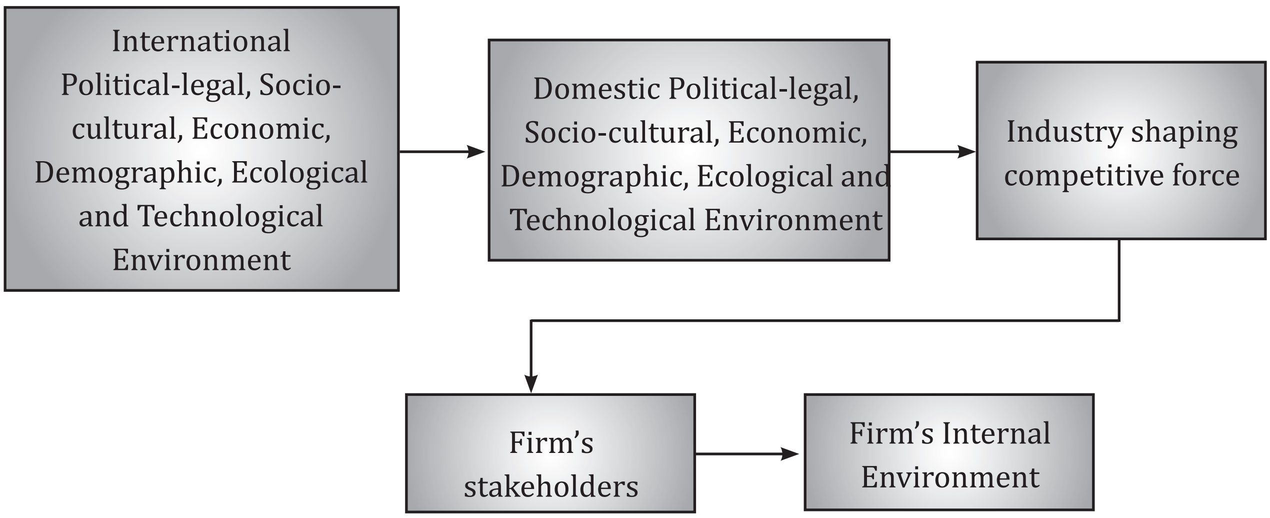
CHAPTER 14

Strategic Analysis: External Environment

INTRODUCTION

- **Organisations are distinguished based** on their size, type of products, markets, geographical coverage, legal status, and like because of vast organisational diversity.
- Organisations do not operate in vacuum and in fact continuously act and react to what happens outside their periphery. The factors that are outside the business operations are typically referred to as organisational/business environment which are shown below:



- The process of strategic formulation begins with a strategic analysis. Its objective is to compile information about internal and external environments in order to assess possibilities while formulating strategic objectives and contemplating strategic activities.

STRATEGIC ANALYSIS

- **Strategy formulation is not a task** in which managers can get by with intuition, opinions, instincts, and creative thinking. Judgements about what strategies to pursue need to **flow directly from analysis of a firm's external environment** and its internal resources and capabilities.
- A **systematic approach** to environmental assessment is essential for managing risk and uncertainty.

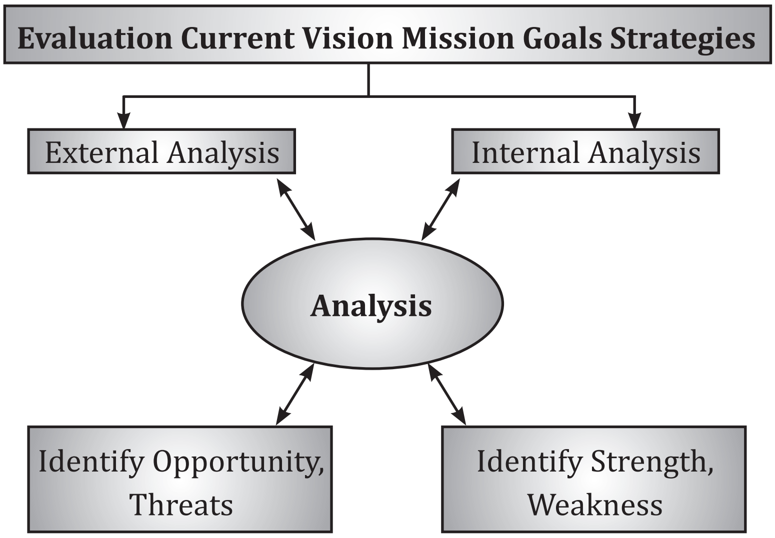
- The **strategic analysis is a component** of business planning that has a methodical approach, makes the right resource investments, and may assist business in achieving its objective. It forces to think about the rivals and aids in the evaluation of business plans to stay ahead of the competition.

The two important situational considerations are:

(1) Industry and competitive conditions, and

(2) An organisation's own capabilities, resources, internal strengths, weaknesses, and market position.

STRATEGIC ANALYSIS



- Accurate diagnosis of the business situation is necessary for managerial preparation to decide on a sound long-term direction, setting appropriate objectives, and crafting a winning strategy.
- The strategic analysis is a continuous process which is not without limitations. There are two major limitations of strategic analysis that we need to be aware of.
  - First, it gives a lot of innovative options but doesn't tell which one to pick. The options can be overlapping, confusing or difficult to implement.
  - Second, it can be time consuming at times, hurting overall organisational functioning and also strain other efficient innovations such as developing a new product or a service.

Issues to consider for Strategic Analysis:

(a) Strategy evolves over a period of time	A current strategy is the result of several little choices taken over a period of time. A management radically changes strategy when they try to speed up the organisational growth. Strategy is influenced by experience, but it has to be updated when the results become clear. It therefore, evolves with time. 

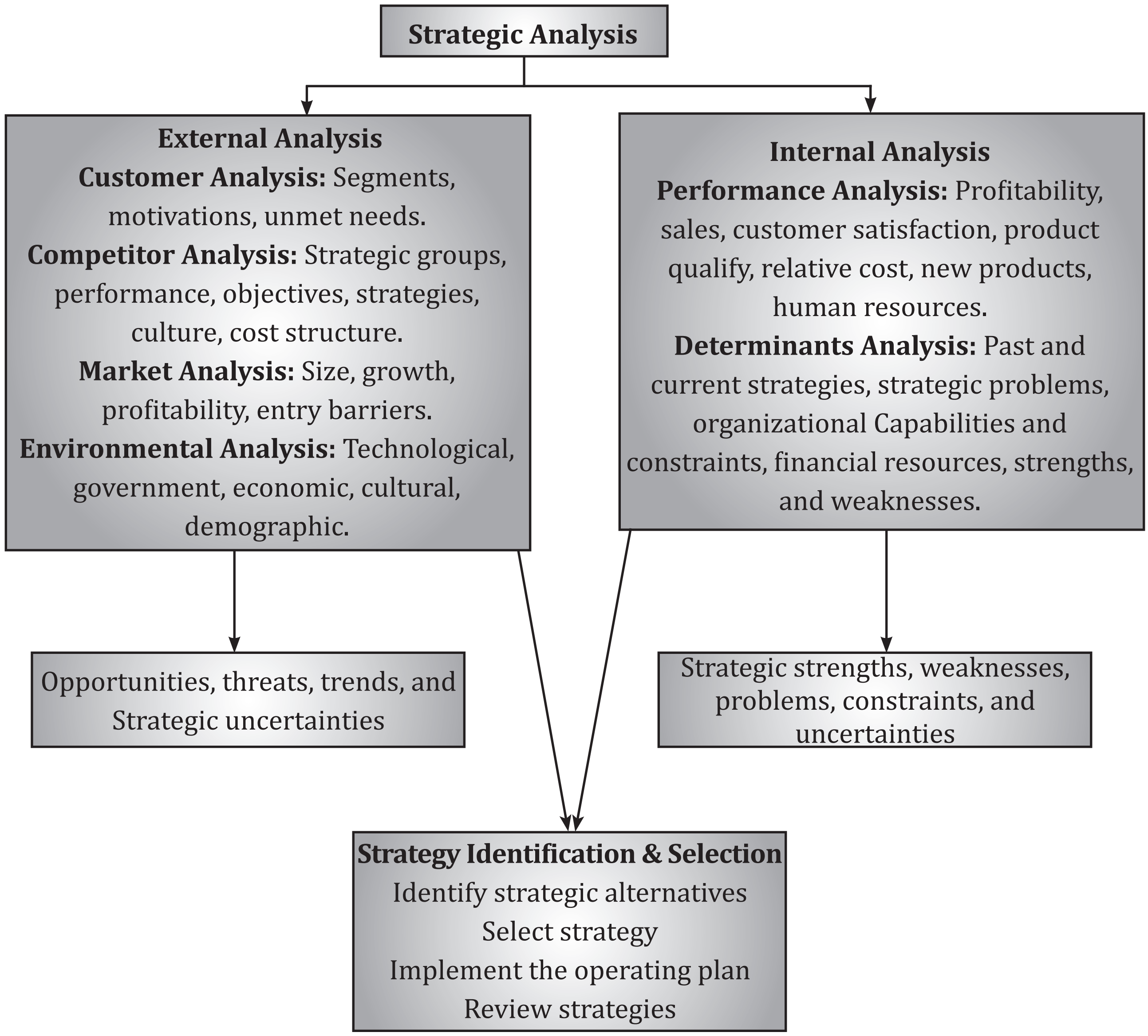
(b) Balance of external and internal factors	Strategy formulation involves matching internal strengths and weaknesses with external opportunities and threats.  **E.g:-** There may be pressures to enter a new market due to high growth potential while there may be constraints like lack of funds. In reality, perfect match between them is not possible. Hence, strategic analysis uses workable balance.
(c) Risk	The complexity and intermingling of variables in the environment reduce the strategic balance in the organisation.  An important aspect of strategic analysis is to identify potential imbalances or risks and assess their consequences. A broad classification of the strategic risk that requires consideration in *strategic analysis is given below:*

