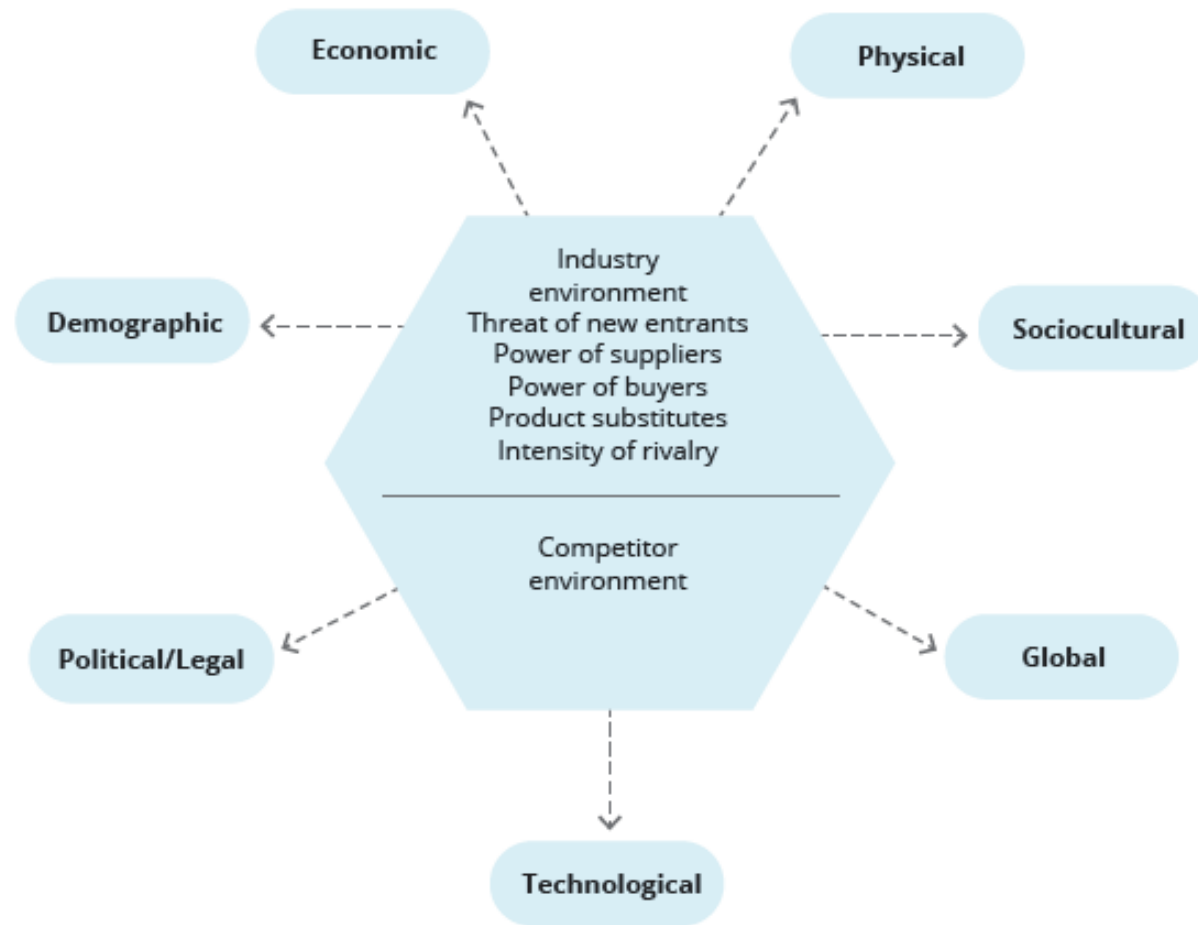


# Week 3 Part A: Chapter 2

## EXTERNAL ENVIROMENT OF A BUSINESS ORGANISATION

**Figure 2.1** The external environment



# The External Environment

- A firm's external environment creates:
  - **opportunities** (e.g. the opportunity for to enter other global markets)
  - **threats** (e.g. the possibility that additional regulations in local and global markets will reduce opportunities).
- Collectively, opportunities and threats affect a firm's strategic actions.
- External environments are:
  - Turbulent, complex, uncertain, ambiguous and incomplete.
- Firms engage in **external environmental analysis** to better understand and cope with their environments.
- This analysis has four parts:
  - **scanning, monitoring, forecasting and assessing.**

# EXTERNAL ENVIRONMENTAL ANALYSIS: SCANNING



Scanning is:

- the study of all segments in the general environment.

