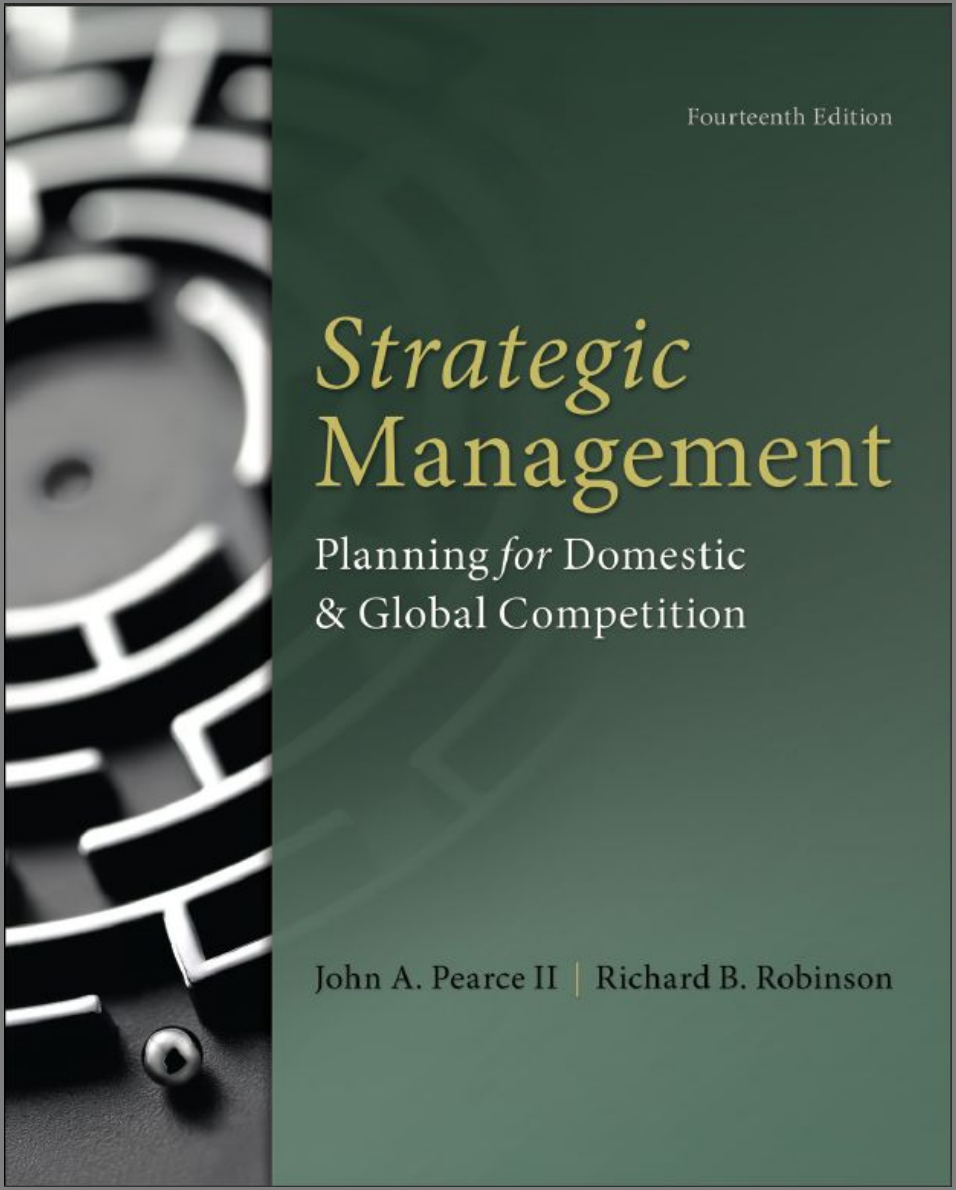
Chapter 6

Internal Analysis



Learning Objectives

1. Understand how to conduct a SWOT analysis
2. Understand value chain analysis and how to use it to disaggregate a firm’s activities
3. Understand the resource-based view of a firm
4. Use “Three Circle Analysis” as a technique to examine a company’s product/service attributes with those of key competitors relative to tangible customer needs
5. Apply four different perspectives for making meaningful comparisons to assess a firm’s internal strengths and weaknesses
6. Refamiliarize yourself with ratio analysis and basic techniques of financial analysis to assist in doing internal analysis

SWOT Analysis

A traditional approach to internal analysis:

SWOT is an acronym for the internal <u>**S**</u>trengths and <u>**W**</u>eaknesses of a firm and the environmental <u>**O**</u>pportunities and <u>**T**</u>hreats facing that firm.