Time

Strategic Risks	Short time	Long time
External	Errors in interpreting the environment cause strategic failure.	Changes in the environment lead to obsolescence of strategy.
Internal	Organizational capacity is unable to cope up with strategic demands.	Inconsistencies with the strategy are developed on account of changes in internal capacities and preferences.

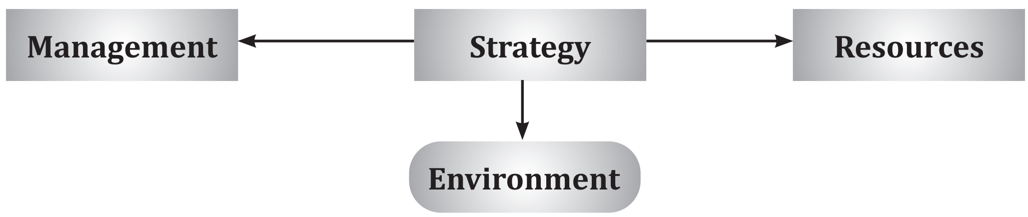
External risk is on account of inconsistencies between strategies and the forces in the environment. Internal risk occurs on account of forces that are either within the organization or are directly interacting with the organization on a routine basis.

Framework of Strategic Analysis



■ STRATEGY AND BUSINESS ENVIRONMENT

- Business strategist creates strategies and formulate policies considering both internal and external factors.
- **Strategy and Environment**



- The business environment is **highly dynamic and continuously evolving.** Strategists provide an interface between the organizational abilities and the opportunities and challenges it **must deal within the larger environment**.

- The term **“business environment”** refers to all external factors, influences, or situations that in some way affect business decisions, plans, and operations. Organisational success is determined by its business environment, and even more from its relationship with it.
- Strategic management is **involved** with choosing a long-term direction in relation to these resources and opportunities. There is a close and continuous interaction between a business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively.
- It helps the business in the following ways:

Determine opportunities & threats	Find new needs and wants of the consumers, changes in laws, changes in social behaviours, and tells what new products the competitors are bringing in the market to attract consumers.
Give direction for growth	The business is aware and understands the changes happening around, it can plan and strategies to have successful business.
Continuous Learning	The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in the realm of business.
Image Building	Environmental understanding helps the business organizations to improve their image by showing their sensitivity to the environment in which they operate. Understanding the needs of the environment help to showcase that the business is aware and responsive to the needs. It creates a positive image and helps it to prosper and win over the competitors.
Meeting Competition	It helps the businesses to analyse the competitors’ strategies and formulate their own strategies accordingly. The idea is to flourish and beat competition for its products and services.

- The changes happening in the external environment challenge organisations to find novel and unique strategies to remain in business and succeed.
- Strategic analysis covering internal and external environment is highly relevant and important for the strategists in organisations in order to achieve competitive advantage, as well as ensure high performance for survival and growth.
- Strategic decisions are significant aspects of business management and are essential for the success and continued existence.
- Two crucial aspects for the success include are the function of top management and the method of formulating strategic decisions. Improvement of strategic decisions is constant endeavour for strategist.

MICRO AND MACRO ENVIRONMENT

- The environment in which an organization exists can be described in terms of the opportunities and threats operating in the external environment apart from the strengths and weaknesses existing in the internal environment.
- For making any strategic decision, they should be able to comprehend the facts available and challenge the underlying assumptions.
- The **external environment can be categorised in two major types** as follows:
  - Micro environment
  - Macro environment

Micro-environment

- Micro-environment is related to **small area or immediate periphery** of an organization. It influences an organization regularly and directly.
- Micro environment consists of suppliers, consumers, marketing intermediaries, competitors, etc. These are specific to the said business or firm and affect its working on a direct and regular basis.
- Within the micro or the immediate environment in which a firm operates we need to address **the following issues:**
  - The employees of the firm, their characteristics and how they are organised.
  - The existing customer base on which the firm relies for business.
  - The ways in which the firm can raise its finance.
  - Who are the firm suppliers and how are the links between the two being developed?
  - The local community within which the firm operates.
  - The direct competition and their comparative performance.
- The factors in micro environment often relate an organization to the macro issues influencing the way a firm reacts in the market place.

Macro environment

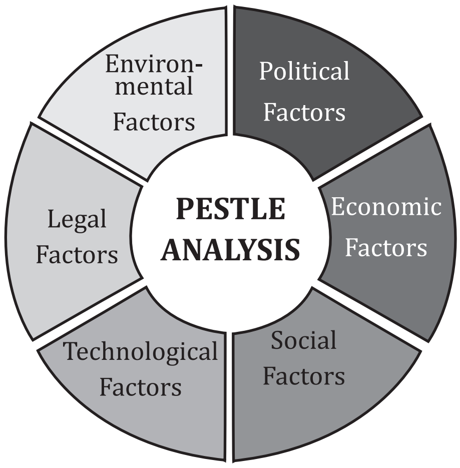
- Macro environment is the portion of the outside world that significantly affects how an organisation operates but is typically much beyond its direct control and influence.
- **Elements of Macro Environment**
  - Macro environment has broader dimensions as it consists of economic, socio- cultural, technological, political and legal factors.
  - The classification of the relevant environment into components or sectors helps an organization to cope with its complexity, comprehend the different influences operating, and relating the environmental changes to its strategic management process.
  - ***The environment includes factors outside the firm which can lead to opportunities for, or threats to the firm. Although, there are many factors, the most important of the factors are socio-economic, technological, supplier, competitors, and government."*** **-Gluek and Jauch**

Demographic Environment	❍ Demographical analysis considers factors such as race, age, income, education, possession of assets, house ownership, job position, region, and the degree of education. Data about these qualities across homes and within a demographic variable are of importance to both businesses and economists. ❍ Considering demographics is of immense importance for any business. Business Organizations need to study different demographic factors. **Particularly, they need to address following issues:** ❍ What demographic trends will affect the market size of the industry? ❍ What demographic trends represent opportunities or threats? ❍ Identifying the implications of changing demographic characteristics or population components for a future strategic competitiveness is often a challenge for strategists.

