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Crafting & Executing
STRATEGY

Chapter 3

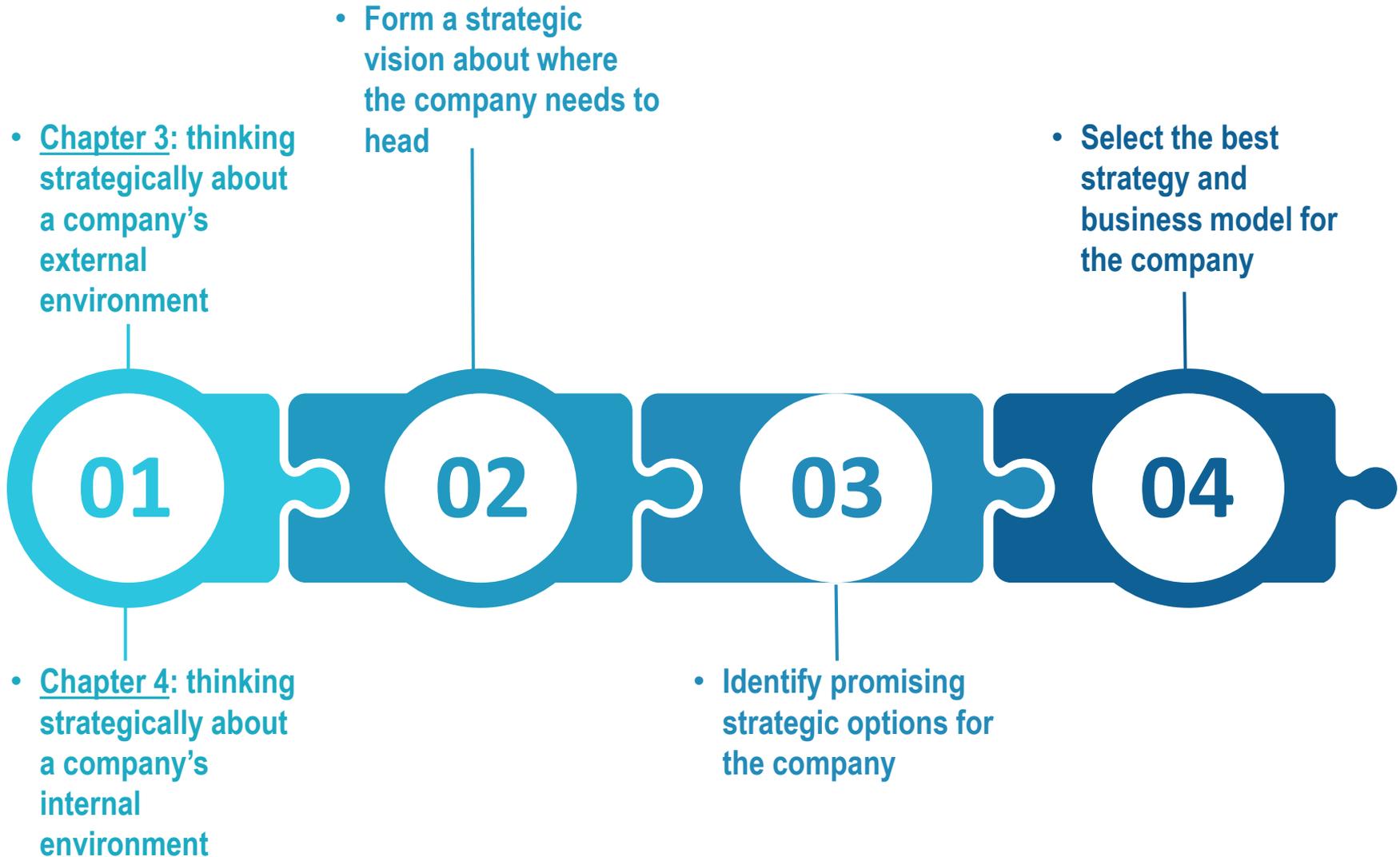
Evaluating a Company's External Environment

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
4. How to use multiple frameworks to determine whether an industry's outlook presents a company with sufficiently attractive opportunities for growth and profitability

