BLOCK 2

ENVIRONMENTAL ANALYSIS

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BLOCK 2 ENVIRONMENTAL ANALYSIS

This block aims at understanding the concept of environmental analysis. It is necessary for any organization to identify the potential markets so that the goals of the organization are achieved. Therefore, it becomes necessary for the organization to assess its environment especially its current and potential resources. This block discusses the external as well as internal environmental which is important part of strategic analysis.

Unit 4: External Environmental Analysis helps understand the environmental (external) factors in detail and the PESTLE analysis framework in analyzing their impacts on strategic development.

Unit 5: Competitive Analysis focuses on the next immediate layer of the external environment called as the competitive environment. This refers to the situation, which an organization faces within its specific area of operations. The Porter's Five Forces model is the universally popular model to analyze the competitive environment. The five forces model which focuses on forces beyond direct rivalry is discussed here to broaden your understanding of how such forces shape up strategies and affect performance in a competitive environment. Further within, most industries or sectors we find many organizations with different characteristics and the basis for their business or competition is found to be different. Analyzing the forces in such cases is possible by using the concept of strategic groups discussed in this unit. This will also help understand the layers, which may exist between the industry and the individual organization.

Unit 6: Internal Environmental Analysis as the name suggests it explains the internal analysis of an organization where focus is on analyzing and understanding organizations' resources and competencies, which help managers match capabilities with opportunities or neutralize threats effectively. Also this helps managers to explain potential uniqueness of the organizations contributing to their superior performance.

UNIT 4 EXTERNAL ENVIRONMENT

Objectives

After reading this unit, you should be able to:

- Understand the importance of environmental analysis;
- Acquaint yourself with the broad dimensions in a general environment;
- Know the relationship between the general environment and strategy;
- Understand the concept of Industrial Organization (I/O) model;
- Know the PESTLE framework for analysis and the implications of its factors.

Structure

4.1 INTRODUCTION

Strategic analysis is basically concerned with structuring the relationship between a business and its environment. The environment in which a business operates has a greater influence on their successes or failures. There is a strong linkage between the changing environment, the strategic response of the business to such changes and the performance. It is therefore important to understand the forces of external environment the way they influence the linkage. The external environment which is dynamic and changing holds both opportunities and threats for the organizations. The organizations while attempting at strategic realignments, try to capture these opportunities and avoid the emerging threats. At the same time the changes in the environment affect the attractiveness or risk levels of various investments of the organizations or the investors.

The first level of the external analysis i.e. understanding of the macro environment has an influence on the success or failure of an organization's strategies. The impact of the changes of the macro environment is felt on the organization and its strategies through their influences on the competitive forces of the competitive environment. Assessing the external environment is also known as environmental scanning or industry analysis. In this unit we will learn a practical approach to assessing and analyzing the external information and understand the concept of Industrial Organization (I/O) model.

4.2 GENERAL ENVIRONMENT AND STRATEGY

A manager needs to analyze the kind of impact the change may bring in their own industry as the impact are never same for all industries. For example, the emerging younger demographic profile of India will have very different consequences for businesses say in health care or entertainment. While the former will face an adverse effect, the latter will have a positive effect and these needs to be analyzed and integrated into strategic decision making. In response to these assessments of differential impacts, managers will be able to take advantages of the opportunities or guard themselves of the threats. Exhibit 1 shows how in different ways various industries get affected by the different environmental trends.

Responding to these various impacts with new strategic initiatives the managers must take notice of the fact that if the changes are significant, it may have the potential of changing the competitive rules of the game in the industry. For example, in India the competitive rules of the game for sectors like telecom, banking and insurance etc, in the post liberalization period changed specially in last few years. With the pandemic crisis, the rules have changed all the more as more stress is towards digitization. With the easing of FDI and participation of major global players, norms have changed dramatically which is reflected in the strategies of most of the organizations in the sector. These changes can be seen in the area of technology and pricing, intensity of advertising and promotions, their business alliances and network in the nation.

Managers need to be cautious of the fact that there may be developments, which are not so easy to predict and therefore need further attention so that they can be incorporated in their strategy. In the global context, the managers must see the kind of impact any single change will have in different markets. It is quite possible that they are very different both in degree and their nature.

Exhibit 1: Environmental trends and their probable impact on different sectors

Environmental trends	Probable positive effects	Probable neutral effects	Probable negative effects
1. Aging population	Medical services	Minerals	Colleges and schools
2. Multiple income families	Fast food	Machine tools	Grocer's supplies
3. Deregulation	Shipping		Financial sector
4. Increased environmental legislation	Waste management	Software	Leather
5. Growing global	Telecommunication/ small scale/ handicrafts	Competition	

Structural Drivers to Change

The PESTLE analysis gives a number of factors and their likely influences. However it is important to identify the specific factors which may influence an industry and force them towards competitive adjustments. These factors are termed as structural drivers of change which have the likely effect on the structure of an industry or on the competitive environment.

As a first step based on PESTLE analysis, the key driving forces need to be identified and then impact of the combined effect of these forces should also be made. Increasing globalization of the industry and the E enabled era could make such driving forces capable of affecting the structure of an industry or its environment.

4.3 PROCESS FOR ANALYZING THE EXTERNAL ENVIRONMENT

Let us now see the process for analyzing the external environment. This consists of three steps which are as follows:

Step 1: Environmental scanning

Step 2: Assimilation

Step 3: Evaluation

The process of analyzing the external environment requires three steps to be followed. In the first step the organization should gather all the information related to political, economic, socio-cultural, technological, legal and environmental (PESTLE) trends. This can be done using internet, magazines, newspapers etc. A periodic scanning report of these factors can be submitted for performing the external audit. The second step involves assimilation of all the information gathered. This involves assessing the opportunities and threats available with the organization. The last step in this process is evaluating. In this the key external factors need to be identified and a list of the same is to be made. These key factors should be important in helping long term objectives of the organization and should be measurable in nature. Using these sources the environmental analysis for any organization can be done.

Environmental scanning

The factors or the forces understood under PESTLE framework put together, present a highly complex and uncertain environment which are difficult to predict or foresee. From a long term view of strategy however, reaching somewhat closer to such forces are important in understanding the key factors influencing the success of such strategies.

Environmental scanning is one of the few ways to detect future driving forces early and this involves studying and interpreting the developments of social, political, economic, ecological and technical events that could become driving forces. It attempts to figure out few radical happenings or path breaking developments which may be catching on and see their possible implications 5 to 20 years into the future. The purpose of environmental scanning is to raise the consciousness of managers about potential developments that could have an impact on industry conditions resulting in new threats or opportunities. Environmental scanning is normally accomplished by systematically monitoring and studying current events, constructing scenarios and employing the Delphi method (a technique for finding consensus among a group of knowledgeable experts).

Constructing scenarios involves a detailed plausible view of how the business environment of an organization might develop in the future based on the groupings of key environmental influences and drivers of change about which there is high level of uncertainty. For example in industries like energy, transportation, defence equipment etc. there is a need for views of the business environment of more than 10-15 years and factors like raw materials, substitutes, consumption patterns, geo politics etc. would be of crucial importance. Foreseeing precisely for such a longer duration may be very difficult but drawing up possible futures may be viable. It is not unnatural to believe that several scenarios could unfold overtime and these need to be understood. Scenario planning technique is briefly discussed in Unit 5 under the competitive environment.

4.4 EXTERNAL ENVIRONMENT

The macro environment in which all organizations operate broadly consist of the economic environment, the political and legal environment, the socio cultural aspects and the environment related issues like pollution, sustainability etc. The technological temper and its progress has been the key driver behind the major changes witnessed in the external environment making it increasingly complex.

These factors often overlap and the developments in one area may influence developments in other. For example, the opening up of economy integrated the markets globally and increased the competition between private and public organizations. This forced the Indian government to revisit its economic policies. Under its new liberalization policy and economic reforms of 1991, regulations like MRTP, which restricted the size of the business and therefore inhibited their efficiency and competitive levels, were removed with a positive impact on the indigenous industries. The current political developments are sure to have an impact on the minds of business people regarding the future policy direction in certain sectors. The social considerations in the context of a developing nation like India also play a critical role in deciding the broad dynamics of the business environment. The clash of ideologies between preserving the Indian ethos and culture and giving a freedom of choice to people often create problems and confusion for business.

4.5 INDUSTRIAL ORGANIZATON MODEL

Let us now discuss the Industrial Organization (IO) Model which forms the basis to understand the concept of strategy leading to competitive advantage. The Industrial Organization Model adopts an external perspective on strategic decision- making. It begins with the idea that external factors have major effects on organization’s strategic activities. In other words, this model assumes that the features and conditions of the external environment impact the formulation and implementation of strategies in order to generate above-average returns and thereby gain competitive advantage. Under this model, external environment forces the organization to develop strategies to meet that demand at the same time limiting the spectrum of tactics that may be suitable and ultimately effective. Further, the model assumes that all organizations operating within an industry possess similar set of resources. This implies that, due to the similarity among set of resources, majority of organizations operating in a certain industry or a section of an industry has comparable skills and consequently pursues similar tactics. The resources required to put strategy into action are highly transferable among organizations. Significant distinctions in strategically relevant resources across enterprises in an industry tend to diminish due to high resource mobility.

The industrial organization model follows a process for achieving competitive advantage as shown in figure 4.1. The steps involved are discussed as below:

- Examine the external environment which includes general, industrial, and competitive environment to identify the external environment attributes and both decide and limit the organization's strategic solutions.
- Based on the structural parameters of the industry, industry (or industries) is to be chosen with a high potential for returns.
- Strategies associated with above-average returns should be developed based on the features of the industry in which the organization plans to operate.
- Acquire or develop the key resources required for successful implementation of the formulated strategies and plans.
- The model indicates that competitive advantage will be achieved if an organization successfully implements the strategic actions which enable an organization to utilize its resources for meeting the demands of external environment.

