STRATEGIC CONCEPTS & CASES MANAGEMENT

A Competitive Advantage Approach

FOURTEENTH EDITION



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The External Assessment

Chapter Three

Chapter Objectives

- 1. Describe how to conduct an external strategicmanagement audit.
- 2. Discuss 10 major external forces that affect organizations: economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive.
- 3. Describe key sources of external information, including the Internet.
- 4. Discuss important forecasting tools used in strategic management.
- 5. Discuss the importance of monitoring external trends and events.

Chapter Objectives (cont.)

- 6. Explain how to develop an EFE Matrix.
- 7. Explain how to develop a Competitive Profile Matrix.
- 8. Discuss the importance of gathering competitive intelligence.
- Describe the trend toward cooperation among competitors.
- 10. Discuss market commonality and resource similarity in relation to competitive analysis.

External Audit

External audit

- → focuses on identifying and evaluating trends and events beyond the control of a single firm
- → reveals key opportunities and threats confronting an organization so that managers can formulate strategies to take advantage of the opportunities and avoid or reduce the impact of threats

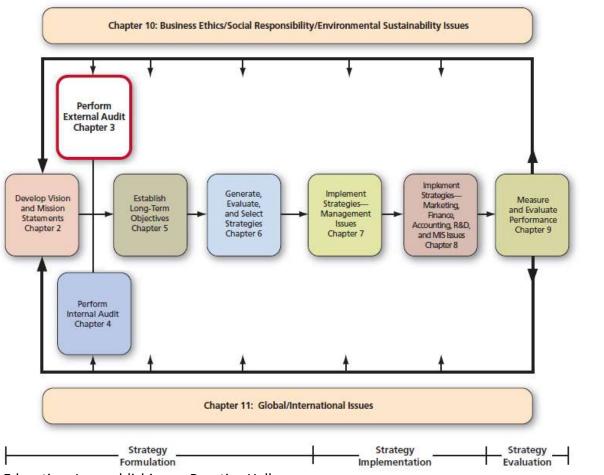
The Nature of an External Audit

- The external audit is aimed at identifying key variables that offer actionable responses
- Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats.

A Comprehensive Strategic-Management Model

FIGURE 3-1

A Comprehensive Strategic-Management Model



Key External Forces

External forces can be divided into five broad categories:

- 1. economic forces
- social, cultural, demographic, and natural environment forces
- 3. political, governmental, and legal forces
- 4. technological forces
- 5. competitive forces

Relationships Between Key External Forces and an Organization

FIGURE 3-2



Markets Natural environment

The Process of Performing an External Audit

First, gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends.

The Process of Performing an External Audit

- Information should be assimilated and evaluated
- A final list of the most important key external factors should be communicated

The Process of Performing an External Audit

Key external factors should be:

- important to achieving long-term and annual objectives
- 2. measurable
- 3. applicable to all competing firms, and
- hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas

The Industrial Organization (I/O) View

The Industrial Organization (I/O) approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm for achieving competitive advantage.