Socio-Cultural Environment	❍ It represents a complex group of factors such as social traditions, values and beliefs, level and standards of literacy, the ethical standards and state of society, the extent of social stratification, conflict, cohesiveness and so forth. ❍ It differs from demographics in the sense that it is not the characteristics of the population, but it is the behaviour and the belief system of that population. ❍ Socio-cultural environment consists of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on the operations of the organization. ❍ Businesses have to adjust to social norms and beliefs to operate successfully. The social environment primarily affects the strategic management process within the organization in the areas of mission and objective setting, and decisions related to products and markets.
Economic Environment	❍ The economic environment refers to the overall economic situation around the business and include conditions at the regional, national and global levels. ❍ Income distribution pattern determine the business possibilities. The important point to consider is to find out the effect of economic prospect, growth and inflation on the operations of the business. ❍ Higher interest rates are detrimental for the businesses with high debt. In the real estate market, they reduce the capability of the prospective buyers to avail loan and pay instalments, thus lower the demand.
Political-Legal Environment	❍ Business is highly guided and controlled by government policies. Hence the type of government running a country is a powerful influence on business. A business has to consider the changes in the regulatory framework and their impact on the business. Taxes and duties are other critical areas that may be levied and affect the business. ❍ Businesses prefer to operate in a country where there is a sound legal system. Businesses must understand the relevant laws relating to companies, competition, intellectual property, foreign exchange, labour and so on.
Technological Environment	❍ Technology has changed the way people communicate and do things. Technology has also changed the ways of how businesses operate now. ❍ Technology and business are linked and are interdependent on one another. ❍ Changes in technology have an effect on how a business runs its operations. The technological advancements might require a business to drastically alter its operational, production and marketing strategies. ❍ Technology can act as opportunity, when a business effectively adopts technological innovations to their strategic advantage. However, at the same time technology can act as a threat too. ❍ Artificial intelligence, machine learning, robotic process automation is some of the new technological tools that businesses are adopting and can act as both opportunity and threat to a business.

PESTLE- A TOOL TO ANALYSE MACRO ENVIRONMENT

- The term PESTLE is often used to describe a framework for analysis of macro environmental factors.
- PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.
- '**PESTLE analysis** is an increasingly used and recognized analytical tool, and it is an **acronym** for:



- The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

The Key Factors

Political factors	Political factors are how and to what extent the government intervenes in the economy and the activities of business firms. Political factors may also influence goods and services which the government wants to provide or be provided and those that the government does not want to be provided.
Economic factors	Economic factors have major impacts on how businesses operate and take decisions. **E.g:-** interest rates affect a firm's cost of capital and therefore to what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy.
Social factors	Social factors affect the demand for a company's products and how that company operates.
Technological factors	Technological factors can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.
Legal factors	Legal factors affect how a company operates, its costs, and the demand for its products, ease of business.
Environmental factors	Environmental factors affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer--it is both creating new markets and diminishing or destroying existing ones.

Summarize

Political →
- Political stability
- Political principles and ideologies
- Current and future taxation policy
- Regulatory bodies and processes
- Government policies
- Government term and change
- Thrust areas of political leaders

Economic →
- Economy situation and trends
- Market and trade cycles
- Specific industry factors
- Customer/end-user drivers
- Interest and exchange rates
- Inflation and unemployment
- Strength of consumer spending

Social →
- Lifestyle trends
- Demographics
- Consumer attitudes and opinions
- Brand, company, technology image
- Consumer buying patterns
- Ethnic/religious factors
- Media views and perception

Technological →
- Replacement technology/solutions
- Maturity of technology
- Manufacturing maturity and capacity
- Innovation potential
- Technology access, licensing, patents, property rights and copyrights

Legal →
- Business and Corporate Laws
- Employment Law
- Competition Law
- Health & Safety Law
- International Treaty and Law
- Regional Legislation

Environmental →

- Ecological/environmental issues
- Environmental hazards
- Environmental legislation
- Energy consumption
- Waste disposal

INTERNATIONALIZATION OF BUSINESS

- Enables a business **to enter new markets in search** of greater earnings and less expensive resources.
- Additionally, expanding internationally enable a business to achieve greater economies of scale and extend the lifespan of its products.
- A business can approach internationalisation systemically with the aid of international strategy planning.
- **Characteristics of a global business**

  To be specific, a global business has **three characteristics:**
  - It is a conglomerate of multiple units (located in different parts of the globe) but all linked by common ownership.
  - Multiple units draw on a common pool of resources, such as money, credit, information, patents, trade names and control systems.
  - The units respond to some common strategy. Besides, its managers and shareholders are also based in different nations.

Developing internationally

- International development is expensive and challenging. Moving on in a thorough and structured manner is thus the ideal approach to adopt.
- The steps in international strategic planning are as follows:
  - Evaluate global opportunities and threats and rate them with the internal capabilities.
  - Describe the scope of the firm's global commercial operations.
  - Create the firm's global business objectives.
  - Develop distinct corporate strategies for the global business and whole organisation.

Why do businesses go global?

- Technological developments and evolving political views are **two important factors** in the rapid rise of multinational organisations.
- Worldwide communication makes it easier to define and implement global strategy by linking corporate headquarters with their abroad operations. There are several reasons why companies go global.
- These are explained as follows:
  - The first and foremost reason is the need to grow. Often finding opportunities in the other parts of the globe, organisations extend their businesses and globalise their operations.
  - There is rapid shrinking of time and distance across the globe, because of faster communication, speedier transportation, growing financial flow of funds and rapid technological changes.

- It is being realised that the domestic markets are no longer adequate. The competition present domestically may not exist in some of the international markets.
- There can be varied other reasons such as need for reliable or cheaper source of raw-materials, cheap labour, etc.
- Companies often set up overseas plants to reduce high transportation costs. It may be cheaper to produce near the market to reduce the time and costs involved in transportation.
- When exporting organisations find foreign markets to open up or grow big, they may naturally look at overseas manufacturing plants and sales branches to generate higher sales and better cash flow.
- The rise of services to constitute the largest single sector in the world economy; and regional economic integration, which has involved both the world's largest economies as well as certain developing economies.
- The apparent and real collapse of international trade barriers redefines the roles of state and industry. The trend is towards increased privatization of manufacturing and services sectors, less government interference in business decisions and more dependence on the value-added sector to gain marketplace competitiveness. The trade tariffs and custom barriers are getting lowered, resulting in increased flow of business.
- Globalization has made companies in different countries to form strategic alliances to ward off economic and technological threats and leverage their respective comparative and competitive advantages.

INTERNATIONAL ENVIRONMENT

- An assessment of the external environment is the first step toward internationalisation.
- Analysing international environment is important since it allows organisation to discover opportunities in the global market and evaluate feasibilities of capitalising on these opportunities.
- Assessments of the **international environment can be done at three levels:** multinational, regional, and country.

Multinational environmental analysis	Multinational environmental analysis **involves** identifying, anticipating, and monitoring significant components of the global environment on a large scale. Understanding global developments covering economic and other macro elements is important. These characteristics are evaluated based on their present and expected future impact.
Regional environmental analysis	Regional environmental analysis is **a more in-depth evaluation** of the critical factors in a specific geographical area. The emphasis would be on discovering market opportunities for a goods, services, or innovations in the chosen location.
Country environmental analysis	Country environmental analysis has to take a deeper look at the important environmental factors. The analysis must be customised for each of the countries to develop effective market entrance strategies.

- International environment has become an inherent part of strategic management for businesses of all sizes with global interests. It becomes more important for the people at the decision-making levels to focus on factors comprising the international environment.

UNDERSTANDING PRODUCT AND INDUSTRY

Business products have certain characteristics as follows:

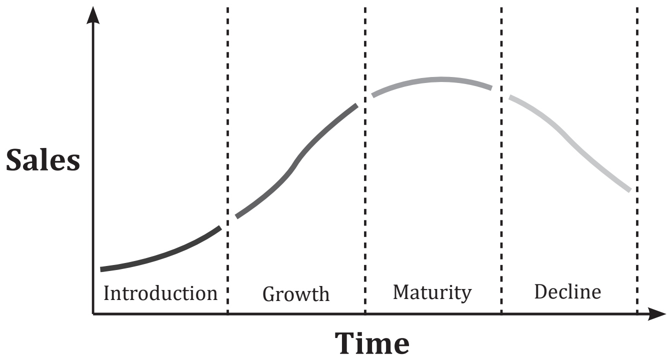
1. Products are **either tangible or intangible**. A tangible product can be handled, seen, and physically felt. Alternatively, an intangible product is not a physical good, such as telecom services, banking, insurance, or repair services.
2. Product **has a price.** The dynamics of supply and demand influence the market price of an item or service. The market price is the price at which quantity provided equals quantity desired. The price that may be paid is determined by the market, the quality, the marketing, and the targeted group. In the present competitive world price is often given by the market and businesses have to work on costs to maintain profitability.