- **SWOT analysis** is a historically popular technique through which managers create a quick overview of a company's strategic situation.

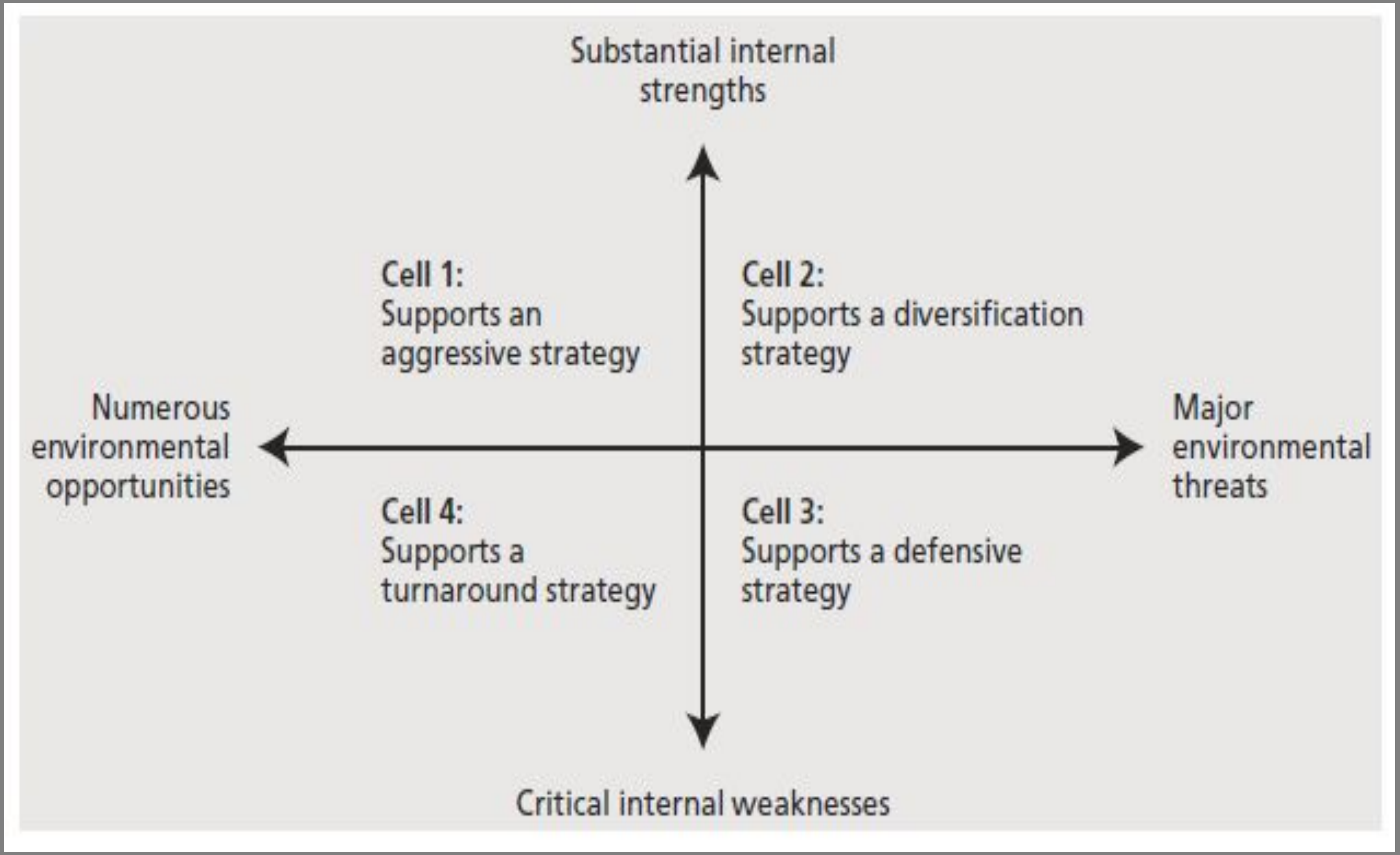
SWOT Components

- An **opportunity** is a major favorable situation in a firm’s environment
- A **threat** is a major unfavorable situation in a firm’s environment

SWOT Components (contd.)

- A **strength** is a resource or capability controlled by or available to a firm that gives it an advantage relative to its competitors in meeting the needs of the customers it serves
- A **weakness** is a limitation or deficiency in one or more of a firm's resources or capabilities relative to its competitors that create a disadvantage in effectively meeting customer needs

Ex. 6.2 SWOT Analysis Diagram



Limitations of SWOT Analysis

- A SWOT analysis can overemphasize internal strengths and downplay external threats
- A SWOT analysis can be static and can risk ignoring changing circumstances
