CHAPTER 2

STRATEGIC ANALYSIS: EXTERNAL ENVIRONMENT

LEARNING OUTCOMES

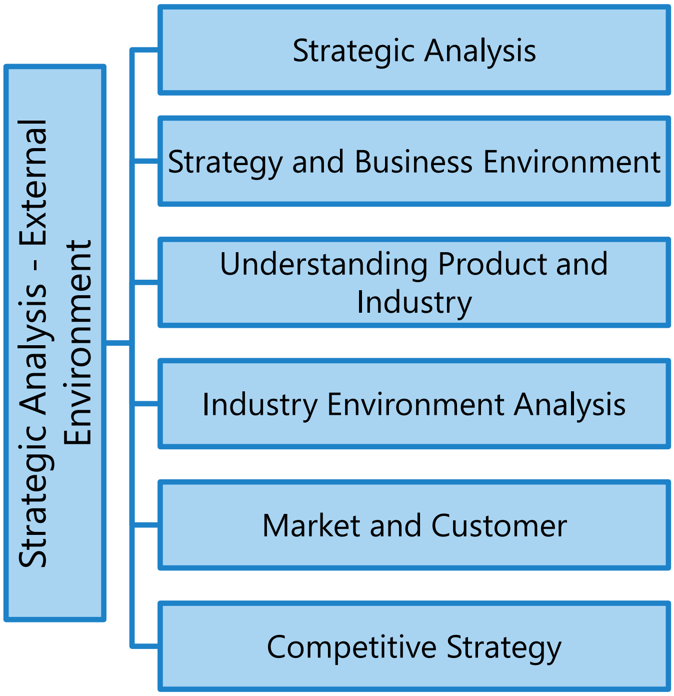
After studying this chapter, you will be able to:

- Examine the criticality of the business environment in strategic analysis.
- Describe various elements of the domestic macro environment of business.
- Utilise PESTLE Analysis as a tool for environmental analysis.
- Situate a business in an industry and conduct industry analysis.
- Analyse aspects related to competition in the industry with reference to Porter's five competitive forces.

Environmental analysis is the process by which strategists monitor the economic, governmental/legal, market/ competitive, supplier / technological, geographic and social settings to determine opportunities and threats to their firms. ***William F. Glueck***

The analysis is the critical starting point of strategic thinking. ***Kenichi Ohmae***

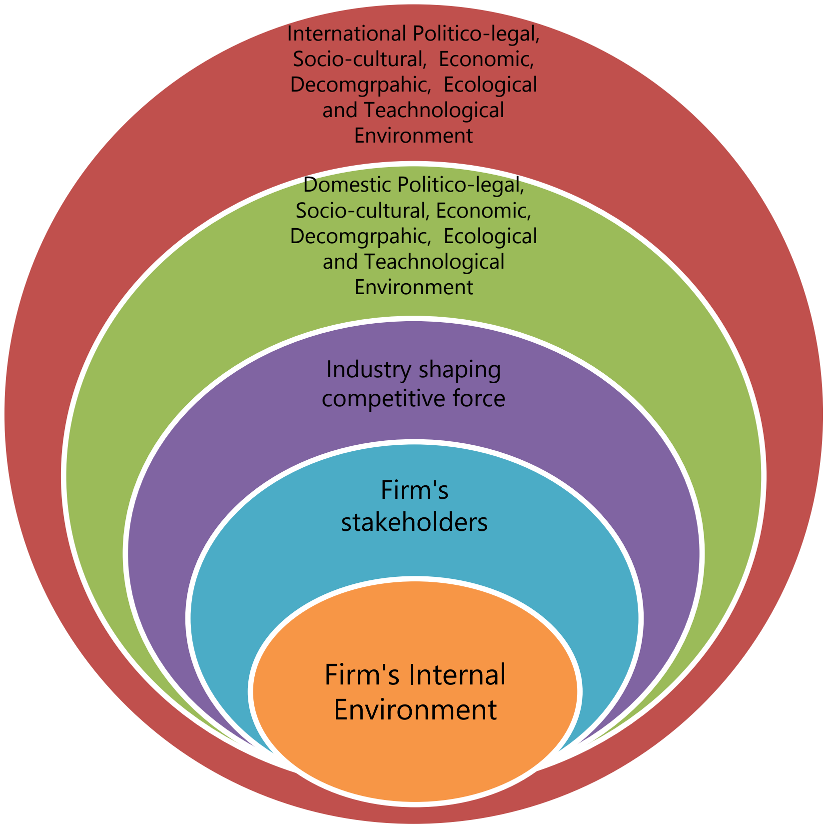
CHAPTER OVERVIEW



2.1 INTRODUCTION

There are different kinds of business activities that take place in an organisational setting, and a cursory look into their world reflects a wide variety of organisations ranging from small local businesses to international or multinational corporations' level. Generally, organisations are distinguished based on their size, type of products, markets, geographical coverage, legal status, and like because of vast organisational diversity.