Through scanning,  
Organisations:

- identify early signals of potential changes in the general environment and
- detect changes that are already underway.

Scanning often  
-reveals ambiguous,  
incomplete or  
unconnected data and  
information.

Many firms use special software to reduce the trade-off between an important missed event and false alarm rates.

# EXTERNAL ENVIRONMENTAL ANALYSIS: MONITORING



Monitoring involves:  
observing meaningful  
environmental changes to see  
if an important trend is  
emerging from among those  
spotted through **scanning**.

It also requires the firm to  
identify important  
**stakeholders** and  
understand its reputation  
among these stakeholders as  
the foundation for serving  
their unique needs.

This is particularly important  
when a business competes in  
an industry with **high  
technological uncertainty**.

# EXTERNAL ENVIRONMENTAL ANALYSIS: FORECASTING



Examines feasibility projections developed for what might happen and how quickly it might happen as a result of the changes and trends detected through scanning and monitoring.

Technology trends are continually reducing product life cycles, which makes forecasting demand for new technological products much more challenging.

Technology trends are continually reducing product life cycles, which makes forecasting demand for new technological products much more challenging.

# EXTERNAL ENVIRONMENTAL ANALYSIS: ASSESSING



Involves determining the timing and significance of the effects of environmental trends that have been identified. It also involves specifying the implications of the understandings gathered at earlier stages.

Interpretation is key. Even if formal assessment is inadequate, the appropriate interpretation of that information is important.

Gathering and organising information is important, but appropriately interpreting that intelligence to determine if an identified trend in the external environment is an opportunity or threat is paramount.

# The External Environment Analysis Tools

- Analysis of the **general environment** is focused on:  
environmental trends
- An analysis of the **industry environment** is focused on :
  - the factors and conditions influencing an industry's profitability potential; and
- An **analysis of competitors** is focused on:
  - predicting competitors' actions, responses and intentions.

# The External Environment: General Environment

- Identifying opportunities and threats is an important objective of studying the general environment.
- An **opportunity** is a condition in the general environment that, if exploited effectively, helps a company achieve strategic competitiveness.
- A **threat** is a condition in the general environment that may hinder a company's efforts to achieve strategic competitiveness.
  - e.g.: Microsoft is experiencing a severe external threat as smartphones are expected to surpass personal computer sales in the near future.

**Table 2.1 The general environment: segments and elements**

Segments	Elements	
Demographic	<ul style="list-style-type: none"> <li>• Population size</li> <li>• Age structure</li> <li>• Geographic distribution</li> </ul>	<ul style="list-style-type: none"> <li>• Ethnic mix</li> <li>• Income distribution</li> </ul>
Economic	<ul style="list-style-type: none"> <li>• Inflation rates</li> <li>• Interest rates</li> <li>• Trade deficits or surpluses</li> <li>• Budget deficits or surpluses</li> </ul>	<ul style="list-style-type: none"> <li>• Personal savings rate</li> <li>• Business savings rates</li> <li>• Gross domestic product</li> </ul>
Political/legal	<ul style="list-style-type: none"> <li>• Taxation laws</li> <li>• Superannuation laws</li> <li>• Deregulation philosophies</li> </ul>	<ul style="list-style-type: none"> <li>• Labour training laws</li> <li>• Educational philosophies and policies</li> </ul>
Sociocultural	<ul style="list-style-type: none"> <li>• Women in the workforce</li> <li>• Workforce diversity</li> <li>• Attitudes about the quality of work life</li> </ul>	<ul style="list-style-type: none"> <li>• Shifts in work and career preferences</li> <li>• Shifts in preferences regarding product and service characteristics</li> <li>• Vegan activists</li> </ul>
Technological	<ul style="list-style-type: none"> <li>• Product innovations</li> <li>• Applications of knowledge</li> </ul>	<ul style="list-style-type: none"> <li>• Focus of private and government-supported R&amp;D expenditures</li> <li>• New communication technologies</li> </ul>
Global	<ul style="list-style-type: none"> <li>• Important political events</li> <li>• Critical global markets</li> <li>• Pandemic (Covid-19)</li> </ul>	<ul style="list-style-type: none"> <li>• Newly industrialised countries</li> <li>• Different cultural and institutional attributes</li> </ul>
Physical environment	<ul style="list-style-type: none"> <li>• Energy consumption</li> <li>• Practices used to develop energy sources</li> <li>• Renewable energy efforts</li> <li>• Minimising an organisation's environmental footprint</li> </ul>	<ul style="list-style-type: none"> <li>• Availability of water as a resource</li> <li>• Producing environmentally friendly products</li> <li>• Reacting to natural or human-made disasters</li> </ul>