   On account of competition, businesses are not able to fix market price by adding profit margin on the costs. Rather, they work on reducing the costs given the prevailing market price.
3. Products have certain **features that deliver satisfaction**. Products should be able to provide value satisfaction to the customers for whom they are meant. Features of the product will distinguish it in terms of its function, design, quality and experience. A customer's cumulative experience with a product from its purchase to the end of its useful life is an important component of a product feature.
4. Product is **pivotal for business**. The product is at the centre of business around which all strategic activities revolve. Product is the driving force behind business activities.
5. A product **has a useful life**. Every product has a usable life after which it must be replaced, as well as a life cycle after which it is to be reinvented or may cease to exist.

PRODUCT LIFE CYCLE

- An important concept in strategic choice is that of product life cycle (PLC).
- PLC is an **S-shaped curve** which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages of introduction, growth, maturity and decline.

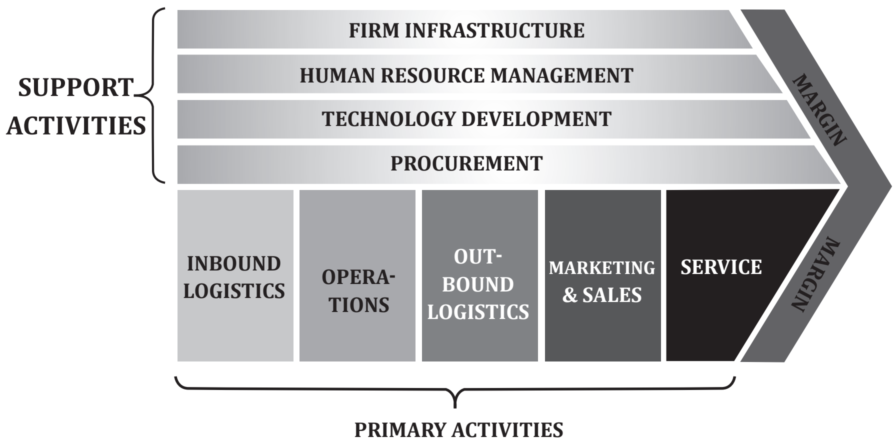
First stage:- of PLC is the introduction stage with **slow sales growth**, in which competition is almost negligible, prices are relatively high, and markets are limited. The growth in sales is at a lower rate because of lack of awareness on the part of customers.
Second phase:- of PLC is growth stage with rapid market acceptance. In the growth stage, the demand expands rapidly, prices fall, competition increases, and market expands. The customer has knowledge about the product and shows interest in purchasing it.
Third phase:- of PLC is maturity stage where there is slowdown in growth rate. In this stage, the competition gets tough, and market gets stabilized. Profit comes down because of stiff competition. At this stage, organisations have to work for maintaining stability.
Fourth stage:- of PLC is declines with sharp downward drift in sales. The sales and profits fall down sharply due to some new product replaces the existing product. So, a combination of strategies can be implemented to stay in the market either by diversification or retrenchment.



- The **main advantage of PLC approach** is that it can be used to diagnose a portfolio of products (or businesses) in order to establish the stage at which each of them exists.
- Particular attention is to be paid on the businesses that are in the declining stage.
- Depending on the diagnosis, appropriate strategic choice can be made. For instance, expansion may be a feasible alternative for businesses in the introductory and growth stages.
- Mature businesses may be used as sources of cash for investment in other businesses which need resources.
- A combination of strategies like selective harvesting, retrenchment, etc. may be adopted for declining businesses.

VALUE CHAIN ANALYSIS

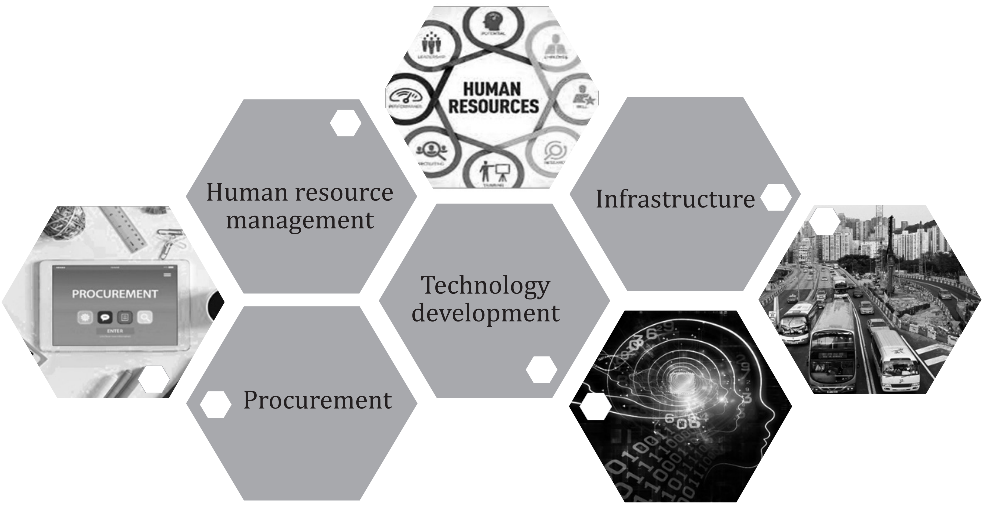
- Value chain analysis is a method **used by strategists to break down** each process that their business employs.
- This analysis could be used to improve the sequence of operations, enhancing efficiency and creating a competitive advantage.
- Value chain analysis is a method of examining each activity in value chain of a business in order to identify areas for improvements. When you do a value chain analysis, you must analyse how each stage in the process adds or subtracts value from the end product or service.
- Value chain analysis has been widely used as a means of describing the activities within and around an organization and relating them to an assessment of the competitive strength of an organization (or its ability to provide value-for-money products or services).
- The **two basic steps of identifying** separate activities and assessing the value added from each were linked to an analysis of an organization's competitive advantage by **Michael Porter**.



- One of the key aspects of value chain analysis is the recognition that organizations are much more than a random collection of machines, material, money and people.
- These resources are of no value unless deployed into activities and organised into systems and routines which ensure that products or services are produced which are valued by the final consumer/user.
- Porter argued that an understanding of strategic capability must start with an identification of these separate value activities.
- The primary activities of the organization are grouped into five main areas:

Inbound logistics ⇨ **Operations** ⇨ **Outbound logistics** ⇨ **Marketing & Sales** ⇨ **Service**

Inbound logistics	The activities concerned with receiving, storing and distributing the inputs to the product/service. This includes materials handling, stock control, transport etc. Like, transportation and warehousing.
Operations	Operations transform these inputs into the final product or service machining, packaging, assembly, testing, etc. convert raw materials in finished goods.
Outbound logistics	Collect, store and distribute the product to customers. For tangible products this would be warehousing, materials handling, transport, etc. In the case of services, it may be more concerned with arrangements for bringing customers to the service, if it is a fixed location (e.g. sports events).
Marketing and sales	Provide the means whereby consumers/users are made aware of the product/ service and are able to purchase it. This would include sales administration, advertising, selling and so on. In public services, communication networks which help users' access a particular service are often important.
Service	Service are all those activities, which enhance or maintain the value of a product/service, such as installation, repair, training and spares.



- Each of these groups of primary activities **are linked to support activities.**
- These can be divided into **four areas;**

Procurement	The processes for acquiring the various resource inputs to the primary activities (not to the resources themselves). As such, it occurs in many parts of the organization.
Technology development	All value activities have a 'technology', even if it is simply know-how. The key technologies may be concerned directly with the product (e.g. R&D product design) or with processes (e.g. process development) or with a particular resource (e.g. raw materials improvements).
Human resource management	A particularly important area which transcends all primary activities. It is concerned with those activities involved in recruiting, managing, training, developing and rewarding people within the organization.
Infrastructure	The systems of planning, finance, quality control, information management, etc. are crucially important to an organization's performance in its primary activities. Infrastructure also consists of the structures and routines of the organization which sustain its culture.

INDUSTRY ENVIRONMENT ANALYSIS

- Industry analysis enable strategic understanding about the entire state of any industry and make decisions about whether the industry is a lucrative or not.
- The goal of the industry environment analysis, which is typically an important step of strategic analysis, is to estimate the amount of competitive pressures the business is presently facing and is expected to face in the near future.
- Analysing these elements enhances knowledge of surrounding and serves as the foundation for aligning strategy with changing industry circumstances and realities.