- A SWOT analysis can overemphasize a single strength or element of strategy
- A strength is not necessarily a source of competitive advantage

Value Chain

- A perspective in which business is seen as a chain of activities that transforms inputs into outputs that customers value.

Value Chain Analysis (VCA)

- **Value chain analysis** (VCA) attempts to understand how a business creates customer value by examining the contributions of different activities within the business to that value
- VCA takes a process point of view

Value Chain Analysis (contd.)

- VCA divides (disaggregates) the business into a set of activities that occur **within the business**.
- Activities are divided into two kinds
  - Primary activities
  - Support activities

Value Chain Analysis (contd.)

- Primary Activities

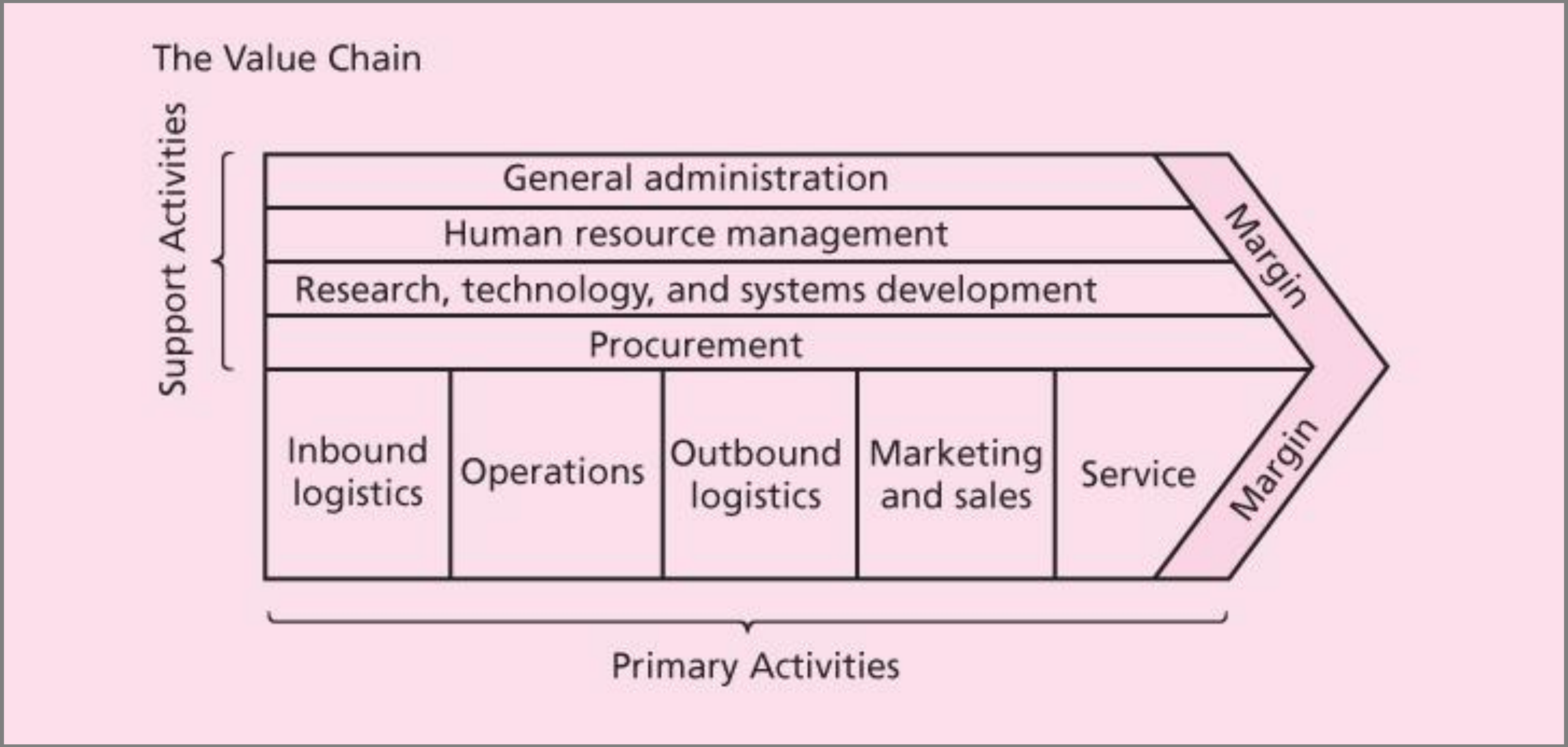
  The activities in a firm of those involved in the physical creation of the product, marketing and transfer to the buyer, and after-sales support

