STRATEGIC ANALYSIS (6.2)

(*Chapter 38 - A Level 6.2*)

Strategic analysis refers to conducting research into the business environment and within the business itself in order to help create future strategies.

By undergoing strategic analysis, a business should be able to answer three important questions. The answers to these questions will help business managers decide on the most effective future strategies to adopt.

- **Where the business is now**, in terms of its products, competitors and market
- **How external events may impact the business**
- **What could the business do to respond to these external events**

The 6 kinds of strategic analysis a business can undertake are :

- SWOT analysis
- PEST analysis
- Vision/mission statements
- Boston matrix analysis
- Porter's five forces
- Core competencies

SWOT analysis

Is a form of strategic analysis that identifies and analyses the main internal **Strengths** and **Weaknesses** of a business as well as its external **Opportunities** and **Threats**. This is part of the process of determining where a business is now (strengths and weaknesses) and where they want to be (opportunities and threats.)

- **Strengths** - these refer to the internal factors of a business that can be used to give them a competitive advantage. Business strengths could include having experienced management, a loyal workforce and a good range of products. The identifying of these strengths is done by an **internal audit** done by specialist management consultants who compare the effectiveness of different business departments and products

- **Weaknesses** - there are the external factors of a business that are viewed as a disadvantage. Common weaknesses of businesses include having a poorly trained workforce, limited production capacity and outdated equipment. Weaknesses can also often be the flip-side of strengths, like the costs that could come with having expensive technology. Weaknesses are also identified in the **internal audit**.

- **Opportunities** - these are the potential factors that will lead to business expansion and increased profits. They are identified by an **external audit** of the firm's market and its major competitors. Examples of some opportunities would be new technology, lower taxes, a competitor failing and potential mergers/takeovers

- **Threats** - external factors that could potentially threaten the business's profits and position. Examples of some business threats include new competitors entering the market, globalisation forcing you to drive down prices to remain competitive, changes in business laws that add to costs and increased tax. Threats are also identified through use of an external audit

<u>Benefits of SWOT analysis</u>

- ★ **Useful to managers when planning a new strategy**, as it helps match the firm's resources and strengths to the opportunities available, while also identifying where they are lacking as well as the potential risk factors they may have to prepare for
- ★ Can **promote discussion and cooperation** between managers
- ★ Usually **inexpensive** when done by managers (unless done by expensive consultants)

<u>Limitations of SWOT analysis</u>

- ➢ Often can be **oversimplified**, can lead to lists being made with no priority or quantitative measure given to each factor
- ➢ Much **more detailed** analysis of strengths, weakness, opportunities and threats need to be analysed before making important decisions
- ➢ The **views of the analysts can be subjective**, two managers may come to different SWOT conclusions
- ➢ Different managers/analyst consultants will give **different issues different levels of importance** (so again, bias.)

Pest analysis

This form of strategic analysis focuses on the macro-environment - basically the big picture external factors that can affect business performance and future strategies. These factors are **Political**, **Economic**, **Social** and **Technology**. Pretty much the four key areas that are beyond a business's control.

PEST is done complementary to SWOT, not alternatively. SWOT analysis mainly focuses on factors directly related to the business, while PEST are the factors outside of business control.

- **Political and legal factors** - such as government stability, planning regulations, tax laws, employment laws, consumer protection laws and environmental laws (pollution etc.)

- **Economic factors -** such as rate of economic growth, recession, interest and tax rates, inflation and currency exchange rates

- **Social factors -** such as demographic changes (immigration, ageing population etc.), the main religion, languages and education/skill levels

- **Technology factors -** such as increased new technology being made available for more effective production, increased government financial support for research and development etc.

