POLITECNICO DI MILANO

SWOT Analysis – The environment (Part 1)

External and Internal Strategy Analysis at a Business level

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Three level:
corporate
business
functional

How to build a SWOT table?

S W

O T

The competition

The environment

Vision => Long-term view of evolution of the BA
Mission =>
Objective => SMART

1. specific, since they shall be relatable to what they are focused on and they shall convey a clear message on what's to achieve.
2. measurable by means of one or more clear indicators, since you can't improve what you can't measure.
3. appropriate or aligned, they must be consistent with the company's overarching vision and mission.
4. realistic: goal setting theory tells managers to set objectives that are challenging, but not perceived as neither impossible nor too easy (because both ways lead to demotivation).
5. timely, they must be related to a clear deadline to achieve them.

Business Strategy level

difference between Ex & In => perspective
Ex : Average Player in the market
In: One Firm compared to competitor

* Narrow the Market

The strategic decision making process at SBU level

Vision/Mission/objectives
Economic value creation

Orientation

EXTERNAL ANALYSIS

OBJECTIVES

Evaluation of the attractiveness of a business area and identification of the main threats and opportunities

METHODOLOGY

Porter's Five Competitive Forces model

PEST model

INTERNAL ANALYSIS

OBJECTIVES

Assessment of the SBU competitive advantage concerning cost and value (strengths and weaknesses)

METHODOLOGY

Porter's Value Chain model

Core Resources and Competencies

Strategic alternatives generation

5 Porter forces => competition
PEST Analysis => Macro Trend

talk about why using a model

Business Strategy level:

External Strategy Analysis

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The competition

The environment

Business strategy

EXTERNAL ANALYSIS

OBJECTIVES

Evaluation of the attractiveness of a business area and identification of the main threats and opportunities

Valid for all the player of the market
For all the competitor

METHODOLOGY

Porter's Five Competitive Forces model
PEST model

Attractiveness of the Business area

Attractiveness of the Business Area

↓

Average profitability and growth of the companies operating in the BA

(both present and future)

Porter's 5 Competitive Forces Model

It is referred to a specific Business Area

Basic assumptions:

Competition is driven by industry structure use the checklist

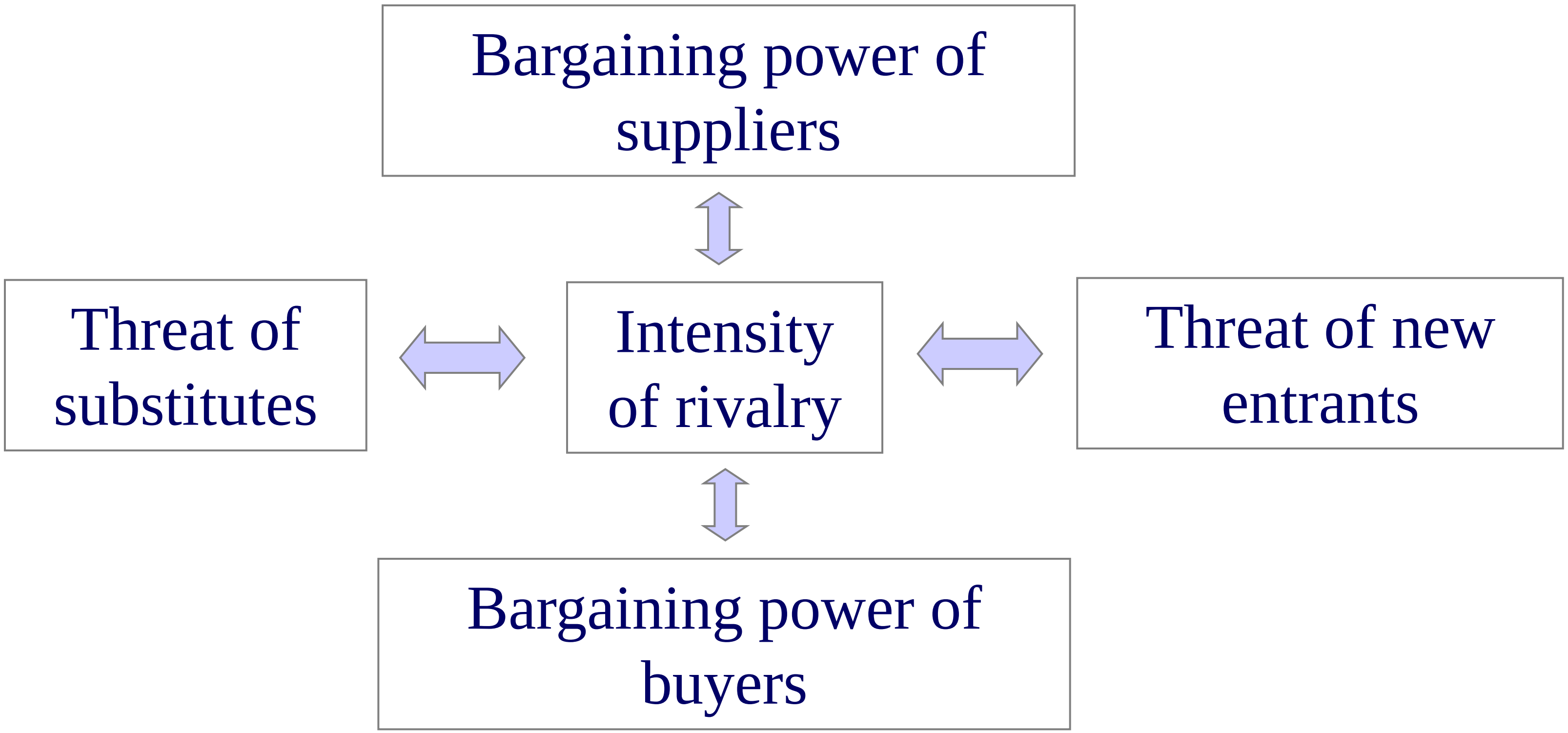
companies' positioning

Business Area's attractiveness is inversely proportional to the level of competition of the competitive environment

Competition in an industry goes well beyond established players: ⇨ concept of *extended rivalry*

Porter's 5 Competitive Forces

read example



Exam => choose a market area that you like, not one of the project work. drop quickly main elements of external analysis. (in 2 minutes)

