

Lesson 3. Environment and firm strategy



At a glance

Lesson 3 is a short introduction to **Strategic Management** concepts and tools.

On the one hand, the analysis of the **environment of the firm** is a prerequisite for sensible decisions.

On the other hand, long term value creation also requires a clear understanding of **business and corporate strategies**.

Strategy is ...

... the overall plan for deploying resources to establish a favorable position.

... the mediating force or match between the firm and its environment.

... a tool for gaining competitive advantage over competitors .

Lesson 3. Environment and firm strategy

3.1. Business environment analysis

3.2. Strategic management

A. Introduction

The interface between strategy and the firm



Outcomes of external analysis

Firms identify what
they **MIGHT DO**



Outcomes of internal analysis



Identification of
unique resources
and capabilities,
(necessary to achieve a
sustainable competitive
advantage)

Firms identify what they
CAN DO

The profitability of US industries, 2000-2010

Industry	Median ROE 2000-10(%)	Leading companies
Tobacco	33.5	Philip Morris Int., Altria, Reynolds American
Household and personal products	27.8	Procter & Gamble, Kimberly-Clark, Colgate- Palmolive
Motor vehicles and parts	4.4	GM, Ford, Johnson Controls
Entertainment	3.9	Time Warner, Walt Disney, News Corporation
Airlines	-11.3	AMR, UAL, Delta Airlines

Source: Data from Fortune 1000 by industry. See Grant & Jordan Table 2.1 for a more detailed list of US industries.

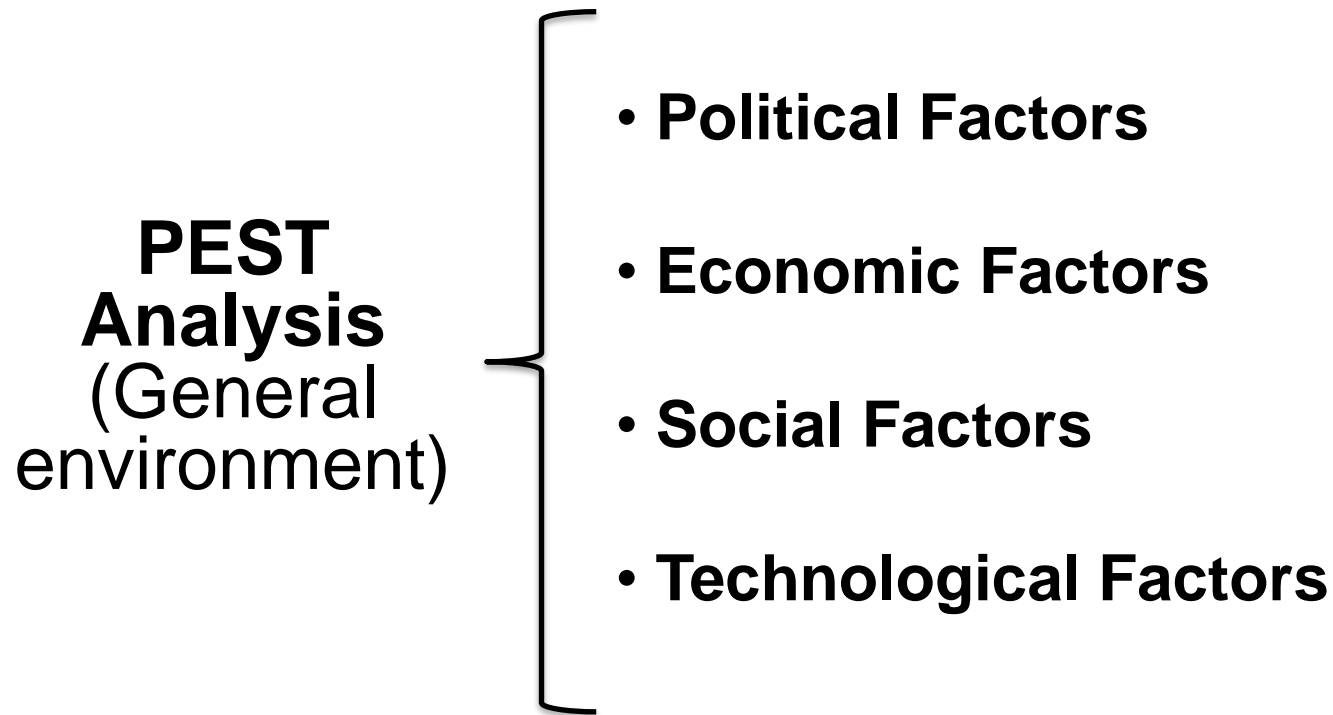
How can we account for these differences in industry profitability?

- It is all down to luck?
- The business/firm **environment** comprises variables (institutions, forces...) outside the organization that potentially affect its performance.
 - **General environment**: Broad external conditions that may affect any organization.
 - **Specific environment**: The real playing field of the firm (i.e. the industry).
- The level of industry profitability is neither random nor entirely the result of industry-specific influences, it is determined by the industry's underlying economic characteristics.

INDUSTRY STRUCTURE

B. PEST Analysis

How macro-environmental factors might impact the firm.



PEST Analysis – General environment

How macro-environmental factors might impact a business organisation:

Political

Changes in government economic policy,
e.g. taxation, government spending, monetary policy

Changes in legal requirements e.g.
employment law, health and safety legislation,
licensing practices, environmental regulations,
competition policy

Changes in the government ownership
e.g. nationalisation, privatisation, de-regulation

Economic

Changes in the level of economic activity,
e.g. growth rates, rates of unemployment,
inflation

Changes in wage rates and income distribution

Changes in exchange rates

Social

Changes in demographics e.g. the size of the population, the age distribution with the population

Changing attitudes e.g. work/life balance, concern for the environment, ethical standards