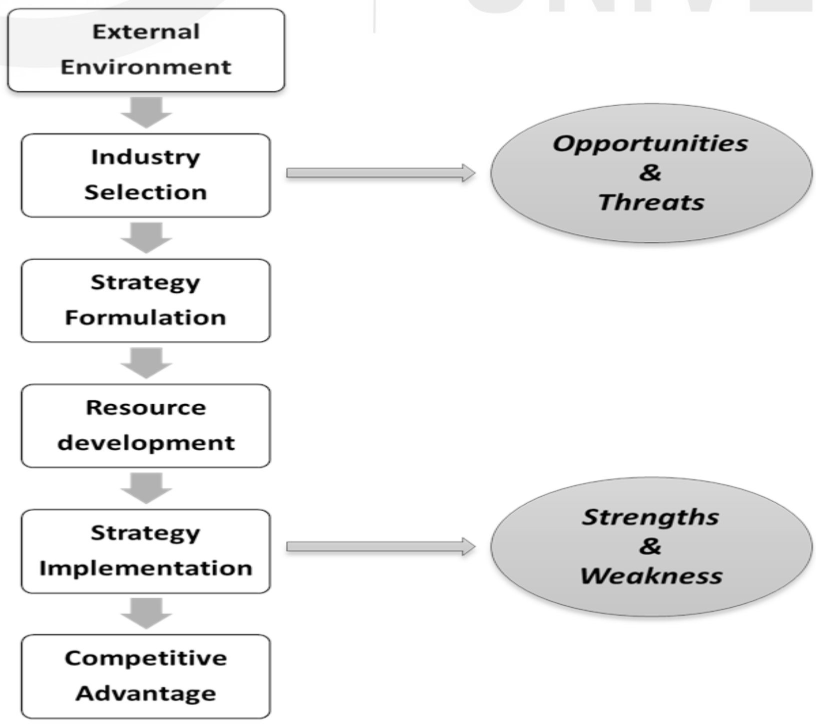

Figure 4.1: Industrial Organization Model

This model is important for the organizations as it helps them assess the strategic position of the organization.

4.6 PESTLE FRAMEWORK

The external forces can be classified into six broad categories: Political, Economic, Social, Technological, Environmental and Legal Forces. Changes in these external forces affect the changes in consumer demand for both industrial and consumer products and services. These external forces affect the types of products produced, the nature of positioning, market segmentation strategies, the types of services offered, and choice of business. Therefore, it becomes important for the organizations to identify and evaluate external opportunities and threats so as to develop a clear mission, design strategies to achieve long-term objectives and develop policies to achieve short term goals. Here, we will discuss all the six forces individually and then try to come to the conclusion regarding environmental analysis. A careful analysis of the above factors will help in identifying major trends for different industries. Exhibit-2 shows the PESTLE framework which is most popularly used for such analysis.

Few indicative points are listed to guide you to find the key factors in the general environment. While PESTLE framework may be used to understand the most important factors at the present time, it should be primarily used to look into the future impact which may be different from their present or past impact.

Exhibit 2: PESTLE Framework

The PESTLE Framework- Marco-environmental influences. The framework primarily involves the following two areas:

1. The environmental factors affecting the organization;
2. The important factors relevant in the present context and in the years to come.

Political

1. Government stability
2. Political values and beliefs shaping policies
3. Regulations towards trade and global business
4. Taxation policies
5. Priorities in social sector

Economic Factors

1. GNP trends
2. Interest rates/ savings rate
3. Money supply inflation rate
4. Inflation rate
5. Unemployment

6. Disposable income
7. Business cycles
8. Trade deficit/surplus

Socio-cultural Factors

1. Population demographics
   - Ethnic composition
   - Aging of population
   - Regional changes in population growth and decline
2. Social mobility
3. Lifestyle changes
4. Attitudes to work and leisure
5. Education-spread or erosion of educational standards
6. Health and fitness awareness
7. Multiple income families

Technological

1. Biotechnology
2. Process innovation
3. Digital revolution
4. Government spending on research
5. Government and industry focus on technological effort
6. New discoveries/development
7. Speed of technology transfer
8. Rates of obsolescence

Legal

1. Monopolies legislation/Antitrust regulation
2. Employment law
3. Health and safety
4. Product safety

Environmental

1. Carbon emissions
2. Pollution levels
3. Environmental sustainability
4. Global warming
5. Biodegradable material

Political factors

Politics has a serious impact on the economic environment of a nation. Political ideology and political stability or instability strongly influence the pace and direction of the economic growth. It also contributes to the economic environment which is conducive for some businesses to grow or indifferent for some businesses or at times be a hurdle. The governments at any levels be it central, state, local and foreign, all have an impact on the businesses. These are the major regulators or deregulators. The businesses all over depend largely on the contracts of government, subsidies etc. which form a major part of external environment. Any change in the laws, regulations, tax slabs etc. can affect the organization to a large extent.

Looking back into the history due to certain ideological beliefs prevalent in some section of politics, few of foreign organizations had to move out of India in the late 70s. Entry barriers, protectionist policies, high tariffs, nationalist pursuits all worked towards a closed economy which continued till the time liberalization policies were introduced in 1991. This situation had a cumulative effect on making the economy weak and the businesses were hardly competitive as compared to the international standards. However in subsequent years, the political consensus developed on issues such as labour reforms, power sector reforms, importance of infrastructure etc. and these sectors are doing a lot good for business.

Activity 1

Identify few key active political forces. Discuss how they are shaping the overall environment in the nation.

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Economic factors

Exhibit 3 gives you a view of broad indicators which give the economic picture of the general environment and these should be carefully looked into while doing the environmental analysis.

Exhibit 3: Common Economic Indicators

A. National Income GNP Personal disposable Income Personal consumption	**B. Policy Initiatives** Monetary policy Fiscal policy Labour and employment policy
C. Savings Personal savings Corporate savings Balance of Payments	**D. Foreign Sector** Exchange rates Exports/Imports

E. Industry Industry Investment FDI flows Services Infrastructure	**F. Sectoral Growth** Agriculture Industry
G. Capital Market Equity market Bond market	**H. Prices, Wages, Productivity** Inflation Labour productivity

Economic factors throw light on the nature and direction of the economy in which an organization operates. The organizations must focus on economic trends in segments that affect their industry. For example the trend of low interest rates on personal savings may compel individuals to move towards equity and bond markets leading to a boom in the capital market activity and the mutual fund industry. Consumption patterns are usually governed by the relative affluence of market segments and organizations must understand them through the level of disposable income and the tendency of people to spend. Interest rates, inflation rates, unemployment rates and trends in the gross national product, government policies and sectoral growth rates are other economic influences it must consider.

The services sector's contribution to national income is increasing year after year and the family incomes are rising faster than individual incomes, job opportunities are more diverse and therefore these speak for different types of opportunities and challenges which are emerging before the business. With the opening up of the economy, trends in the global market needs a careful look. The above needs to be analyzed and incorporated in your inferences for the general environment and its other forces and how all these together may influence business.

Activity 2

Suppose the foreign exchange reserves in the nation gets depleted by half of the present level because of few developments in the outside world. Discuss the environmental effects it may lead to.

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Social factors

Socio-cultural factors have a major impact on the markets, products, services and customers. Almost all the organizations face challenges arising from the changes in demographic and cultural variables. Let us discuss these in brief.

Demographic Factors*:* Demographic characteristics such as population, age distribution, literacy levels, inter-state migration, rural-urban mobility, income distribution etc. are the key indicators for understanding the demographic impact on environment. The shifts in age distribution caused by improved birth control methods have created opportunities for youth centric products ranging from clothes to entertainment to media. The growing number of senior citizens and their livelihood needs have been highlighted and the government is paying more attention in the form of social security benefits etc.

Considering literacy and the composition of literates in the nation creates opportunities for particular type of industries and type of jobs. For example on one hand, the presence of a large number of English speaking engineers encouraged many software giants to set up shops in India and on the other, the availability of cheap labour, India becomes a destination for labour intensive projects. Moreover, large labour mobility across different occupations and regions, in recent times, has cut down wage differentials greatly and this has an impact for businesses which needs to be understood.

Cultural Factors: Social attitudes, values, customs, beliefs, rituals and practices also influence business practices in a major way. Festivals in India offer great business opportunity for certain industries like clothes and garments, jewellery, gift items, sweetmeats and many others, the list could be endless.

Social values and beliefs are important as they affect our buying behaviour. For example, a multinational fast food chain does not serve the beef burgers in India because Indians do not have cow meat since the animal is considered holy and sacred. A related example of an entertainment giant also brings out clearly, the impact different cultures may bring to business. This organization which has been so successful in the US market could not be so successful in European nations because of the difference in the way in which people entertain themselves there. Due to this they had to customize its offerings in order to be successful in these markets. The spread of consumerism, the rise of the middle class with high disposable income, the flashy lifestyles of people working in software, telecom, media and multinational companies seem to have changed the socio-cultural scenario and these needs to be understood deeply. The pandemic crisis bringing the Work from Home (WFH) culture also has impacted the way the market is perceived. Values in society also determine the work culture, approach towards stakeholders and the various responsibilities the organization thinks of owing to its stockholders and the society.

Activity 3

There has been a thrust on women literacy. Discuss the influences you see in the social environment and their impact on business.

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Technological factors

Technological factors represent major opportunities and threats which must be taken into account while formulating strategies. Technological breakthroughs can drastically influence the organization's products, services markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices and competitive position. Technological advancements can open up new markets, change the relative position of industry and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills and result in changing values and expectations of customers and employees.

The impact of information technology (IT) which combines fruits of both telecommunications and computers has been revolutionary in every field. Not only has it opened up new vistas of business but also has changed the way the businesses are done. IT has specifically brought in another dimension 'Speed' which organizations recognize as the additional source of competitive advantage beyond low cost and differentiation. Manufacturers, bankers and retailers have used IT to carry out their traditional tasks at lower costs and deliver higher value added products and services. The pandemic situation has altogether changed the way the organizations work. Artificial intelligence, robotics, cloud computing, blockchain technology etc. have penetrated the business world to a large extent.

Activity 4

Enumerate few of the technological advances in the field of agriculture and discuss its role in tapping better opportunities in the overseas markets.

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Legal factors

Licensing policies, quota restrictions, import duties, FOREX regulations, FDI regulations, controls on distribution and pricing of commodities together made business difficult before the liberalization. However, with economic reforms things have changed and legal formalities have eased. Nevertheless with globalization, the rules of competition, trade mark rights and patents, WTO rules and implications, price controls and product quality laws and a number of other legal issues in individual nations have become important and therefore they need to be included while understanding the general environment.

Activity 5

Discuss the legislation on patents in India and its impact on the business.

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Environmental factors

Environment conservation and protection is an issue, which has gained prominence because of deteriorating environmental balance which is threatening the sustainability of life and nature. Largely, businesses are also held responsible for such situations as emissions from industries polluting the air, excessive chemical effluents drained out in water making it poisonous and unfit for use, usage of bio non-degradable resources affecting the bio-chain adversely and exposure of employees to hazardous radiations bring their life in danger. All these have been taken very seriously by different stakeholders in the society including the government and legislations and movements are creating pressure for an environment friendly business. These have far reaching implications for businesses ranging from the kind of business, the product being manufactured, how it is manufactured and how friendly it is for mankind and nature. Many multinationals that come under the purview of the society regarding the environmental hazards have started using more sustainable methods to survive in the business.The businesses all over are now concentrating more on preserving the nature than harming it.