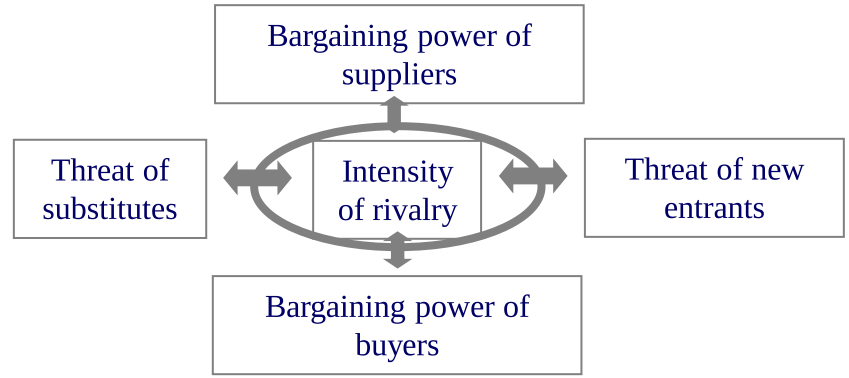
smart phone industry (Can't!)

Intensity of internal rivalry

all the players
Similar to you

Direct competition

Structural determinants:



- Concentration and balance
  number of competitor
- Diversity of competitors
  products are different
- Industry growth
  CAGR, Overall value, revenue
- Product differentiations
  like diversity
- Switching costs
  Customer has to pay in general to change the product
  not money, Efforts!! (ecosystem & Comparability)
- Fixed costs impact
  cost of machines, storage, manufacturing
- Storage costs
  food and supermarkets
- Exit barriers
  exiting is easy or no?

Specialized assets

Fixed costs of exit

Strategic interrelationships

Emotional barriers

Government and social restrictions

Threat of new entrants

Potential competition

Bargaining power of suppliers

Threat of substitutes

Intensity of rivalry

Threat of new entrants

Bargaining power of buyers

Structural determinants:

Entry barriers

- **Economies of scale** decrease of unitary cost if we increase the production
- **Capital requirements**
- **Brand identity** strong brand and potential brand leverage
- **Switching costs** entrant persp. / switch to new entrant
- **Access to distribution channel**
- **Cost advantages independent of size**
- **Legislation or government actions**

Incumbent's expected reactions (retaliation)

Proprietary product technology

Favourable access to raw materials

Favourable location

Learning curve

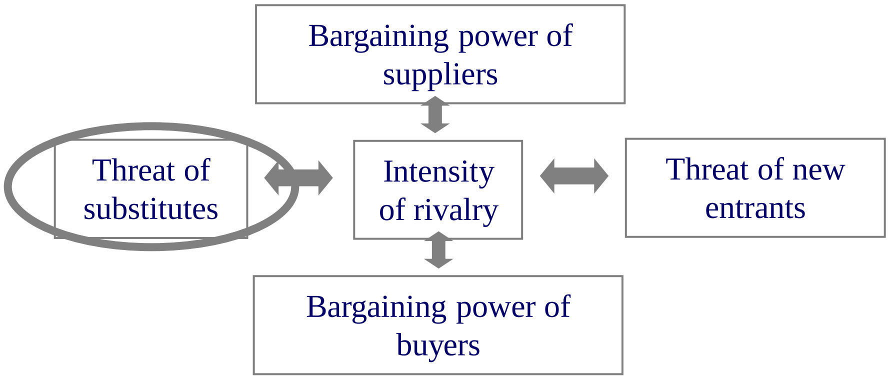
Government subsidies

Threat of substitutes

Indirect competition

Substitutes = Products able to satisfy the same needs

product technically different



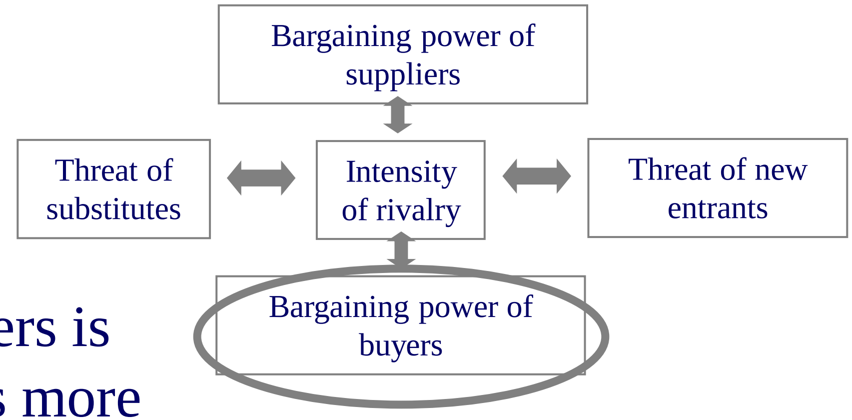
The existence of substitutes sets some constraints to the behaviour of firms belonging to a specific Business Area

In particular, such constraints are referred to price definition: substitutes limit the potential returns of a BA by placing a ceiling on the prices internal firms in the BA can set

The more attractive the price/performance ratio of substitutes, the higher the risk to lose customers to the advantage of substitutes

Bargaining power of buyers

Downstream competition



It can derive from:

low number of customers

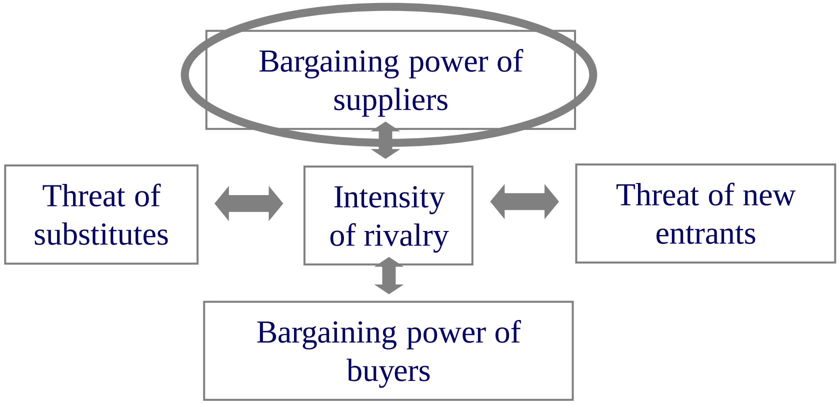
- **Relative concentration**
  - The bargaining power of buyers is higher if their business area is more concentrated than that of suppliers

