Increase shareholder value | Return on capital employed (ROCE)<br>Economic value added<br>Market-to-book ratio |
| Improve cost structure | Cost per unit, benchmarked against competitors<br>General, selling and administrative expenses per unit of output or as % of sales |
| Increase asset utilisation | Sales/asset ratio<br>Inventory turnover ratio<br>% capacity utilisation |
| Enhance existing customer value | % growth in existing customers' business<br>% revenue growth |
| Expand revenue opportunities | Revenue % from new products<br>Revenue % from new customers |

## Customer Perspective

- The **customer perspective** should describe how a company intends to attract, retain and deepen relationships with targeted customers by differentiating itself from competitors.

| Objectives | Measures |
|---|---|
| **Achieve customer satisfaction and loyalty** | Customer satisfaction in targeted segments<br>% repeat customers<br>% growth in revenue from existing customers<br>Willingness to recommend |
| **Acquire new customers** | # of new customers acquired<br>Cost per new customer acquired<br>% of sales to new customers |
| **Improve market share** | Market share in targeted customer segments |
| **Enhance customer profitability** | Number or percent of unprofitable customers |

- The **value proposition** is the unique mix of product performance, price, quality, availability, ease of purchase, service, relationship and image that a company offers its targeted group of customers.
  - The value proposition represents the 'advantage' of a company's strategy; it should communicate what it intends to deliver to its customers better or differently from competitors.

| **Low Total Cost Value Proposition** | Measures |
|---|---|
| Be a low cost supplier | Price, relative to competitors<br>Customer's cost of ownership |
| Deliver consistent high quality | # returns; $ value of returns<br># and % customer complaints<br># incidents of warranty and field service repairs |
| Provide a speedy, easy purchase | % on-time delivery<br>Customer lead time (from order to delivery)<br>% perfect orders (right product, right quantity, delivered on time) |
| Offer appropriate selection | - |
| **Product Leadership Value Proposition** | Measures |
| Offer high-performance products | Customer innovation rating<br>Competitive product performance (speed, size, etc.)<br>Gross margins, new products |
| Be first to market with new products | Number of products that are FIRST to market |

| **Customer Solutions Value Proposition** | Measures |
|---|---|
| Provide customised solutions | # customers with profiled preferences |
| Sell multiple products and services to customers | # products and services per customer<br># clients above $xx million annual in sales |
| Deliver excellent post-sales services | Revenues from maintenance, repair and logistical services |
| Develop personalised relationships | # sole-sourced contracts<br>Client retention |

- By developing objectives and measures that are specific to its value proposition, a company translates its strategy into tangible measures that all employees can understand and work toward improving.

## Process Perspective

- The **process perspective** identifies the critical operations management, customer management, innovation, and regulatory and social processes in which the organisation must excel to achieve its customer, revenue growth and profitability objectives.
- **Operations management processes** are the basic, day-to-day processes that produce products and services and deliver them to customers.
  - Some typical objectives for operating processes include the following:
    - Achieve superior supplier capability;
    - Improve the cost, quality and cycle times of operating (production) processes
    - Improve asset utilisation
    - Deliver goods and services responsively to customers
- **Customer management processes** expand and deepen relationships with targeted customers.
  - Three objectives for a company's customer management processes:
    - Acquire new customers.
    - Satisfy and retain existing customers.
    - Generate growth with customers.
  - Customer acquisition relates to generating leads, communicating with potential customers, choosing entry-level products, pricing the products, and closing the sale.
  - Customer satisfaction and retention requires excellent service and response to customer requests.
  - To generate growth with customers, the company must manage its relationships effectively, cross-sell multiple products and services, and become known to the customer as a trusted adviser and supplier.
- **Innovation processes** develop new products, processes and services, often enabling the company to penetrate new markets and customer segments.
  - Successful innovation drives customer acquisition, loyalty and growth, in turn leading to enhanced operating margins.
  - Without innovation, a company's value proposition can eventually be imitated, leading to competition solely on price for its undifferentiated products and services.
  - We can identify two important innovation sub-processes:
    - Develop innovative products and services
    - Achieve excellence in research and development processes.
- **Regulatory and social processes** make up the final process group.
  - National and local regulations impose minimum standards on companies' practices and companies must comply with these to avoid shutdowns or expensive litigation.
  - Many companies, however, seek to go beyond mere compliance and seek to perform better than the regulatory constraints so that they develop a stronger reputation.
  - Customers can manage/report their regulatory + social performance along several dimensions: (1) environment; (2) health and safety; (3) employment practices; (4) community investment.

| Process Objectives | Measures |
|---|---|
| **Operations Management** | |
| Improve the cost, quality and cycle times of operating (production) processes | Supplier scorecard ratings: quality, delivery, cost<br>Cost per unit of output<br>Product and process defect rates |
| Improve asset utilisation | Lead times, from order to delivery<br>Capacity utilisation (%)<br>Equipment reliability, percent availability |
| **Customer Management** | |
| Acquire new customers | % leads converted<br>Cost per new customer acquired |
| Satisfy and retain existing customers | Time to resolve customer concern or complaint<br># referenceable customers (willing to recommend) |
| Generate growth with customers | # products and services per customer<br>Revenue or margin from post-sale services |
| **Innovation** | |
| Develop innovative products and services | # fundamental new ideas entering product development |
| Achieve excellence in R&D processes | # patent applications filed or patents earned<br>Total product development time: from idea to market<br>Product development cost versus budget |
| **Regulatory and social** | |
| Improve environmental, health and safety performance | # of environmental and safety incidents<br>Days absent from work |
| Enhance reputation as 'good neighbour' | Employee diversity index<br># employees from disadvantaged communities |

- Typically, the financial benefits from improving processes occur within different time frames:
  - *Operational processes*: 6-12 months
  - *Customer relationships*: 12-24 months (intermediate term)
  - *Innovation processes*: 24 to 48 months (generally take longer)
  - *Regulatory and social processes*: typically take longer

## Learning and Growth Perspective

- The **learning and growth perspective** identifies the objectives for the people, information technology and organisational alignment that will drive improvement in the various process objectives.
  - It is in the learning and growth scorecard perspective that executive target improvements in their intangible assets – see below.

**Human Resources**

- ***Strategic competency availability*** – company's employees have the appropriate mix of skills, talent and know-how to perform activities required by the strategy.

**Information Technology**

- ***Strategic information availability*** – company's information systems and knowledge applications contribute to effective strategy execution by facilitating process improvements and better linkages with suppliers and customers.

**Organisation Culture and Alignment**

- ***Culture and climate*** – employees have an awareness and understanding of the shared vision, strategy, and cultural values needed to execute the strategy.
- ***Goal alignment*** – employee goals and incentives are aligned with the strategy at all organisation levels.