The competitive environment refers to the situation which organization's face within its specific area of operation, and this can be understood at an industry level or with respect to smaller groups called Strategic groups**.** Generally understood, an industry in the economy is recognized as a group of organizations producing the same principal product or more broadly the group of organizations producing products that are close substitutes for each other and in a given industry different organizations have different intermediate basis of understanding its relative position with respect to other organizations in the industry.

Organizations within an industry with similar strategic characteristics, following similar strategies or competing on similar bases are called strategic groups. These characteristics for a particular group will be different from those in other strategic groups in the same industry or sector. There may be many different characteristics, which distinguish between strategic groups. For example size, breadth of product range, geographical coverage, quality or service levels or marketing spend. The concept of strategic groups when used helps in understanding who is the direct competitor of any given organization and on what basis competitive rivalry is likely to take place within each strategic group. There are competitive forces beyond direct rivals which shape up the competitive environment that can be better understood with the five forces framework which we will discuss in unit 5.

Activity 6

List out five major industries which in your view, may pose danger to the environment.Suggest measures as to how these industries may act in an environment friendly nature.

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4.7 EXTERNAL FACTOR EVALUATION MATRIX

The External Factor Evaluation Matrix (EFE) is a tool which helps strategists to summarize and evaluate the PESTEL factors. This involves five steps which are as follows:

1. List key external factors
2. Assign weight to each factor
3. Assign a rating to each factor
4. Determine a weighted score
5. Determine the total weighted score.

Let us see how each step is to be performed to find out the EFE. Exhibit 4 gives an example of EFE.

1. **List key external factors:** Once the PESTEL is performed, key external factors are identified. In this all the factors (10 or 20) are included which determine the opportunities and threats for the organization. Then the listing of all the opportunities and threats is done using percentages, ratios etc.

2. **Assign weight to each factor:** This is the second step where each factor is assigned weight sranging from 0.0 (not so important) to 1.0 (very important). These weights depict the relative importance to each factor. These weights are determined by comparing successful competitors with unsuccessful ones or through a group discussion in the organization. The sum of all weights should be 1.0. These are industry based.

3. **Assign rating to each factor:** A rating of 1 to 4 factors is assigned. This is done to show the effectiveness of the organization's present strategic response to the factor. The rating scale is depicted as below:

   1 = Poor response

   2 = Average response

   3 = Above average response

   4 = Superior response.

   Ratings are organization based.

4. **Determine a weighted score:** This is the fourth step and it involves multiplying weight of each factor by its rating.

5. **Determine the total weight score:** This is the last step to be performed and in this step a score of the weighted score of each variable is considered and this gives the total weighted score of the organization.

Exhibit 4: External Factor Evaluation (EFE) Matrix of X Inc.

Key External Factors	Weight (0.0 – 1.0)	Rating (1 - 4)	Weighted score (Weight X Rating)
Opportunities			
1. Global markets untapped by alcohol free beverages	0.15	1	0.15
2. Increased demand by ban on use of alcoholic beverages	0.05	3	0.15
3. Growth of social media advertising	0.05	1	0.05
4. Social pressure to reduce use of alcoholic beverages	0.15	4	0.65
5. Y the leader in discounted alcoholic beverage market	0.10	3	0.30
Threats			
1. Limit against public use of alcohol	0.10	2	0.20
2. Limit on production of alcohol increases competition	0.05	3	0.15
3. Alcohol free beverage market concentration in another region of the nation	0.05	2	0.10
4. Poor media exposure	0.10	2	0.20
5. Government regulation	0.20	1	0.20
Total	**1.00**		**2.10**

One thing is to be noted here is that despite number of opportunities or threats in an EFE matrix the maximum possible weighted score for an organization is 4.0 and the minimum possible score is 1.0. This shows that if an organization gets a weighted score of 4.0, then the response of the organization to the opportunities and threats is excellent and vice-versa. The example shown in exhibit shows the total weighted score of 1.0. This indicates the organization is not able to tap the opportunities and avoid the threats. Therefore, it is important for organizations to have a thorough understanding of the factors so as to maximize the opportunities and minimize the threats.

4.8 SUMMARY

Understanding of the general environment in which an organization operates is the foremost prerequisite towards strategy formulation. The six broad dimensions which this PESTLE framework provides the environment-political, economic, socio- cultural, technological, legal and environmental are capable of giving a comprehensive overview of how things may be unfolding. The objective of the analysis of this framework however should not only restrict to the present and past but the real focus should be on projecting the trends into future in order to get the real feel of the environment. This shall enable the organizations to proactively strategize for future considering the general environment.EFE matrix is used to assess these factors.

The immediate competitive environment influences an organization and therefore has to be understood alongside the general environment. It is therefore a challenging task for managers to imitate and formulate strategies which can effectively neutralize the negative impact on the competitive structure of industry generated by these forces.

4.9 KEYWORDS

PESTLE Framework : This framework categorizes environmental influences into 6 main types — political, economic, social, technological, legal and environmental.

Structural Drivers of Change : The factors which have a likely effect on the structure of an industry or on the competitive environment.

Environmental Scanning : One of the few ways to detect future driving forces.

Competitive Environment : It refers to the situation which an organization faces within its specific arena of operation.

4.10 SELF-ASSESSMENT QUESTIONS

1) Briefly summarize what you understand by the general environment and its importance for business.

2) Explain what is external analysis and its relationship with strategy formulation?

3) Briefly explain the PESTLE framework.

4) Identify an industry of your choice and do a PESTLE analysis.

5) Explain the Industrial Organization Model.

4.11 REFERENCES AND FURTHER READINGS

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UNIT 5 COMPETITIVE ANALYSIS

Objectives

After reading this unit, you should be able to:

- Learn about competitive forces;
- Understand the concept of competitive analysis;
- Understand Porters five forces framework;
- Know the role of strategic groups in competitive analysis;
- Analyze the social media competitive analysis;
- Understand the Competitive Profile Matrix (CPM).

Structure

5.1 INTRODUCTION

In unit 4 we have learnt how the external environment is scanned. This unit is in continuation to the external analysis. In this unit we will discuss the importance of competitive analysis in the external environment scanning and will learn different aspects of competitive analysis. We have seen that it is very important to identify the competitors and determine their strengths, weaknesses, opportunities and threats. This is the reason a proper competitive analysis is required. The unit discusses how the analysis goes beyond the scope of a single business unit and how strategic groups become important. The unit focuses on Porter's five forces model which describes the competitive analysis in detail. The unit also explains the competitive profile matrix. Overall the unit gives a detailed description of competitive analysis through various modes.

5.2 COMPETITIVE FORCES

Any organization can only be successful if it has the ability to formulate an effective strategy. This can be done by collecting all the relevant information about competitors and evaluate them to formulate their own strategy. It has been witnessed in many cases that identifying the competitors is quite difficult as number of organizations have divisions which compete in different industries which means that the businesses are diversified. Most of the organizations do not make the sales and profit information pubic due to competitive reasons. In present times internet has become a major source for obtaining the information on the competitors.

Competition in any industry is usually intense. In the past many cases have been witnessed whereby the organizations have capitalized on the weaknesses of its competitors. Therefore it is very important to understand the forces which are important for a competitive analysis. These are:

- Strengths of the competitors;
- Weaknesses of the competitors ;
- Objectives and strategies of the competitors;
- Response of the competitors towards PESTLE factors;
- Vulnerability of the competitors to alternative strategies of other organization;
- Vulnerability of the organizations to their alternative strategies;
- Positioning of the products / services relative to major competitors;
- The status of entry and exit of new and old business organizations respectively;
- The key factors resulting in the present competitive position in the industry;
- Trends of the sales and profits ranking of major competitors in the industry;
- Supplier and distributor relationships in the industry;
- Threat to the competitors due to the substitute products/ services.

This is not an exhaustive list. However this gives an idea about the competitive forces which are important in conducting a competitive analysis.

5.3 PORTER'S FIVE FORCES FRAMEWORK

Competitive analysis is one of the most critical parts of an organization's strategic plan. This involves identifying the strategies of the competitors to assess their strengths and weaknesses and thereby evaluating them. A proper evaluation of a competitor's strategy helps the organization in establishing the USP (Unique Service Proposition) of its product or service. The evaluation of the competitors can be done by placing them in strategic groups which we will discuss in section 5.4. Porter's Five-Forces Model of competitive analysis is one of the most widely used approaches to develop strategies as shown in figure 5.1.

The five forces framework developed by Michael Porter is the most widely known tool for analyzing the competitive environment, which helps in explaining how forces in the competitive environment shape strategies and affect performance. The framework as shown in figure 5.1 suggests that there are competitive forces other than direct rivals which shape up the competitive environment. These competitive forces are as follows:

1) The rivalry among competitors in the industry
2) The potential entrants
3) The substitute products
4) The bargaining power of suppliers
5) The bargaining power of buyers

However, these five forces are not independent of each other. Pressures from one direction can trigger off changes in another which is capable of shifting sources of competition. In the following section each of these five forces are discussed in detail so as to understand how each of these forces affect an Industry's environment so that one can identify the most appropriate strategic position within the industry.