# The External Environment: Industry Analysis

- An industry is a group of organisations that produce similar products or offer similar services that are close substitutes.
- Compared with the general environment, the industry environment has a more direct effect on a firm's:
  - Strategic competitiveness
  - Ability to earn above-average returns.

**Figure 2.4**

## The five forces of competition model



# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

- Historically, firms concentrated only on direct competitors
- Focusing on wider industry members highlights potential opportunities and competitors
- Five forces analysis helps firms understand the profitability potential of an industry
- [https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjauMC6r8v5AhVX63MBHRUjDikQwqsBegQIMhAB&url=https%3A%2F%2Fwww.youtube.com%2Fwatch%3Fv%3D\\_laBZmB09RE&usg=AOvVaw2HfKmkOcnRzZr6lWY4m7Z](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjauMC6r8v5AhVX63MBHRUjDikQwqsBegQIMhAB&url=https%3A%2F%2Fwww.youtube.com%2Fwatch%3Fv%3D_laBZmB09RE&usg=AOvVaw2HfKmkOcnRzZr6lWY4m7Z)

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 1. THREAT OF NEW ENTRANTS: BARRIERS TO ENTRY

- High entry barriers tend to increase the returns for existing firms in an industry and may allow some firms to dominate the industry
- Industry incumbents want to maintain high entry barriers in order to discourage potential competitors from entering the industry

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 1. THREAT OF NEW ENTRANTS: BARRIERS TO ENTRY

- Function of two factors:
  - Barriers to entry
    - Economies of scale
    - Product differentiation
    - Capital requirements
    - Switching costs
    - Access to distribution channels
    - Cost disadvantages independent of scale
    - Government policy
  - Expected retaliation

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Economies of scale**
    - Marginal improvements in efficiency that a firm experiences as it incrementally increases its size
    - Can be developed in most business functions, such as marketing, manufacturing, research and development and purchasing

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Product Differentiation**
    - Unique products
    - Customer loyalty
    - Lower prices (frequently offered by new entrants)

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Capital Requirements**
    - Differ according to industry
    - Availability of capital
    - Physical facilities, inventories and marketing activities
    - Knowledge requirements

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Switching Costs**
    - One-time costs customers incur when they buy from a different supplier:
      - New equipment
      - Retraining employees
      - Psychological costs of ending a supplier relationship

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Access to Distribution Channels**
    - Stocking or shelf space
    - Price breaks; cooperative advertising allowances
    - Less of a barrier for products that can be sold on the Internet

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Cost Disadvantages Independent Of Scale**
    - Proprietary product technology
    - Favourable access to raw materials
    - Desirable locations

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

1.  
THREAT OF NEW ENTRANTS:  
BARRIERS TO ENTRY

- Barriers to entry
  - **Government Policy**
    - Licensing and permit requirements
    - Regulation and deregulation of industries
    - Antitrust violations resulting from industry dominance

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 1. THREAT OF NEW ENTRANTS: BARRIERS TO ENTRY

- **Expected retaliation**
  - Vigorous retaliation can be expected when an existing firm has a major stake in the industry.
  - It has fixed assets with few, if any, alternative uses.
  - It has substantial resources.
  - This is especially true if industry growth is slow or constrained.
  - Locating market niches not being served by incumbents allows a new entrant to avoid entry barriers.
  - Small entrepreneurial firms are generally best suited for identifying and serving neglected market segments.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 2. BARGAINING POWER OF SUPPLIERS