- **Product's features**
  - The bargaining power of buyers increases if:
    - product differences are low product similar to each other
    - switching costs are low easy to change?
    - product's impact on the final performance is weak (only for intermediate products) plastic

Bargaining power of buyers - continue

- Buyer's characteristics
  - The bargaining power of buyers increases if:
    - they are not very profitable will be price sensitive
    - they are able to integrate themselves backward
    - they have clear information about the product
    - the component or material cost is a high percentage of the total cost most of the budget

Bargaining power of suppliers



Upstream competition

The structural determinants of bargaining power of suppliers are dual to those influencing the bargaining power of buyers

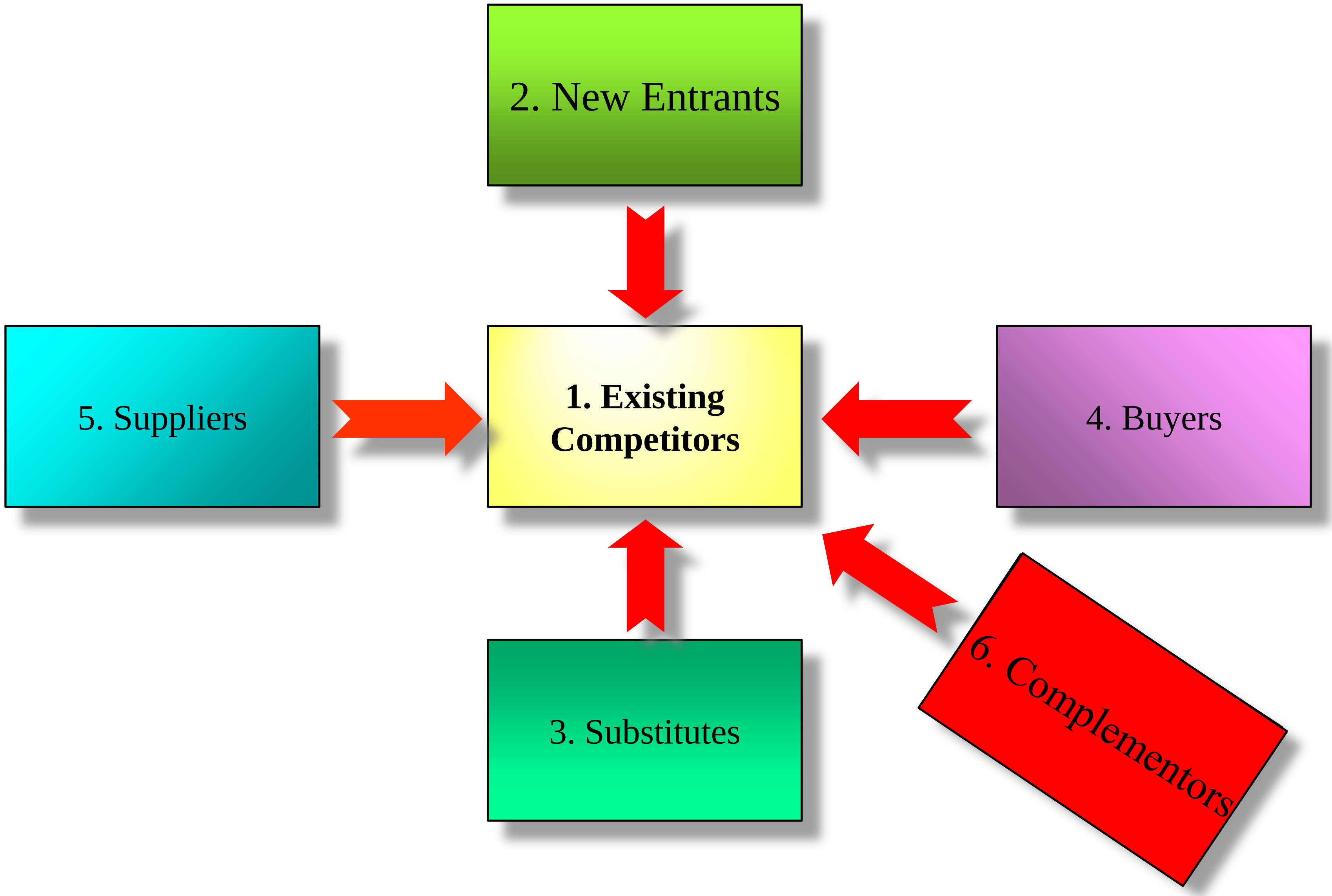
A sixth force: complementors

digital world

product that are complementary to the product analyzing.
bundle, platform offer

- While substitutes have a negative impact on value, complements have a positive impact.
- Unlike the other five forces, complementors are not a competitive force
- Complements are always important in affecting the overall demand for an industry's product
- Example: in the video game industry the producers of software (games) are complementors to the producers of hardware (consoles)

The five forces model plus "complementors"



Understanding industry structure

- "Understanding the forces that shape competition in an industry is the starting point for developing strategy.
- …Most importantly, an understanding of industry structure guides managers towards possibilities for strategic action, including (1) positioning the company vis-à-vis the current competitive forces; (2) anticipating shifts in the forces and exploiting them: (3) shaping the balance of forces to create new more favourable structure or one that favours the company."

M. Porter, HBS, 2006

Five forces analysis: key questions and implications

- What are **boundaries of the business area** to which the model is applied? poor infromative
- What are the **key forces** at work in the competitive environment?
- Are there **underlying forces** driving competitive forces?
- Will **competitive forces** change?
- How **attractive** is this industry?
- Can **competitive strategy** implemented by players influence competitive forces (e.g. by building barriers to entry or reducing competitive rivalry)?

PEST Analysis

The results coming from the 5 Competitive Forces analysis can be integrated by studying which **macro-environmental factors** can have a significant influence on the Business Area under scrutiny, so to identify a more comprehensive set of external opportunities and threats.