PORTER'S FIVE FORCES MODEL

- Every business operates in the competitive environment.
- Porter's Five Forces analysis is a simple but efficient way for determining the key sources of competition in business or industry.
- It is a powerful and widely used tool to systematically diagnose the significant competitive pressures in a market and assess the strength and importance of each.
- Michael Porter believes that the basic unit of analysis for understanding is a group of competitors producing goods or services that compete directly with each other.
- The model holds that the state of competition in an industry is a composite of competitive pressures operating in **five areas of the overall market:**

Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.

Competitive pressures associated with the threat of new entrants into the market.

Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.

Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.

Competitive pressures stemming from buyer bargaining power and seller- buyer Collaboration.

The strategists can use the five-forces model to determine what competition is like in a given industry by undertaking the following steps:

Step-1
Identify the specific competitive pressures associated with each of the five forces.

→

Step-2
Evaluate how strong the pressures comprising each of the five forces are (fierce, strong, moderate to normal, or weak).

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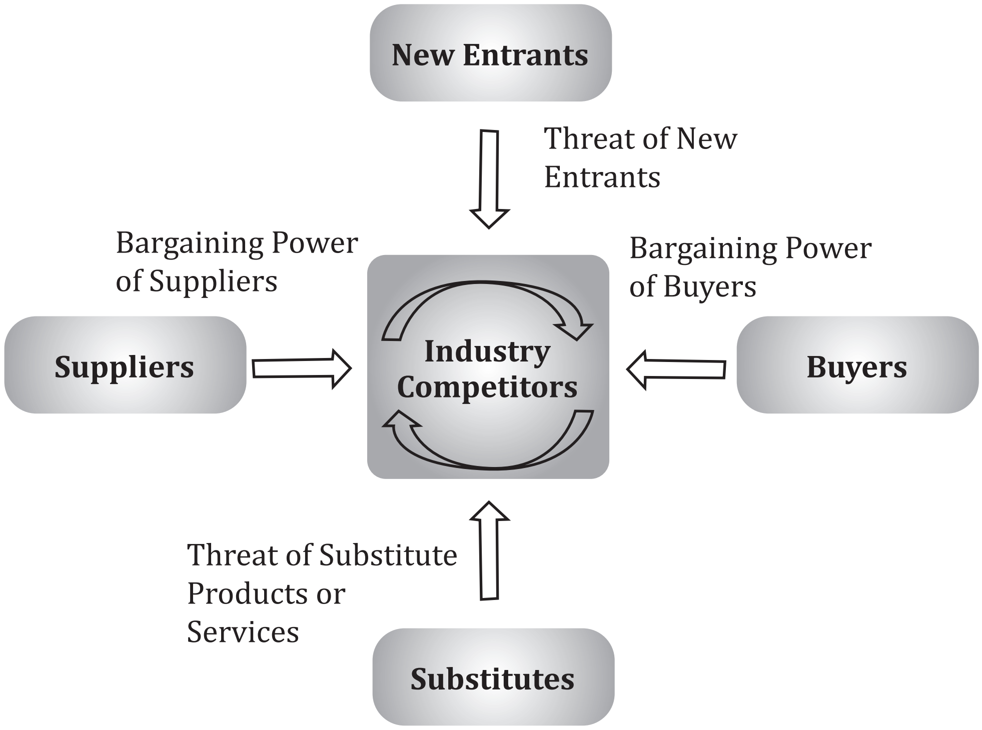
Step-3
Determine whether the collective strength of the five competitive forces is conducive to earning attractive profits.



By applying Porter's five forces model of industry attractiveness to their own industries, the manager can gauge their own firm's strengths, weaknesses, and future opportunities.

(I) The Threat of New Entrants

- New entrants can reduce industry profitability because they add new production capacity leading to an increase supply of the product even at a lower price and can substantially erode existing firm's market share position.
- The new capacity and product range they bring in throw up new competitive pressure. And the bigger the new entrant, the more severe the competitive effect.
- To discourage new entrants, existing firms can try to raise barriers to entry. Barriers to entry represent economic forces (or 'hurdles') that slow down or impede entry by other firms. These **are explained as follows:**

Capital Requirements	When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from the industry, thus enhancing the profitability of existing firms in the industry.
Economies of Scale	Economies of scale refer to the decline in the per-unit cost of production (or other activity) as volume grows. A large firm that enjoys economies of scale can produce high volumes of goods at successively lower costs. This tends to discourage new entrants.
Product Differentiation	Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers.
Switching Costs	To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, and train personnel to use the equipment, or modify facilities for product use. Buyers often incur substantial financial (and psychological) costs in switching between firms. When such switching costs are high, buyers are often reluctant to change.
Brand Identity	Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer. New entrants often encounter significant difficulties in building up the brand identity, because to do so they must commit substantial resources over a long period.
Access to Distribution Channels	Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals.
Possibility of Aggressive Retaliation	Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry. **E.g:-** Introduction of products by a new firm may lead incumbents firms to reduce their product prices and increase their advertising budgets.

(II) Bargaining Power of Buyers

- This force will become heavier depending on the possibilities of the buyers' forming groups or cartels.
- The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.
- Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services.
- This leverage is particularly evident when:

Buyers have full knowledge of the sources of products and their substitutes.

They spend a lot of money on the industry's products i.e. they are big buyers.

The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

(III) Bargaining Power of Suppliers

- The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.
- Suppliers can influence the profitability of an industry in a number of ways.
- Suppliers can command bargaining power over a firm when:

Their products are crucial to the buyer and substitutes are not available. ⇨ **They can erect high switching costs.** ⇨ **They are more concentrated than their buyers.**

(IV) The Nature of Rivalry in the Industry

- The intensity of rivalry in an industry is a significant determinant of industry attractiveness and profitability.
- The intensity of rivalry can influence the costs of suppliers, distribution, and of attracting customers and thus directly affect the profitability.
- The more intensive the rivalry, the less attractive is the industry.
- Rivalry among competitors tends to be cutthroat and industry profitability low under various conditions explained as follows:

Industry Leader	A strong industry leader can discourage price wars by disciplining initiators of such activity. Because of its greater financial resources, a leader can generally outlast smaller rivals in a price war.
Number of Competitors	Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult.
Fixed Costs	When rivals operate with high fixed costs, they feel strong motivation to utilize their capacity and therefore are inclined to cut prices when they have excess capacity.
Exit Barriers	Rivalry among competitors declines if some competitors leave an industry. Exit barriers come in many forms. Assets of a firm considering exit may be highly specialized and therefore of little value to any other firm. Such a firm can thus find no buyer for its assets. This discourages exit. When barriers to exit are powerful, competitors desiring exit may refrain from leaving. Their continued presence in an industry exerts downward pressure on the profitability of all competitors.
Product Differentiation	Firms can sometimes insulate themselves from price wars by differentiating their products from those of rivals. As a consequence, profitability tends to be higher in industries that offer opportunity for differentiation. Profitability tends to be lower in industries involving undifferentiated commodities. **E.g:-** Memory chips, natural resources, processed metals and railroads.

Slow Growth	Industries whose growth is slowing down tend to face more intense rivalry. As industry growth slows, rivals must often fight harder to grow or even to keep their existing market share. The resulting intensive rivalry tends to reduce profitability for all.

(V) Threat of Substitutes

- Substitute products are a latent source of competition in an industry.
- Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden.

E.g:- Coir suffered at the hands of synthetic fibre.

A final force that can influence industry profitability is the availability of substitutes for an industry's product.

E.g:- Real estate, insurance, bonds and bank deposits for example are clear substitutes for common stocks, because they represent alternate ways to invest funds.

The five forces together determine industry attractiveness/ profitability.

E.g:- Elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces. The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.