The Industrial Organization (I/O) View

Firm performance is based more on industry properties

Economies of scale

Barriers to market entry

Product differentiation

The economy

Level of competitiveness

Economic Forces

TABLE 3-1 Key Economic Variables to Be Monitored

Shift to a service economy in the

United States

Availability of credit

Level of disposable income

Propensity of people to spend

Interest rates

Inflation rates

Money market rates

Federal government budget deficits

Gross domestic product trend

Consumption patterns

Unemployment trends

Worker productivity levels

Value of the dollar in world markets

Stock market trends

Foreign countries' economic conditions

Import/export factors

Demand shifts for different categories of goods

and services

Income differences by region and

consumer groups

Price fluctuations

Export of labor and capital from the

United States

Monetary policies

Fiscal policies

Tax rates

European Economic Community

(EEC) policies

Organization of Petroleum Exporting

Countries (OPEC) policies

Coalitions of Lesser Developed

Countries (LDC) policies

Advantages and Disadvantages of a Weak Dollar

TABLE 3-2 Advantages and Disadvantages of a Weak Dollar for Domestic Firms

Advantages	Disadvantages
Leads to more exports	1. Can lead to inflation
2. Leads to lower imports	2. Can cause rise in oil prices
3. Makes U.S. goods cheaper to foreign consumers	3. Can weaken U.S. government
 Combats deflation by pushing up prices of imports 	 Makes it unattractive for Americans to travel globally
5. Can contribute to rise in stock prices in short run	 Can contribute to fall in stock prices in long run
 Encourages foreign countries to lower interest rates 	
Raises the revenues and profits of firms that do business outside the United States	
8. Forces foreign firms to raise prices	
9. Reduces the U.S. trade deficit	
10. Encourages firms to globalize	
11. Encourages foreigners to visit the United States	
8. Forces foreign firms to raise prices9. Reduces the U.S. trade deficit10. Encourages firms to globalize	

Social, Cultural, Demographic, and Natural Environmental Forces

- U.S. Facts
 - → Aging population
 - Less white
 - → Widening gap between rich & poor
 - → 2025 = 18.5% population > 65 years
 - → 2075 = no ethnic or racial majority

Social, Cultural, Demographic, and Natural Environmental Forces

Facts

- → World population 7 billion
- → World population = 8 billion by 2028
- → World population = 9 billion by 2054
- → U.S. population > 310 million

Key Social, Cultural, Demographic, and Natural Environment Variables

TABLE 3-3 Key Social, Cultural, Demographic, and Natural Environment Variables

Childbearing rates

Number of special-interest groups

Number of marriages Number of divorces

Number of births

Number of deaths

Immigration and emigration rates Social Security programs

Life expectancy rates Per capita income

Location of retailing, manufacturing,

and service businesses

Attitudes toward business

Lifestyles

Traffic congestion

Inner-city environments

Average disposable income

Trust in government

Attitudes toward government Attitudes toward work

Buying habits

Ethical concerns

Attitudes toward saving

Sex roles

Attitudes toward investing

Racial equality
Use of birth control
Average level of education
Government regulation

Attitudes toward retirement

Attitudes toward leisure time

Attitudes toward product quality

Attitudes toward customer service

Pollution control

Attitudes toward foreign peoples

Energy conservation Social programs

Number of churches

Number of church members

Social responsibility

Attitudes toward careers

Population changes by race, age, sex,

and level of affluence Attitudes toward authority

Population changes by city, county, state,

region, and country

Value placed on leisure time

Regional changes in tastes and preferences Number of women and minority workers Number of high school and college

graduates by geographic area

Recycling

Waste management

Air pollution Water pollution

Ozone depletion

Endangered species

Political, Governmental, and Legal Forces

The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

Political, Government, and Legal Variables

TABLE 3-5 Some Political, Governmental, and Legal Variables

Government regulations or deregulations

Changes in tax laws

Special tariffs

Political action committees

Voter participation rates

Number, severity, and location of government protests

Number of patents

Changes in patent laws

Environmental protection laws

Level of defense expenditures

Legislation on equal employment

Level of government subsidies

Antitrust legislation

Sino-American relationships

Russian-American relationships

European-American relationships

African-American relationships

Import-export regulations

Government fiscal and monetary policy changes

Political conditions in foreign countries

Special local, state, and federal laws

Lobbying activities

Size of government budgets

World oil, currency, and labor markets

Location and severity of terrorist activities

Local, state, and national elections

American Labor Unions

- The extent that a state is unionized can be a significant political factor in strategic planning decisions as related to manufacturing plant location and other operational matters
- The size of American labor unions has fallen sharply in the last decade due in large part to erosion of the U.S. manufacturing base

The *Internet* has changed the very nature of opportunities and threats by:

- altering the life cycles of products,
- increasing the speed of distribution,
- creating new products and services,
- erasing limitations of traditional geographic markets,
- changing the historical trade-off between production standardization and flexibility.

The *Internet* is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors

Many firms now have a Chief Information Officer (CIO) and a Chief Technology Officer (CTO) who work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed

Technological advancements can:

- Create new markets,
- Result in a proliferation of new and improved products,
- Change the relative competitive cost positions in an industry,
- Render existing products and services obsolete.