Whatever their size or other distinguishing feature they do not operate in a vacuum. They continuously act and react to what happens outside their periphery. The factors that are outside the business operations are typically referred to as organisational / business environment. In other words, and in the specific context of business, environment may be defined as a set of all external factors that weigh in the minds of the managers. Drawing an analogy with the term 'atmosphere' one could envision layers of such influences. See Figure-



The process of strategic formulation begins with a strategic analysis. Its objective is to compile information about internal and external environments in order to assess possibilities while formulating strategic objectives and contemplating strategic activities. In this chapter various aspects of external environment are covered with the perspective of strategic analysis. We will also attempt to understand how to identify, and tackle strategies to adapt within complex and turbulent external environment.

2.2 STRATEGIC ANALYSIS

Strategy formulation is not a task in which managers can get by with intuition, opinions, instincts, and creative thinking. Judgments about what strategies to pursue need to flow directly from analysis of a firm's external environment and its internal resources and capabilities. Environmental scanning is a natural and continuous activity for every business and some do it on an informal basis, while others have a formal structure to collect meaningful information. It is just as important to learn about changes in tax regulations through television news as it is through a well-established reading material from experts. The capacity to collect important information in informal settings usually separates great entrepreneurs and managers. Using just informal techniques, on the other hand, exposes the organisation to missed opportunities and unanticipated hazards. A systematic approach to environmental assessment is essential for managing risk and uncertainty.

The majority of the rapidly expanding organisations use strategic planning throughout various stages of their operations. The strategic analysis is a component of business planning that has a methodical approach, makes the right resource investments, and may assist business in achieving its objective. It forces to think about the rivals and aids in the evaluation of business plans to stay ahead of the competition. The two important situational considerations are:

(1) industry and competitive conditions, and

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

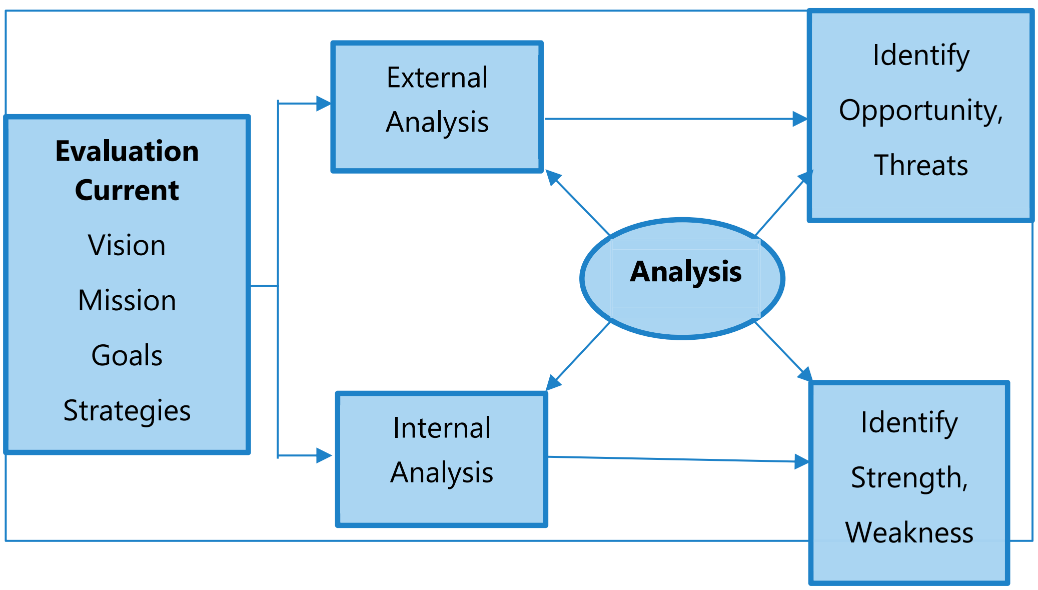


Figure: Strategic Analysis

The analytical sequence is from strategic appraisal of the external and internal situation to evaluation of alternatives of strategies, to the final choice of strategy.