Changes in social structure e.g. socio-economic groupings, social mobility

Technological

Development of new products and processes

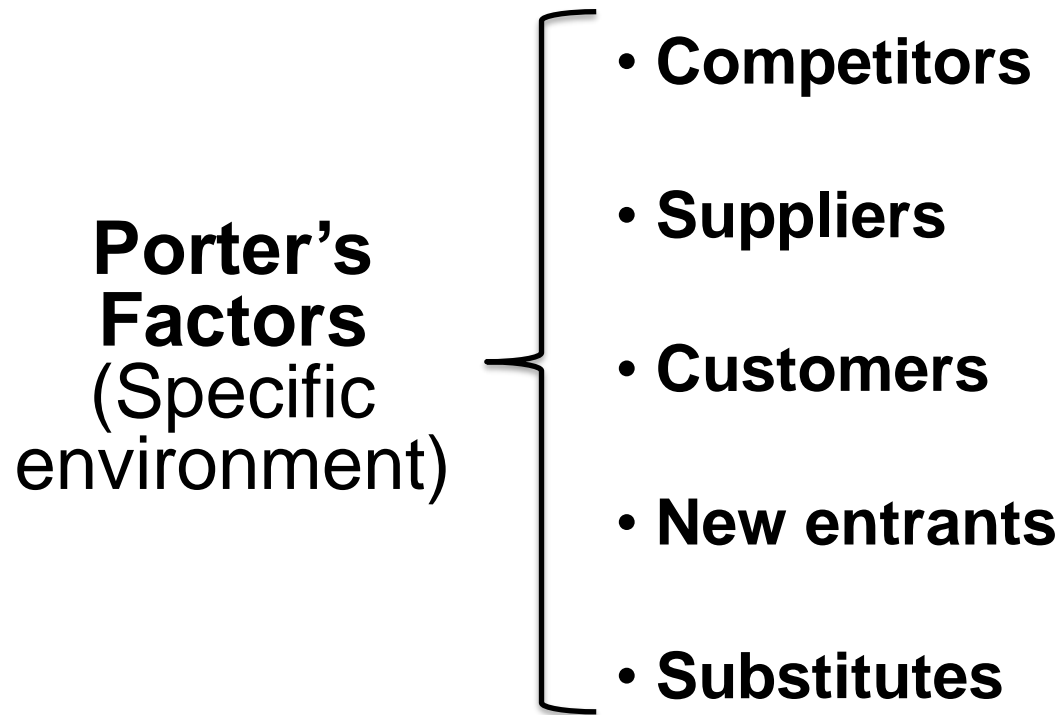
Automation

Developments in information and communication technologies

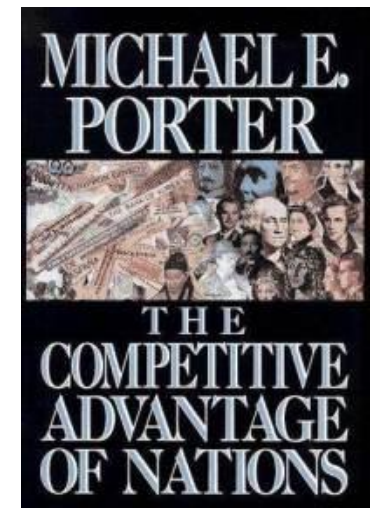
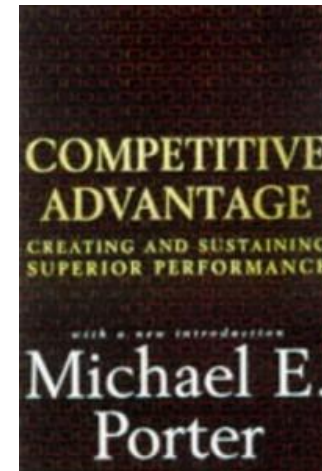
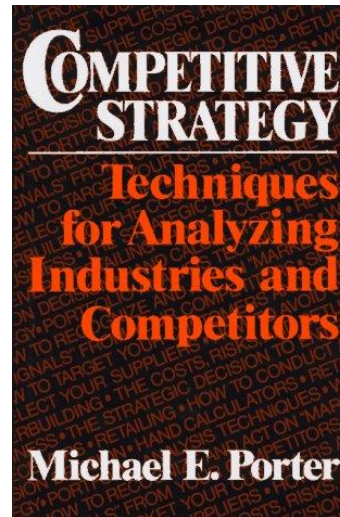
Developments in the natural sciences

C. Porter's Analysis

How micro-environmental factors impact the firm.