Competitive Forces

An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies

Competitive Forces

Characteristics of the most competitive companies:

- 1. Market share matters
- 2.Understand and remember precisely what business you are in
- 3. Whether it's broke or not, fix it—make it better
- 4.Innovate or evaporate
- Acquisition is essential to growth
- 6. People make a difference
- 7. There is no substitute for quality

Key Questions About Competitors

TABLE 3-7 Key Questions About Competitors

- 1. What are the major competitors' strengths?
- 2. What are the major competitors' weaknesses?
- 3. What are the major competitors' objectives and strategies?
- 4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
- 5. How vulnerable are the major competitors to our alternative company strategies?
- 6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
- 7. How are our products or services positioned relative to major competitors?
- 8. To what extent are new firms entering and old firms leaving this industry?
- 9. What key factors have resulted in our present competitive position in this industry?
- 10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
- 11. What is the nature of supplier and distributor relationships in this industry?
- 12. To what extent could substitute products or services be a threat to competitors in this industry?

Competitive Intelligence Programs

Competitive intelligence (CI)

→ a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals

Competitive Intelligence Programs

The three basic objectives of a CI program are:

- 1. to provide a general understanding of an industry and its competitors
- to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors

Competitive Intelligence Programs

3. to identify potential moves that a competitor might make that would endanger a firm's position in the market

Market Commonality and Resource Similarity

Market commonality

→ the number and significance of markets that a firm competes in with rivals

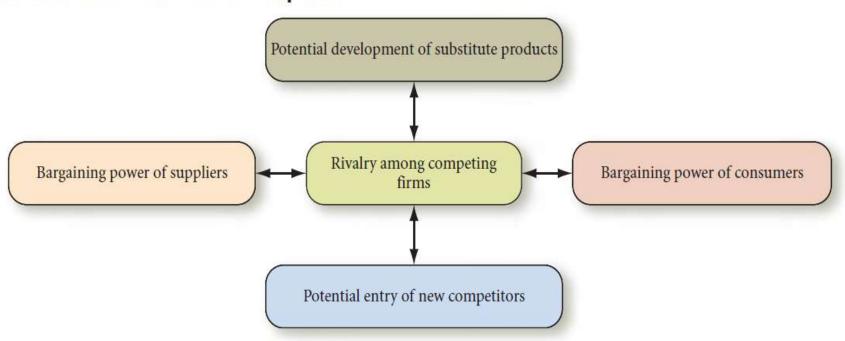
Resource similarity

→ the extent to which the type and amount of a firm's internal resources are comparable to a rival

The Five-Forces Model of Competition

FIGURE 3-3

The Five-Forces Model of Competition



The Five-Forces Model of Competition

- 1. Identify key aspects or elements of each competitive force that impact the firm.
- 2. Evaluate how strong and important each element is for the firm.
- 3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

The Five-Forces Model

Rivalry among competing firms

- → Most powerful of the five forces
- → Focus on competitive advantage of strategies over other firms

The Five-Forces Model

TABLE 3-9 Conditions That Cause High Rivalry Among Competing Firms

- 1. High number of competing firms
- 2. Similar size of firms competing
- 3. Similar capability of firms competing
- 4. Falling demand for the industry's products
- 5. Falling product/service prices in the industry
- 6. When consumers can switch brands easily
- When barriers to leaving the market are high
- 8. When barriers to entering the market are low
- When fixed costs are high among firms competing
- 10. When the product is perishable
- When rivals have excess capacity
- When consumer demand is falling
- When rivals have excess inventory
- 14. When rivals sell similar products/services
- When mergers are common in the industry

Potential Entry of New Competitors

- → Barriers to entry are important
- → Quality, pricing, and marketing can overcome barriers

Barriers to Entry

- Need to gain economies of scale quickly
- Need to gain technology and specialized knowhow
- Lack of experience
- Strong customer loyalty
- Strong brand preferences
- Large capital requirements
- Lack of adequate distribution channels

Barriers to Entry

- Government regulatory policies
- Tariffs
- Lack of access to raw materials
- Possession of patents
- Undesirable locations
- Counterattack by entrenched firms
- Potential saturation of the market

Potential development of substitute products

- → Pressure increases when:
 - Prices of substitutes decrease
 - Consumers' switching costs decrease