In particular, **Political, Economic, Social** and **Technological** influences can be very important

Hence, the **PEST analysis** aims at analysing environmental influences' trends

PEST Analysis

EU with gasoline engine is banned

Political/legal

- Monopolies legislation
- Environmental protection laws
- Taxation policy
- Foreign trade regulations
- Employment law
- Government stability

Economic

- Business cycles
- GNP trends
- Interest rates
- Money supply and Inflation
- Unemployment & av. income
- Energy availability and cost

Socio-cultural

- Population demographics
- Income distribution
- Social mobility
- Lifestyle changes
- Attitude to work and leisure
- Levels of education

Technological

- Govn. spending on research
- Govn./industry focus on technological effort
- New findings/developments
- Speed of technology transfer
- Rates of obsolescence

PEST Analysis

PESTE model/analysis/framework for an educated approach to cover important environmental factors

A practical way of carrying out this analysis is to:

- Identify each possible factor
- Give each factor a probability of occurrence in % and a rating for their impact in the coming 3-5 years where:
  - -5= extremely negative impact
  - +5= extremely positive impact
- Map the factor as an opportunity/threat to include in the OT portion of the SWOT analysis

PEST Analysis – example of representation

ENVIRONMENTAL ANALYSIS

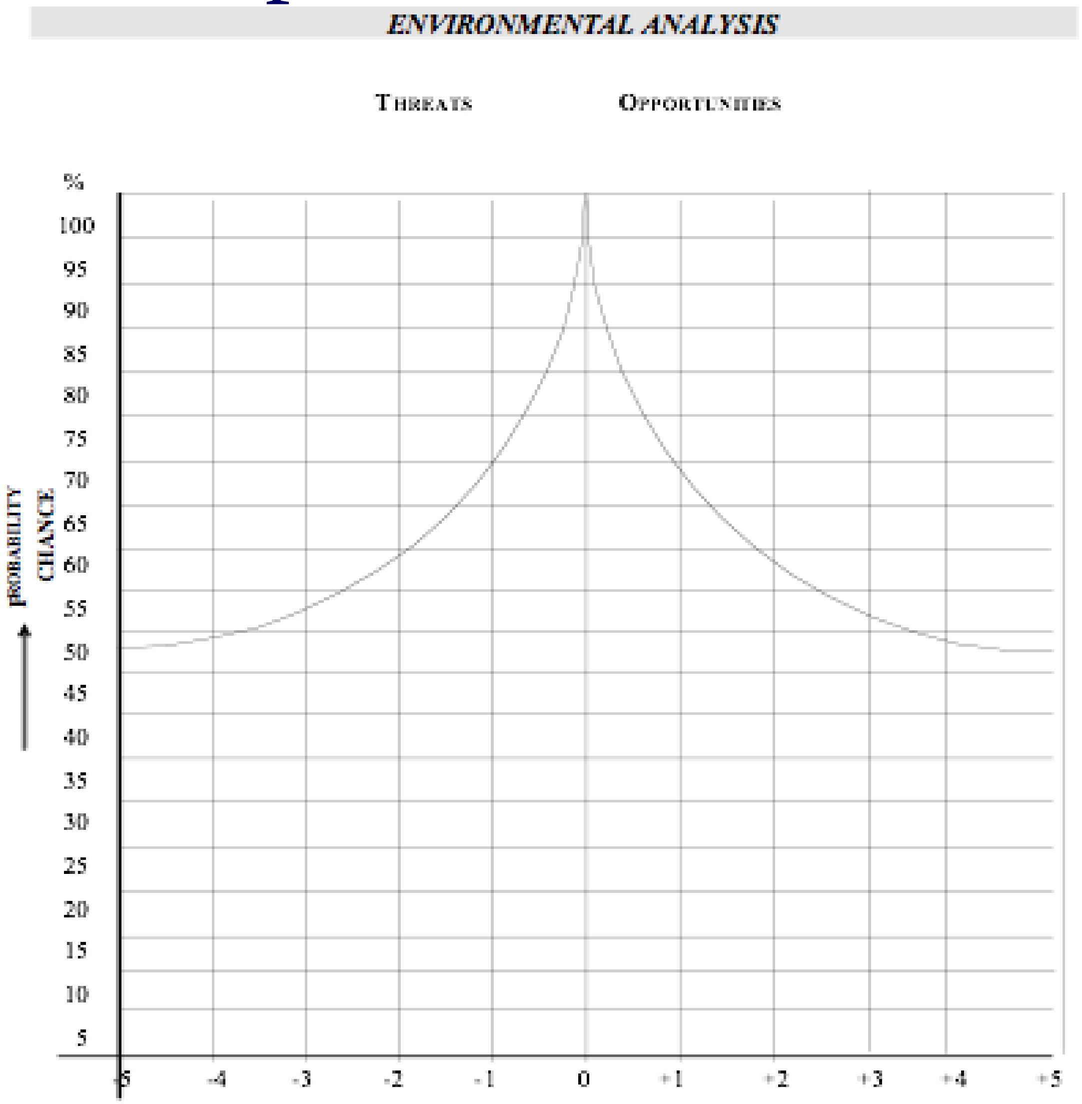
FACTOR	IMPACT	RESPONSE	Prob.%	Imp. (-5 to +5)
1. ***SOCIAL:***				
2. ***TECHNOLOGICAL:***				
3. ***ECOLOGICAL:***				

PEST Analysis – example of representation

ENVIRONMENTAL ANALYSIS

FACTOR	IMPACT	RESPONSE	Prob.%	Imp. (-5 to +5)
4. ***ECONOMIC:***				
5. ***POLITICAL:***				

PEST Analysis – example of representation



Business Strategy level:

Internal Strategy Analysis

perspective is the specific company

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The competition

The environment

Business strategy

Logic pattern of the strategic decision making process at SBU level

Mission/objectives
Economic value creation

EXTERNAL ANALYSIS

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PEST model

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Business strategy

INTERNAL ANALYSIS

OBJECTIVES

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METHODOLOGY

Porter's Value Chain model less suitable for service company

Core Resources and Competencies approach

Competitive advantage at SBU level

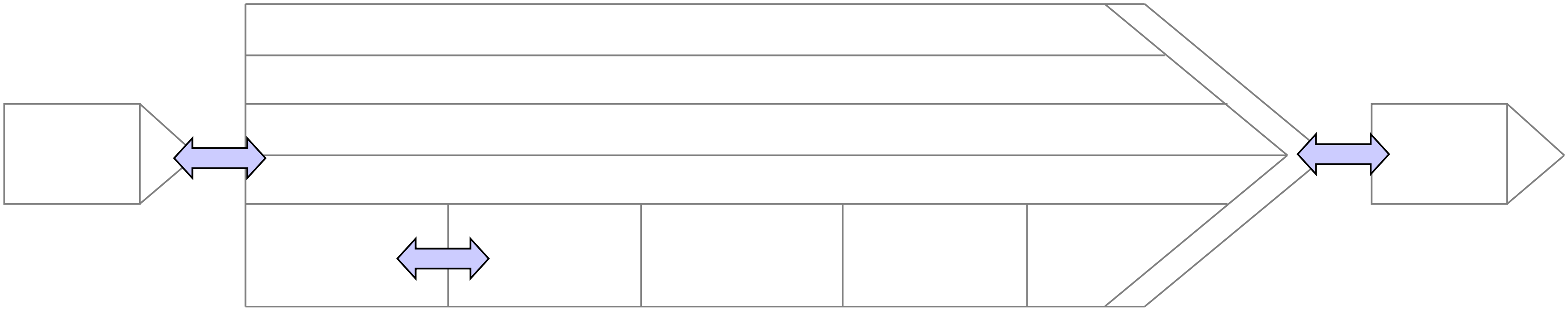
It is not possible to analyse the SBU's competitive advantage considering the SBU as a "black box" transforming inputs in outputs and separated from customers and suppliers

The Value Chain model can be used to analyse the SBU's competitive advantage

Porter's Value Chain

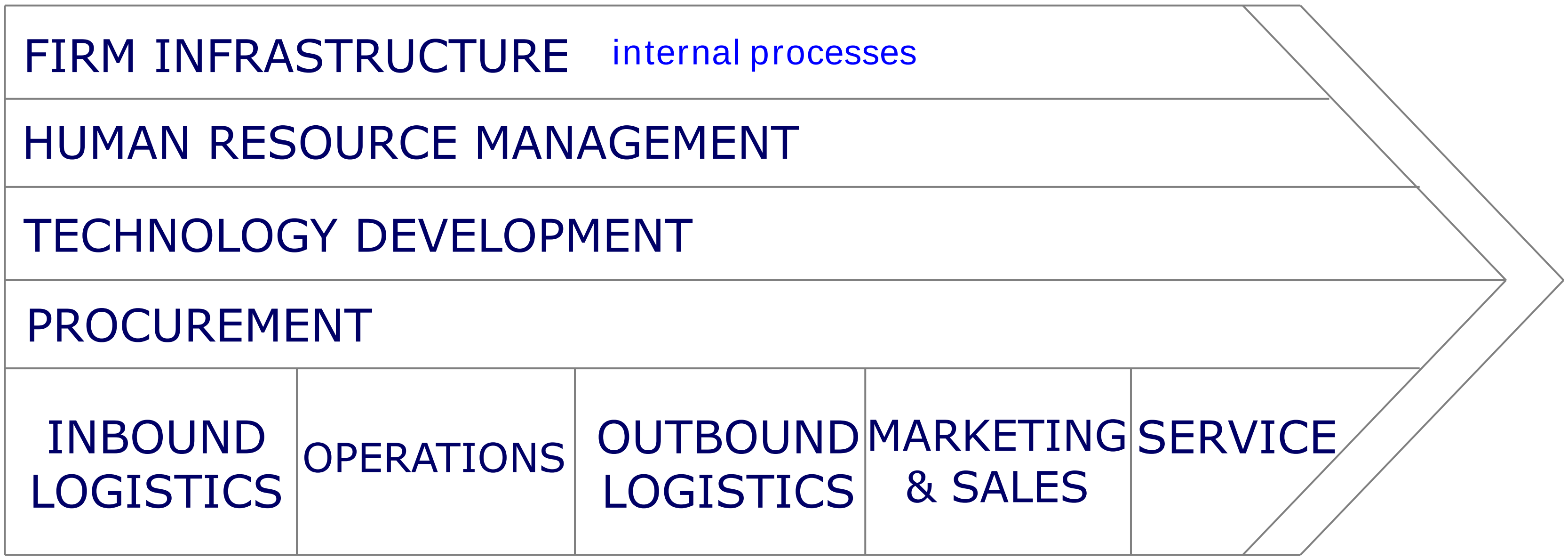
A company's sources of cost/value competitive advantages depend on:

- **The overall system of activities (boundary)**
- **The single significant activities**
- **The links between activities**



- **The Value Chain is referred to a specific SBU**

Porter's Value Chain:
an example of a manufacturing company



Primary activities

They are directly responsible for value creation through the Value Chain

- *Inbound logistics*: activities related to the receipt, storage, transport and distribution of the inputs
- *Operations*: activities related to the conversion of inputs into outputs
- *Outbound logistics*: activities related to the storage of the finished products and to their distribution
- *Marketing and sales*: activities aimed at promoting and selling the products (advertising, promotion, managing of the distribution and sales channels, …)
- *Service*: for instance set up, technical assistance, maintenance, …

Support activities

They allow the continuative execution of primary activities

- *Procurement*: activities related to the acquisition of all the input (raw materials, components, equipment, technologies, services, …) needed by the firm (for instance: suppliers selection, negotiation, qualification, …)
- *Human resource management*: activities related to the recruitment, training, incentive and evaluation of employees
- *Technology development*: R&D, engineering, …
- *Firm infrastructure*: administration, finance, planning, quality control, …

Focus: **Cost** competitive advantage

The sources of cost competitive advantages depend on:

- Single activities
- Links between activities
- Overall system of activities

Two main porter strategy: cost leadership & Differentiation

Cost Leadership : Selling with lower price like Sugar
Differ. : Charge for more price due to a better value Like Smart phones

Cost competitive advantage: Analysing specific activities

- Competitive advantages may depend on the way the company runs the specific activity. Main steps of the analysis:
  - Identification of the activities considered “significant” for what concerns costs in terms of:
    - High impact on the overall costs
    - Different causes
    - Different behaviour of competitors
  - Evaluation of the specific activities’ costs.