Value Chain Analysis (contd.)

- Support Activities

  The activities in a firm that assist the firm as a whole by providing infrastructure or inputs that allow the primary activities to take place on an ongoing basis

Ex. 6.3 The Value Chain



Ex. 6.3 (adapted) Primary Activities in a Value Chain

Primary Activities

- **In bound logistics**—Activities, costs, and assets associated with obtaining fuel, energy, raw materials, parts components, merchandise, and consumable items from vendors; receiving, storing, and disseminating inputs from suppliers; inspection; and inventory management.
- **Operations**—Activities, costs, and assets associated with converting inputs into final product form (production, assembly, packaging, equipment maintenance, facilities, operations, quality assurance, environmental protection).
- **Outbound logistics**—Activities, costs, and assets dealing with physically distributing the product to buyers (finished goods warehousing, order processing, order picking and packing, shipping, delivery vehicle operations).
- **Marketing and sales**—Activities, costs, and assets related to sales force efforts, advertising and promotion, social media/community, market research and planning, and dealer/distributor support.
- **Service**—Activities, costs, and assets associated with providing assistance to buyers, such as installation, spare parts delivery, maintenance and repair, technical assistance, buyer inquiries, and complaints.

Ex. 6.3 (adapted) Support Activities in a Value Chain

Support Activities

- **General administration**—Activities, costs, and assets relating to general management, accounting and finance, legal and regulatory affairs, safety and security, management information systems, social media strategy, and other "overhead" functions.
- **Human resources management**—Activities, costs, and assets associated with the recruitment, hiring, training, development, and compensation of all types of personnel; labor relations activities; development of knowledge-based skills.
- **Research, technology, and systems development**—Activities, costs, and assets relating to product R&D, process R&D, process design improvement, equipment design, computer software development, telecommunications systems, computer-assisted design and engineering, social media and community-building technologies, new database capabilities, and development of computerized support systems.
- **Procurement**—Activities, costs, and assets associated with purchasing and providing raw materials, supplies, services, and outsourcing necessary to support the firm and its activities. Sometimes this activity is assigned as part of a firm's inbound logistic purchasing activities.