Benefits of PEST analysis :

★ Provides an **understanding of the wider business environmen**t, as opposed to just the factors that directly affect you
★ Helps to **identify future problems** and take action to avoid them or minimise their affect
★ Different PEST analysis for different countries will highlight political, economic, social, cultural and legal differences
★ Overall **develop a better long-term strategy** by acknowledging factors that are not within your control

Limitations of PEST analysis :

➔ **Not always in depth -** can give surface level list of points
➔ May need to be **updated regularly**, given changing business environment
➔ Information may be based on **inaccurate forecasts**
➔ Judgements will need to be made about **how relevant** the factors are to the business

Mission and vision statements

The **mission statement** of a business communicates its core objectives to its stakeholders (mainly used to motivate employees and inform shareholders.) A good mission statement will answer three questions : What do we do? Who do we do it for? What is its benefit?

The **vision statement** of a business is a statement of what the business would like to accomplish in the long term.

Basically a vision statement is what the organisation wants to become (future) but a mission statement concerns what an organisation is all about (present). Mission statements outline the overall purpose of the organisation. A vision statement, on the other hand, describes a picture of the 'preferred future'. These statements help with planning strategies in the right direction.

Benefits of vision and mission statements :

★ Helps provide direction and focus when coming up with strategies - will this new strategy help us achieve our vision/mission?
★ Can provide a sense of purpose to employees - we must come up with better strategies to achieve our vision/mission

Limitations of vision and mission statements :

★ Can be quite vague and general so may be of limited use when making decisions
★ May need to be constantly reviewed/changed in order to keep up with changing circumstances and business environment (a vision of growth would have to be altered during a recession, for example.)

Boston matrix analysis

The **Boston matrix analysis** is a method of analysing the **product portfolio** of a business in terms of its **market share** and **market growth**. Basically how profitable and successful their respective products are.

A **product portfolio** is the collection of all the products or services offered by a company.

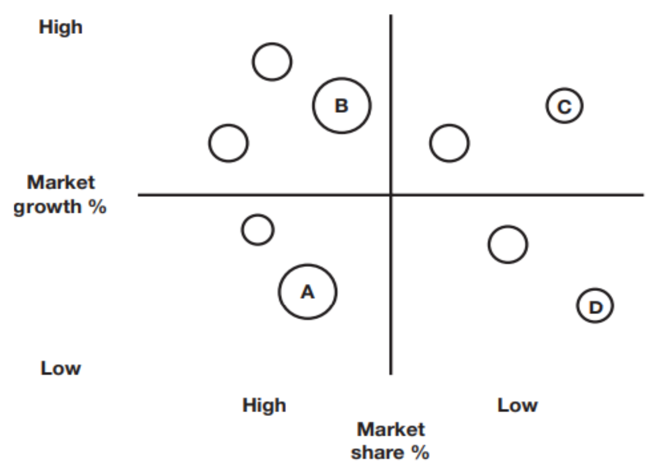
The boston matrix here ➡ shows :

■ 4 products sold by one business (A, B, C,D)

■The size of each circle represents the value of sales for each product

■ The four products are in different markets with different rates of sales growth (the different boxes)

■ The products have either a high or low market share



The four Boston Matrix product classifications are :

- **Product A** - the ‘cash cow’, meaning it has a low market growth but high market share. So it’s a well-established product in mature market
- **Product B** - ‘star’, has a high market growth AND a high market share. A successful product that people are increasingly buying in an expanding market
- **Product C** - ‘problem child’, has a high market growth but low market share. It consumes resources with little return. So may be a newly launched product
- **Product D** - ‘dog’, low market growth AND low market share. Offers no value to the business, should probably be replaced or dropped entirely

Benefits of Boston Matrix analysis :

★ **Analyses the performance** and current market position of a business's products
★ **Helps the managers make strategic decisions** regarding said products, like ⬇
★ Whether to **stop the production of 'dog' products**, or maybe develop a replacement product
★ Whether to **support and build 'problem child' products** with additional advertising etc. The finance used for this could be from the 'cash cow' products
★ **Whether to hold and support a 'star' product** to maintain its success, additional advertising work may need to be done to maintain a fresh image and new brand

Limitations of Boston Matrix analysis :