CHOOSING A STRATEGY



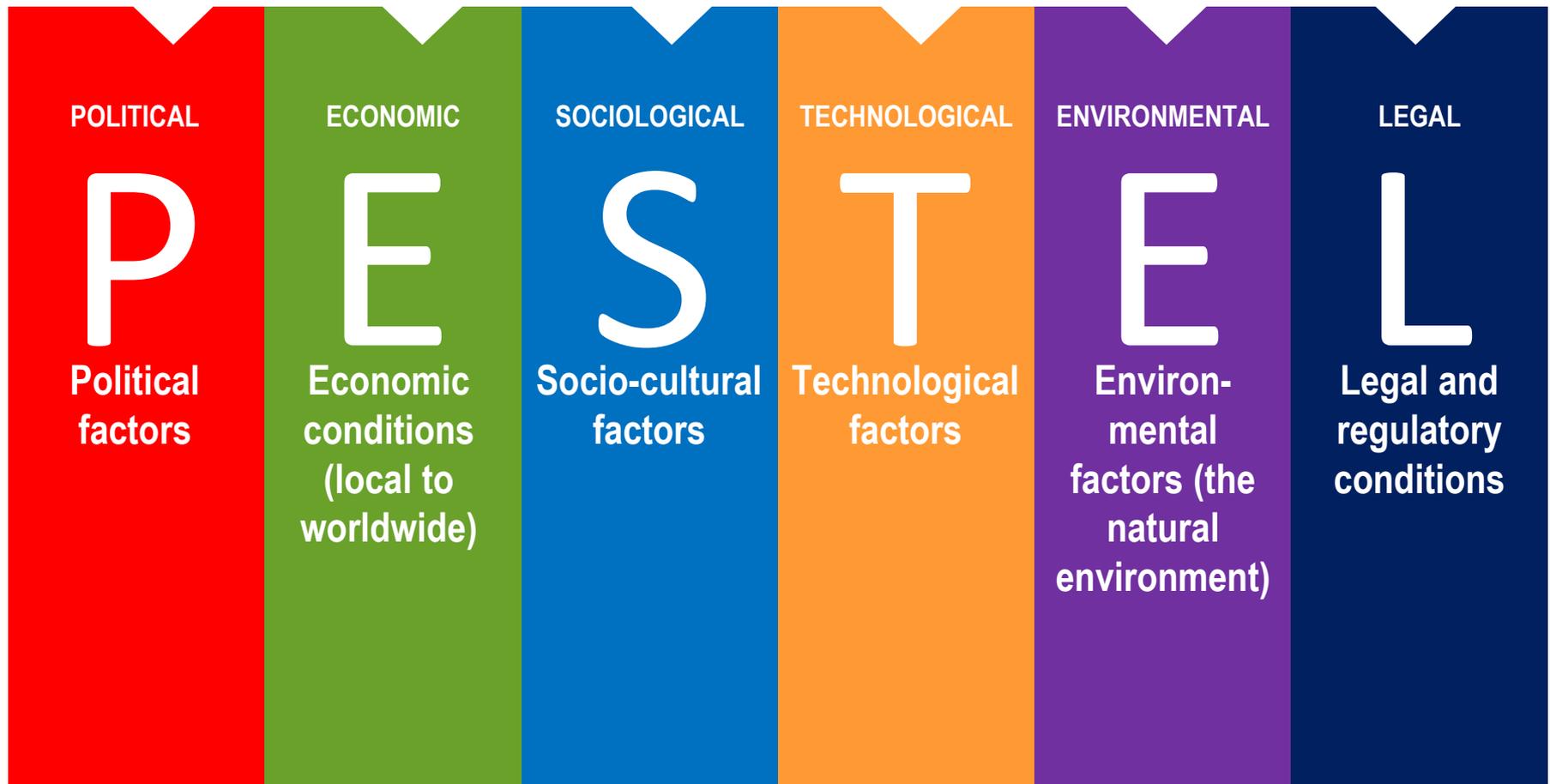
CORE CONCEPT

The **macro-environment** encompasses the broad environmental context in which a company's industry is situated.

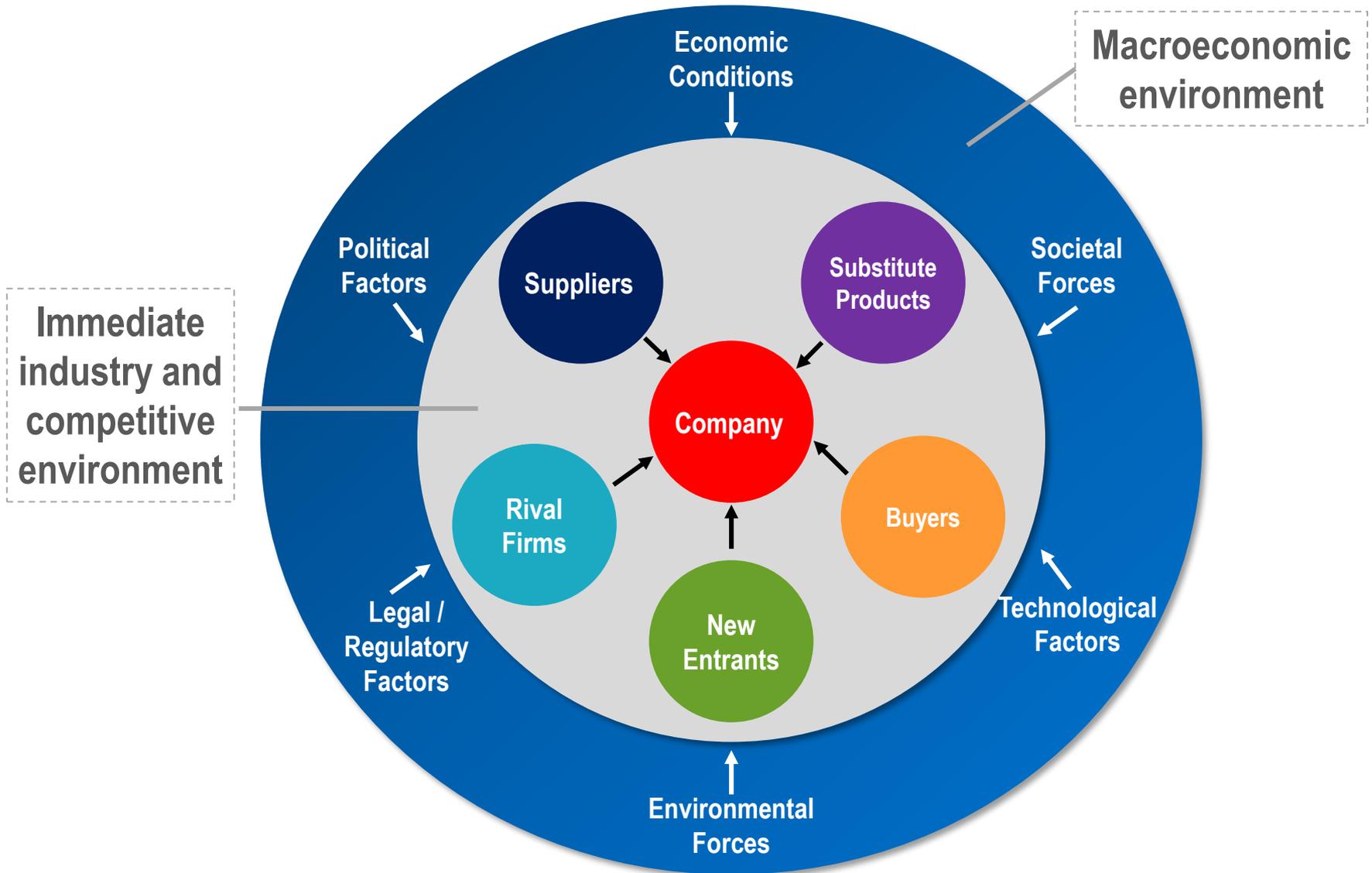
Includes strategically relevant components over which the firm has **no direct control**.