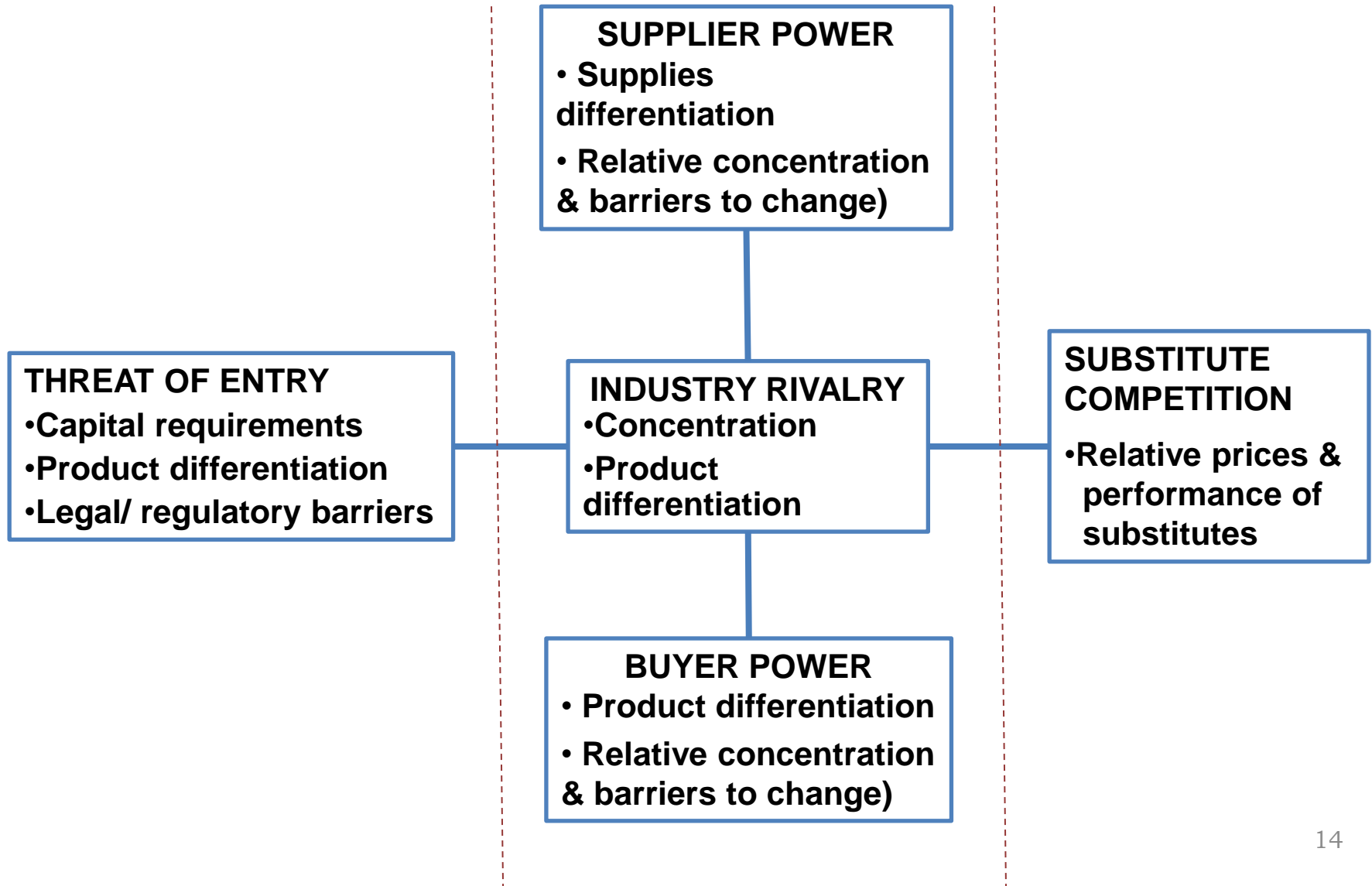


Specific environment: Porter's five forces analysis



Michael E. Porter – Professor at Harvard Business School

Specific environment: Porter's five forces analysis



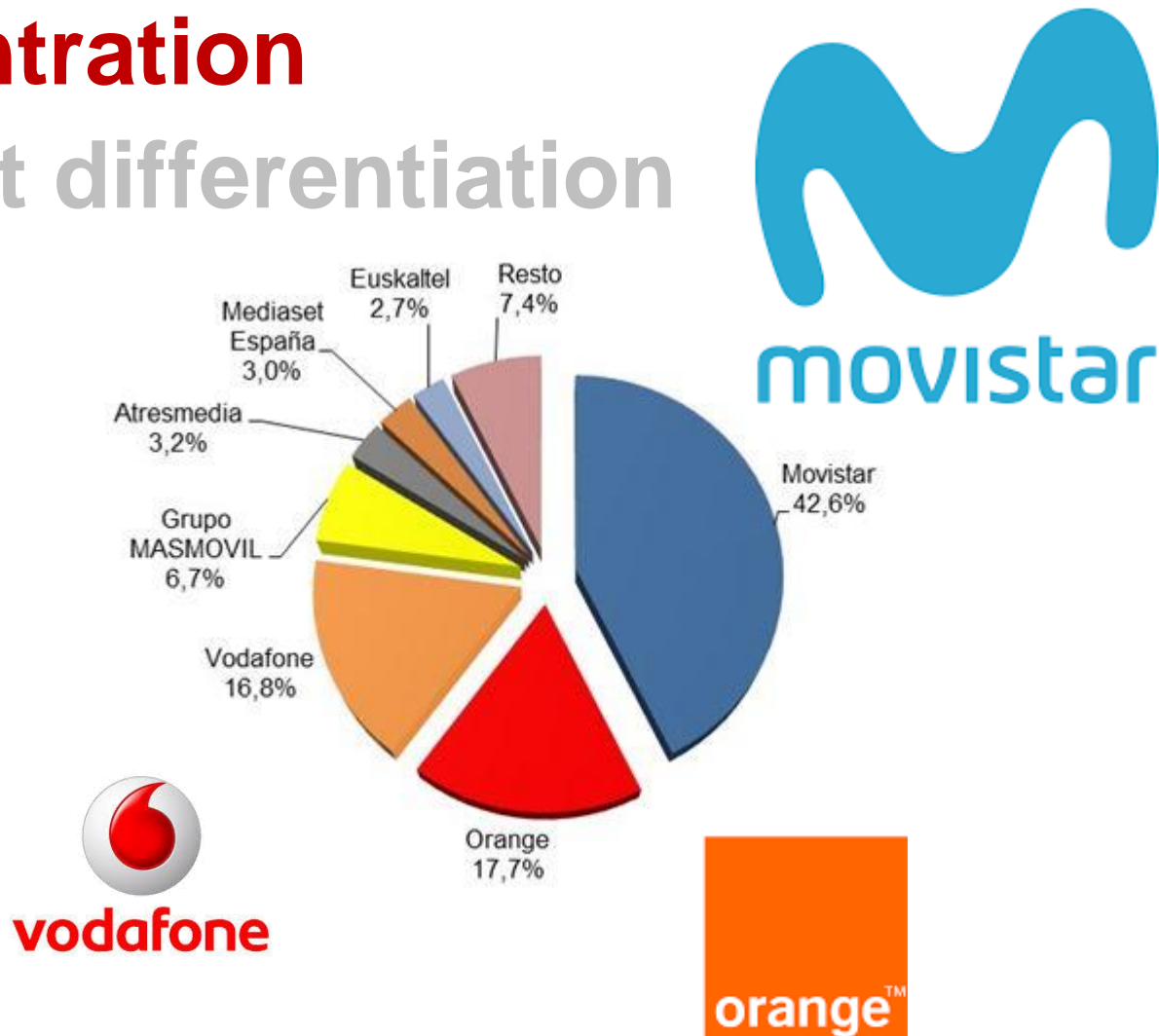
RIVALRY AMONG COMPETITORS

- Concentration
- **Product differentiation**



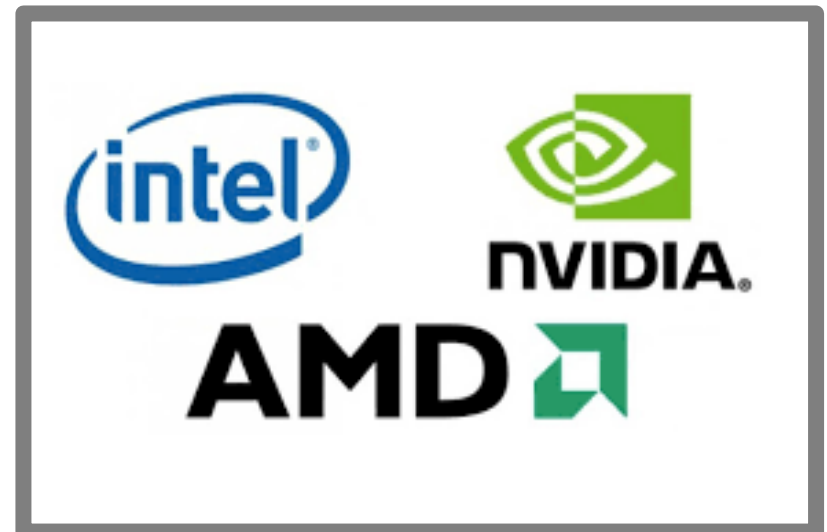
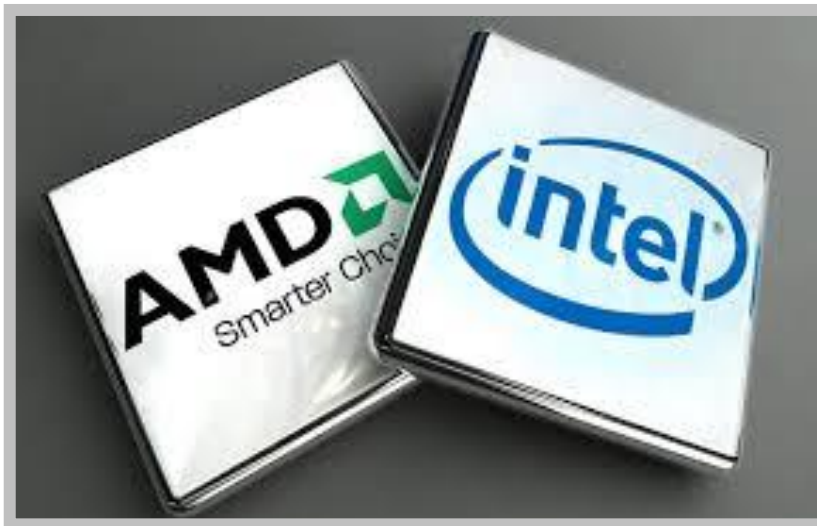
RIVALRY AMONG COMPETITORS

- **Concentration**
- Product differentiation



POWER OF SUPPLIERS

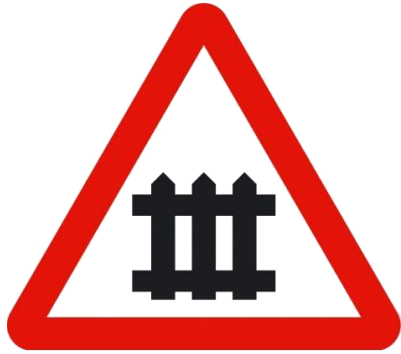
- **Raw material differentiation**
- **Concentration of suppliers**
- **Barriers to change**



POWER OF CUSTOMERS

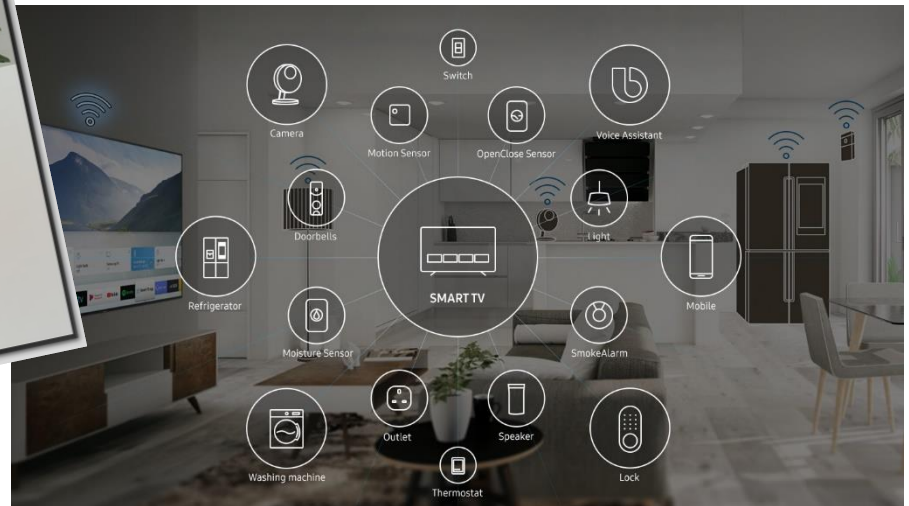
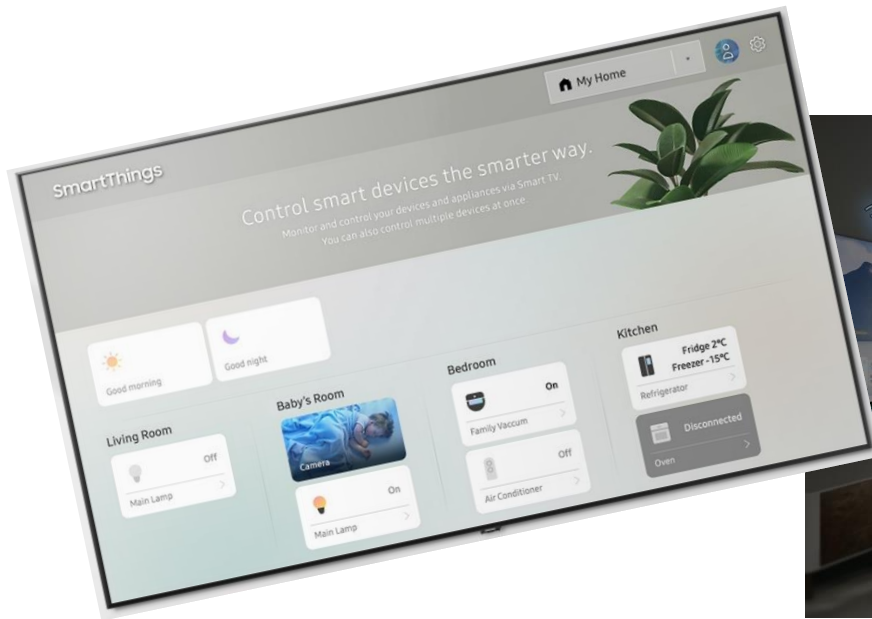
- Final product differentiation
- Concentration of customers
 - Barriers to change





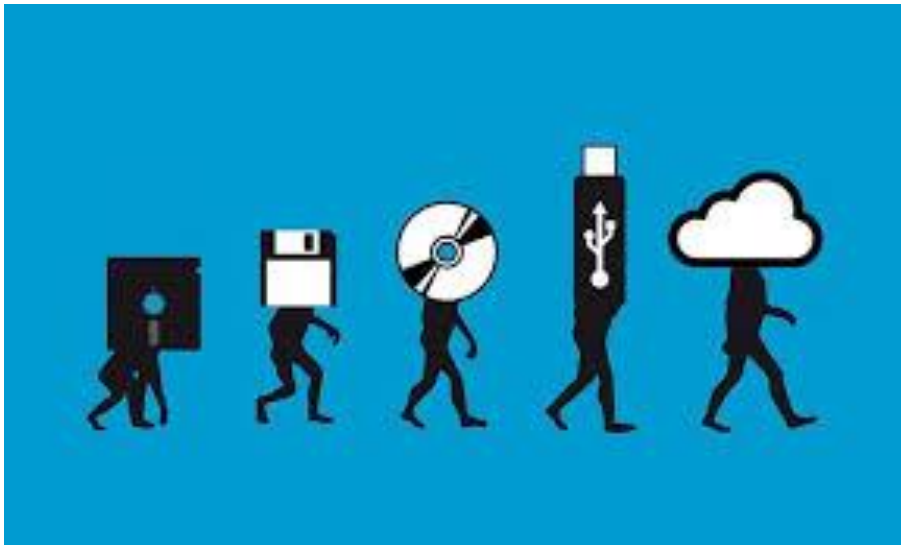
THREAT OF NEW ENTRANTS

Depends on BARRIERS TO ENTRY:
Capital requirements, differentiation,
legal barriers...