    Main problems:
    - Cost accounting registrations not consistent
    - Shared activities
  - Identification of the costs’ specific **determinants**

Benchmark to competitors:

Relative positioning

Cost competitive advantage: Analysing specific activities - continue

- Each activity has a specific cost structure and hence its costs' determinants may be different

- Examples of **determinants of costs** are
  - Economies of scale
  - Economies of learning
  - Degree of saturation of the production capacity 80 Pcs / 1000 pcs
  - Localisation closing thing to you
  - Preferential access to distribution
  - Institutional factors
  - Product/process design

Cost competitive advantage: Analysing links between activities

- Competitive advantages may depend on the way the company manages the links between:
  - its activities (internal links)
  - its activities and those of customers and suppliers (external links)

In the last years several techniques (as “just in time”, concurrent engineering and design for manufacturing) have been introduced in order to “optimize” both the internal and external links

Cost competitive advantage: Analysing overall system of activities

- Competitive advantages may depend on Make or Buy choices

internally or externally

"Make" decision

Advantages

- Less transactional costs
- Gain of supplier's margin
- Learning and controlling core competence
- More independence from suppliers

Disadvantages

- Less efficiency than suppliers
- Low motivation
- Less flexibility
- More capital equipment
- Co-ordination costs

Cost competitive advantage and economic value

Decisional levers

⇓

Cost competitive advantage

⇓

Economic value creation

Costs decrease, but the price remains unchanged =>

- **Contribution margin increases (Δm)**
- **Sales level does not change (Q)**
- **ΔNCF = Δm * Q**

Costs decrease and price decreases accordingly =>

- **Contribution margin does not change (m)**
- **Sales level increases (ΔQ)**
- **ΔNCF = m * ΔQ**

Focus: **Value** competitive advantage

It aims at making the product/service "unique" for the customer
Example of value competitive advantages are:

- **Quality**: product's nominal performances, but also effective performances
- **Time**: both for what concerns delivery time and time to market
- **Service**: both incorporated with the product or complementary
- **Variety/customisation**: fullness of the array of products and level of personalisation
- **Reputation**: both of the firm and of the brand

Focus: **Value** competitive advantage

The sources of value competitive advantages depend on:

- Single activities
- Links between activities
- Overall system of activities

Value competitive advantage and economic value

Decisional levers

⇓

Attractiveness competitive advantage

⇓

Economic value creation

Price increases =>

- **Contribution margin increases (Δm)**
- **Sales level does not change (Q)**
- **$\Delta NCF = \Delta m * Q$**

Price does not change =>

- **Contribution margin does not change (m)**
- **Sales level increases (ΔQ)**
- **$\Delta NCF = m * \Delta Q$**

Examples of value chain's application

- **Xerox**, by developing the value chain analysis, has discovered that its service competitive disadvantages were linked to the high complexity of its copy machines' design that made difficult the ex-post individuation of problems
- **Caterpillar**, comparing its value chain with that of competitors has individuated a cost competitive disadvantage. In order to reduce costs it has decided on the one hand to increase its array of products and on the other hand to sell its diesel engines to competitors aiming at better exploiting economies of scale (in production, but also in marketing, sales and service).
- **Volkswagen**, analysing the value chain of its Brazilian plant has verified how some activities could not be managed effectively in-house. Hence it has involved more deeply its suppliers that now are responsible of all logistics activities to the very installation of components on the assembly line.
- **Compaq** has utilised the value chain analysis in order to understand why it was unable to provide the desired value to customers. The results of the analysis have pushed Compaq towards the development of different links with its customers.

Business Strategy level:

Resource and competence-based View

-- select a company you like, highlight the source of competitive advantages

-- the different resources and competencies the company has, apply 5 core test, understand if they are core or not, able to leverage to create competitive advantage or not

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it's only about the company! internal analysis ... company can influence or leverage

A critique of the Positioning School

- The «Positioning School» focuses on:
  - spotting the most attractive business area (external analysis) and
  - Shaping the right competitive positioning in such business area (internal analysis)
- However:
  - Competitive advantage does not come from competitive positioning alone
  - The focus of strategy cannot be largely placed outside of the company's boundaries («outside-in» approach)
  - The Positioning School leads to a distorted vision of the company's organizazional structure, where SBUs are separated and fully devoted to cover the business areas where the company chooses to locate the products and services it offers in its portfolio: this results in a static and disjointed view of the company, identified as the «tyranny or the SBUs» (Hamel, Prahalad, 1990)

An alternative theory for internal analysis: the Resource & Competence-based View (1/2)

- According to the RCBV, companies are a unique collection of tangible and intangile resources and competencies (Barney, 1991; Collis, Montgomery, 1995)
- Those resources and competencies that influence the achievement of competitive advantage are labelled as «core»
- A core resource or competence is **an area of specialized expertise within the company, resulting from specific the harmonization of complex technology streams and working activities, and which:**
  - **offers benefits to the customer**
  - **is hardly imitable by competitors, and**
  - **you can leverage in a multitude of products and/or markets** (Hamel, Prahalad, 1990)
- Two companies cannot be totally alike, as each and every company possesses its own and unique asset of experiences, its own acquired resources and competencies, its own organizational culture.
- Such core resources and competencies determine how efficiently and effectively a company carries out its functional activities, and ultimately influence its ability to achieve and sustain competitive advantage.

resources & competencies

I. Core = Competitive adv.

II. Non-Core =

An alternative theory for internal analysis: the Resource & Competence-based View (2/2)

- Valuable resources can take different forms:
  - Tangible, physical assets;
  - Intangible asset – e.g. brand, know-how;
  - derive from an organizational skill resident in the firm's routines, processes or culture.
- Notwithstanding the nature of these resources and competencies, the RCBV holds that the very possession of such distinctive assets constitutes the basis of a company's competitive advantage.
- Instead of a portfolio of products, a company should be seen as a portfolio of competencies.