PESTEL ANALYSIS

- A PESTEL analysis focuses on principal components of strategic significance in the macro-environment



MACRO-ECONOMIC ENVIRONMENT



ASSESSING THE COMPETITIVE ENVIRONMENT

1. How strong are the industry's **competitive forces**?
2. What are the **driving forces** in the industry, and what impact will they have on competitive intensity and industry profitability?
3. What **market positions** do industry rivals occupy - who is strongly positioned and who is not?
4. What **strategic moves** are rivals likely to make next?
5. What are the industry's **key success factors**?
6. Is the industry outlook **conducive** to strong **profitability**?

PORTER'S 5 FORCES ANALYSIS

Supplier Power

Competitive pressure stemming from significant supplier power. The greater the supplier power the worse for the company.

Threat of New Entry

Competitive pressure coming from the threat of new entrants. The greater the threat, the worse for the company.



Competitive Rivalry

Threat of Substitutes

Competitive pressure coming from the producers of substitute products. The greater the pressure, from substitutes the worse for the company.

Buyer Power

Competitive pressure stemming from significant buyer power. The greater the buyer power the worse for the company.

USING THE 5 FORCES MODEL

01

Identification

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

02

Evaluation

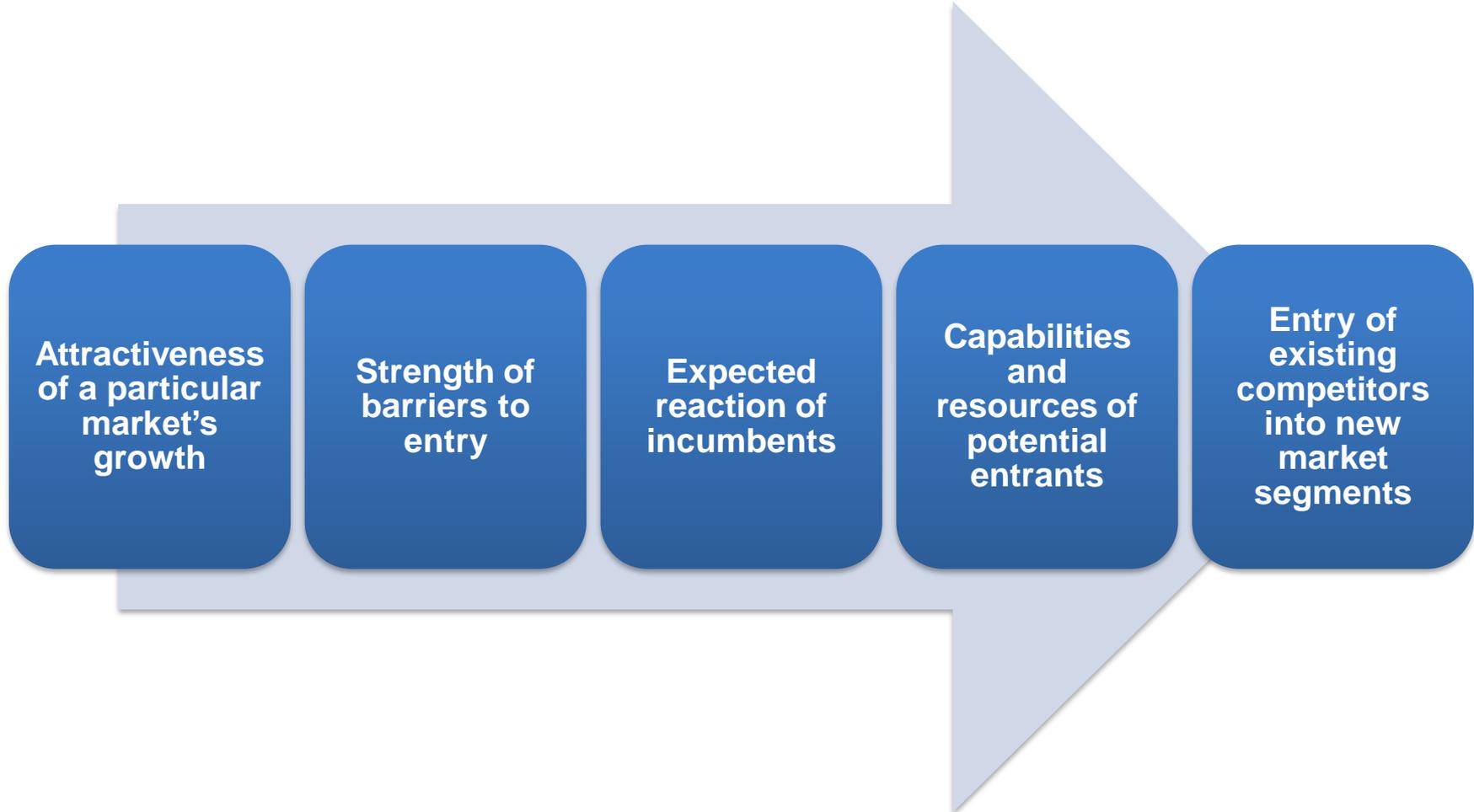
Evaluate how strong the pressures stemming from each of the five forces are (strong, moderate, or weak).

