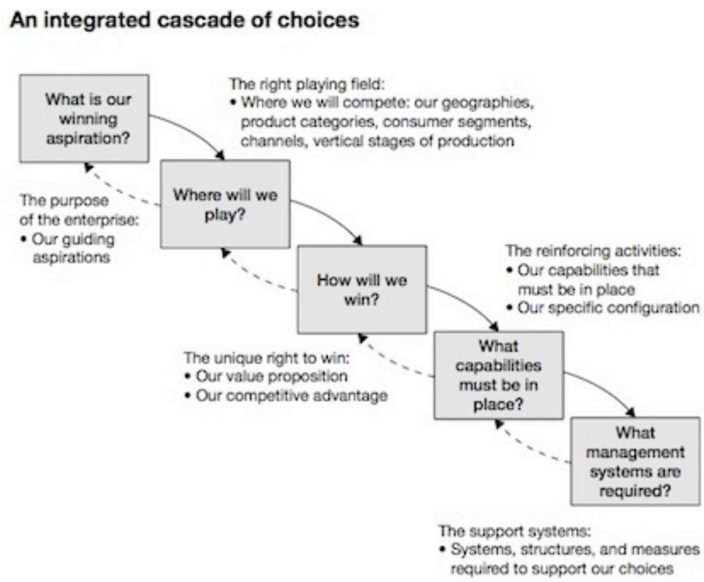
Week 4: The External Environment

The 'Playing to Win' Strategy Framework (Lafley and Martin 2013)

- Any given strategy is a series of decisions and choices
- Need to understand how businesses/managers make decisions
    - May need to understand *neuroscience* and how people make decisions in groups, this has less and less to do with economics (assumption of the rational decision-maker)
- No strategy process is a linear process → *iterative* (have to go backwards as well as forwards)



1. Purpose – why do we exist?
2. Values – what do we believe in? (linked to purpose – *identity/DNA* of organisation)
3. Vision – where are we going? [S (specific), M (measurability), A (aligned), R (reachable/ realistic – are these 'soft'?), T (time-frame)] → SMART goals (financial performance, growth, customers, people and culture, innovation, corporate engagement and CSR)
4. Strategy – how will we get there?

Stage 2 – Where Will We Play? Levels of Environment

- (1) Internal
    - Knowledge, competence, systems, resources, capability
- (2) Sensory/Industry
    - Service users, clients, commissioners, suppliers, stakeholders, unions, regulators
- (3) Macro → what factors will drive change in our industry? What scenarios can we envisage? PEST (improve you signal/noise ratio)
    - Political economic, socio-cultural, technological, eco-environmental
        - **Political/Legal →** monopolies legislation, tax policy, environmental protection laws, foreign trade regulation, employment law, government stability
        - **Economics →** business cycles, GNP trends, interest rates, inflation, unemployment
        - **Socio-Cultural →** population demographics, income distribution, social mobility, lifestyle changes, attitudes to work and leisure, consumerism, levels of education
        - **Technological →** spending on research, new discoveries/development, speed
- **Winning formula → understand why does industry's are good and bad (airlines)**
    - Long-term profit rate = attractiveness of industry structure + competitive advantage
        - RHS of equation comes down to ***dynamic environment***
        - Subtract a competitive disadvantage

Porter's 5 Forces Industry Analysis Model (1979)

Threat of new entrants	Suppliers	Customers	Threat of substitutes	Internal Rivalry
• Economies of scale • High capital requirements • Access to distribution channels • Government policy • Product differentiation • Switching costs • Low industry margins • Cost disadvantages • Independent of scale • Technology • Raw materials • Locations • Expected retaliation	• Concentrated suppliers • Product is critical to buyer • No substitutes • Threat of forward integration	• Concentrated customers • Product undifferentiated • Switching costs are low • Buyers have full information • Buyers industry earns low profits • Buyers threaten backward integration • Product unimportant to buyer • Product presents a significant proportion of buyers costs	• What are the potential substitutes? What future impact will they have? • Is the performance or cost position of substitute improving?	• Industry structure • Lifecycle stage • Lack of differentiation or switching costs • Level of cooperation • Strategic groups • Exit barriers

Core Assumptions of Five Forces

- Every industry is unique and every industry will change over time
- Competition is a *bad thing* (from perspective of individual business in the market)
- Competition is everywhere (major contribution) – competing for who captures economic value (i.e. also customers and suppliers) → ***zero sum game***
    - Sydney University wants to give student less for more, lecturers want to be paid more and the University wants to pay them less, substitutes – free online qualifications

Calibrations of Five Forces

- Geographic dimension/narrowness of market (Australian SUV market or global car industry)

Strategic Options

New Entrants

- Build entry barriers, watch out for mavericks

Powerful Suppliers

- Diversify supply vase, reduce supplier costs, standardise requirements, integrate backwards

Powerful Buyers

- Select customers, build switching costs (specifications, relationships, service), integrate forward

Substitutes

- Understand customer preferences before reacting, examine indirect substitutes, consider diversification

→ **Internal Rivalry:** strengthen competitive advantage, re-segment, outsource to reduce fixed costs, acquire competitors (with care)