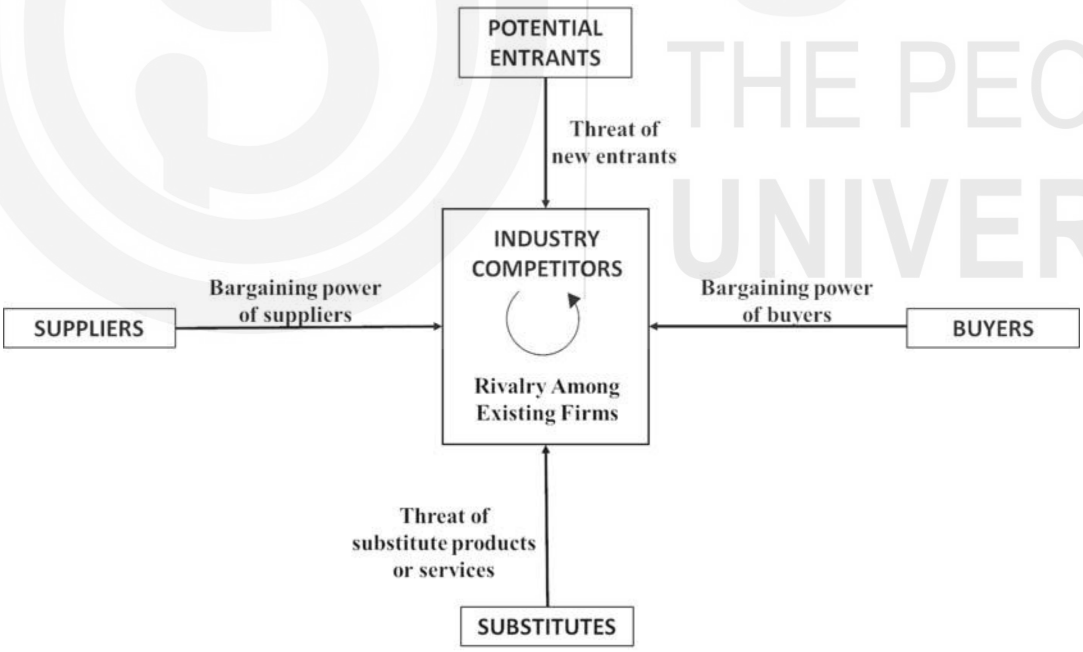

Figure 5.1: Porter's five Forces Model of Competition

1) Threat of New Entrants

Entry of a business organization in and operating in a market is seen as a threat to the established business organizations in that market. The competitive position of the established business organizations is affected because the entrants may add new production capacity or it may affect their market shares. They may also bring additional resources with them which may force the existing business organizations to invest more than what was not required before. Altogether the situation becomes difficult for the existing business organizations if not threatening always and therefore they resort to raising barriers to entry. These barriers are intended to discourage new entrants and this may be done by organizations, be in any one or more ways, as discussed below:

a) ***Economies of Scale*:** Business organizations which operate on a large scale get benefits of lower cost of production because of the economies of scale. Since the new business organization normally would start its operation at a smaller scale and therefore will have a relatively higher cost of production, its competitive position in the industry gets adversely affected. This barrier created through large scale of operation is not only applicable for production side but it can be extended to advertising, marketing, distribution, financing, after sales customer service, raw materials, purchasing and Research and Development as well. For example, you would have noticed in durable industry the kind of investments which players in the durables market do on advertising and promotions normally and especially during events like World Cup cricket match. This makes it nearly impossible for any new third player to launch and sustain such intensive and investment driven marketing attack.

b) ***Learning or Experience Effect*:** The theory explaining the experience curve or the learning curve suggests that as business organizations produce more they grow more efficient and this brings them cost benefits. The efficiency levels achieved is an outcome of the experience, which teaches the organization better ways of doing things. This again keeps any new entrant at a disadvantage.

c) ***Cost Disadvantage Independent of Scale*:** New entrants may face disadvantages which are independent of the operations. It may be on account of the lack of proprietary product knowledge such as patents, favourable access to raw material, favourable locations, existing plants built and equipped years earlier at lower costs, lower borrowing costs etc.

d) ***Brand benefits*:** Buyers are often attached to established brands. Differences in physical or mere perceived value make existing products unique and the new entrants have to really work hard to beat such brands and change the mindset of the customers.

e) ***Capital Requirements*:** High investments required for a start up in any business is another deterrent for new entrants bringing down the possibility of increased competition.

f) ***Switching Costs*:** Switching costs, which is nothing but the expenses (financial or psychological) which a customer incurs in switching from one seller to another. Cases where such an expense is higher, new entrants find it difficult to establish or survive. Such costs may be because of a strong brand association or the comfort level a customer may be enjoying or it may be on account of a particular technology like different operating systems.

g) ***Access to Distribution Channel*****:** Any such critical activity like distribution channel in the business can be a barrier for the entrants when accessibility to them is found to be difficult. Most existing business organizations in FMCG industry are found to have a strong favourable distribution channels which is very difficult to penetrate.

h) ***Anticipated Growth*****:** Incumbents in a rapidly growing market are less likely to respond to a new entrant when the market's growth offers enough opportunities to share. But a new entrant position will be opposite in a slowly growing market.

i) In addition to the above, few general entry barriers exist in each industry's case, for example, regulatory policies, tariffs and international trade restrictions are few such additional factors.

Activity 1

Identify any industry of your choice and illustrate the possibility of new entrants entering in that industry and why? Do you see any barriers being raised by the existing players?

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2) Bargaining Power of Suppliers

Business organizations have a large dependency on suppliers and the latter influence their profit potential significantly. Suppliers' decisions on prices, quality of goods and services and other terms and conditions of delivery and payments have significant impact on the profit trends of an industry. However, suppliers' ability to do all these depends on the bargaining power over buyers.

Suppliers' bargaining power would normally depend on:

a) ***Importance of the Buyer to the Supplier Group:*** The size of the supplies taken by a particular buyer is likely to put the buyers in a relatively advantageous position. The same may be found true if the supplier tends to get an image advantage by supplying to a particular business organization. Consequently in dealing with such buyers, suppliers' bargaining power is naturally reduced. Just opposite happens when buyer is not so important to the supplier and the latter then is less likely to offer favourable terms to win or retain the customer.

b) ***Importance of the Supplier's Product to Buyers*****:** Here the position may just be opposite of the above situation where suppliers have a better bargaining power coming from their sheer size or image.

c) ***Greater Concentration among Suppliers than among Buyers*****:** An industry, which is largely dominated by a few large business organizations, is a highly concentrated industry. Such few business organizations hold greater power with them as the proportion of the industry's total output is in hands of such large business organizations. This gives such business organizations greater power over those who do business with them. The converse is true when industry has low concentration in suppliers. A higher concentrated supplier position may be possible on account of the sources of raw materials available, R & D or patent rights available with fewer business organizations.

d) ***High Switching Costs for Buyers*****:** In this case buyers suffer because of the suppliers' advantageous position or by the nature of supplies itself, the buyers have to face a higher switching cost.

e) ***Credible Threat of Forward Integration by Suppliers*****:** Suppliers in a given situation may see an opportunity in moving up the value chain and may seriously think of getting into the business of what its buyers have been doing till now. Any indication of that nature from supplier side puts the buyers at the receiving end as they feel threatened because of a new player in that market and of losing an assured source of supplies. A recent example may be of an organization engaged in the petroleum sector which has decided to move from exploration and refining of oil to selling of oil through its own retail petrol pumps.

Activity 2

Identify any industry of your choice and study the suppliers for the industry. Examine their strengths using the parameters discussed above as compared to buyers.

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3) Bargaining Power of Customers

Customers with a stronger bargaining power relative to their suppliers may force supply prices down or demand better quality for the same price and may demand more favourable terms of business. For instance, there will always be a difference in the bargaining power between an individual's buying different construction material like cement, steel or bricks and a real estate builder buying them for the number of properties he may have been building over so many years.

Few of the following facts attach greater power to buyers:

a) **Undifferentiated or Standard Supplies:** A supplier, given the nature of products it supplies, may have a very limited choice in providing any differentiated products and this enables a customer to get the deal at the most favourable terms. In perfectly competitive market situations with large number of suppliers, prices automatically are at their lowest.

b) **Customer's Price Sensitivity:** Customer's buying behaviour varies with respect to their sensitivity to prices. Depending on how important the item is for the customer's usage and proportion s/he may be spending on the item concerned, buyers' sensitivity to price varies. Any customer with high price sensitivity gains advantage in its bargaining power.

c) **Accurate Information about the Cost Structure of Suppliers:** A more informed customer is capable of negotiating with suppliers. Whenever such customers notice a decline in the supplier's costs they would always bargain for a proportional decrease in price. This aspect is more relevant in today's context of global markets where cost benefits can come from anywhere in the world at any point in time for various reasons. There may be a general decline in prices of a product in world market because of a glut situation or somewhere some new discoveries may have pulled the prices down.

d) **Greater concentration in Buyer's Industry than in Supplier's Industry and relatively large volume purchase:** This means that buyers are large and more powerful than suppliers. Government departments like police department when negotiating for large orders of security weapons or intelligence equipments will necessarily command a greater hold than its supplier as there will be only few numbers of such institutions buying them at a given point of time.

e) **Credible threat of Backward Integration by Buyers:** Different from forward integration which suppliers tend to attempt at, buyers in order to hold their position stronger in the market may integrate in backward manner. This will mean that the buyer extends itself to the previous stage of manufacturing or distribution for which it had been dependent on suppliers till now. An example could be of an entertainment channel which airs programmes outsourced from organizations producing them outside, get into the business of producing its programmes in house.

4) Threat of Substitutes

Often business organizations in an industry face competition from outside industry products, which may be close substitutes of each other. For example, with the new technologies in place now the electronic publishing are the direct substitutes of the texts published in print. Similarly, newspaper finds their closest substitutes in their online version, though it may be a smart strategic move to position them as complementary products.

However, the competitive pressure, which any industry may face, depends primarily on three factors:

1) Whether the substitutes available are attractively priced;

2) Whether buyers view substitutes available as satisfactory in terms of their quality and performance;

3) How easily buyers can switch to substitutes.

Generally it is observed that the availability and acceptability of substitutes determine an upper price limit to a product. When relative prices of the product in question raise above that of the substitute products, customers tend to switch away from them.

Activity 3

Identify any industry of your choice and study the substitutes for the products of the industry.

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5) Competitive Rivalry

The level of rivalry is lowest in a perfectly competitive market where there are large number of buyers and sellers and the product is uniform with everyone. Same is true for a monopoly market where there is only one player and the type of product is also one. However in case of oligopoly or monopolistic competition, where you will find few players and the market conditions allow them to differentiate their products and services, competition if found to be fierce. Few of the following factors explain the level of rivalry:

a) ***The Stability of Environment*****:** An unstable environment is likely to call for a hyper-competitive situation and of the several factors that affect stability could be technological innovation, changes in government regulations, customers' profile and their needs. In an industry which witnesses high movements in terms of entry or exit, the rules of the game may change too frequently. One of such instances of fierce competition could be noticed on account of the onslaught of new technologies. The entry of new technology tends to intensify the rivalry between the players.

b) ***The Life Expectancy of Competitive Advantage*****:** There are industries for example consumer electronics or white goods in which the fruits of innovations do not last longer and hence the companies do not even bother to patent them. This has an adverse implication for the stability of the competitive environment leading to intense rivalry. Length of innovation cycle, patent protection or switching costs between rivals are some factors, which may impact the life expectancy of competitive advantage.

c) ***Characteristics of the strategies pursued by competitors*****:** This also has or may have an impact on the general approach to rivalry. For example, in a market segmented approach on part of the competitor leads to less rivalry. Also the kind of goals, which competitors pursue has an impact on the rivalry. Competitors pursuing the goal of increased market share will lead to increased rivalry again.