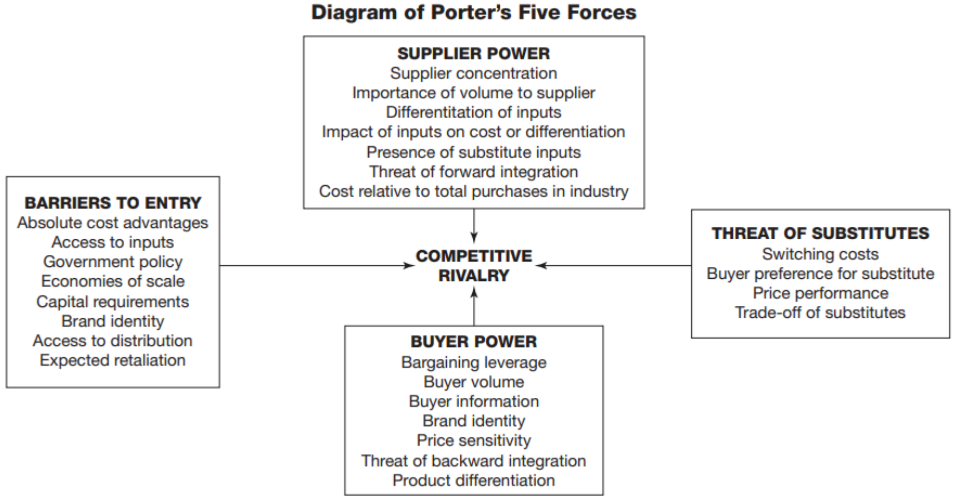
➔ Tells you the position of a product (whether it's successful, growing, failing) but **not why**
➔ Makes the **assumption that higher rates of profit are directly related to high market shares** – this isn't necessarily the case when sales are being gained by reducing prices and profit margins
➔ **Cannot forecast what might happen** with each product - a successful product today may not be one tomorrow. Other information is needed on top of Boston Matrix analysis

Porter's five forces analysis

Michael Porter provided a framework that shows the **forces that determine competitive rivalry**. By understand these forces the following types of strategic decisions could be made more effectively :

- Which markets to enter and what are the potential barriers?
- Do we stay in existing markets if it is becoming more competitive?
- What actions can be taken to improve our competitive position?

Diagram of Porter's Five Forces



The objective of Porter's Five Forces model is to assess the overall competitiveness of a particular business sector. It can be used to guide business strategy to increase competitive advantage. It is often criticised however as it **analyses an industry at a moment in time**, where many industries are constantly changing. (So it can quickly become outdated.)

The 5 forces include :

- **Number and power of a company's competitive rivals -** the more competitors and the more powerful said competitors the are the more influence they have over the market and thus the less power your business has by comparison
- **How hard it is to enter a market -** the less time and money it costs for a competitor to enter a company's market and be an effective competitor, the more an established company's position could be weakened. An industry with strong barriers to entry is ideal for existing companies, as they can continue to charge high prices without challenge
- **Power of suppliers -** refers to how easily suppliers can drive up the cost of supplying. It is affected by the number of suppliers of key materials of a good or service, how unique these materials are, and how much it would cost a company to switch to another supplier. The fewer suppliers to an industry, the more a company would depend on a supplier, and thus the more power said supplier has over them
- **Power of customers -** basically the ability that customers have to drive prices lower. It is affected by how many buyers or customers a company has, how significant each customer is, and how much it would cost a company to find new customers or markets for its products. A smaller and more powerful client base means that each customer has more power to negotiate for lower prices and better deals
- **Substitute products -** the easier it is for a consumer to find a similar enough substitute for a companies products the harder it is for the company to be able to charge higher prices without risking customers switching over to cheaper substitutes

Core competencies

A **core competence** is an important business capability that gives a firm competitive advantage. Once a core competence has been established it opens up strategic opportunities to develop **core products**.

Core competencies should be able to offer recognisable value to consumers, not be easy for other firms to copy and be applicable to a range of products and markets. Examples include :

- Consistently high quality goods and services
- Great customer service
- Clever, successful marketing
- Innovative technology or production processes that are hard for rivals to replicate