The available resources and competencies

Tangible assets		Intangible assets		
Physical	**Financial**	**Human**	**Technological**	**Reputation**
▪ characteristics production facilities ▪ location ▪ production flexibility ▪ capacity surpluses ▪ property and equipment	▪ receivables from clients ▪ cash and cash equivalents ▪ liabilities ▪ equity	▪ knowlegde and expertise ▪ adaptability ▪ loyalty ▪ availability ▪ performance	▪ patents, copyright, company secrets ▪ R&D facilities ▪ qualifications of employees	▪ brands ▪ corporate image ▪ corporate identity ▪ relationship with suppliers ▪ customer satisfaction

The RCBV approach (1/2)

Hamel & Prahalad (1990)

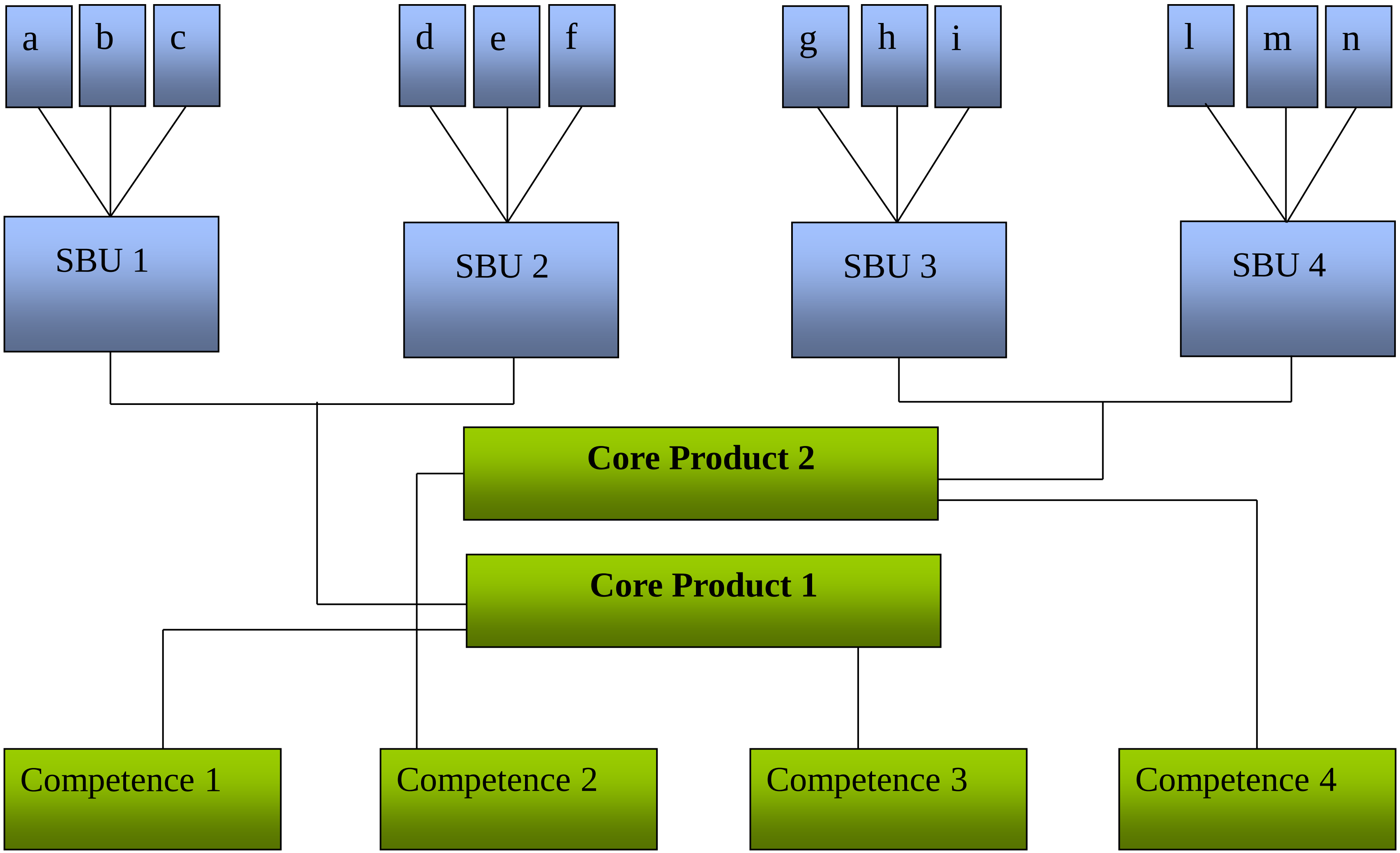
*"The diversified corporation is like a big tree. The trunk and the main branches represent the **core products**, the smallest branches are the **business units**, while the leaves, flowers and fruits are the **end products**.*

*The system of roots providing nourishment and stability are the **core competencies.**"*