ATTRACTIVENESS OF INDUSTRY

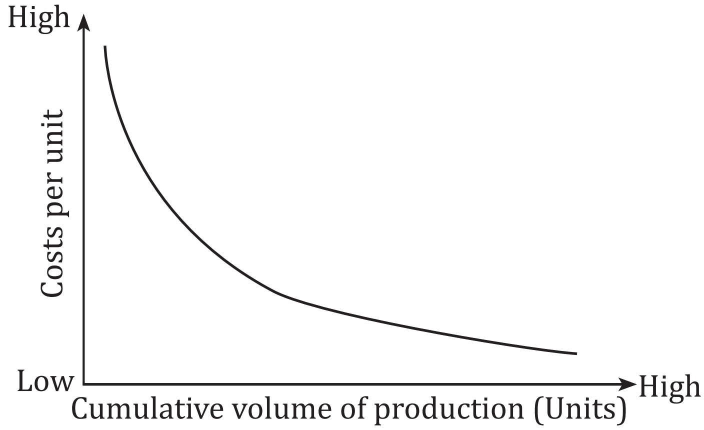
- The industry analysis culminates into identification of various issues and draw conclusions about the relative attractiveness or unattractiveness of the industry, both near-term and long-term.
- The important factors on which the management may base such conclusions include:
  - The industry's growth potential, is it futuristically viable?
  - Whether competition currently permits adequate profitability and whether competitive forces will become stronger or weaker?
  - Whether industry profitability will be favourably or unfavourably affected by the prevailing driving forces?
  - The competitive position of an organisation in the industry and whether its position is likely to grow stronger or weaker. (Being a well-entrenched leader or strongly positioned contender in an otherwise lackluster industry can still produce good profitability; however, having to fight an uphill battle against much stronger rivals can make an otherwise attractive industry unattractive).
  - The potential to capitalize on the vulnerabilities of weaker rivals (perhaps converting an unattractive industry situation into a potentially rewarding company opportunity).
  - Whether the company is able to defend against or counteract the factors that make the industry unattractive?
  - The degrees of risk and uncertainty in the industry's future.
  - The severity of problems confronting the industry as a whole.
  - Whether continued participation in this industry adds importantly to the firm's ability to be successful in other industries in which it may have business interests?

EXPERIENCE CURVE

- Experience curve **akin to a learning curve** which explains the efficiency increase gained by workers through repetitive productive work.
- Experience curve is based on the commonly observed phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production.
- It is based on the concept, **"we learn as we grow"**.
- Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production.
- Experience curve has **following features**:

  - As business organisation grow, they gain experience.
  - Experience may provide an advantage over the competition. Experience is a key barrier to entry.
  - Large and successful organisation possess stronger "experience effect".

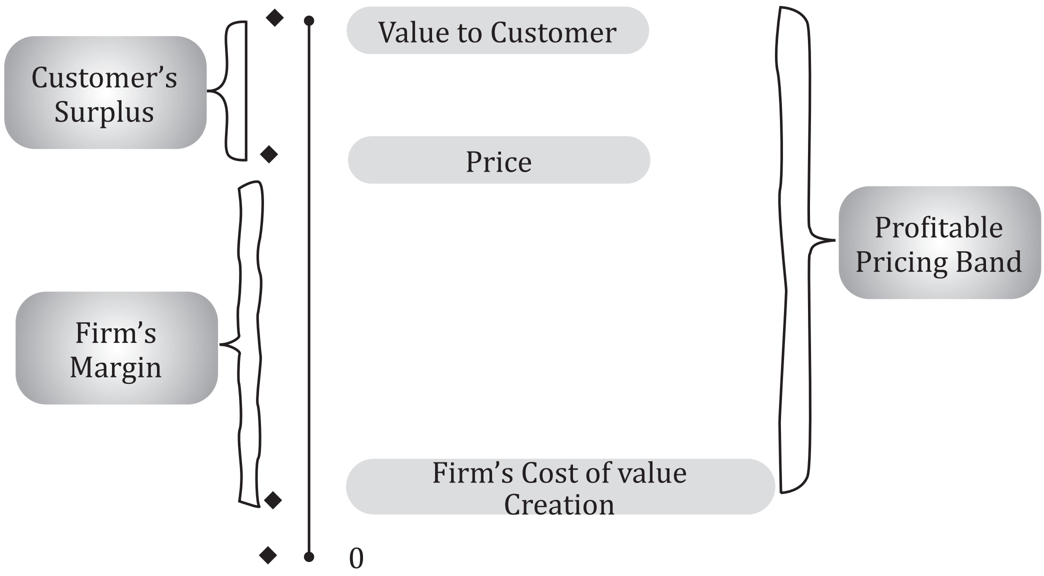
- A typical experience curve may be depicted as follows:



- As a business grows, it understands the complexities and benefits from its experiences.
- The concept of experience curve is relevant for a number of areas in strategic management.
- For instance, experience curve is considered a barrier for new firms contemplating entry in an industry.
- The likely strategic choice for competitors can be a market niche approach or segmentation based on demography or geography.

VALUE CREATION

- The concept of value creation was introduced primarily for providing products and services to the customers with more worth.
- The concept took more space in the business and organizations started discussing about the value creation for stakeholders.



- The value creation is an activity or performance by the firm to create value that increases the worth of goods, services, business processes or even the whole business system.
- This concept gives business a competitive advantage in the industry and helps them earn above average profits/returns.
- Competitive advantage leads to superior profitability.
- Profitable a company becomes depends on **three factors**:
  (*a*) the value customers place on the company's products;
  (*b*) the price that a company charges for its products; and
  (*c*) the costs of creating those products.
- The value customers place on a product reflects the utility they get from a product.
- Companies are ultimately aiming to achieve sustainable competitive advantage, which enables them to succeed in the long run.
- Michael Porter argues that a company can generate competitive advantage in **two different ways**, either through **differentiation or cost advantage**.
  - According to Porter's, differentiation means the capability to provide customers superior and special value in the form of product's special features and quality or in the form of aftersales customer service.
  - As a result of differentiation, a company can demand higher price for its products or services. A company will earn higher profits due to differentiation in case the expenses stay comparable to the costs of competitors.
  - The differentiation and cost advantage will affect a company's ability to achieve competitive advantage, but there are many different organizational functions that will influence whether a company can achieve cost advantage or differentiation advantage.
- Value chain analysis provides an excellent tool to examine the origin of competitive advantage. It divides the organisations into two different strategically important group of activities, namely, primary activities and supporting activities, which can help to comprehend the potential sources for differentiation and to understand an organisation's costs behaviour.

Market And Customer

- A market is a place for interested parties, buyers and sellers, where items and services can be exchanged for a price.
- The market might be physical, such as a departmental store where people engage in person.
- They may also be virtual, such as an online market where buyers and sellers do not meet in person but tools of technology to strike a deal.
- Example: it might be used to describe the stock exchange, where securities are traded.
- The term "marketing" encompasses a wide range of operations, including research, designing, pricing, promotion, transportation, and distribution.
- Often market activities are categorised and explained in terms of four Ps of marketing - product, place, pricing, and promotion.

Customer

- A customer is a person or business that buys products or services from another organisation.
- The terms customer and consumer are practically synonymous and are frequently used interchangeably. There is, a thin distinction.
- Individuals or businesses that consume or utilise products and services are referred to as consumers. Customers are the purchasers of products and services in the economy, and they might exist as consumers or only as customers.

Customer Analysis

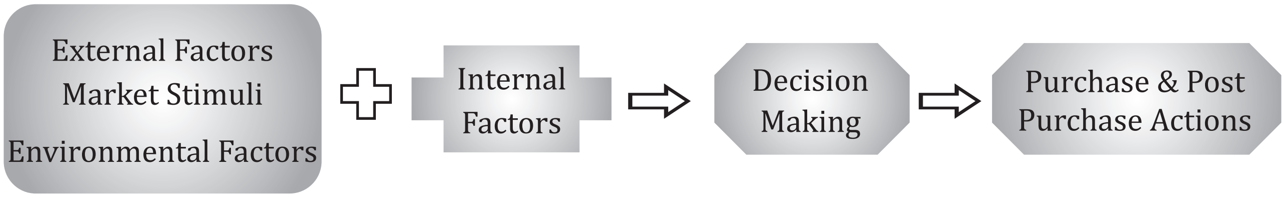
- Customer analysis is an essential marketing component of any strategic business plan.
- It identifies target clients, determines their wants, and then defines how the product meets those needs. Thus, it involves the examination and evaluation of consumer needs, desires, and wants.
- Customer analysis includes the administration of customer surveys, the study of consumer data, the evaluation of market positioning strategies, development of customer profiles, and the selection of the best market segmentation techniques.