Lastly, few implications can be picked up from the five forces framework itself. Lower threats to entry or a higher possibility for substitutes have the potential of increasing rivalry. A lower engagement between suppliers will result into a lesser rivalry, so will be the effect when buyers face higher switching costs.

In an overall assessment, two critical observations regarding rivalry can be made here. First a powerful competitive strategy employed by one rival can greatly intensify the competitive pressure on other rivals. Second, the frequency and rigor with which rivals use any or all competitive weapons at their disposal can be a major determinant of whether the competitive pressures associated with rivalry are cutthroat, fierce, strong, moderate or weak.

Activity 4

Identify two separate industries, which you may consider are relatively stable and unstable respectively. Comment on the nature of rivalry, which may exist in those industries.

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5.4 STRATEGIC GROUPS

They are conceptual clusters in the sense that they are grouped together for purpose of improving analysis and understanding competition within their industry. They do not necessarily belong to any formal group such as an industry, trade, association or any strategic alliances and they do not necessarily differ in their average profitability.

Research has shown that industries vary greatly in the similarity of their business organizations in terms of strategies pursued and we need to analyze the two types of industries differently. For industries, which are considered heterogeneous comprising multiple strategic groups, it would be inappropriate and misleading to combine different strategic groups in the same environmental analysis. For example in a four-wheeler automobile industry, strategic groups can be thought of Cars, Multi-utility Vehicles (MUVs) or Sports car vehicles.

Strategic groups are merely conceptual clusters in order to facilitate analysis and therefore the categorizing of business organizations may be in a way beneficial or insightful. Size of the business organizations may be one of the criterions when analysis is to be understood how giants differ from smaller business organizations. Geographic distribution, breadth of markets, products/ service quality may be few others to determine strategic groups. Furthermore it often makes sense to use different combinations of strategic dimensions to more precisely identify groups.

In a homogeneous industry it is reasonable for all the competitors to be considered as part of the same strategic group in a single industry-wise analysis.

Competitive Intelligence

It is the information which is relevant to strategy formulation regarding the environmental context within which a business organization competes. Such intelligence has several uses and these are:

a) Providing description of the competitive environment that inform strategist and guide strategy formulation;

b) Challenge common assumption about the competitive environment;

c) Forecasting future development in the competitive environment;

d) Identifying and compensating for exposed competitive weaknesses;

e) Determining when a strategy is no longer viable or sustainable;

f) Indicating when and how strategy should be adjusted to changing competitive environment.

5.5 SCENARIO PLANNING

Scenarios are tools for ordering one's perceptions about alternative future environments in which today's decisions might be framed. In practice, scenarios resemble a set of stories, written or spoken, built around carefully constructed plots. These stories can express multiple perspectives on complex events; scenarios give meaning to these events. Scenarios are powerful planning tools precisely because the future is unpredictable. Unlike traditional forecasting or market research, scenarios present alternative images instead of extrapolating current trends from the present. Scenarios also embrace qualitative perspectives and the potential for sharp discontinuities that econometric models exclude. Consequently, creating scenarios requires decision-makers to question their broadest assumptions about the way the world works so they can foresee decisions that might be missed or denied.

Within an organization, scenarios provide a common vocabulary and an effective basis for communicating complex – sometimes paradoxical – conditions and options. Good scenarios are plausible and surprising, they have the power to break old stereotypes, and their creators assume ownership and put them to work. Using scenarios is rehearsing the future. By recognizing the warning signals, the threats and opportunities that is unfolding, one can avoid surprises, adapt, and act effectively.

Decisions which have been pre-tested against a range of what may offer are more likely to stand the test of time, produce robust and resilient strategies, and create distinct competitive advantage. Ultimately, the result of scenario planning is not a more accurate picture of tomorrow but better thinking and an ongoing strategic conversation about the future.

Example of Scenario planning in an Energy Producing Business organization

Understanding the business of an energy producing business organization and the environment it faces, Scenario planning can be found useful in the following ways:

- Creating alignment between energy situation and business organization's vision and purpose. ("What is our 21st century business idea?").
- Sparking innovation and new forms of value creation ("What new products and services might replace the traditional one?").
- It will involve many people with ability-to-perceive and/or ability-to-act as effective participants in the process.
- It will provide space for multiple interpretations to make sense of what is happening.
- By including people from a broad spectrum of backgrounds, scenario planning will be capable of creating early breakthroughs in perception and understanding, allowing the business organization to get grip of the new environment it can't escape from.

Implementation of Scenario Planning

A company-wide involvement in Scenario Planning leads to better result in a business organization. A cross-functional team is instituted for the identification and monitoring of issues.

Employees are encouraged to participate on an incentive based process. The onus of refining and final implementation of the suggestions then lies on the cross functional team. With the following steps indicated, you will be getting a better understanding of the whole process:

STEP 1: Identification of the Issues

Understand the effects of external factors on business and these factors can be:

- Technology driven (new product, IT based integration)
- Political (deregulation, instability)
- Economic (sudden downturns, boom)
- Competitive positioning (moves from competitors)

Participants need not limit themselves to above mentioned factors only; any factor that may have an impact on the company is acceptable.

STEP 2: Classification of the Issues

- Support the issue identified with reports/propositions/any other method.
- Determine the uncertainty and kind of impact of the issue.

STEP 3: Analyzing and Problem Solving

Based on above classification a display board of the issues as per their classification can be used to communicate the issue to all and the following sequence can be taken for analysis and finding the solution to the problem. Figure 5.2 depicts the relationship between uncertainty and impact.

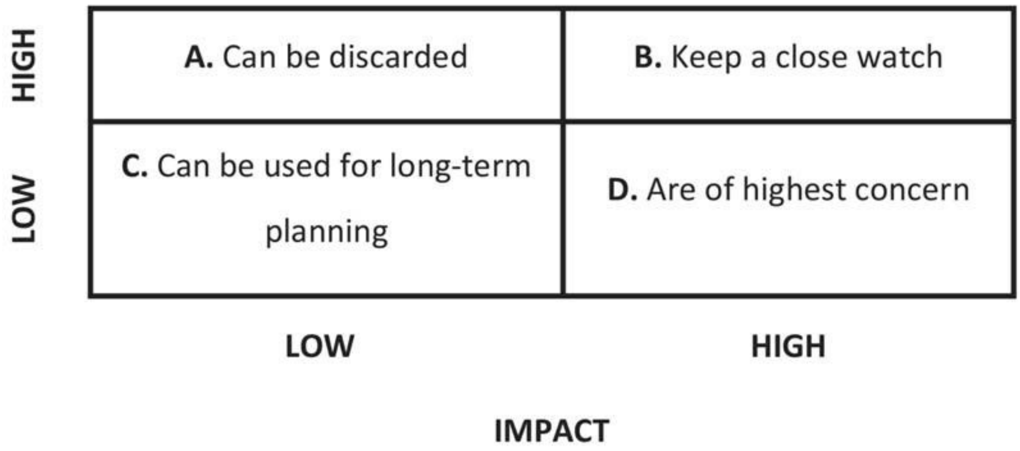

Figure 5.2: A matrix between uncertainty and impact

D category: High impact-low uncertainty: These are highest priority issues which need to be addressed immediately and more cautiously. All employees must first focus on these issues.

B category: High risk issues: These issues need to be observed closely and monitored strictly because of high uncertainty involved.

C category: Low impact-low uncertainty: These issues can be used for long term planning.

A category: High uncertainty-low impact: Because of low impact to the organization and high degree of uncertainty involve, these issues can be altogether discarded.

The analysis and problem solution proposition part can be done on an individual or team basis depending upon the interest of the participant(s). All ideas/reports should then be submitted to the cross functional team for further analysis and implementation.

5.6 SOCIAL MEDIA COMPETITIVE ANALYSIS

We now know the concept of competitive analysis. It is a kind of benchmark of the organization's performance against its competitors. In the present competitive world, the organizations are straining hard to stay ahead of the competition. Social media competitive analysis is one way to stay ahead of the competitors and gauge new opportunities and potential threats.

Why is it necessary for organization to go for social media competitive analysis?

Social media competitive analysis helps in:

- Identifying competitors an social media;
- Knowing the social platforms the competitors are using;
- Knowing the ways they are using these platforms;
- Understanding the response towards the social strategy of the competitors;
- Benchmarking the social results against the competition;

- Identifying social threats;
- Finding gaps of one's own social media strategy.

This can be done using scenario planning techniques. The steps used in Social Media Competitors Analysis are:

1. Determine the competitors
2. Information gathering
3. SWOT Analysis
4. Up-to date information

There are many tools which help the organization to develop their social media visibility and perform the competitive analysis.

5.7 COMPETITIVE PROFILE MATRIX

Competitive Profile Matrix (CPM) is a strategic management tool used to compare the organization with its competitors. It tries to highlight the strong and weak points of the organization relative to its competitors. This tool is used to understand the external environment in a better way. This involves four steps which are as follows:

1. Identify critical success factors
2. Assign a weight to each critical success factor
3. Assign the ratings to each organization
4. Assign a score to each organization.

Let us discuss these steps in brief.

1. **Identify Critical Success Factors (CSFs):** CSFs as the name suggests are the key focus areas which determine the success of an organization in a particular industry. These areas can be internal as well as external in nature. These factors vary among industries and also in the strategic groups. Since these factors include internal as well as external issues, the ratings include the strengths and weaknesses.

2. **Assign a weight to each critical success factor**: The weights are assigned to each CSF from 0.0 (least important) to 1.0 (highly important). This indicates the degree of importance to a particular factor.

3. **Assign the ratings to each organization**: The ratings as mentioned earlier means the range from 4-1. The rating scale and its meaning is given below:

   4= Major strength

   3= Minor strength

   2 = Minor weakness

   1 = Major weakness

The ratings and weights should be assigned to each organization subjectively. This can be done using benchmarking.

4. **Assign a score to each organization**: The last step in performing CPM is assigning a score to each organization. This is done by multiplying the rating with the assigned weights. i.e.

   Score = Weights assigned X rating assigned

   Then the total score of the organization is calculated. Total score is the sum total of all the individual scores of organization. Then the scores of each organization are compared and the one with the highest total score is perceived to be stronger than its competitors. Table 5.1 shows a sample of the CPM.

   CPM in general provides more internal strategic information and helps the organization in design- making.