- Bargaining Power of Suppliers is increased when there are:

 - → Few substitutes
- Backward integration is gaining control or ownership of suppliers

Bargaining power of consumers

- Customers being concentrated or buying in volume affects intensity of competition
- → Consumer power is higher where products are standard or undifferentiated

Conditions Where Consumers Gain Bargaining Power

- 1. If buyers can inexpensively switch
- 2. If buyers are particularly important
- 3. If sellers are struggling in the face of falling consumer demand
- 4. If buyers are informed about sellers' products, prices, and costs
- If buyers have discretion in whether and when they purchase the product

Sources of External Information

- Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders.
- Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals.

Sources of External Information

- marketwatch.multexinvestor.com
- * moneycentral.msn.com
- finance.yahoo.com
- www.clearstation.com
- us.etrade.com/e/t/invest/markets
- www.hoovers.com
- globaledge.msu.edu/industries/

Forecasting Tools and Techniques

Forecasts

- educated assumptions about future trends and events
- → quantitative, qualitative techniques

Making Assumptions

Assumptions

→ Best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results.

Industry Analysis: The External Factor Evaluation (EFE) Matrix

- Economic
- Social
- Cultural
- Demographic
- Environmental

- Political
- Governmental
- Technological
- Competitive
- Legal

EFE Matrix Steps

- 1. List key external factors
- 2. Weight from 0 to 1
- 3. Rate effectiveness of current strategies
- 4. Multiply weight * rating
- 5. Sum weighted scores

EFE Matrix for a Local Ten-Theater Cinema Complex

TABLE 3-10 EFE Matrix for a Local Ten-Theater Cinema Complex

Key External Factors	Weight	Rating	Weighted Score	
Opportunities				
1. Rowan County is growing 8% annually in population	0.05	3	0.15	
2. TDB University is expanding 6% annually	0.08	4	0.32	
3. Major competitor across town recently ceased operations	0.08	3	0.24	
4. Demand for going to cinema growing 10% annually	0.07	2	0.14	
5. Two new neighborhoods being developed within 3 miles	0.09	1	0.09	
6. Disposable income among citizens grew 5% in prior year	0.06	3	0.18	
7. Unemployment rate in county declined to 3.1%	0.03	2	0.06	
Threats				
8. Trend toward healthy eating eroding concession sales	0.12	4	0.48	
9. Demand for online movies and DVDs growing 10% annually	0.06	2	0.12	
10. Commercial property adjacent to cinemas for sale	0.06	3	0.18	
11. TDB University installing an on-campus movie theater	0.04	3	0.12	
12. County and city property taxes increasing 25% this year	0.08	2	0.16	
13. Local religious groups object to R-rated movies being shown	0.04	3	0.12	
14. Movies rented from local Blockbuster store up 12%	0.08	2	0.16	
15. Movies rented last quarter from Time Warner up 15%	0.06	1	0.06	
Total	1.00		2.58	

Industry Analysis: Competitive Profile Matrix (CPM)

- Identifies firm's major competitors and their strengths & weaknesses in relation to a sample firm's strategic positions
- Critical success factors include internal and external issues

An Example Competitive Profile Matrix

TABLE 3-12 An Example Competitive Profile Matrix

Critical Success Factors	Weight	Company 1		Company 2		Company 3	
		Rating	Score	Rating	Score	Rating	Score
Advertising	0.20	1	0.20	4	0.80	3	0.60
Product Quality	0.10	4	0.40	3	0.30	2	0.20
Price Competitiveness	0.10	3	0.30	2	0.20	1	0.10
Management	0.10	4	0.40	3	0.20	1	0.10
Financial Position	0.15	4	0.60	2	0.30	3	0.45
Customer Loyalty	0.10	4	0.40	3	0.30	2	0.20
Global Expansion	0.20	4	0.80	1	0.20	2	0.40
Market Share	0.05	1	0.05	4	0.20	3	0.15
Total	1.00		3.15		2.50		2.20

Note: (1) The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength. (2) As indicated by the total weighted score of 2.50, Competitor 2 is weakest. (3) Only eight critical success factors are included for simplicity; this is too few in actuality.

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