Accurate diagnosis of the business situation is necessary for managerial preparation to decide on a sound long-term direction, setting appropriate objectives, and crafting a winning strategy. Without perceptive understanding of the strategic aspects of a company's external and internal environments, the chances are greatly increased that managers will finalize a strategic game plan that doesn't fit the situation well, that holds little prospect for building competitive advantage, and that is unlikely to boost company performance.

The strategic analysis is a continuous process which is not without limitations. There are two major limitations of strategic analysis that we need to be aware of. First, it gives a lot of innovative options but doesn't tell which one to pick. The options can be overlapping, confusing or difficult to implement. Second, it can be time-consuming at times, hurting overall organisational functioning and also strain other efficient innovations such as developing a new product or a service.

2.2.1 Issues to consider for Strategic Analysis

Strategy evolves over a period of time: Each strategic decision must balance the different factors that impact and constrain strategy. A key element of strategic analysis is the probable outcomes of everyday decisions. A current strategy is the result of several little choices taken over a protracted period of time. A management radically changes strategy when they try to speed up the organisational growth. Strategy is influenced by experience, but it has to be updated when the results become clear. It therefore evolves with time.

Balance of external and internal factors: In practise, strategic analysis necessitates creating a reasonable balance between many and conflicting challenges, because a perfect fit between them is unlikely. Management must consider opportunities, influences, and constraints while taking a strategic decision. There are factors driving a decision, such as entering a new market. Concurrently, there exist constraints that limit the option, such as the presence of a large opponent. These limiting constraints will have various implications on the kind, degree, volume, and significance of the impact. While some of these aspects are under your control, there will be others way beyond the existing capabilities.

Risk: In strategic analysis, the principle of maintaining balance is important. However, the complexity and intermingling of variables in the environment reduces the strategic balance in the organisation. Competitive markets, liberalization, globalization, booms, recessions, technological advancements, inter-country relationships all affect businesses and pose risk at varying degrees. An important aspect of strategic analysis is to identify potential imbalances or risks and assess their consequences. A broad classification of the strategic risk that requires consideration in strategic analysis is given below:

Time

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

Figure: Strategic Risk

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

The below given broad list of analysis that a business undertakes to plan a strategy covers both aspects of external analysis and internal analysis. An analysis helps identify opportunities, threats, strengths and weaknesses.

Strategic Analysis

External Analysis	Internal Analysis
Customer Analysis: Segments, motivations, unmet needs. ***Competitor Analysis:*** Strategic groups, performance, objectives, strategies, culture, cost structure. ***Market Analysis:*** Size, growth, profitability, entry barriers. ***Environmental Analysis:*** Technological, government, economic, cultural, demographic.	***Performance Analysis:*** Profitability, sales, customer satisfaction, product qualify, relative cost, new products, human resources. ***Determinants Analysis:*** Past and current strategies, strategic problems, organizational Capabilities and constraints, financial resources, strengths, and weaknesses.
Opportunities, threats, trends, and Strategic uncertainties	Strategic strengths, weaknesses, problems, constraints, and uncertainties

Strategy Identification & Selection

- Identify strategic alternatives
- Select strategy
- Implement the operating plan
- Review strategies

Figure: Framework of Strategic Analysis

It is evident that industries differ widely in their economic characteristics, competitive situations, and future profit prospects. The economic character of industries varies according to such factors as overall size and market growth rate, the pace of technological change, the geographic boundaries of the market (which can extend from local to worldwide), the number and size of buyers and sellers, whether sellers' products are virtually identical or highly differentiated, the extent to which costs are affected by economies of scale, and the types of distribution channels used to access buyers, marketing opportunities, disposable income of prospective buyers, government support, etc. Competitive forces can be moderate in one industry and fierce, even cutthroat, in another. In some industries competition focuses on who has the best price, while in others competition is centered on quality and reliability (as in monitors for PCs and laptops) or product features and performance (as in mobile phones) or quick service and convenience. (as in online shopping and fast foods) or brand reputation (as in laundry detergents and soft drinks). In other industries, the challenge is for companies to work cooperatively with suppliers, customers, and maybe even select competitors to create the next round of product innovations and open up whole new vistas of market opportunities.