Table 5.1: A sample of Competitive Profile Matrix

Critical Success Factors	Weight	Competitor 1		Competitor 2		Competitor 3	
		Rating	Score	Rating	Score	Rating	Score
Online advertising	0.12	3	0.36	3	0.36	4	0.48
Market share	0.12	2	0.24	4	0.48	4	0.48
Credibility	0.12	2	0.24	3	0.36	1	0.12
IT facilities	0.12	3	0.3	4	0.48	4	0.48
Innovation	0.1	4	0.4	3	0.3	1	0.1
Sales per employee	0.1	1	0.1	2	0.2	3	0.3
Advertising	0.08	1	0.08	2	0.16	1	0.08
Supply chain	0.08	4	0.32	2	0.16	2	0.16
Product range	0.05	3	0.15	1	0.05	2	0.1
Cost structure	0.05	1	0.05	3	0.15	4	0.2
New Product	0.05	3	0.15	3	0.15	3	0.15
Customer loyalty	0.01	2	0.02	4	0.04	1	0.01
Total	**1.00**		**2.41**		**2.89**		**2.66**

If we see the sample we will find that competitor 2 is having the highest score. This means that the competitor 2 is stronger than its rivals in the industry.

5.8 SUMMARY

The competitive analysis in any organization is based on the assessment of its external environment. In this unit we have discussed various aspects of competitive analysis. The focus is on the five forces framework which helps us in understanding any industry by identifying the strengths of each of the five forces and the nature of competitive pressure that each force generates. It also enables an understanding of the overall structure of competition. The competitive structure of an industry sounds unattractive when rivalry among organizations are strong, there exists low entry barriers and substitutes are more common along with, when both suppliers and buyers command a higher bargaining power. In case of reverse position the competitive structure is found to be lucrative. The Competitive Profile Matrix has been discussed to understand as to how the competitive analysis is performed.

5.9 KEYWORDS

Bargaining Power : It is decided by the relative strengths or weaknesses between two players or partners.

Learning or Experience Effect : It suggests that as organizations increases their productivity, they grow more efficient and this brings them cost benefits.

Switching Costs : These are the expenses (financial or psychological) which a customer incurs in switching from one seller to another.

Concentration in an Industry : An industry largely dominated by a few large organizations is a highly concentrated industry.

5.10 SELF-ASSESSMENT QUESTIONS

1) Explain the competitive environment for any industry and discuss external analysis framework of that industry.

2) Explain briefly the five forces framework and use it for analyzing competitive environment of any industry of your choice.

3) Write short notes on Strategic groups and Scenario Planning.

4) How does the nature of markets determine the competitive rivalry between business organizations? Explain with suitable examples.

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UNIT 6 INTERNAL ANALYSIS

Objectives

After reading the unit you should be able to:

- Understand the concept of internal analysis and its contribution to strategy formulation;
- Understand concept of core competence and guidelines to assess what resources and abilities constitute core competency of an organization;
- Examine type of resources which organizations possess and their strategic importance;
- Understand the concept of value chain framework;
- Assess SWOT analysis.

Structure

6.1 INTRODUCTION

In previous units in this block you have learnt how the ever changing nature of external environment, both at macro and micro level affect an organization's business. The changes in the environment may create opportunities, which the organizations try to exploit or may bring threats for the organizations, which the latter tries to control or neutralize. However, in order to develop successful strategies to exploit such opportunities or control the threats, analysis of an organization's capabilities is important for strategy making which aims at producing a good fit between a nation's resource capability and its external situation. Internal analysis helps us understand the organizational capability which influences the evolution of successful strategies.

Many of the issues of strategic development are concerned with changing strategic capability better to fit a changing environment. However, looking at strategic development from a different perspective i.e. stretching and exploiting the organizations capability to create opportunities, it again becomes important to understand these capabilities. The above two perspectives together are called the Resource Based View (RBV) of strategy.

Professionals from different organizations suggest that an organization's overall strengths and weaknesses and its ability to execute are often found more important to its performance than environmental factors. Internal capabilities and process execution at times allow organizations to gain competitive edge over competitors even with relatively lesser resources and lesser advantageous position. In this unit we will also discuss the concept of value chain and have a brief understanding of SWOT analysis.

6.2 RESOURCE BASED VIEW

Resource based view (RBV) model was proposed around the end of 20th century. This model particularly focuses on the organizational resources. Initially the model emphasize on the physical as well as human resources and the organizational capabilities to use these resources to either develop unique products and services or capture new markets. Subsequent developments of this model highlight the significance on tacit knowledge which an organization may possess. Tacit knowledge is the kind of knowledge which is usually hidden among the members of the organization. In other words, it is a form of the knowledge about which the members of the organizations are unaware or unconscious. Tacit knowledge can be of immense importance to the organization as it can be a resource which is unique and may be difficult to imitate by the competitors.

RBV model is centred on the concept of resources as the key to superior organizational performances. The managers are required to make strategic decisions based on the resources and capabilities. RBV model adopts the internal perception to explain how an organization's unique internal resources and capabilities serves as a basis for earning above average returns and thereby gaining competitive advantage over their competitors. Therefore, the model uses internal resources and capabilities to develop core competencies as a response to external environment. Resources and capabilities are the driving forces for strategies which are formulated as a measure to cope with the forces of external environment.

As RBV model gives immense importance to resources, therefore, it is essential to learn about resources and their essential features for a better understanding of this model. A resource is something which an organization owns is accessible or can be developed to formulate and execute strategies for improving effectiveness and efficiency. Resource can include tangible assets, intangible assets, core competencies, capabilities, organizational processes, technical know-how and knowledge. Under RBV model, a resource should be heterogeneous and immobile. Heterogeneity implies that the acquired resource should be different from what other organizations have in the industry. On the other hand, immobility implies that the resources are not easy to transfer to various organizations.

Types of Resources

There are three types of resources – **assets, capabilities and competencies,** which have been identified under Resource Based View of the organization (RBV). Strategic thinkers explaining the RBV suggest that the organizations are collections of tangible and intangible assets combined with capabilities to use those assets. These help organizations develop understanding these three types of resources and help us to know how an organization's internal strength and weaknesses affect its ability to compete.

Assets

The factors of production used by organizations in providing its customers with valuable goods and services are called assets. These assets are of two types- tangible assets and intangible assets. Any physical means an organization uses to provide value to its customers are its tangible assets. Similarly, intangible assets are equally valuable for organizations but their physical presence cannot be felt or seen. For example, a brand name is a very important resource for any organization even though it is intangible. Exhibit 1 gives some examples of tangible and intangible assets.

Exhibit 1: Examples of tangible and intangible assets

Examples of tangible assets	Examples of intangible assets
• Organization's property and equipment	• Brand name, which is trusted
• Patents	• Knowledgeable workforce
• Distribution network	• Robust Organization structure
• IT network system	• Organizational Culture

Capabilities

In order to take full advantage of its assets the organization needs to develop skills, as experience suggests that with similar assets two different organizations may add value of different amount for themselves. This difference can only be explained by the differences in the capabilities in utilizing these assets. For example, in a sector like management education, you will find institutions more or less with similar resources and infrastructure; however, the quality of their output in terms of new professionals for business may be starkly different for different institutions. This is greatly reflected in the type of organizations that pick them up for employment and the kind of job responsibilities they are offered. This difference in output can be explained on account of the skills which these institutions carry with themselves. This position has been found true in case of many Indian organizations as well as the multinational corporations.

Competencies

Most simply put, it refers to the ability to perform. Experts from field of strategy, using the term 'distinctive competencies' refer to the critical bundle of skills that an organization can draw on to distinguish itself from competitors. However, in order to have a better understanding of the concept, you need to understand first the resources, which are available to an organization and how they differentiate themselves as competencies or core competencies.

Strategic Importance of Resources

1) **Available Resources:** These are those resources that are basic to the capability of any organization which can be listed broadly as:

   Physical Resources**:** These can be buildings, machinery or operational capacity. However, the specific condition and capability of each resource determines their usefulness.

   Human Resources**:** Traditionally or in today's knowledge economy both, people are considered as 'the most valuable asset' of an organization. Knowledge and skill of people together prove to be a great asset.

   Financial Resources: These can be capital, cash, debtors and creditors and providers of money.

   Intellectual capital**:** These are intangible resources which include the knowledge that has been captured in patents, brands, business systems and relationships with associates. In knowledge economy intellectual capital is considered as a major asset of many organizations. Exhibit 2 shows a relationship between the resources, competencies and the competitive advantage.

Exhibit 2: Resources, competencies and competitive advantage

	Same as Competitors' or Easy to imitate	**Better than Competitors' or Difficult to imitate**
Resources	Threshold Resources	Unique Resources
Competencies	Threshold competencies	Core competencies

2) **Threshold Resources**

Organizations need a set of threshold resources to perform in any market and there is a continuous need to improve such resources to stay in business. This becomes inevitable because of the competitors and sometimes the new entrants. We can think of many industries in India like automobile, durable goods, telecom etc. which with the foreign players had to acquire new sets of resources as their threshold resources to survive.

3) **Unique Resources**

Unique resources as defined in strategy texts are those resources, which critically underpin competitive advantage. Their ability to provide value in product is better than competitor's resources and is difficult to imitate. Just think of a big music stores like M inc. or the ones from different group, the scale and range of collection of music provides uniqueness to these stores as compared to any of the traditional music shop. Some organizations have patented products or services that give them advantage for some service organizations. Unique resources may be particularly the people working in that organization.

4) Core Competencies

We learnt that competencies refer to the ability to perform. The difference in performance between organizations in the same market is rarely explainable by differences in their resource base, since resources can usually be imitated or traded. Superior performance is actually determined by the way in which resources are deployed to create competences in the organization's activities. An organization needs to achieve a threshold level of competence in all of the activities and processes.

Core competencies are activities or processes that critically underpin an organization's competitive advantage. They create and sustain ability to meet the critical success factors of particular customer groups better than other and provide ways that are difficult to imitate.

Now the question arises as to how to assess what constitutes a valuable asset capability or competence. This can be done by testing for scarcity, inimitability, durability and superiority.

Scarcity: This is a very basic test to understand its resource value. Just in case any resource is widely available, then it is not likely to be a source of competitive advantage.

Inimitability: A resource that is easy to imitate is of little competitive advantage because it will be widely available from a variety of sources. e. g. services / designs etc. Inimitability however does not last long and at some point of time competition matches or even betters any offering. However, organizations should make an effort which may temporarily limit imitation. Physical uniqueness, causal ambiguity or scale deterrence are few ways how organizations attempt doing this.

Durability: Hyper competitive market conditions have a tendency to make competitive advantage less and less sustainable. Durability in such situations becomes a more stringent test for valuing resources, capabilities and competencies.