Conducting a VCA

1. Identify activities
2. Allocate costs

- VCA proponents hold that the activity-based VCA approach would provide a more meaningful analysis of the procurement function's costs and consequent value added than the traditional cost accounting approach

Ex. 6.5 Traditional Cost Accounting vs Activity Based Cost Accounting

Traditional Cost Accounting in a Purchasing Department	
Wages and salaries	$175,000
Employee benefits	57,500
Supplies	3,250
Travel	1,200
Depreciation	8,500
Other fixed charges	62,000
Miscellaneous operating expenses	12,625
	$320,075

Activity-Based Cost Accounting in the Same Purchasing Department for Its "Procurement" Activities	
Evaluate supplier capabilities	$ 67,875
Process purchase orders	41,050
Expedite supplier deliveries	11,750
Expedite internal processing	7,920
Check quality of items purchased	47,150
Check incoming deliveries against purchase orders	24,225
Resolve problems	55,000
Internal administration	65,105
	$320,075

Difficulty in Activity-Based Cost Accounting

- It is important to note that existing financial management and accounting systems in many firms are not set up to easily provide activity-based cost breakdowns
- The information requirements to support activity-based cost accounting can create redundant work
- The time and energy to change to an activity-based approach can be formidable

Resource-Based View (RBV)

- **RBV** is a method of analyzing and identifying a firm’s strategic advantages based on examining its distinct combination of assets, skills, capabilities, and intangibles

Resource-Based View (RBV) (contd.)

- The RBV's underlying premise is that firms differ in fundamental ways because each firm possesses a unique "bundle" of resources
- Each firm develops competencies from these resources, and these become the source of the firm's competitive advantages

Resource-Based View (RBV) (contd.)

- **Core Competence** is a capability or skill that a firm emphasizes and excels in doing while in pursuit of its overall mission.

Three Basic Resources

1. **Tangible assets** are the easiest “resources” to identify and are often found on a firm’s balance sheet
2. **Intangible assets** are “resources” such as brand names, company reputation, organizational morale, technical knowledge, patents and trademarks, and accumulated experience
3. **Organizational capabilities** are not specific “inputs.” They are the skills that a company uses to transform inputs into outputs

What makes a resource valuable?

4 Guidelines:

1. Is the resource or skill critical to fulfilling a customer's need better than that of the firm's competitors?
2. Is the resource scarce? Is it in short supply or not easily substituted for or imitated?
3. Appropriability: Who actually gets the profit created by a resource?
4. Durability: How rapidly will the resource depreciate?

Elements of Scarcity

- Short Supply
- Availability of Substitutes
- Imitation
- Isolating Mechanisms:

  Physically Unique Resources

  “Path-Dependent” Resources

  Casual Ambiguity

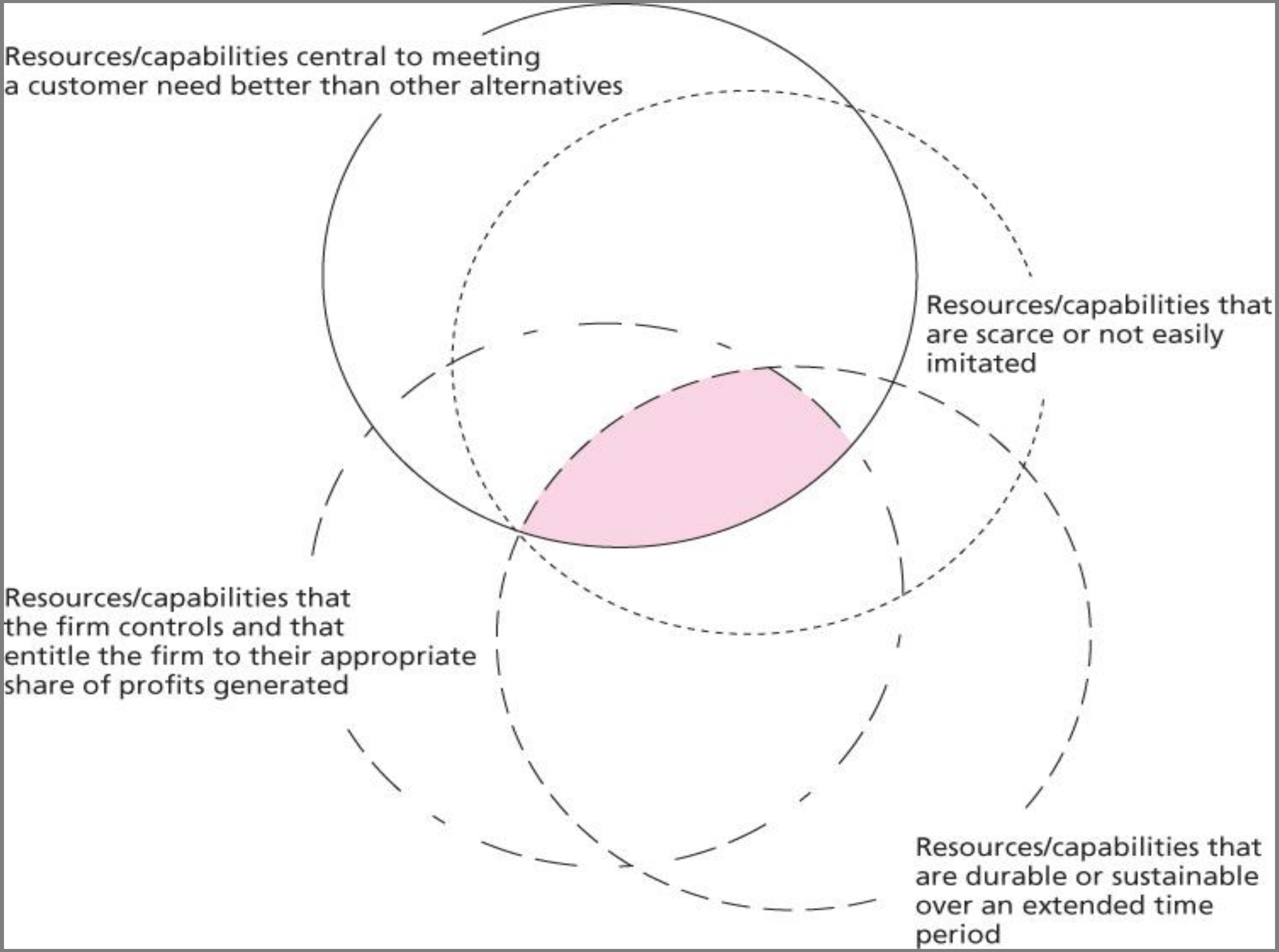
  Economic Deterrence

Using RBV in Internal Analysis

It is helpful to:

- Disaggregate resources
- Utilize a functional perspective
- Look at organizational processes
- Use the value chain approach