An industry's economic traits and competitive conditions, and how they are expected to change, determine whether its profit prospects are poor, average, or excellent. Industry and competitive conditions differ so much that leading companies in unattractive industries can find it hard to earn respectable profits, while even weak companies in attractive industries can achieve good performance.

2.3 STRATEGY AND BUSINESS ENVIRONMENT

To accomplish the goals and objectives of a business, business strategist creates strategies and formulate policies considering both internal and external factors. A framework for adjusting to the demands of an unpredictable environment and an uncertain future is provided by strategic management.

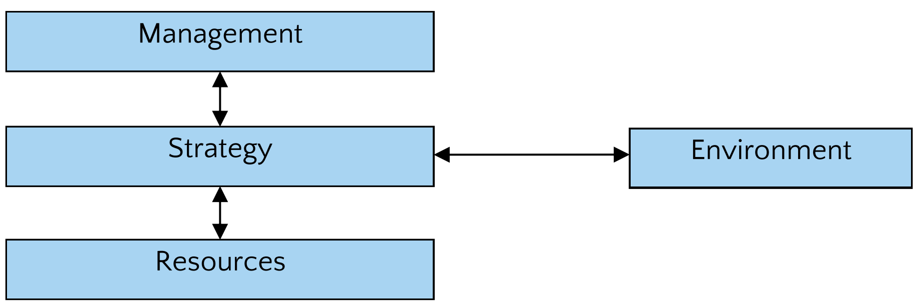


Figure: Strategy and Environment

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

The term "business environment" refers to all external factors, influences, or situations that in some way affect business decisions, plans, and operations. Organisational success is determined by its business environment, and even more from its relationship with it.

Strategic management is involved with choosing a long-term direction in relation to these resources and opportunities. There is a close and continuous interaction between a business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. It helps the business in the following ways:

i. **Determine opportunities and threats:** The interaction between the business and its environment would explain opportunities and threats to the business. It helps to find new needs and wants of the consumers, changes in laws, changes in social behaviours, and tells what new products the competitors are bringing in the market to attract consumers.

ii. **Give direction for growth:** The interaction with the environment enables the business to identify the areas for growth and expansion of their activities. Once the business is aware and understands the changes happening around, it can plan and strategise to have successful business.

iii. **Continuous Learning:** The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in the realm of business.

iv. **Image Building:** Environmental understanding helps the business organizations to improve their image by showing their sensitivity to the environment in which they operate. **For example**, in view of the shortage of power, many companies have set up captive power plants with their factories to meet their own requirement of power as well as extend surplus capacities in the vicinity. Understanding the needs of the environment help to showcase that the business is aware and responsive to the needs. It creates a positive image and helps it to prosper and win over the competitors.

v. **Meeting Competition:** It helps the businesses to analyse the competitors' strategies and formulate their own strategies accordingly. The idea is to flourish and beat competition for its products and services.

Business strategies relate organisational resources to challenges and opportunities in the larger environment. The changes happening in the external environment challenge organisations to find novel and unique strategies to remain in business and succeed. As the world is getting smaller and competition is increasing, organisations have an increasing pressure to develop their businesses and strengthen their competitiveness. Strategic analysis covering internal and external environment is highly relevant and important for the strategists in organisations in order to achieve competitive advantage, as well as ensure high performance for survival and growth.

To flourish, a business must be aware of, assess, and respond to the many opportunities and threats present in its environment. In order to succeed, the business must not only be aware of the numerous aspects of its surroundings but also be able to handle and adapt to them. The business must continuously evaluate its environment and modify its operations in order to thrive and expand.

Strategic decisions are significant aspects of business management and are essential for the success and continued existence. Two crucial aspects for the success include are the function of top management and the method of formulating strategic decisions. Improvement of strategic decisions is constant endeavour for strategist. Due to the contemporary environment's changes and the challenges that managers must overcome when making decisions, there is interest in enhancing strategic decision-making. The environment is far more dynamic and unpredictable than it used to be.

2.3.1 Micro and Macro Environment

The environment in which an organization exists can be described in terms of the opportunities and threats operating in the external environment apart from the strengths and weaknesses existing in the internal environment. Business strategists should always be adequately informed on developments occurring in their company, its industry, and within micro and macro environment of business. For making any strategic decision, they should be able to comprehend the facts available and challenge the underlying assumptions.