03

Determination

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

COMPETITIVE PRESSURE – NEW ENTRANTS



BARRIERS FOR NEW ENTRANTS

- **Economies of scale** in production, distribution, advertising, or other areas of operation
- Experience and **learning curve** effects
- Unique **cost advantages** of industry incumbents
- Strong **brand preferences** and customer loyalty
- Strong “**network effects**” in customer demand
- High **capital requirements**
- Building a **network of distributors** or dealers and securing adequate space on retailers’ shelves
- **Restrictive government** policies

BUYER BARGAINING POWER

- Buyer Bargaining Power Considerations:
 - Buyer **costs** for **switching** to competing sellers
 - Degree to which industry products are **commoditized**
 - **Number and size** of buyers relative to sellers
 - **Strength** of buyer demand for sellers' products
 - **Buyer knowledge** of products, costs and pricing
 - **Backward integration** of buyers into sellers' industry
 - **Buyer discretion** in delaying purchases
 - **Buyer price sensitivity** due to low profits, size of purchase, and consequences of purchase

BUYER BARGAINING POWER (CONT.)

- Buyer bargaining power is **stronger** when:
 - Buyer **demand** is **weak** in relation to industry supply
 - The industry's products are **standard** and **non-differentiated**
 - Buyer **costs** of **switching** to competing products are **low**
 - Buyers are **large** and few in number relative to the number of industry sellers
 - Buyers are **well-informed** about the quality, prices and costs of sellers
 - Buyers have the ability to **postpone** purchases

PRESSURES OF SUBSTITUTE PRODUCTS

- Substitute Products Considerations:
 - **Ready availability** of substitutes
 - **Pricing**, quality, performance, and other relevant attributes of substitutes
 - **Switching costs** that buyers incur
- Indicators of Substitutes' Competitive Strength:
 - Increasing rate of **growth** in sales of substitutes
 - Substitute producers adding **output capacity**
 - Increasing **profitability** of substitute producers

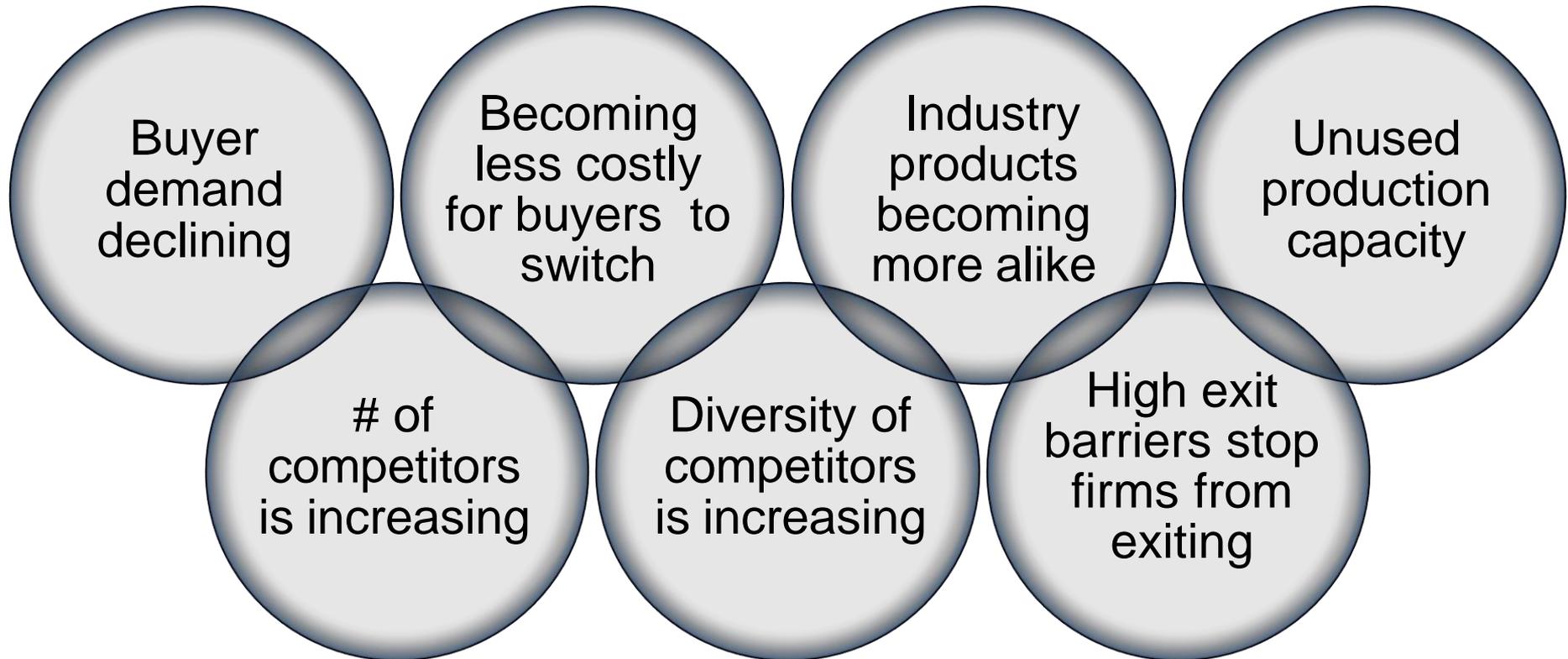
SUPPLIER BARGAINING POWER

- Supplier Bargaining Power Considerations:
 - **Ready availability** of supplier products
 - **Criticality** of supplier products as industry inputs
 - **Number of suppliers** of standard\commodity items
 - Buyers' **costs** for **switching** among suppliers
 - **Availability of substitutes** for suppliers' products
 - **Fraction of supplier** sales due to industry demand
 - **Ratio of suppliers** relative to industry buyers
 - **Backward integration** into suppliers' industry

SUPPLIER BARGAINING POWER (CONT.)