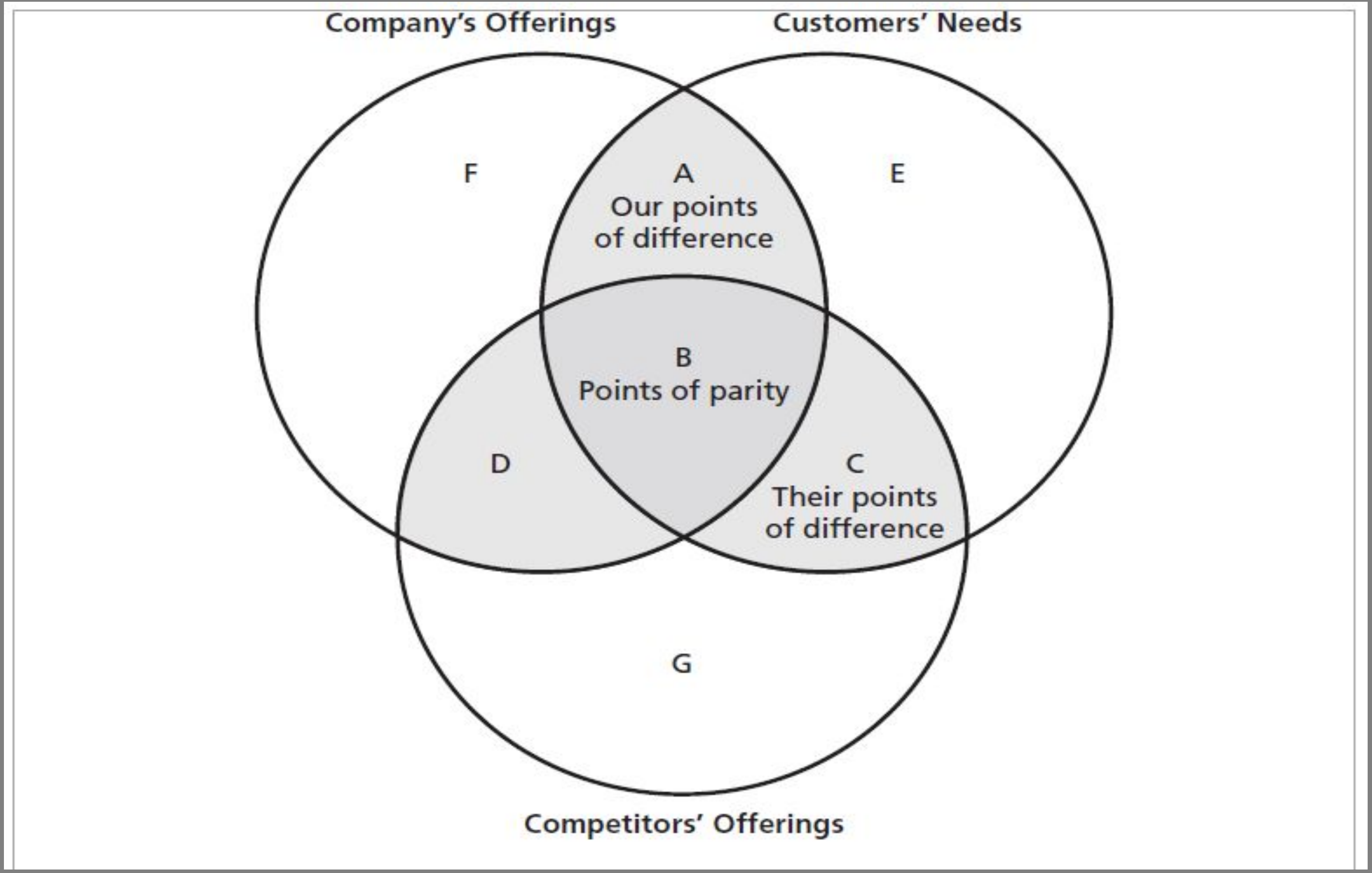
Ex. 6.11 Applying the Resource Based View



Three Circles Analysis

- An internal analysis technique wherein strategists examine customers’ needs, company offerings, and competitor’s offerings to more clearly articulate what their company’s competitive advantage is and how it differs from those of competitors.

Ex. 6.13 Three Circles Analysis



Three Circles Analysis (contd.)

Questions to Ask About Each Circle

- Circle A
  - How big and sustainable are our advantages?
  - Are they based on distinctive capabilities?
- Circle B
  - Are we delivering effectively in the area of parity?
- Circle C
  - How can we counter our competitors’ advantages?

Making Meaningful Comparisons

- Managers need objective standards to use when examining internal resources and value-building activities
- Strategists use the firm's historical experience as a basis for evaluating internal factors
- **Benchmarking**, or comparing the way "our" company performs a specific activity with a competitor or other company doing the same thing, has become a central concern of managers in quality commitment companies worldwide