Customer Behaviour

- Customer behaviour moves beyond the identification of customers to explain how they purchase products.
- Understanding the behaviours of customers enables businesses to establish effective marketing and advertising campaigns, provide products and services that meet their needs, and retain customers for repeat sales.
- Consumer behaviour may be influenced by a number of things. These elements can be categorised into the following **three conceptual domains**:

External Influences	External influences, like advertisement, peer recommendations or social norms. The focus of external effects is on the numerous elements that have an impact on customers as they choose which needs to satisfy and which products to use to do so. These aspects are divided into two groups - the company's marketing - efforts and the numerous environmental elements.
Internal Influences	Internal processes are psychological factors internal to customer and affect consumer decision making. Consumer behaviour is influenced by a combination of internal and external influences, including motivation and attitudes.

Decision Making	A rational consumer, as decision maker would seek information about potential decisions and carefully integrate this with the existing knowledge about the product. The **stages of decision-making process** can be described as: ❍ Problem recognition, i.e., identify an existing need or desire that is unfulfilled ❍ Search for desirable alternative and list them ❍ Seeking information on available alternatives and weighing their pros and cons. ❍ Make a final choice This behaviour of making decisions happens very frequently.
Post-decision Processes	After making a decision and purchasing a product, the final phase in the decision-making process is evaluating the outcome. The consumer's reaction may vary depending upon the satisfaction.



COMPETITIVE STRATEGY

- Competition is a fundamental attribute of economic systems and business, and it is frequently connected with small and large organisations.
- The competitive strategy of a business is concerned with how to compete in the business areas in which the organization operates.
- The competitive strategy of a firm within a certain business field is analysed using two criteria: **the creation of competitive advantage and the protection of competitive advantage.**
- An important component of industry and competitive analysis involves delving into the industry's competitive process to discover what the main sources of competitive pressure are and how strong each competitive force is.
- This analytical step is essential because managers cannot devise a successful strategy without in-depth understanding of the industry's competitive character.
- Even though competitive pressures in various industries are never precisely the same, the competitive process works similarly enough to use a common analytical framework in gauging the nature and intensity of competitive forces.

COMPETITIVE LANDSCAPE

- Competitive landscape is a business analysis which identifies competitors, either direct or indirect.
- Competitive landscape is about identifying and understanding the competitors and at the same time, it permits the comprehension of their vision, mission, core values, niche market, strengths and weaknesses.
- Understanding of competitive landscape requires an application of "competitive intelligence".

- Thus, understanding the competitive landscape is important to build upon a competitive advantage.
- Steps to understand the Competitive Landscape

Identify the competitor	The firm's industry and have actual data about their respective market share. This answers the question: Who are the competitors and how big are they?
Understand the competitors	The strategist can use market research report, internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by them in different markets. This answers the question: What are their product and services?
Determine the strengths of the competitors	This answers the questions: What are their financial positions? What gives them cost and price advantage?; What are they likely to do next? How strong is their distribution network? What are their human resource strengths?
Determine the weaknesses of the competitors	Identify the areas where the competitor is lacking or is weak. Weaknesses (and strengths) can be identified by going through consumer reports and reviews appearing in various media. Financial strength and weakness can always be learnt from annual reports.
Put all of the information together	The strategist should put together all information about competitors and draw inference about what they are not offering and what the firm can do to fill in the gaps. The strategist can also know the areas which need to be strengthen by the firm.

Key Factors For Competitive Success

- An industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace - the particular strategy elements, product attributes, resources, competencies, competitive capabilities, and business outcomes that spell the difference between profit and loss and, ultimately, between competitive success or failure.
- Key success factors are the prerequisites for industry success or, to put it another way, KSFs are the factors that shape whether a company will be financially and competitively successful.
- The answers to **three questions** help identify an industry's key success factors:

On what basis do customers choose between the competing brands of sellers? What product attributes are crucial to sales?

What resources and competitive capabilities does a seller need to have to be competitively successful, better human capital, quality of product or quantity of product, cost of service, etc.?

What does it take for sellers to achieve a sustainable competitive advantage, something that can be sustained for long term?

E.g:- In apparel manufacturing, the KSFs are appealing designs and colour combinations (to create buyer interest) and low-cost manufacturing efficiency (to permit attractive retail pricing and ample profit margins).

Key success factors vary from industry to industry and even from time to time within the same industry as driving forces and competitive conditions change. Only rarely does an industry have more than three or four key success factors at any one time.

The purpose of identifying KSFs is to make judgments about what things are more important to competitive success and what things are less important.

TEST YOUR KNOWLEDGE – MCQS

1. **KSFs stand for:**
   (*a*) Key strategic factors
   (*b*) Key supervisory factors
   (*c*) Key success factors
   (*d*) Key sufficient factors
2. **Competitive landscape requires the application of-**
   (*a*) Competitive advantage
   (*b*) Competitive strategy
   (*c*) Competitive acumen
   (*d*) Competitive intelligence
3. **The term PESTLE analysis is used to describe a framework for analysing:**
   (*a*) Macro environment
   (*b*) Micro environment
   (*c*) Both Micro and Macro environment
   (*d*) None of the above
4. **'Attractiveness of firms' while conducting industry analysis should be seen in-**
   (*a*) Relative terms
   (*b*) Absolute terms
   (*c*) Comparative terms
   (*d*) All of the above
5. **What is not one of Michael Porter's five competitive forces?**
   (*a*) New entrants
   (*b*) Rivalry among existing firms
   (*c*) Bargaining power of unions
   (*d*) Bargaining power of suppliers
6. **Which of the following constitute Demographic Environment?**
   (*a*) Nature of economy i.e. capitalism, socialism, Mixed
   (*b*) Size, composition, distribution of population, sex ratio
   (*c*) Foreign trade policy of Government
   (*d*) Economic policy i.e. fiscal and monetary policy of Government
7. **All are elements of Macro environment except:**
   (*a*) Society (*b*) Government (*c*) Competitors (*d*) Technology
8. **The emphasis on product design is very high, the intensity of competition is low, and the market growth rate is low in the _____ stage of the industry life cycle.**
   (*a*) Maturity (*b*) Introduction (*c*) Growth (*d*) Decline

ANSWER KEY

1.	(c)	**2.**	(d)	**3.**	(a)	**4.**	(a)	**5.**	(c)	**6.**	(b)	**7.**	(c)	**8.**	(b)

TEST YOUR KNOWLEDGE – CASE STUDIES

1. **Suresh Singhania is the owner of an agri-based private company in Sangrur, Punjab. His unit is producing puree, ketchups and sauces. While its products have significant market share in the northern part of country, the sales are on decline in last couple of years. He seeks help of a management expert who advises him to first understand the competitive landscape.**

   Explain the steps to be followed by Suresh Singhania to understand competitive landscape.

Ans. Steps to understand the competitive landscape:

(*a*) **Identify the competitor:** The first step to understand the competitive landscape is to identify the competitors in the firm's industry and have actual data about their respective market share.

(*b*) **Understand the competitors:** Once the competitors have been identified, the strategist can use market research report, internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by them in different markets.

(*c*) **Determine the strengths of the competitors:** What is the strength of the competitors? What do they do well? Do they offer great products? Do they utilize marketing in a way that comparatively reaches out to more consumers? Why do customers give them their business?

(*d*) **Determine the weakness of the competitors:** Weakness (and strengths) can be identified by going through consumer reports and reviews appearing in various media. After all, consumers are often willing to give their opinions, especially when the products or service are either great or very poor.

(*e*) **Put all of the information together:** At this stage, the strategist should put together all information about competitors and draw inference about what they are not offering and what the firm can do to fill in the gaps. The strategist can also know the areas which need to be strengthen by the firm.

2. **Eco-carry bags Ltd., a recyclable plastic bags manufacturing, and trading company has seen a potential in the ever-growing awareness around hazards of plastics and the positive outlook of the society towards recycling and reusing plastics.**

   A major concern for Eco-carry bags Ltd. are paper bags and old cloth bags. Even though they are costlier than recyclable plastic bags, irrespective, they are being welcomed positively by the consumers.

   Identify and explain that competition from paper bags and old cloth bags fall under which category of Porter's Five Forces Model for Competitive Analysis?

Ans. Eco-carry bags Ltd. faces competition from paper bags and old cloth bags and falls under Threat of Substitutes force categories in Porter's five Forces Model for Competitive Analysis. Paper and cloth bags are substitutes of recyclable plastic bags as they perform the same function as plasctic bags. Substitute products are a latent source of competition in an industry. In many cases, they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry.