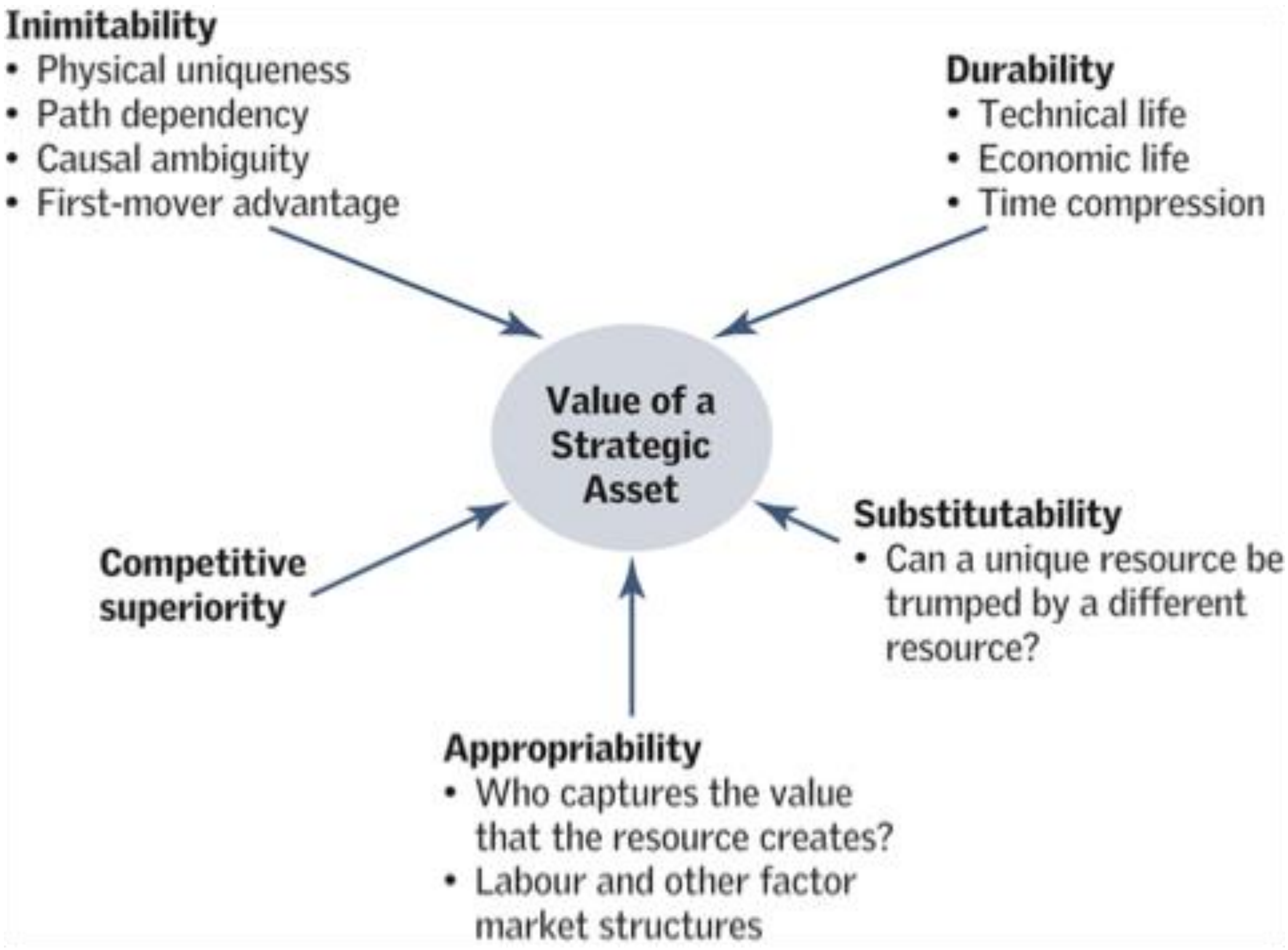
- It is essential that the management focuses its attention on **developing internal competencies and resources to leverage in order to create the end products**, rather than on assessing the final markets' attractiveness.
- The link between core competencies and end products is defined **core product**, that is**, the physical concretization of one or more core competencies**
- These core products are the components or modules determining the value of the end products springing from them (e.g. engines for Honda, semiconductors for Nec, compressors for Matsushita, data drives & lasers for Sony and Philips)

The RCBV approach (2/2)

<u>Resources and competencies are at the roots of a company's competitiveness</u>



Not all assets are core



How to identify the company's core resources and competencies

Five «Core Test» (Collis, Montgomery, 1995):

1. Inimitability – hard to copy, thanks to physical uniqueness, path dependency, causal ambiguity and economic deterrence
2. Durability – slowly depreciating
3. Appropriability – creating value that is easily captured by the firm
4. Non-substitution – not replaceable by alternative resources satisfying the same need
5. Competitive superiority – performing better than competitors' resources

Core resources and competencies: the Disney case (1/3)

- When in 1984 Micheal Eisner became Walt Disney’s chairman, the company was facing its fourth consecutive year of decline, enough to attract speculators on the stock market
- A boost in the turnover was registered between 1984 and 1988: net profits went from 98 million to 570 million dollars and the value of the company on the stock market went from 1.8 to US $ 10.3 billion
- Nevertheless, noticeable changes in strategy didn’t occur in Eisner’s first three years as chairman
- The key success factor was due to the mobilization of the company’s huge resource base

Core resources and competencies: the Disney case (2/3)

- Asset profitability improvement:
  - hotels, residential and resort construction
  - increased number of attractions @ Epocot Center;
  - new theme park construction (Disney-MGM studios),
  - Euro Disneyland construction

- Better exploitation of the huge owned film library:
  - new release of the classic movies;
  - sales of licenses for movies to television networks
  - VCR’s sales

Core resources and competencies: the Disney case (3/3)

- Disney studios' rebirth:
  - booming of the Touchstone label
  - doubling of the number of films produced
  - Aggressive recruitment of producers, directors, actors and writers

- The management was able to exploit the most powerful available resource: the loyalty of millions of people from different countries and age, linked to the name and characters created by Disney

Strategic Business Unit vs. core resource & competence

	SBU	Core Competence
Basis for competition	Competition among existing products	Competizione among companies to build competencies
Corporate Structure	Portfolio of businesses related in terms of products and/or markets	Portfolio of competencies, core products and businesses
SBU Status	Significant autonomy. SBUs own all of their resources excluding cash	SBUs are potentials pools of core competencies
Resource allocation	Single businesses are the unit of analysis and capitol is allotted to each business	Businesses and competencies are the unit of analysis. Top Management allots both capital and competencies
Value added by the Top Management	Optimize corporate profits by properly managing the trade-offs and synergies among SBUs	Define the strategic architecture and build/share the competencies to support the company's future

The Positioning School and the RCBV: a mediation

- The Positioning School relates competitive advantage to the right strategic positioning of the company and on the chain of activities it performs, thus adopting a perspective that privileges external analysis
- The Resource & Competence Based View sees competitive advantage as stemming from the pool of distinctive core resources and competencies that the company developed, thus focusing on internal analysis
- However, should we decompose these two theories in their key assumptions, what we find is that:
  - When the Positioning School looks within a company's boundary to identify strengths and weaknesses in the value chain (e.g. physical assets, know how, brand image, sound organizational processes, service level and customer relationship), it is actually looking for core resources and competencies
  - The RCBV proposes an approach that has little significance if deprived of a link with the external environment. Resources and competencies cannot be assessed as if they were isolated, since their value is determined by the interaction with the competitive forces: a resource is valuable in a given business area and in a given timeframe