Superiority: Competencies are valuable only if they manifest themselves as competitive advantages and this means that they are superior to those held by rivals. Being good is not enough and an organization must be better than its competitor.

The above points lead to determining how an organization uses internal resources which might be linked to producing a competitive advantage and the resources which actually fit in so as to produce a competitive advantage.

To be heterogeneous and immobile, a resource should have four traits, collectively referred to as VRIO framework. These are:

- Valuable
- Rare
- Inimitable
- Organize

Now, let us discuss these in detail below.

a. **Valuable:** A resource is considered to be valuable if it either has a cost advantage or provides any differential advantage. For instance, any innovative process of producing a product reduces the overall cost of production, and then such a process will be considered as a valuable resource. Moreover if a technology is used to create a different and unique feature in a product or service, then such a technology will also be considered as a valuable resource.

b. **Rare:** A resource is considered to be rare if it is distinctive and unique in nature. A resource which is owned by several other organizations in the same industry will not be a rare strategic resource rather it will be considered as a threshold resource. For a resource to be unique, it should be exclusive to the organization. For example, an organization making products based on a specific metal ore which are very scarce in the world will be a rare resource.

c. **Inimitable:** A resource is considered to be inimitable if it is difficult for other to imitate or acquire. This can be possible if the resource is expensive to copy, requires specific knowledge to operate or has been built or developed over a considerable time period. For example, a production machine built by an organization by investing huge cost and time will be considered to be an inimitable resource.

d. **Organize**: A valuable, inimitable or rare resource can only be useful for the organization only if the organization knows how to exploit or utilize it for its own advantage. Therefore, organizing a resource properly is important for gaining strategic advantage. An organization cannot acquire, use, or control its resources effectively unless it is properly organized. This is true even for businesses with valuable, rare, and imperfectly imitable resources. A resource cannot be used to build a lasting competitive advantage if it lacks structure.

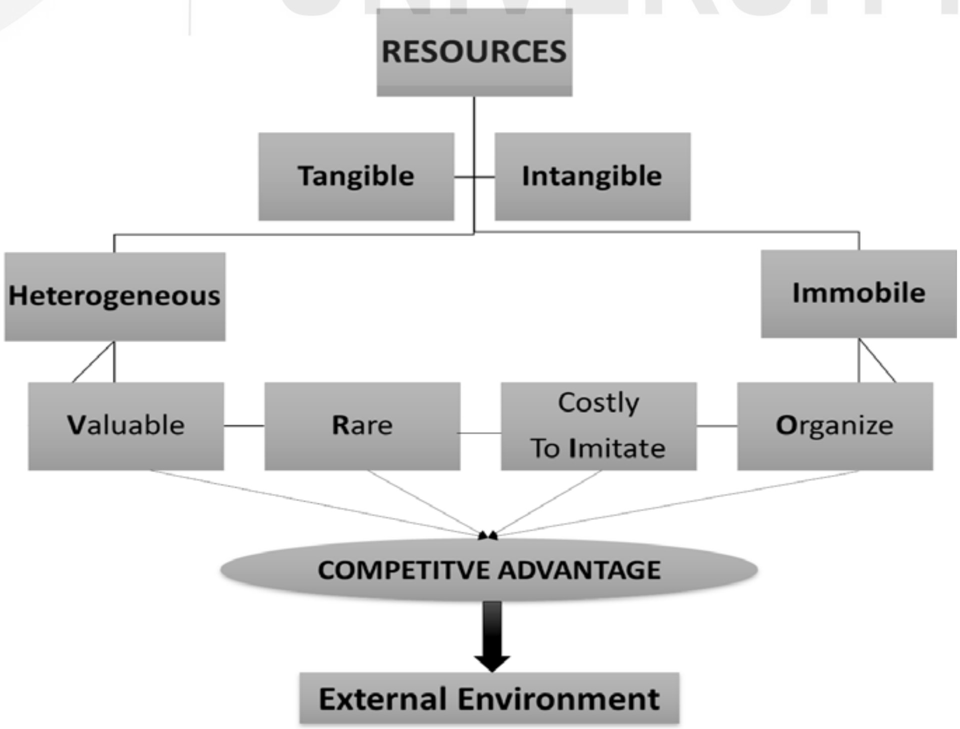

Figure 6.1: Resource Based View Model

The resource based view model indicates that competitive advantage will be achieved by ensuring that resources are developed as per VRIO framework and used to develop strategic response to external environment demands as shown in figure 6.1.

Activity 1

Identify an organization of your choice. Enumerate its threshold resources, unique resources, threshold competencies, core competencies.

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Frameworks for Identifying What to Assess

We will now discuss different frameworks to assess the strengths and weaknesses of the organizations. Managers commonly use two frameworks to guide the analysis of organization's strengths and weaknesses – **Critical success factors (CSF)** and **The Value Chain Analysis**.

6.3 THE CRITICAL SUCCESS FACTOR (CSF)

Critical success factors are those which contribute to organization's success in a competitive environment and therefore the organization needs to improve on them since poor results may lead to declining performance. Organizations depending on the environment they operate in and their own internal conditions can identify relevant critical success factors. However, literature on strategy suggests few general sources of critical success factors that have been identified based on empirical research. They are as follows:

Industry Characteristics**:** Industry specific critical success factors are factors critical for the performance of an industry. For example in hospitality industry excellent and customized service, wide presence and an excellent booking and reservation system is critical. Similarly for airline industry fuel efficiency, load factors and an excellent reservation system are critical.

Competitive Position: Critical success factors for an organization may also be determined by its relative position with respect to its competitors. In some instances, industry is dominated by few large players and their actions lead to determining the critical success factors for the industry which smaller players have to ensure for their success. For example, for the pathological laboratory centers earlier the CSF was authentic, hygienic and scientific testing facilities until few big players added service features like door to door sample collection or home delivery of reports. Very soon approachability and ease became the additional CSFs for the players.

General environment viewed from any of the dimensions may determine the CSFs. Most simply put in years of drought, availability of water is at premium and having access to assured source of water can become the critical success factor for many industries like tanneries etc. For the same industry considering environmental norms, adhering to anti-pollution standards becomes critical success factor. On many occasions' developments within the organizations, force internal considerations to become temporary critical success factors.

Activity 2

Using the following critical success factors identified for retail industry, pick two large retail stores located in your locality and compare their performance:

Critical Success Factors	Retail 1	Retail 2
1. Low sales and administrative expense	....	....
2. Efficient distribution systems	....	....
3. Reputation for value	....	....
4. Organization culture	....	....
5. Top management turnover	....	....
6. Supplier relationships	....	....

6.4 THE VALUE CHAIN FRAMEWORK

This is the other framework most commonly used to guide analysis of any organization's strengths and weaknesses. In this framework, any business is seen as a number of linked activities, each producing value for the customer. By creating additional value, the organization may charge more or is able to deliver same value at a lower cost, either of this leading to a higher profit margin. This ultimately adds to the organization's financial performance.

The value chain framework as shown in figure 6.2 is a typical value chain within an organization. Using this framework, it is possible to analyze the organization's contributions of individual activities in a business and how they add up to the overall level of customer value, the organization produces.

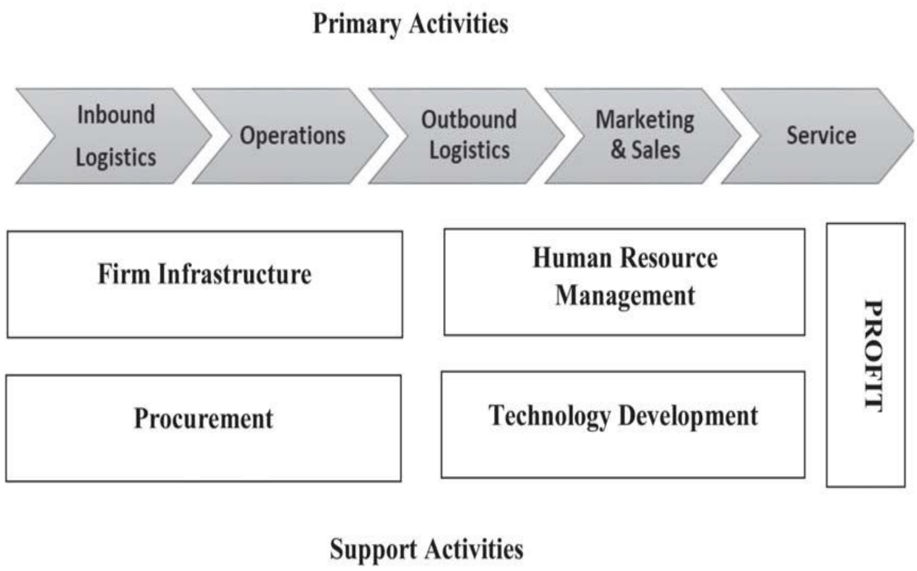

Figure 6.2: Porter's Value Chain Model

It is divided into two parts i.e. primary activities and support activities. The primary activities constitute of the following:

a) **Inbound Logistics** are activities concerned with receiving, storing and distributing the inputs to the product or service. They include materials handling, stock control, transport etc.

b) **Operations** transform various inputs into the final product or service like manufacturing, packaging, assembly testing etc.

c) **Outbound Logistics** collect, store and distribute the product to customers. For tangible products this would be warehousing, materials handling, transportation etc. In the case of services they may be more concerned with arrangements for bringing customers to the service if it is a fixed location (e.g. entertainment show).

d) **Marketing and Sales** makes consumers/ users aware of the product or service so that they are able to purchase it. This includes sales administration, advertising, selling and so on.

e) A **services** activity helps improving the effectiveness or efficiency of primary activities.

Each of the groups of primary activities is linked to support activities which are as follows:

a) **Procurement:** This is a process for acquiring the various resource inputs to the primary activities and this is present in many parts of the organization.

b) **Technology Development:** There are key technologies attached to different activities which may be directly linked with the product or with processes or with resource inputs.

c) **Human Resource Management:** This is an area involved with recruiting, managing, training, developing and rewarding people within the organization. This categorization of the activities as primary or support may be found true for organizations in general; however it is always better to have one's own judgment in identifying activities for particular organizations in consideration.

Exhibit 3 shows some of the guiding points for evaluating primary activities.