- Supplier bargaining power is **stronger** when:
 - Supplier products or services are in **short supply**
 - Supplier products or services are **differentiated**
 - Industry members incur **high costs** in **switching** from one supplier to another
 - The supplier industry is more **concentrated** than the industry they serve
 - Industry members **do not** have the ability to **integrate backward**
 - There are **no** good **substitutes** for the product or service provided by suppliers
 - Industry members do not account for a significant percentage of supplier sales

PRESSURES LEADING TO ↑ RIVALRY



FORCES CONDUCTIVE TO PROFITABILITY

- Is the state of competition in the industry stronger than normal?
- Can industry firms expect to earn decent profits given prevailing competitive forces?
- Are some of the competitive forces sufficiently powerful to undermine industry profitability?
 - Even one powerful force may be enough to make the industry unattractive in terms of its profit potential

CORE CONCEPT

The **strongest** of the five forces determines the extent of the downward **pressure** on an industry's **profitability**.

Having more than one strong force means that an industry has multiple competitive challenges with which to cope.

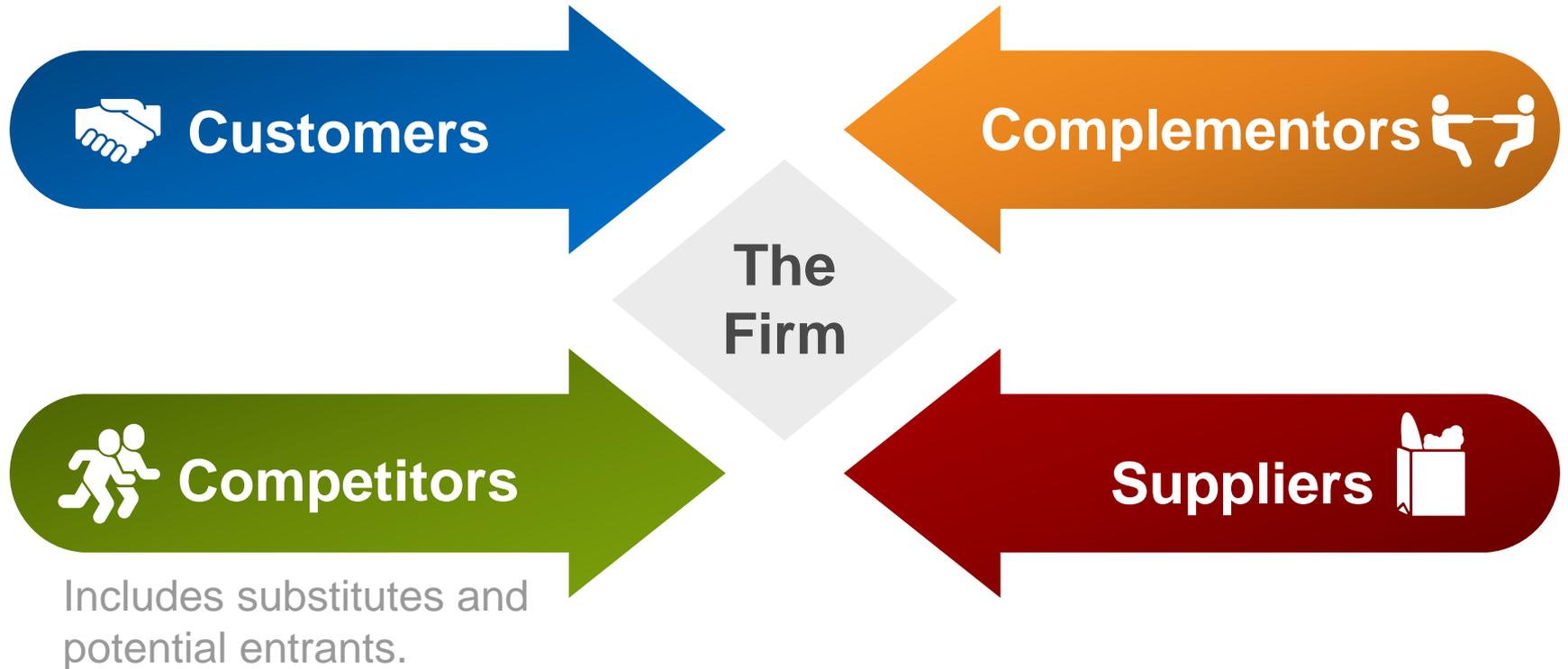
CORE CONCEPT

A company's strategy is increasingly effective the more it provides some **insulation** from competitive **pressures**, shifts the competitive battle in the company's favor, and positions firms to take advantage of attractive **growth** opportunities.

FORCES CONDUCTIVE TO PROFITABILITY

- 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

THE VALUE NET



CORE CONCEPT

Complementors are the producers of **complementary** products, which are products that **enhance** the value of the focal firm's products when they are **used together**.