- Supplier power increases when:
  - Suppliers are large and few in number
  - Suitable substitute products are not available
  - Industry organisations are not a significant customer for the suppliers
  - Suppliers' goods are critical to buyers' marketplace success.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 2. BARGAINING POWER OF SUPPLIERS

- Supplier power increases when:
  - Suppliers' products create high switching costs
  - Suppliers have substantial resources and provide a highly differentiated product
  - Suppliers pose a credible threat to integrate forward into the buyers' industry.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 3. BARGAINING POWER OF BUYERS

- Buyer power increases when:
  - The industry's products are undifferentiated or standardised
  - Buyers pose a credible threat to integrate backward into the sellers' industry.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 3. BARGAINING POWER OF BUYERS

- Buyer power increases when:
  - Buyers purchase a large portion of an industry's total output
  - Buyers' purchases are a significant portion of a seller's annual revenues
  - Switching costs (to other industry products) are low.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 4. THREAT OF SUBSTITUTE PRODUCTS

- The threat of substitute products increases when:
  - Buyers face few switching costs
  - The substitute product's price is lower
  - Substitute product's quality and performance are equal to or greater than the existing product
- Differentiated industry products that are valued by customers reduce this threat.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 4. THREAT OF SUBSTITUTE PRODUCTS

- **Function of a substitute**
  - Places a ceiling on prices firms can charge.
  - Goods or services outside a given industry perform the same or similar functions at a competitive price (e.g. plastic has replaced steel in many applications).

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 5. RIVALRY AMONG COMPETING FIRMS

### ▪ **Industry Rivalry**

- Competitors are rarely homogeneous; they differ in resources and capabilities and seek to differentiate themselves from competitors.
- Firms seek to differentiate their products in ways that customers value and in ways in which the firms have a competitive advantage.
- Common rivalry dimensions include:
  - Price
  - Service after the sale
  - Innovation

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 5. RIVALRY AMONG COMPETING FIRMS

- **Exit barriers:**
  - High exit barriers prevent competitors from leaving the industry.
  - Examples of high exit barriers include:
    - **Specialised assets** – assets with values linked to a particular business
    - **Fixed costs of exit** (e.g. labour agreements)

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 5. RIVALRY AMONG COMPETING FIRMS

- **Exit barriers:**
  - Examples of high exit barriers include:
    - **Strategic interrelationships** – relationships of mutual dependence (e.g. those between one business and other parts of a company's operations, including shared facilities and access to financial markets)
    - **Emotional barriers** – an aversion to economically justified business decisions because of fear for one's own career, loyalty to employees, etc.

# INDUSTRY ENVIRONMENT ANALYSIS: THE FIVE FORCES OF COMPETITION MODEL

## 5. RIVALRY AMONG COMPETING FIRMS

- **Exit barriers:**
  - Examples of high exit barriers include:
    - Government and social restrictions – often based on government concerns for job losses and regional economic effects; more common outside the USA.

# INTERPRETING THE FIVE FORCES MODEL



**Unattractive  
Industry  
and  
Low Profit  
Potential**

# INTERPRETING THE FIVE FORCES MODEL



# INDUSTRY ENVIRONMENT ANALYSIS: STRATEGIC GROUPS

- Strategic Group Dimensions
  - Extent of technological leadership
  - Product quality
  - Pricing policies
  - Distribution channels
  - Customer service

**Figure 2.5** Competitor analysis components

**Future objectives**

- How do our goals compare with our competitors' goals?
- Where will emphasis be placed in the future?
- What is the attitude towards risk?

**Current strategy**

- How are we currently competing?
- Does this strategy support changes in the competitive structure?

**Assumptions**

- Do we assume the future will be volatile?
- Are we operating under a status quo?
- What assumptions do our competitors hold about the industry and themselves?

**Capabilities**

- What are our strengths and weaknesses?
- How do we rate compared to our competitors?

**Response**

- What will our competitors do in the future?
- Where do we hold an advantage over our competitors?
- How will this change our relationship with our competitors?

## Group Experiential Exercise 2

### What does the future look like? P. 66