Exhibit 3: Select guiding points for evaluating primary activities

a) **Inbound Logistics**

- Soundness of material and inventory control systems
- Efficiency of raw material warehousing activities

b) **Operations**

- Productivity of equipment compared to that of key competitors
- Appropriate automation of production processes

- Effectiveness of control systems to improve quality and reduce cost
- Efficiency of plant layout and work flow design

c) **Outbound Logistics**

- Timeliness and efficiency of delivery of finished goods and services
- Efficiency of finished goods warehousing activities

d) **Marketing and Sales**

- Effectiveness of market research to identify customer segments and needs
- Innovation in sales promotion and advertising
- Evaluation of alternate distribution channels
- Motivation and competence of sales force
- Development of an image of quality and a favourable reputation
- Extent of market dominance within the market segment or overall market

e) **Customer Service**

- Means to solicit customer input for product improvements
- Promptness of attention to customer complaints
- Appropriateness of warranty and guarantee policies
- Ability to provide replacement parts and repair services

Exhibit 4 shows some guiding points for evaluating support activities.

Exhibit 4: Select guiding points for evaluating Support activities

Organization Infrastructure

- Coordination and integration
- Level of Information system
- Quality of planning system
- Timely and accurate information on environment

Human Resource Management

- Effectiveness of recruitment, training procedures
- Appropriateness of reward systems
- Relationship with trade unions
- Level of employee motivation and job satisfaction

Technology Development

- Success of R & D environment

- Quality of laboratories and other facilities
- Ability of work environment
- Qualification and experience of technical hands

Procurement

- Sources of raw material – time, cost, quality

  Procedures for procurements
- Relationships with reliable suppliers

With the indicative guiding points, you must have realized how with the Value Chain Framework, organizations can use these indicators as a reference point in order to improve its overall ability to create value. Miller suggests that the value chain framework can also be useful in a broader sense while deciding in what and where to specialize in the value activities from product design to the delivery of the final product or service to the final consumer.

Activity 3

Suppose there is an organization which is into fast food business with home delivery facility. Identify the critical success factors for this particular organization's success.

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The Balance Scorecard

This concept offers a well-rounded evaluation that views the organization from different complimentary perspectives as is shown below:

The four perspectives of the Balanced Scorecard are

Financial —— E VA/Profitability/Growth

Customer —— Differentiation / Cost / Quick Response

Operations —— Product Development/ Demand Management/ Order fulfilling

Organizational —— Leadership/ Organizational Learning/ Ability to change

Source *:* Adapted from Miller (1998)

Looking at the flow chart we can very well understand that performance as assessed in one perspective supports performance in other areas and therefore we need to consider all four perspectives in carrying out a complete internal analysis.

6.5 COMPARISON STANDARDS

In order to arrive at some meaningful conclusion regarding strengths and weaknesses, the above analysis should be supported by appropriate standards for comparison, for example, Industry norms, Historical performance and Benchmarks. These are three commonly accepted comparison standards which are often found useful for internal analysis by the organizations.

Industry Norms

The industry norms compare the performance of an organization in the same industry or sector against a set of agreed performance indicators. Data on industry norms are widely available and can be found from several published sources. Using such data and comparing an organization against others in its industry helps the organization understand its true position. In case of the healthcare sector, such indicators can be mortality index, doctors per 100 beds, nurses per 100 beds, waiting time per in- patient's treatment, waiting time per outpatient treatment, patient's trust in doctors.

The danger of industry norms comparison is that the whole industry may be performing badly and losing out competitively to other industries. Another problem with such comparisons may also arise as the boundaries of industries are coming down through competitive activity and industry convergence. For example publishing houses are evolving into multiple media groups working around the infotainment industry.

Moreover talking of industry norms, it is an average indictor and organizations must endeavour in beating them rather meeting them. In order to understand how they have been doing so it is always suggested that industry norm comparisons are supplemented with analysis on organization's own historical performance.

Historical Comparisons

Historical comparisons look at the performance of an organization in relation to previous years in order to identify significant changes. Organizations must endeavour to improve their performance over time in order to remain competitive and overpower the performance of competitors. It must try to beat its own best in future, which would call for continuous improvement.

However in case of the historical comparison it also entails scope for complacency since the organizations compare their rate of improvement over years with that of competitors and it is possible that the latter may itself be operating at a relatively lower average. Such historical trends can even be misleading when they entail changes made on a very small base.

Benchmarking

Benchmarking compares an organization's performance against 'best in class' performance wherever that is found. Managers seek out the best examples of a particular practice in other organizations as part of an effort to improve the corresponding practice in their own organization.

When the search for best practices is limited to competitors, the process is called competitive benchmarking. Other times managers may seek out the best practices regardless of what industry they are in, called functional benchmarking. Benchmarking provides the motivation and the means many organizations need to seriously rethink how their organizations perform certain tasks.

A comprehensive internal analysis of an organization's strengths and weaknesses must however utilize all three types of comparison standards. For instance, an organization can study industry norms to assess where it stands in terms of number of complaints generated regarding defects during guarantee period of a product. Then it could benchmark the organization that is best at controlling the defects. Based on the benchmarking results it could implement major new programmes and track improvements in these programmes over time using, historical comparisons.

6.6 SWOT ANALYSIS

Strengths

SWOT stands for Strengths, Weaknesses, Opportunities and Threats. A SWOT analysis summarizes the key issues from the external environment and the internal capabilities of an organization those which become critical for strategy development. The aim through this is to identify the extent to which the strengths and weaknesses are relevant to and capable of dealing with changes in the business environment. It also reflects whether there are opportunities to exploit further the competencies of the organization.

Internal Environment	**S** **Strengths**	**W** **Weakness**
External Environment	**O** **Opportunities**	**T** **Threats**

Figure 6.3: SWOT Analysis

How to perform a SWOT Analysis in organizations?

We know that SWOT analysis is assessing the internal as well as external environment of an organization. Let us see an example of X Corporation which is into manufacturing software. Exhibit 5 shows the SWOT analysis of X Corporation.

Exhibit 5: SWOT ANALYSIS FOR X CORPORATION

SWOT FOR X CORPORATION			
STRENGTHS	**WEAKNESSES**	**OPPORTUNITIES**	**THREATS**
• High quality products • Good reputation • Learning from mistakes and producing better products • Highly competitive • Competitive pricing • Low production cost	• Into loss making • Sales slowing down • No sense of direction • Decrease in productivity • No proper collaboration within the functional departments	• Increase in the size of engineering division. • Original work • Increase in promotional techniques • Trying to sell high quality products cheaper • May expand its operations • Increase in demand of products • Overseas demand • Favourable government policies	• Competitors like Y corporations • Reports show that some of its products are fake, decline in reputation • Lacks proper strategy • Losing to competitors due to the complexity of products • Entry of new substitutes in market • Inflation in raw material cost

6.7 INTERNAL FACTOR EVALUATION MATRIX

The Internal factor Evaluation Matrix (IFE) is used as a strategic tool to evaluate the internal environment of the organizations. This tool evaluates the major strengths and weaknesses of the organization in the functional areas of a business. It also provides a basis for assessing the relationship among those areas. This involves five steps which are as follows:

1. List key internal factors
2. Assign weight to each factor
3. Assign a rating to each factor
4. Determine a weighted score
5. Determine the total weighted score.

Let us see how each step is to be performed to find out the IFE. Table 6.1 gives an example of IFE.

1. **List key internal factors:**Around 10 or 20 key internal factors are to be identified which determine the strengths and weaknesses for the organization. Then the listing of all the strengths and weaknesses is done.

2. **Assign weight to each factor:** In this step each factor is assigned weights ranging from 0.0 (not so important) to 1.0 (very important). These weighs depict the relative importance to each factor for being successful in the industry. The weights are industry based and the sum of all weights should be 1.0.

3. **Assign rating to each factor:** A rating in the scale of 1 to 4 is assigned to each factor and these are organization based. The rating scale is as follows:

   1 = major weakness

   2 = minor weakness

   3 = minor strength

   4 = major strength

4. **Determine a weighted score:** This step involves multiplying weight of each factor by its rating.

5. **Determine the total weight score:** In this step a sum of the weighted score of each variable is calculated.

In IFE matrix it is important to note that the total weighted score can be as low as 1.0 and as high as 4.0 and the average score should be 2.5. a score below 2.5 indicates a weak internal position and a score above 2.5 indicates a strong internal position of the organization. Table 6.1 shows a sample of IFE Matrix.

Table 6.1: A sample of Internal Factor Evaluation Matrix

	Key Internal Factors	Weight	Rating	Weighted Score	
STRENGTHS	Diversified income	0.08	3	0.24	1.92
	Credibility	0.1	4	0.4	
	Number of patents	0.02	3	0.06	
	HR advantage	0.07	4	0.28	
	Competency in takeovers	0.06	3	0.18	
	Diversified products	0.11	4	0.44	
	SCM	0.08	4	0.32	
WEAKNESS	Level of debts	0.1	1	0.1	0.82
	Sales only from one product	0.13	2	0.26	
	Margins of profits	0.07	2	0.14	
	Price competitiveness	0.09	2	0.18	
	Culture	0.04	1	0.04	
	Impact of external environment	0.05	2	0.1	
	Total	1.00	2.74		

6.7 SUMMARY

Understanding of the strengths and weaknesses of an organization comes through the internal analysis. This is important for any organization in order to respond effectively to its environment both micro and macro. Also understanding them enables the organization to stretch its capabilities and create new opportunities for themselves. However managers have to work hard in assessing the capabilities using frameworks like Critical success factors and the Value chain analysis and analyzing them through quantitative or qualitative analysis. The end result goes as an important input for SWOT analysis.

6.8 KEYWORDS

Tangible Assets : Any physical means a organization uses to provide value to its customers.

Intangible Assets : are equally valuable for organizations but their physical presence cannot be felt or seen.

Competencies : refers to the ability of an organization to perform.

Core Competencies : are activities or processes that critically underpin an organization's competitive advantage.

Critical Success Factors : are those which contribute to organization's success in a competitive environment.

Financial Quantitative Analysis : traditionally financial analysis emphasizes on the study of financial ratios which is commonly known as ratio analysis.

Industry Norms : compare the performance of an organization in the same industry or sector against a set of agreed performance indicators.

Benchmarking : compares an organization's performance against 'best in class' performance.

SWOT : stands for Strengths, Weaknesses, Opportunities and Threats.

6.9 SELF-ASSESSMENT QUESTIONS

1) Explain and identify the type of resources which an organization may possess.
2) What do you understand by the term critical success factor and what is the core competency of an organization?
3) Why is Resource Based View important for organizations? Discuss.
4) Briefly discuss the value chain framework.
5) Identify the difference of various comparison standards and explain how they can be important for internal analysis?
6) Perform a SWOT analysis for an organization of your choice.

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