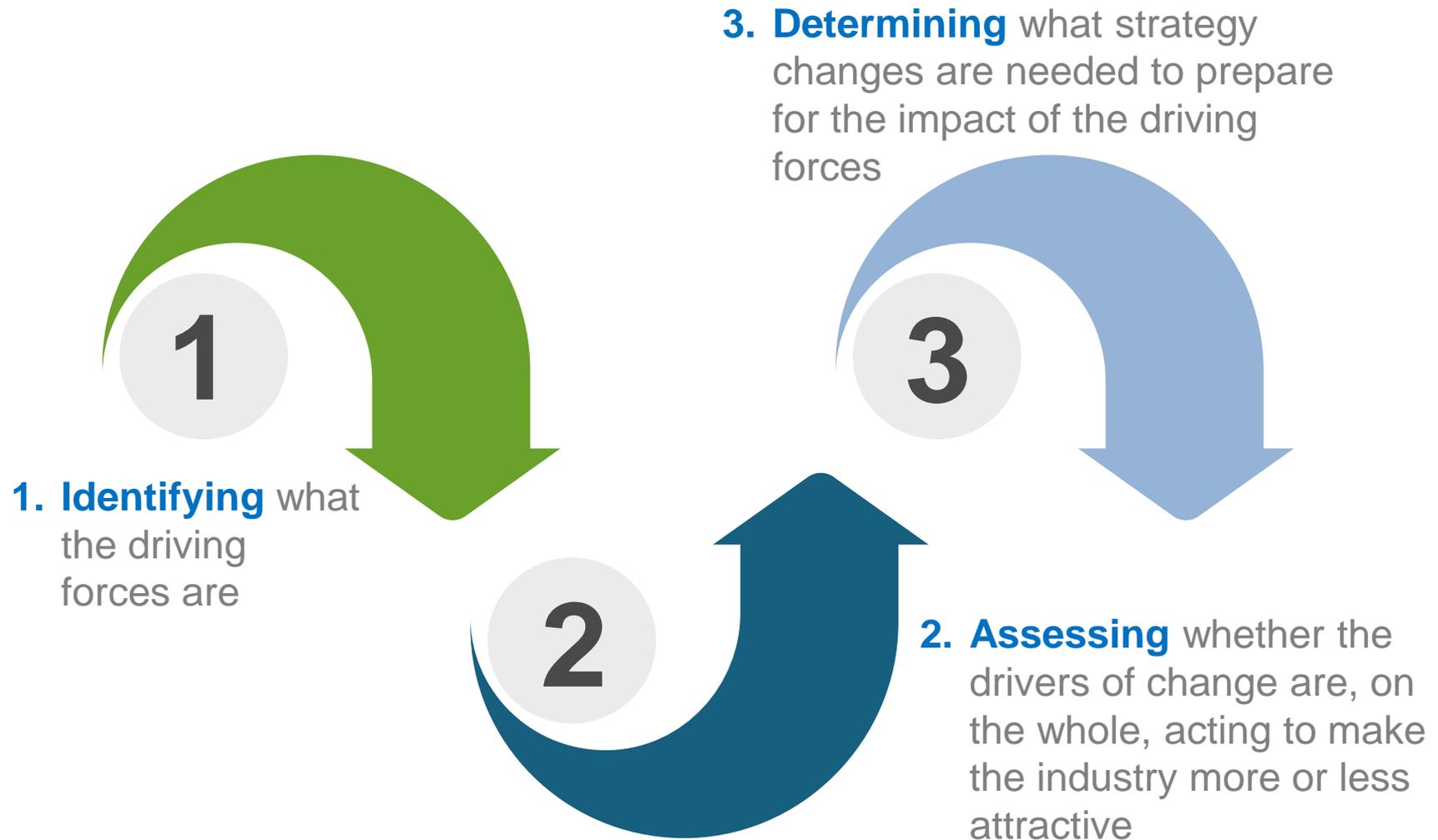
FORCES CONDUCTIVE TO PROFITABILITY

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CORE CONCEPT

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

STEPS TO DRIVING FORCES ANALYSIS



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

DRIVERS OF INDUSTRY CHANGE (CONT.)

- 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

CORE CONCEPT

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**.

IMPACT OF DRIVERS OF INDUSTRY CHANGES

- Are the driving forces, on balance, acting to cause demand for the industry's product to increase or decrease?
- Is the collective impact of the driving forces making competition more or less intense?
- Will the combined impacts of the driving forces lead to higher or lower industry profitability?

CORE CONCEPT

The real payoff of driving-forces analysis is to help managers understand **what** strategy **changes** are **needed** to prepare for the impacts of the driving forces.

STRATEGY ADJUSTMENTS

- What **strategy adjustments** will be needed to deal with the impacts of the driving forces?
 - What adjustments must be made **immediately**?
 - What actions currently being taken **should be halted or abandoned**?
 - What can we do now to **prepare** for adjustments we anticipate making in the future?