SUBSTITUTES

- Relative prices
- Performance of the substitutes



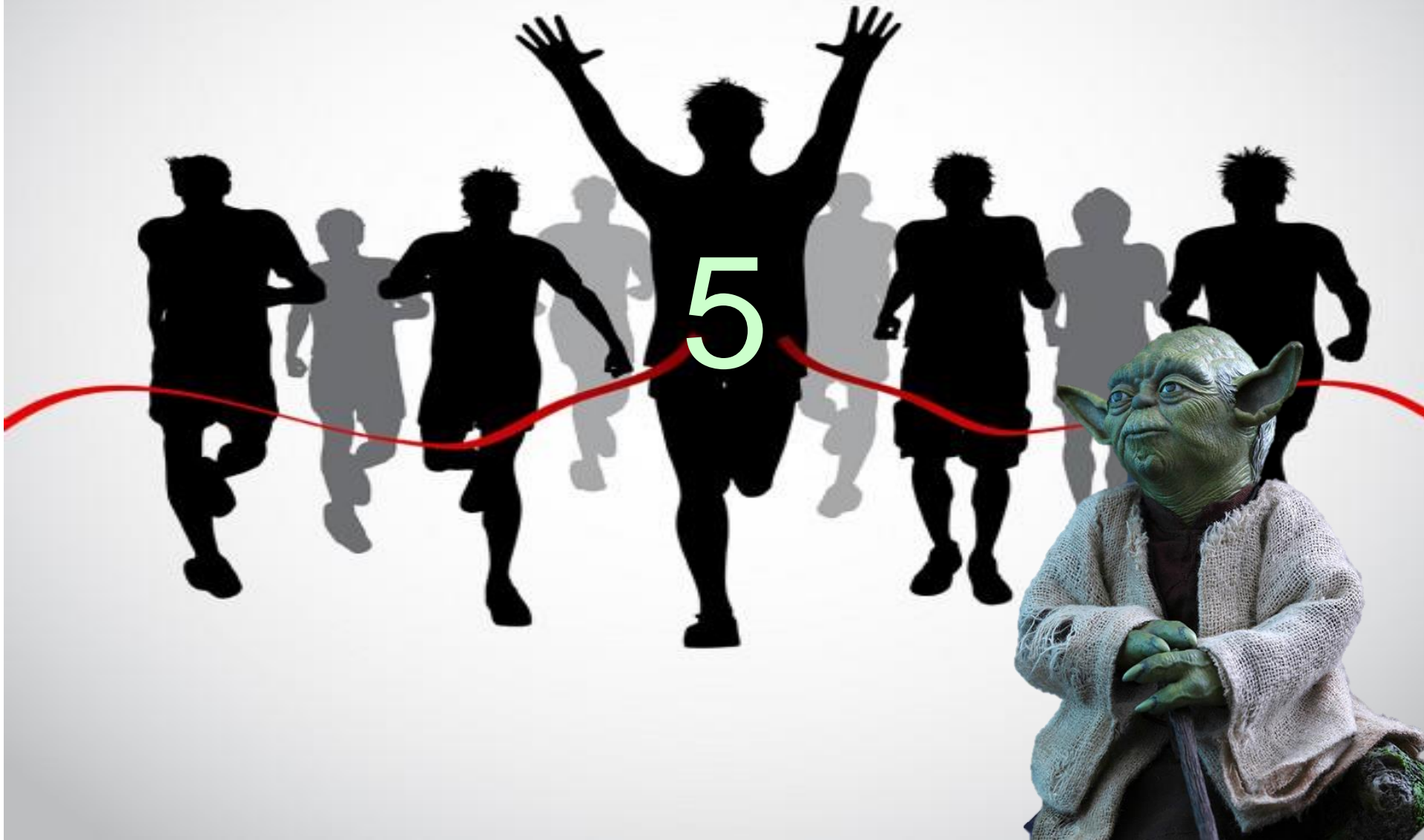
Understanding Porter's Analysis

Porter's Analysis can be used to:

- **Explain differences in profitability** between industries and changes in the profitability of a given industry over time.
- Assist managers in **positioning the firm** advantageously.



May the 5 FORCES be with you...!!



Rationale for the Resource-based Approach to Strategy

- When the external environment is subject to rapid change, internal resources and capabilities offer a more secure basis for strategy than market focus.
- Resources and capabilities are the primary sources of profitability.

EXTERNAL VS. INTERNAL ENVIRONMENT

A man in a grey suit and blue tie is pushing a large, shiny metal ball. There are four other identical balls in a row to his right. The background is a blurred cityscape. The title 'INTERNAL ENVIRONMENT' is written in purple, bold, italicized capital letters at the top.

INTERNAL ENVIRONMENT

Resources and capabilities R&C

- Each firm is a unique collection of R&C
 - Tangible resources: physical & financial
 - Intangible resources: reputation, technology, intellectual capital (people)
 - Capabilities: ability to mobilize resources to perform a task or activity.