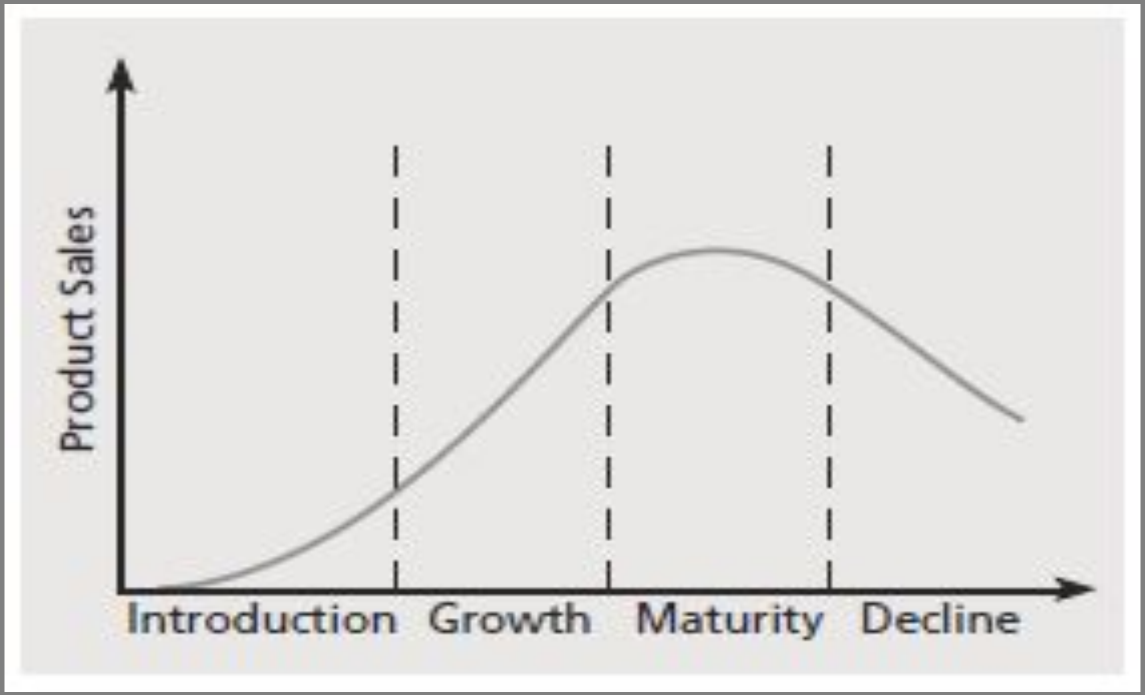
Comparison with Success Factors in the Industry

- The key determinants of success in an industry may be used to identify a firm's internal strengths and weaknesses
- A strategist seeks to determine whether a firm's current internal capabilities represent strengths or weaknesses in new competitive arenas

Product Life Cycle

- A concept that describes a product's sales, profitability, and competencies that are key drivers of the success of that product as it moves through a sequence of stages from development, introduction to growth, maturity, decline, and eventual removal from market.

Exhibit 6.13 Illustration of the Product Life Cycle



Product Life Cycle

Competencies Needed at Each Stage

- **Introduction**
  - Ability to create product awareness
  - Good channel relationships
  - Premium pricing to “skim” profitability
  - Solid relationship with and access to trendsetting early adopters
  - Financial resources to absorb an initial cash drain

Product Life Cycle

Competencies Needed at Each Stage (contd.)

- **Growth**
  - Brand awareness and ability to build brand
  - Advertising skills and resources to back them
  - Product features that differentiate
  - Establishing and stabilizing market shares
  - Access to multiple distribution channels
  - Ability to add additional features

Product Life Cycle

Competencies Needed at Each Stage (contd.)

- **Maturity**
  - Sustained brand awareness
  - Ability to differentiate products and features
  - Resources to initiate or sustain price wars
  - Operating advantages to improve slimming margins
  - Judgment to know whether to stay in or exit saturated market segments

Product Life Cycle

Competencies Needed at Each Stage (contd.)

- **Decline**
  - Ability to withstand intense price-cutting
  - Brand strength to allow reduced marketing
  - Cost cutting capacity and slack to allow it
  - Good supplier relationship to gain cost concessions
  - Innovation skills to create new products or “re-create” existing ones

Key Terms

- Benchmarking
- Core competence
- Intangible assets
- Isolating mechanisms
- Opportunity
- Organizational capabilities
- Primary activities
- Product life cycle
- Resource-based view
- Strength

Key Terms (contd.)

- SWOT analysis
- Support activities
- Tangible assets
- Threats
- Three circles analysis
- Value chain
- Value chain analysis
- Weakness