3. **Baby Turtle is a children's clothing brand that has been created a new age demand for washable diapers. The major benefit for the brand has been that not many companies have shown interest in the product, thinking it is not viable, however, customers, majorly working mothers are loving their product. The core material needed for production is also**

used in many other water proofing products in various industries. Baby Turtle sources this material from a renowned supplier at comparatively low prices. Which of the five forces of competitive pressure would Baby Turtle experience due to above setup and what are major factors that create such pressure for a product? Do you think Baby Turtle has an advantage in some way to fight off this pressure?

Ans. Baby Turtle would experience, Bargaining Power of Suppliers, as a competitive pressure for their washable diaper product. This is because the core material for production is sourced from a single supplier, who is renowned and in a position to create pressure in terms of prices.

Further, other factors that lead to such pressure are:

(*a*) Their products are crucial to the buyer and substitutes to the material required for production are not available

(*b*) Suppliers can manipulate switching cost as the brand is in inception stage and making margins are important.

An advantage that Baby turtle has is even though the material required has no substitutes, but it used to make many other products and thus there are many other suppliers who can provide that material. It might affect operations in short term but will help to fight off the pressure created by existing supplier.

TEST YOUR KNOWLEDGE – DESCRIPTIVE QUESTIONS

1. Examine the significance of KSFs (Key Success Factors) for competitive success. (Nov 2018)

Ans. As industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the market place – the particular strategy elements, product attributes, resources, competencies, competitive capabilities and business outcomes that spell the difference between profit & loss and ultimately, between competitive success or failure. KSFs by their very nature are so important that all firms in the industry must pay close attention to them. They are the prerequisites for industry success, or, to put it in another way, KSFs are the rules that shape whether a company will be financially and competitively successful.

2. "Industry and competitive analysis begin with an overview of the industry's dominant economic features." Explain and also narrate the factors to be considered in profiling in industry's economic features. (Nov 2019)

Ans. Industry is "a group of firms whose products have the same and similar attributes such that they compete for the same buyers." Industries differ significantly in their basic character and structure. Industry and competitive analysis begins with an overview of the industry's dominant economic features.

The factors to be considered while profiling an industry's economic features are fairly standard and are given as under:

- Size and nature of market. Scope of competitive rivalry.
- Market growth rate and position in the business life.
- Number of rivals and their relative market share.
- The number of buyers and their relative sizes.
- The types of distribution channels used to access consumers.
- The pace of technological change in both production process innovation and new product introductions.

- Whether the products and services of rival firms are highly differentiated, weakly differentiated, or essentially identical?
- Whether organizations can realize economies of scale in purchasing, manufacturing, transportation, marketing, or advertising.
- Whether key industry participants are clustered in a location.
- Whether certain industry activities are characterized by strong learning and experience effects ("learning by doing") such that unit costs decline as cumulative output grows.
- Whether high rates of capacity utilization are crucial to achieve low-cost production efficiency.
- Capital requirements and the ease of entry and exit.
- Whether industry profitability is above or below par?

3. Explain the Strategic Alliance. Describe the advantages of Strategic Alliance. (Nov 2019)

Ans. A strategic alliance is a relationship between two or more businesses that enables each to achieve certain strategic objectives which neither would be able to achieve on its own. The strategic partners maintain their status as independent and separate entities, share the benefits and control over the partnership, and continue to make contributions to the alliance until it is terminated. Advantages of Strategic Alliance.

Strategic alliances usually are only formed if they provide an advantage to all the parties in the alliance. These advantages can be broadly categorized as follows:

(1) Organizational: Strategic alliance helps to learn necessary skills and obtain certain capabilities from strategic partners. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend the supply chain. Strategic partners may provide a good or service that complements thereby creating a synergy. Having a strategic partner who is well-known and respected also helps add legitimacy and credibility to a new venture.

(2) Economic: There can be reduction in costs and risks by distributing them across the members of the alliance. Greater economies of scale can be obtained in an alliance, as production volume can increase, causing the cost per unit to decline. Finally, partners can take advantage of co-specialization, creating additional value.

(3) Strategic: Rivals can join together to cooperate instead of compete. Vertical integration can be created where partners are part of the supply chain. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.

(4) Political: Sometimes strategic alliances are formed with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry. Forming strategic alliances with politically-influential partners may also help improve your own influence and position.

4. Why should companies go global? Mention any five reasons. (Nov 2020)

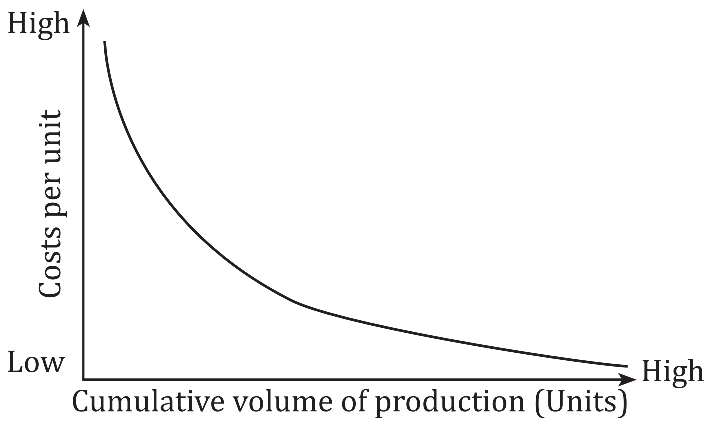
Ans. There are several reasons why companies go global. These are discussed as follows:

- One reason could be the rapid shrinking of time and distance across the globe - thanks to faster communication, speedier transportation, growing financial flows and rapid technological changes.

- It is being realized that the domestic markets are no longer adequate and rich. Companies globalize to take advantage of opportunities available elsewhere.
- A new product may gradually get acceptance and grow locally and then globally. This may initially be in the form of exports and then later production facilities may begin in other countries.
- Organizations may go global to take advantage of cheaper raw material and labor costs.
- Companies often set up overseas plants to reduce high transportation costs.
- The motivation to go global in high-tech industries is slightly different. Companies in electronics and telecommunications must spend large sums on research and development for new products and thus may be compelled to seek ways to improve sales volume to support high overhead expenses.
- The companies may also go global to take advantage of local taxation laws.
- To form strategic alliances to ward off economic and technological threats and leverage their respective comparative and competitive advantages.

5. Explain the concept of Experience Curve and highlight its relevance in strategic management. (SM)

Ans. Experience curve is similar to learning curve which explains the efficiency gained by workers through repetitive productive work. Experience curve is based on the commonly observed phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production. It is represented diagrammatically as shown below:



The implication is that larger firms in an industry would tend to have lower unit costs as compared to those of smaller organizations, thereby gaining a competitive cost advantage. Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production.

The concept of experience curve is relevant for a number of areas in strategic management. For instance, experience curve is considered a barrier for new firms contemplating entry in an industry. It is also used to build market share and discourage competition.

6. Write a short note on Product Life Cycle (PLC) and its significance in portfolio diagnosis. (SM)

Ans. Refer to notes mentioned above.

7. Explain Porter's five forces model as to how businesses can deal with the competition. (SM)

Ans. Refer to notes mentioned above.

8. "The bargaining power of suppliers determines an industry's attractiveness and profitability." Discuss. **(May 2022)**

Ans. Quite often, suppliers too, exercise considerable bargaining power over purchasing companies. The more specialized the offering from the supplier, greater may be its clout. Further, when the suppliers are limited in number, they may openly exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry, and therefore, an industry's attractiveness and profitability.

Suppliers can influence the profitability of an industry in a number of ways.

Suppliers can command bargaining power over a firm when;

(i) Their products are crucial to the buyer and substitutes are not available.

(ii) They can erect/ensure high switching costs.

(iii) They are more concentrated than their buyers. Less suppliers, more buyers.

9. Buyers of an industry's products or services can sometimes exert considerable pressure on the company. In the light of the five forces as propagated by Michael Porter explain this force. Also state as to when this leverage is evident. **(May 2023)**

Ans. Bargaining Power of Buyers: This is another force that influences the competitive condition of an industry. This force becomes heavier depending on the possibility of buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or even informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences costs and investments of the producer. This is because powerful buyers usually bargain for better services which involves more investment on the part of the producer.

Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services.

This leverage is particularly evident when;

(i) Buyers have full knowledge of the source(s) of products and their substitutes. Thus, challenging the price being charged by producers.

(ii) They spend a lot of money on the industry's products i.e., they are big buyers. Thus, in a position to demand favourable terms of contract.

(iii) The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.