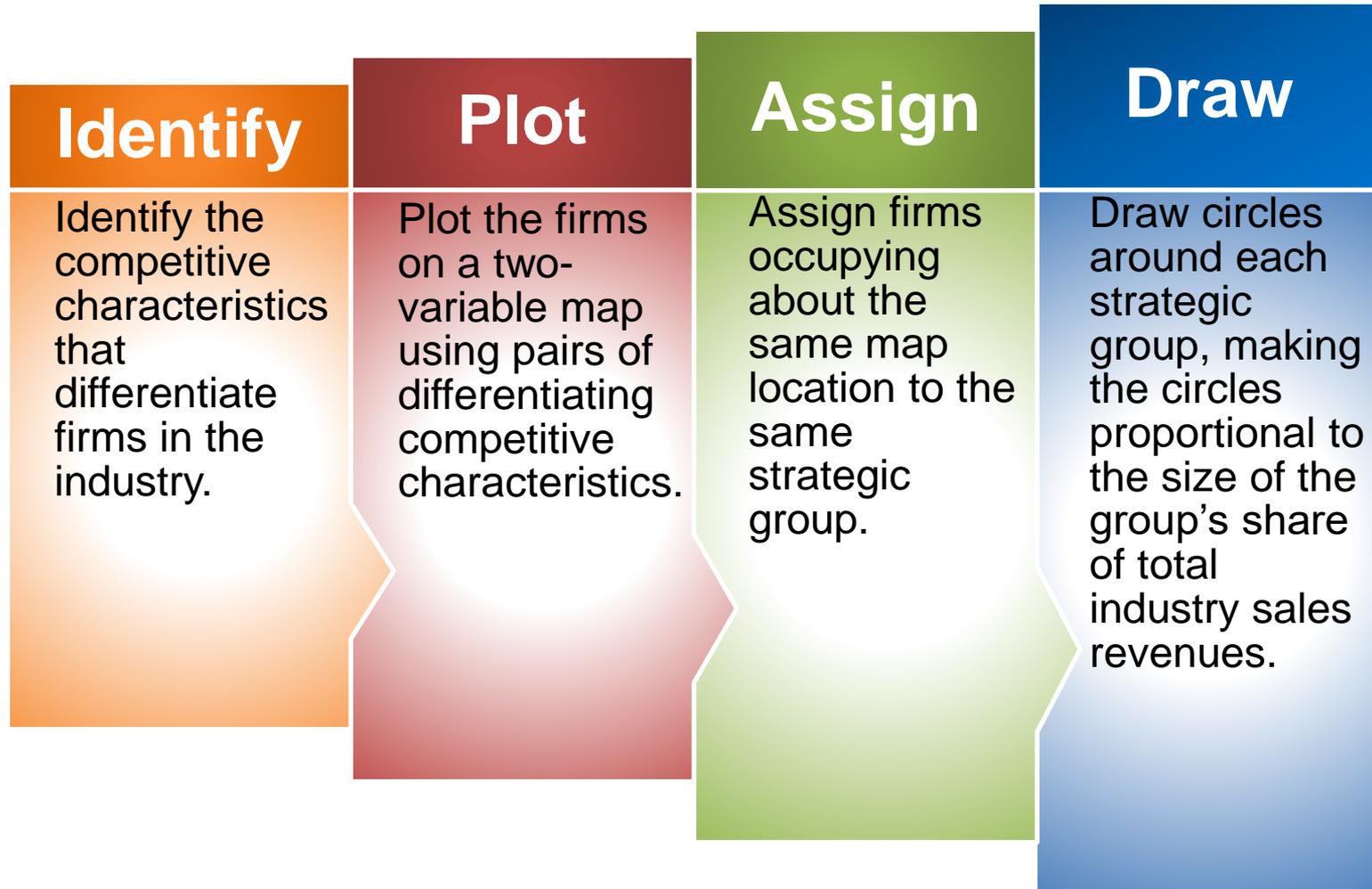
STRATEGIC GROUP ANALYSIS

- A strategic group consists of those industry members with similar competitive approaches and positions in the market
 - Having comparable **product-line** breadth
 - Emphasizing the same **distribution** channels
 - Depending on identical **technological** approaches
 - Offering the same **product attributes** to buyers
 - Offering similar **services** and technical assistance