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3.2. Strategic management

A. Introduction

ENVIRONMENTAL ANALYSIS

DECISION
MAKING

**External
analysis**

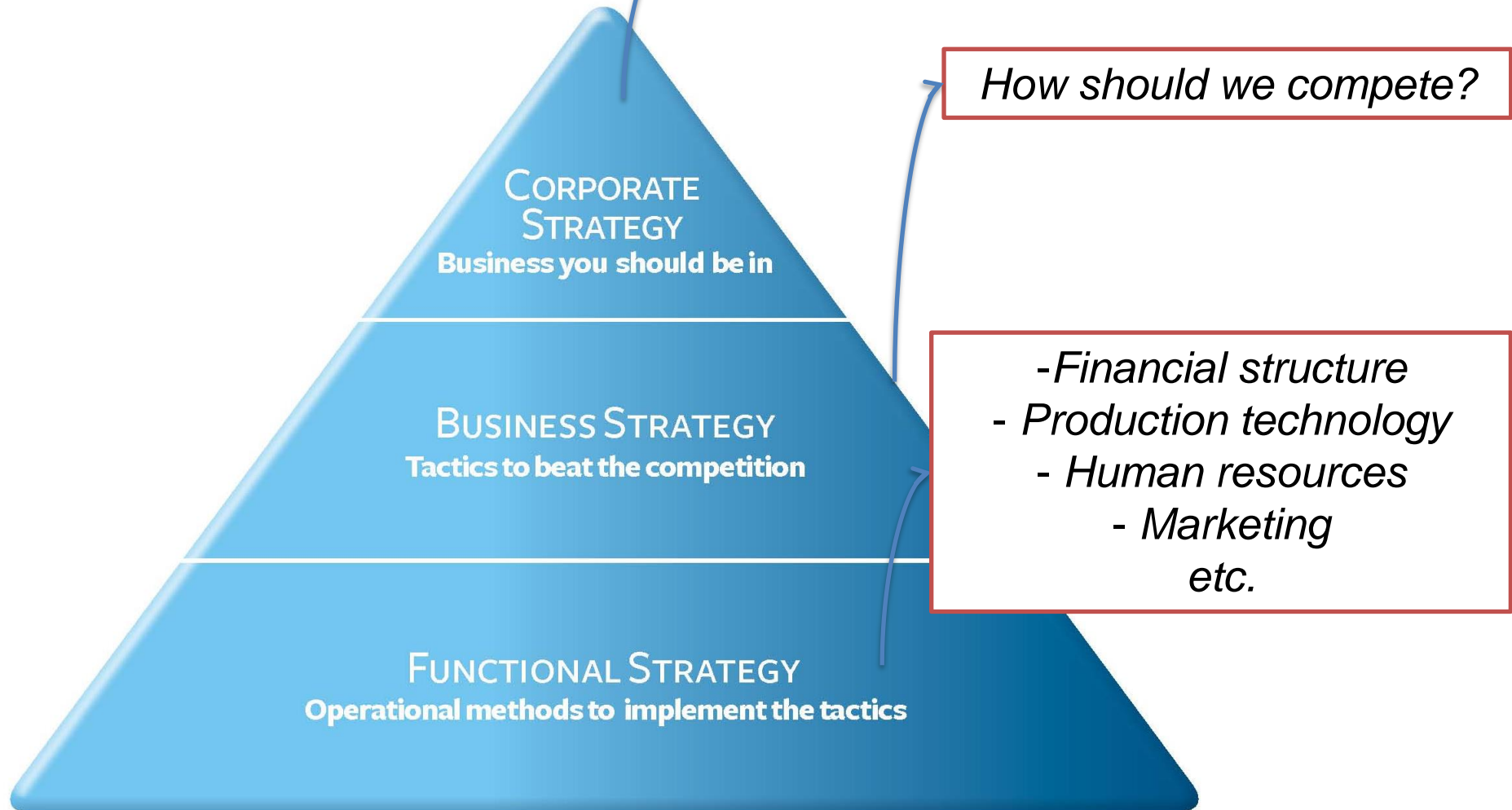
Internal analysis

**Strategy
formulation**

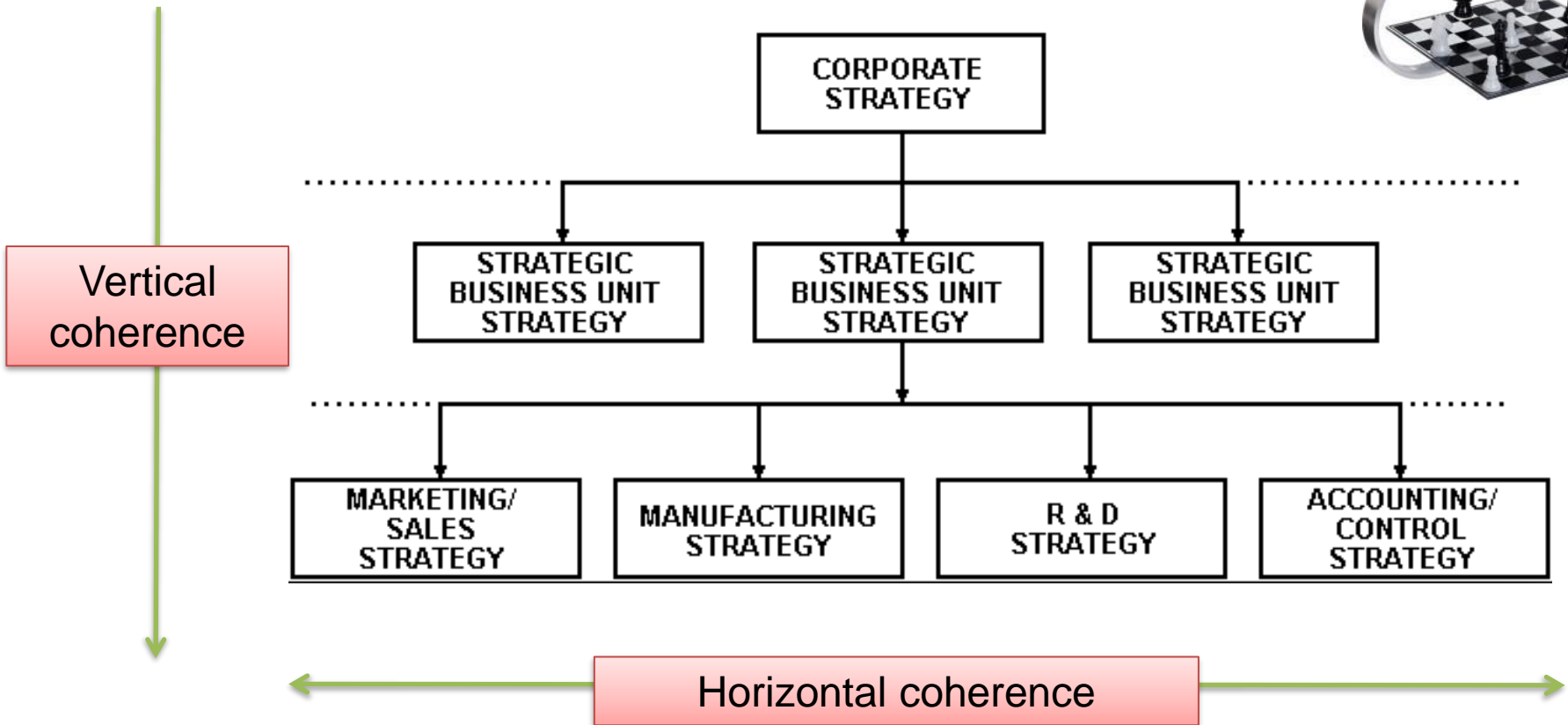
Strategy levels:

- Corporate strategy
- Business strategy
- Functional strategy

Strategy levels



Strategic coherence

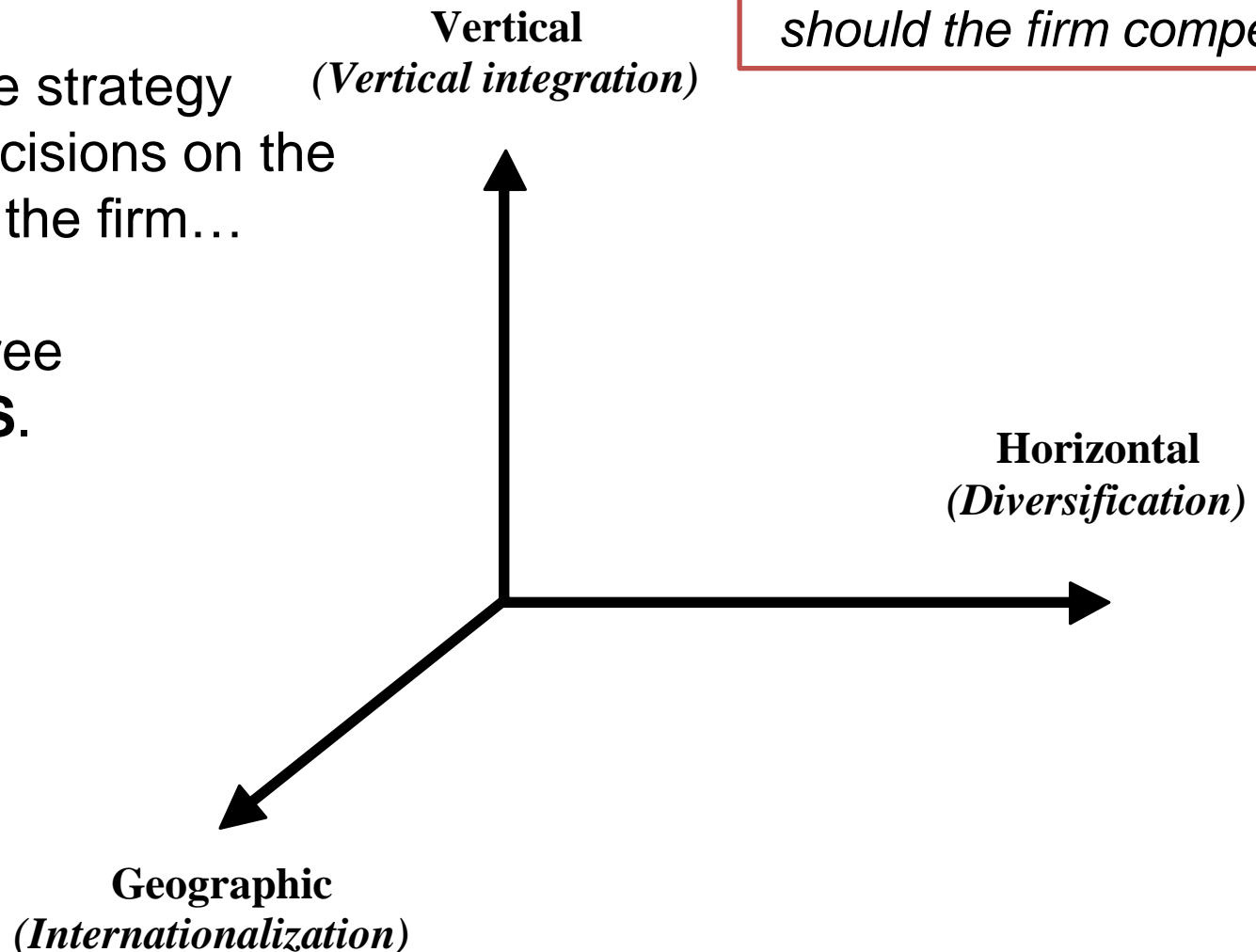


B. Corporate Strategy

*In which businesses
should the firm compete?*

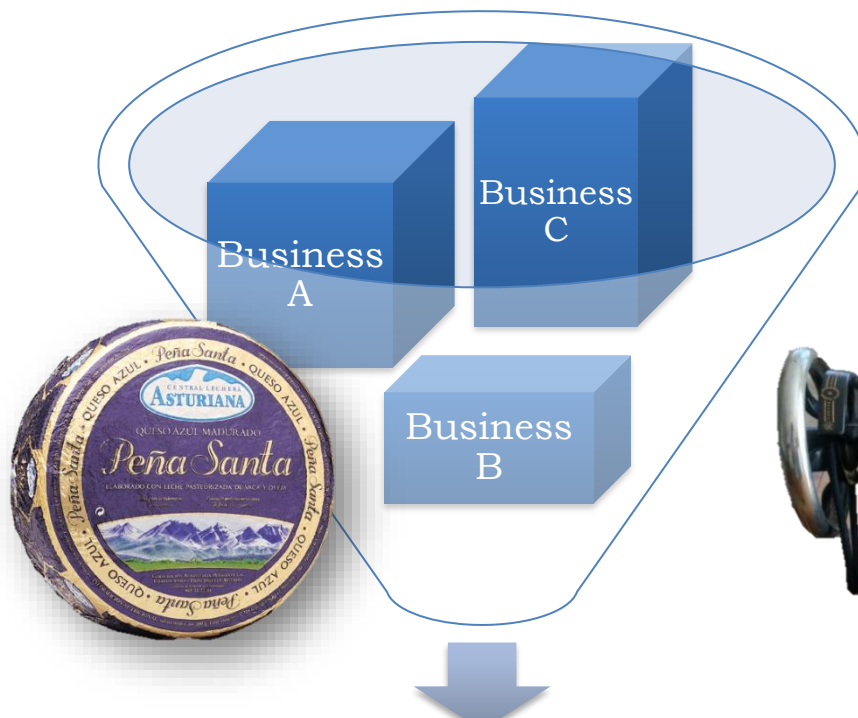
The corporate strategy
deals with decisions on the
GROWTH of the firm...

which has three
DIRECTIONS.



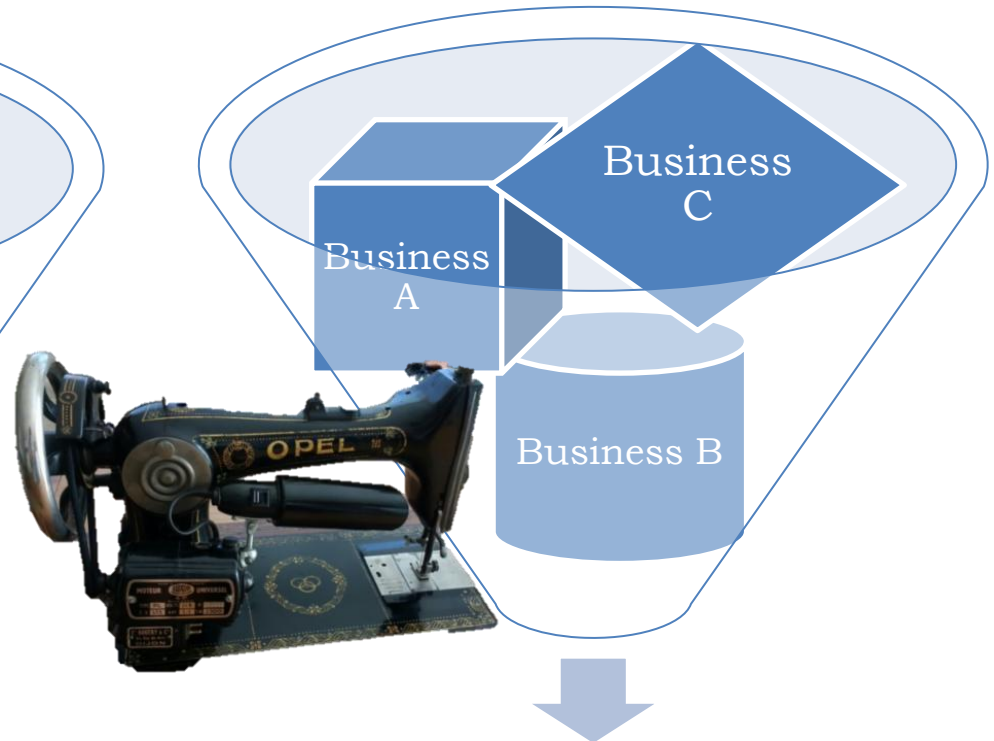
1. Diversification (vs. Concentration)

Diversification is to enter into a new industry where the firm is not currently in by creating a new product. That is, to increase the business portfolio.



RELATED DIVERSIFICATION

- Share resources.
- Synergies.



UNRELATED DIVERSIFICATION

- Risk dispersion.
- Empire building.

Sharing resources



BRAND
DISTRIBUTION CHANNEL
TECHNOLOGY



Transferring or leveraging capabilities



CAPABILITY: Shaping of plastic materials
(Brand and distribution capability)

Based in the domain of a generic technology

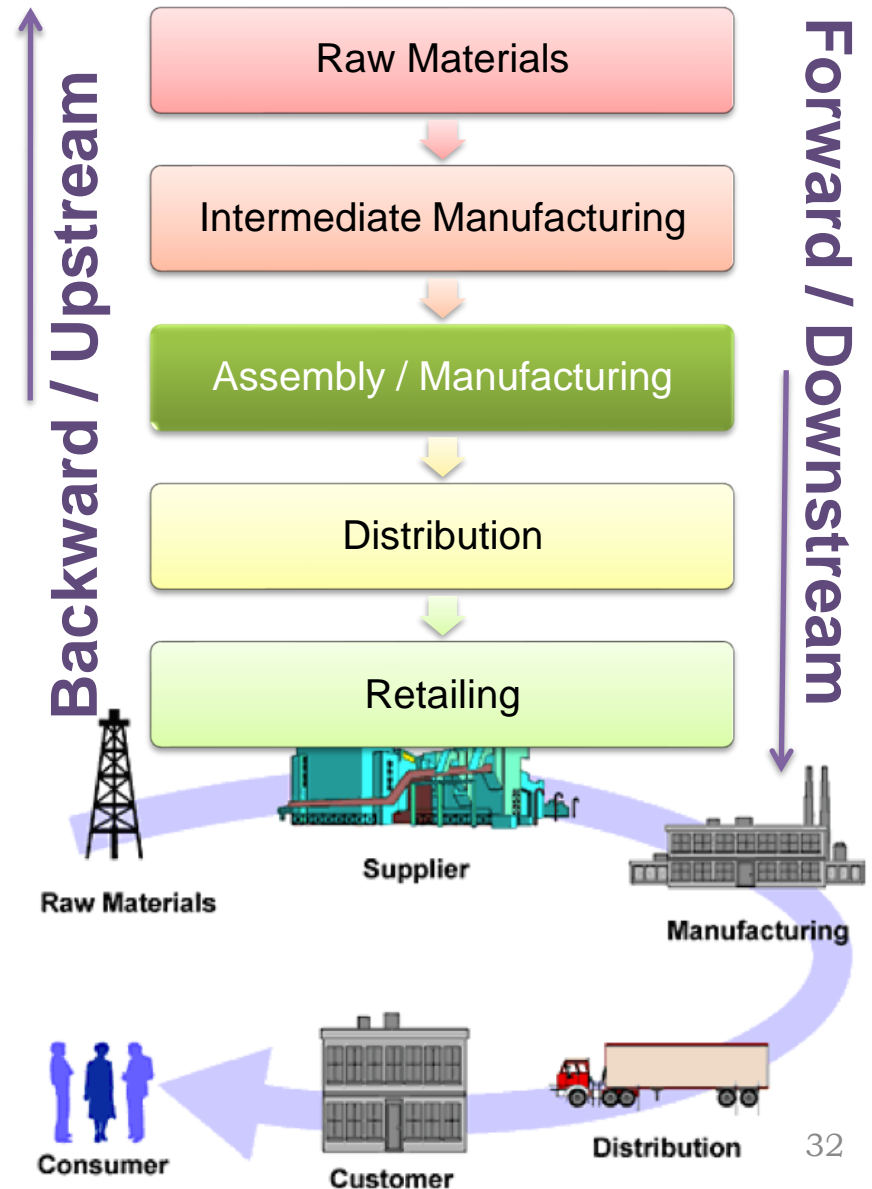


Adhesives
Abrasives

3M

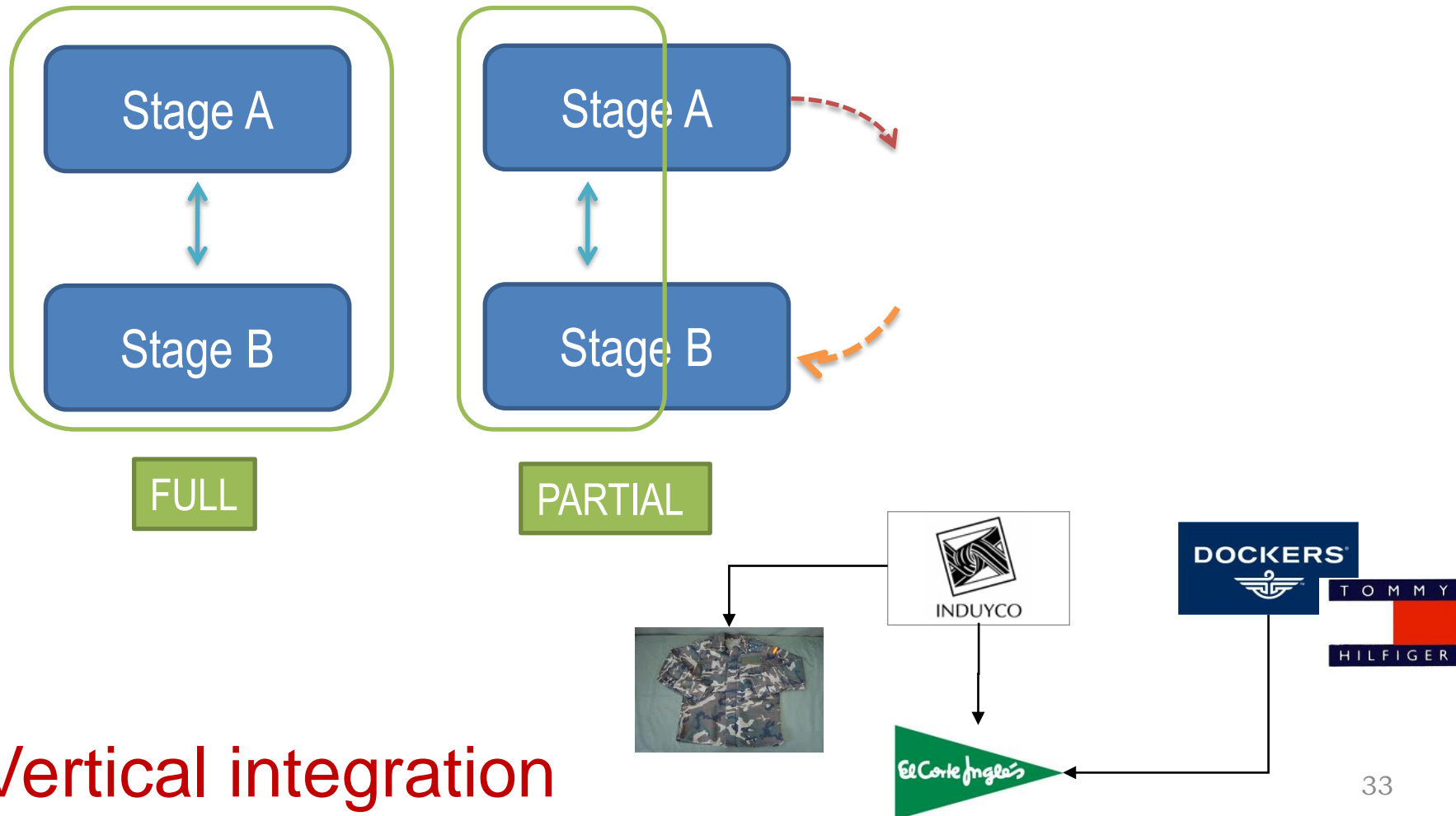
2. Vertical integration (vs. outsourcing)

Vertical integration occurs when a firm expands its business into areas that are at different points on the same supply chain. It expands to areas where it can offer something more valuable than competitors.



2. Vertical integration (vs. outsourcing)

Vertical integration refers to a firm's ownership of vertically related activities



3. Internationalization

Internationalization is the process of increasing involvement of enterprises in international markets.



Corporate strategy encompasses decisions not only on the **directions of growth**, but also on the **MODES OF GROWTH**.

Internal growth

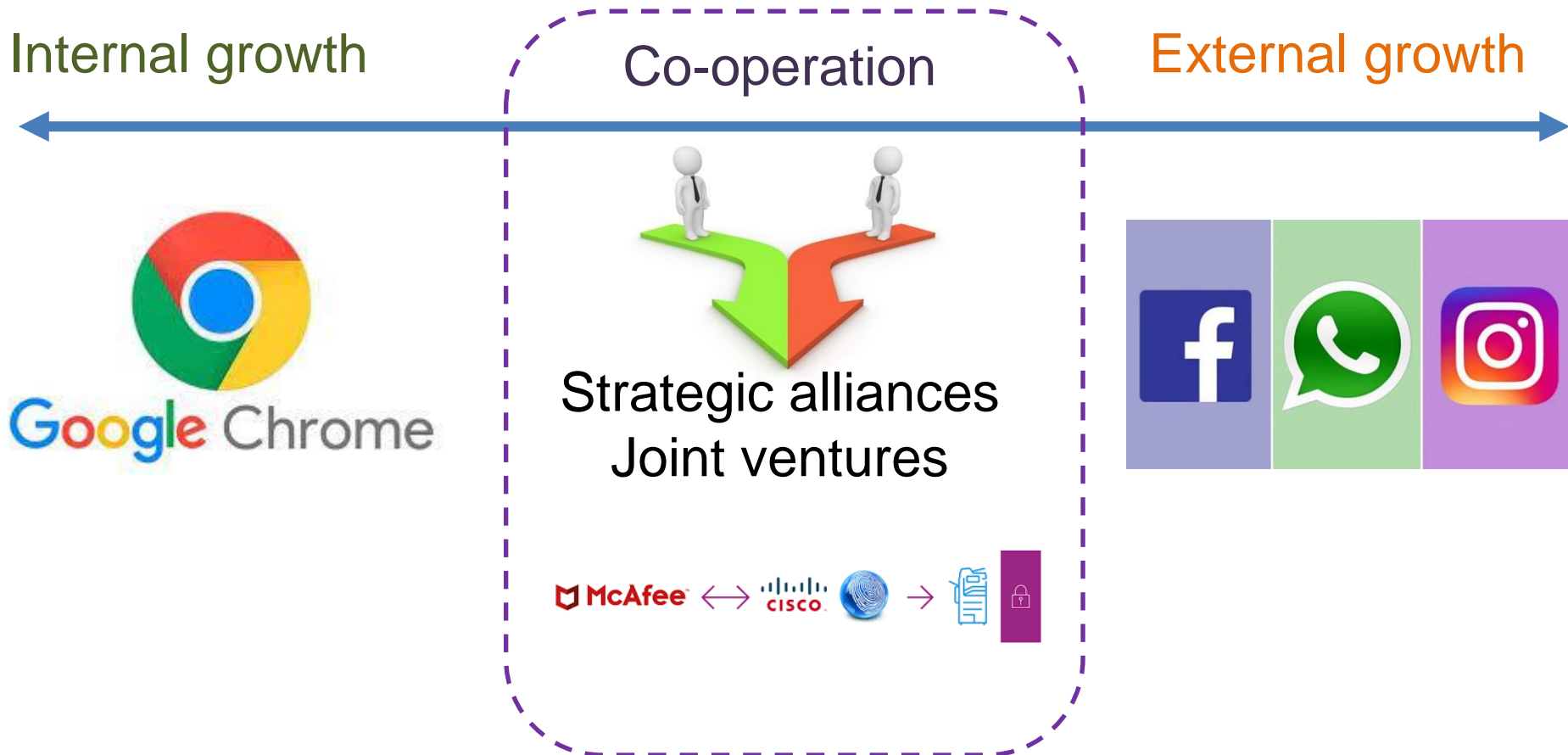
External growth

Start a business
Increase capacity

Acquisitions
Mergers



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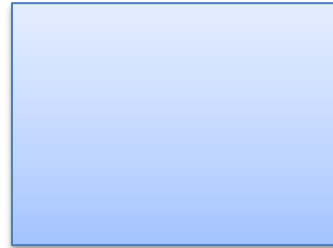
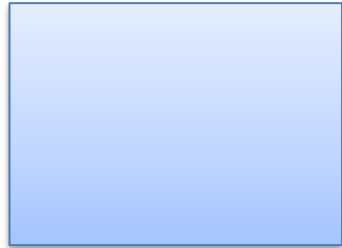


Mode of growth

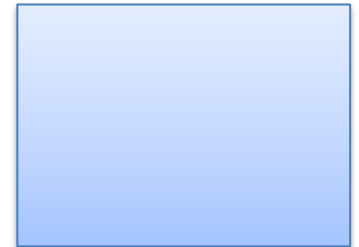
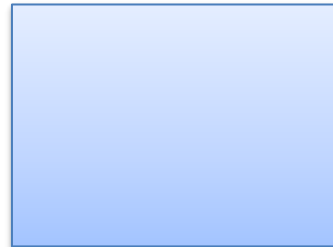
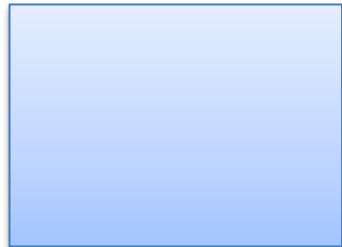
Internal growth Co-operation External growth