CORE CONCEPT

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

CONSTRUCTING A STRATEGIC GROUP MAP



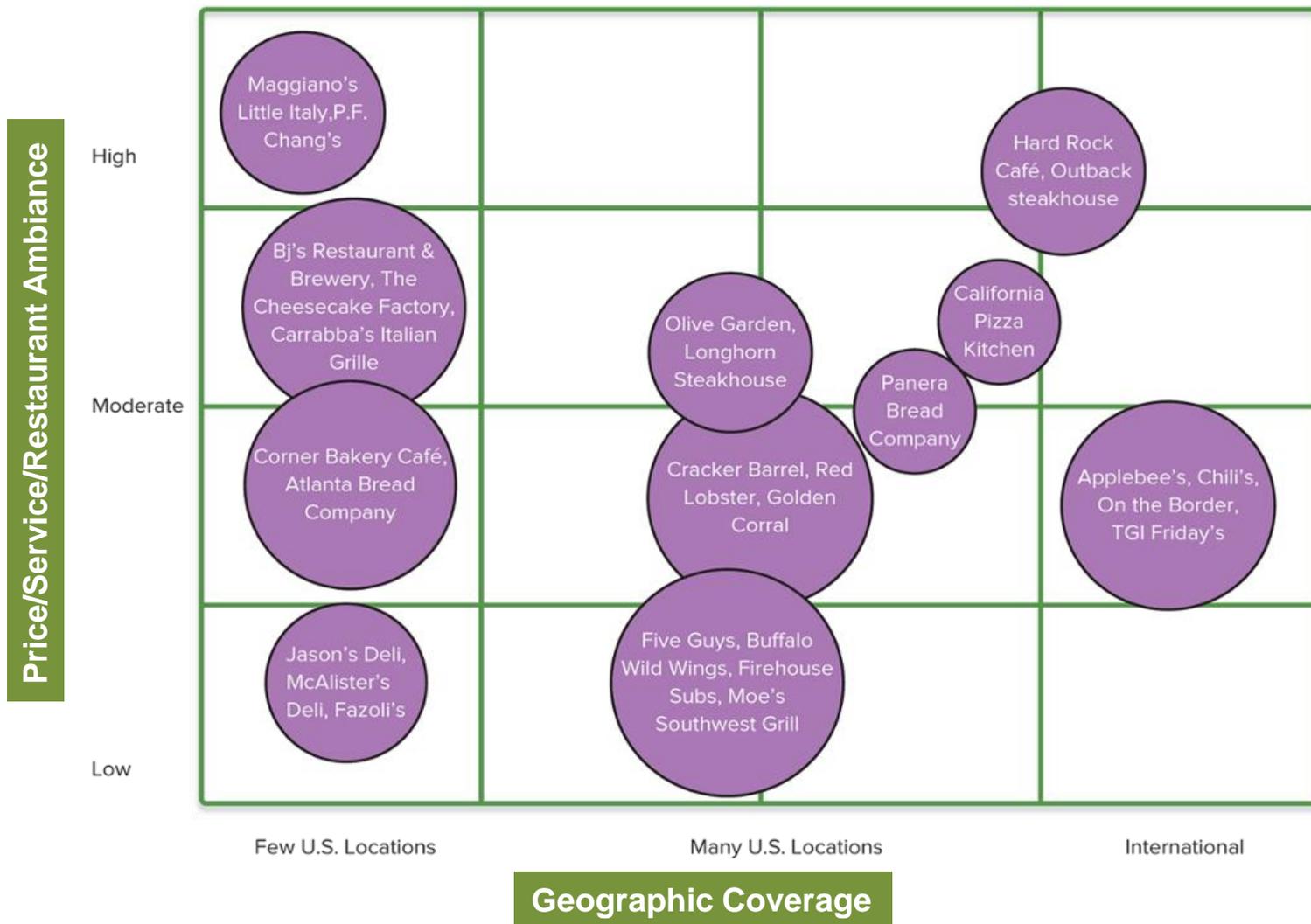
STRATEGIC GROUP MAPPING

- Typical variables used in constructing a strategic group map
 - Price and quality range (high, medium, low)
 - Geographic coverage (local, 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)

STRATEGIC GROUP MAPPING (CONT.)

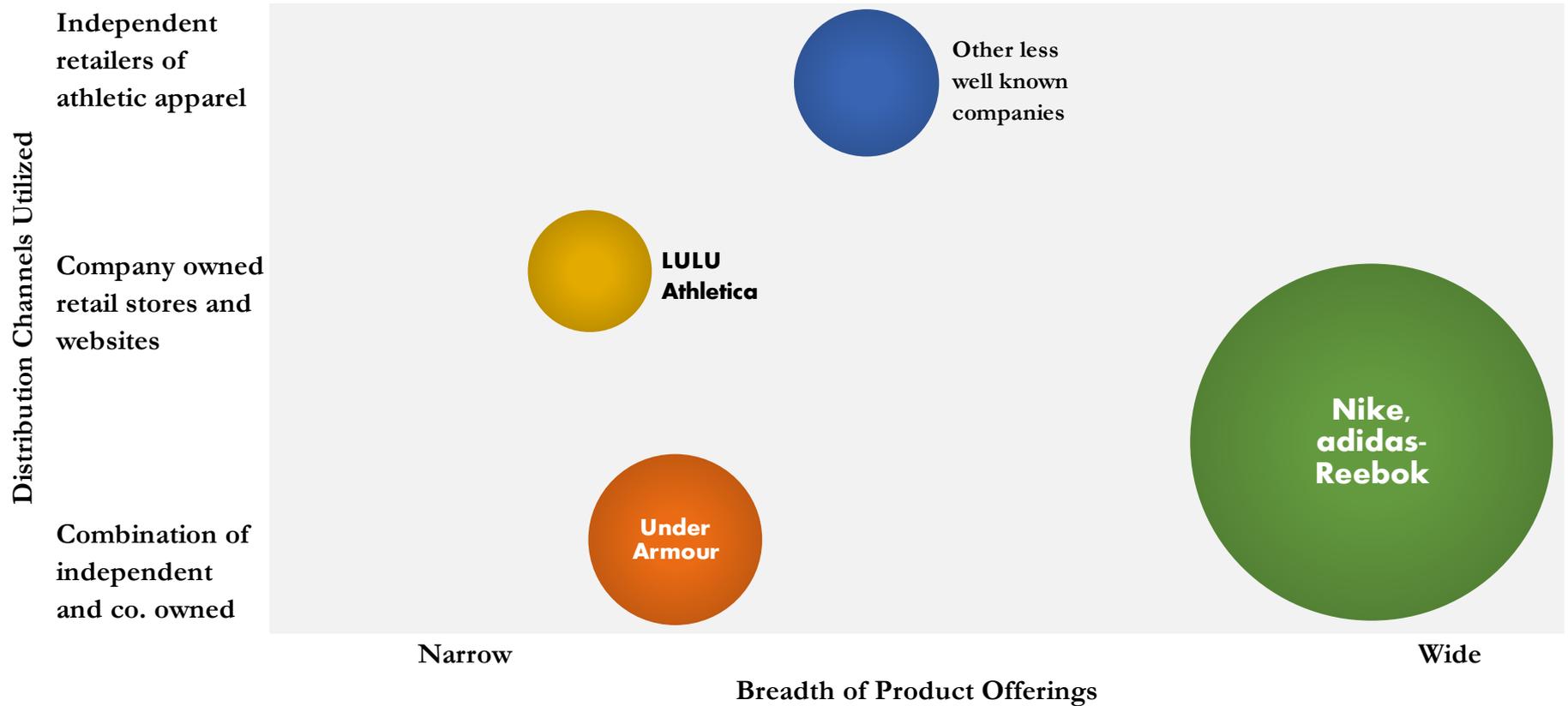
- Guidelines for creating a strategic group map
 - Variables selected as map axes should not be highly correlated.
 - Variables should reflect important (sizable) differences among rival approaches.
 - Variables may be quantitative, continuous, discrete, or defined in terms of distinct classes and combinations.
 - Drawing group circles proportional to the combined sales of firms in each group will reflect the relative sizes of each strategic group.
 - Drawing maps using different pairs of variables will show the different competitive positioning relationships present in the industry's structure.

SAMPLE STRATEGIC GROUP MAP



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

SAMPLE STRATEGIC GROUP MAP



EXAMINING POSITIONING ON MAP

- 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?

CORE CONCEPT

Some strategic groups are more **favorably positioned** than others because they confront **weaker** competitive forces or because they are more favorably **impacted** by industry driving forces.

VALUE OF A STRATEGIC GROUP MAP

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

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.

IDENTIFICATION OF KEY SUCCESS FACTORS

1. What **product attributes** and **service features** strongly affect buyers when choosing between the competing brands of sellers?
2. What **resources** and **competitive capabilities** are required for a firm to execute a successful strategy in the marketplace?
3. What **shortcomings** will put a firm at a significant competitive disadvantage?