Direction of growth

Diversification

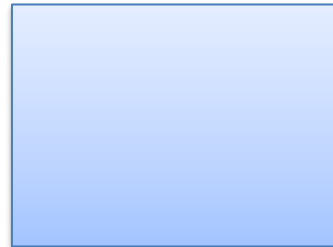


Vertical
Integration



International
Expansion

Green Field
Investment

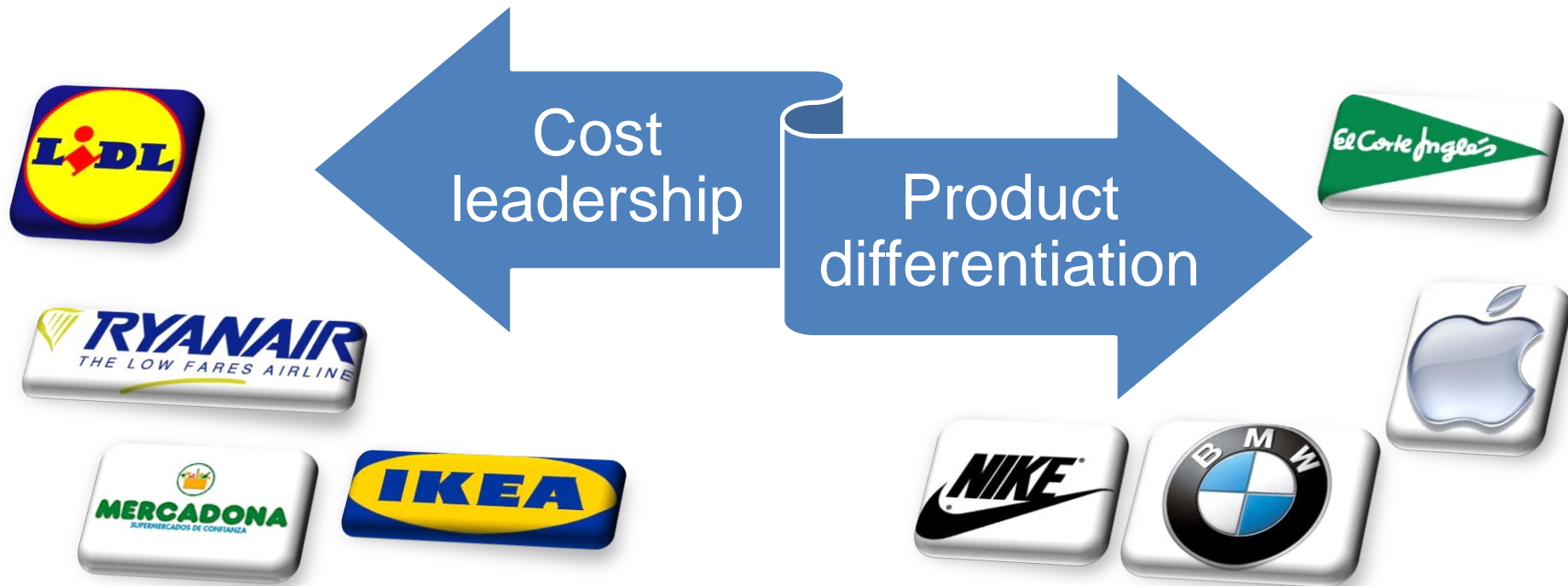


Brown Field
Investment

C. Business Strategy

How should we compete?

The business strategy is based on determining how to strengthen the competitiveness of the firm , i.e. on seeking **COMPETITIVE ADVANTAGE**.



Business strategy

Cost Leadership

- Low cost producer (compared to competitors)
- Increasing ROA through Assets Turnover



How to achieve it?

Designing efficient operations systems
Reducing advertising expenses
Outsourcing some activities
Minimizing R&D
Changes of suppliers
Etc.



Business strategy

Product Differentiation

- Development of a product that customers perceive to be better than the ones of the competition. This value added allows the firm to charge a premium price for it.
- Increasing ROA through Return on Sales

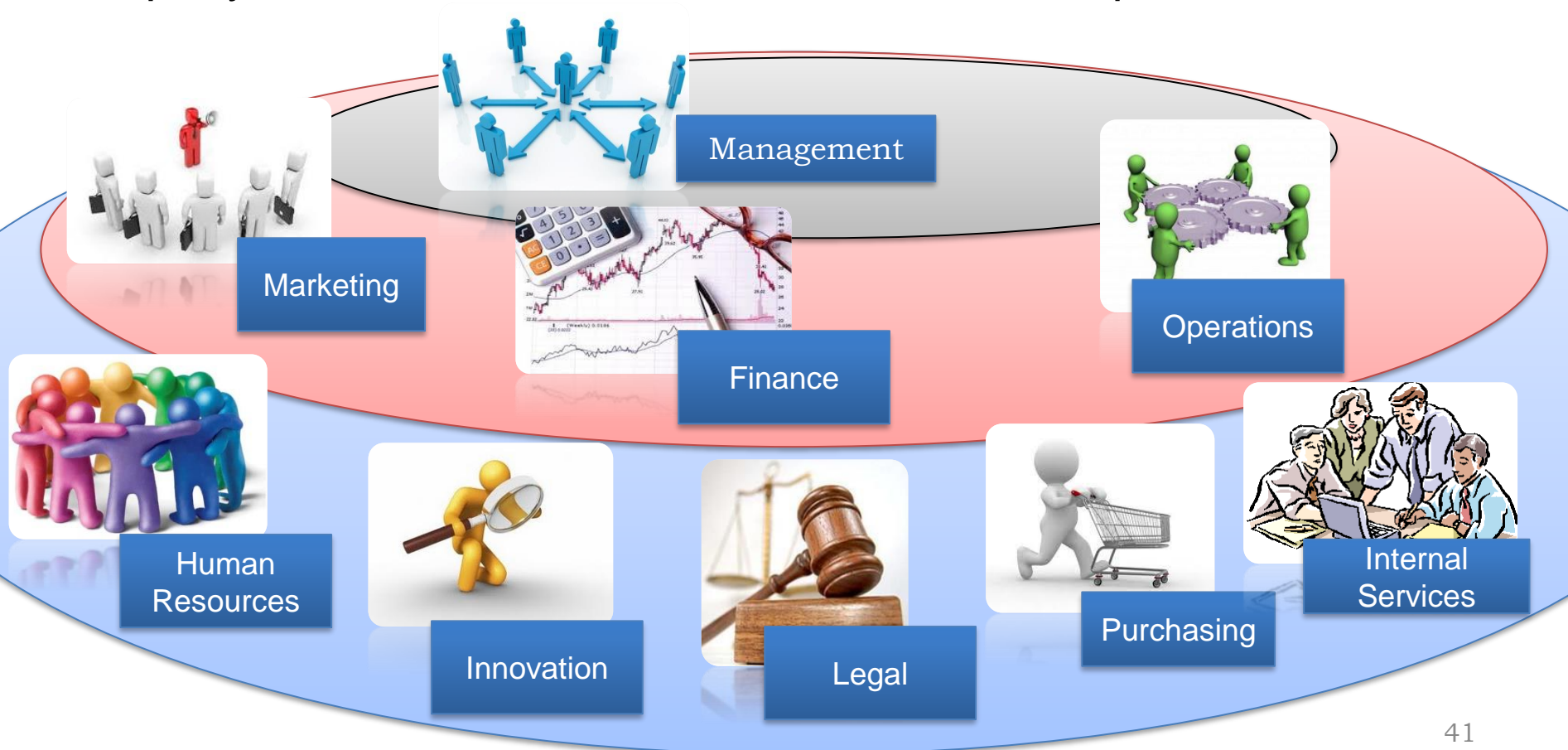
How to achieve it?

Distinctive design
Employing quality materials
Increasing advertising expenses
Innovation (increasing R&D)
After-sales and customer services
Etc.



C. Functional Strategy

It refers to the strategy of the various functions that form the company, which must be coordinated around the previous ones.



Functional strategy

The Management Function (lesson 4)

- Strategy.
- Coordinate processes
- ...



The Financial Function (lesson 5)

- Seek funding
- Determine profitability
- ...



The Marketing Function (lesson 7)

- Advertise products
- Determine the target market.
- Receive feedback
- ...



The Operations Function (lesson 6)

- Manufacture products
- Buy raw materials.
- Forecast demand
- ...



Key concepts

Environment: general and specific

PESTEL analysis

Porter's five forces analysis

Corporate, business and functional strategies

Vertical integration

Backward (upstream) and forward (downstream) vertical integration

Diversification

Related and unrelated diversification

Geographical expansion / internationalisation

Internal and external growth

Greenfield investments

Merger and acquisitions

Co-operation

Strategic alliances

Cost leadership

Differentiation