The external environment can be categorised in two major types as follows:

- Micro environment
- Macro environment

Micro-environment is related to small area or immediate periphery of an organization. It influences an organization regularly and directly. Micro environment consists of suppliers, consumers, marketing intermediaries, competitors, etc. These are specific to the said business or firm and affect its working on a direct and regular basis. Within the micro or the immediate environment in which a firm operates we need to address the following issues:

- The employees of the firm, their characteristics and how they are organised.
- The existing customer base on which the firm relies for business.
- The ways in which the firm can raise its finance.
- Who are the firm suppliers and how are the links between the two being developed?
- The local community within which the firm operates.
- The direct competition and their comparative performance.

The factors in micro environment often relate an organization to the macro issues influencing the way a firm reacts in the market place. The macro environment is the portion of the outside world that significantly affects how an organisation operates but is typically much beyond its direct control and influence.

2.3.2 Elements of Macro Environment

Macro environment has broader dimensions as it consists of economic, socio-cultural, technological, political and legal factors. The classification of the relevant environment into components or sectors helps an organization to cope with its complexity, comprehend the different influences operating, and relating the environmental changes to its strategic management process.

> ***"The environment includes factors outside the firm which can lead to opportunities for, or threats to the firm. Although, there are many factors, the most important of the factors are socio-economic, technological, supplier, competitors, and government."*** ***Gluek and Jauch***

The external environment of an organisation is made up of all the individuals, teams, organisations, agencies, and factors that it routinely interacts with when conducting business. In addition to carrying out transactions, it develops and puts into action pertinent plans and policies to address environmental changes. It negotiates its way into the future as well.

Demographic Environment

Demographics are the characteristics of a population that have been classified and explained according to certain criteria, such age, gender, and income, in order to understand the features of a specific group. Demographical analysis considers factors such as race, age, income, education, possession of assets, house ownership, job position, region, and the degree of education. Data about these qualities across homes and within a demographic variable are of importance to both businesses and economists. Marketers and other social scientists regularly divide up populations based on their demographic makeup. India has relatively younger population as compared to many other countries. Many multinationals are interested in India considering its population size.

Considering demographics is of immense importance for any business. Business Organizations need to study different demographic factors. Particularly, they need to address following issues:

- ♦ What demographic trends will affect the market size of the industry?
- ♦ What demographic trends represent opportunities or threats?

The size, age distribution, geographic dispersion, ethnic mix, and income distribution of a population are all of great importance to the organisation. Identifying the implications of changing demographic characteristics or population components for a future strategic competitiveness is often a challenge for strategists.

Socio-Cultural Environment

A general factor that influences almost all enterprises in a similar manner. It represents a complex group of factors such as social traditions, values and beliefs, level and standards of literacy, the ethical standards and state of society, the extent of social stratification, conflict, cohesiveness and so forth. It differs from demographics in the sense that it is not the characteristics of the population, but it is the behaviour and the belief system of that population.

Socio-cultural environment consists of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on the operations of the organization. The beliefs, values and norms of a society determine how individuals and organizations should be interrelated. The core beliefs of a particular society tend to be persistent. It is difficult for a business to change these core values, which becomes a determinant of its functioning. This means, that businesses have to adjust to social norms and beliefs to operate successfully. The social environment primarily affects the strategic management process within the organization in the areas of mission and objective setting, and decisions related to products and markets.

Economic Environment

Economic conditions have a direct bearing over the business strategies. The economic environment refers to the overall economic situation around the business and include conditions at the regional, national and global levels. It encompasses conditions in the markets for resources that have an effect on the supply of inputs and outputs of the business, their costs, and the dependability, quality, and availability.

Economic environment determines the strength and size of the market. The purchasing power in an economy depends on current income, prices, savings, circulation of money, debt and credit availability. Income distribution pattern determine the business possibilities. The important point to consider is to find out the effect of economic prospect, growth and inflation on the operations of the business.

Higher interest rates are detrimental for the businesses with high debt. In the real estate market, they reduce the capability of the prospective buyers to avail loan and pay instalments, thus lower the demand.

The economic conditions of a nation refer to a set of economic factors that have great influence on business organizations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market, interest rates, disposable income, unemployment, inflation, etc. All these factors generally tell the state of the economy. Whether it is doing good or is it performing poorly.

Political-Legal Environment

Political-legal environment takes into account elements like the general level of political development, the degree to which business and economic issues have been politicised, the degree of political morality, the state of law and order, political stability, the political ideology and practises of the ruling party, the effectiveness and purposefulness of governmental agencies, and the scope and type of governmental intervention in the economy and industry. It is partly general to all similar enterprises and partly specific to an individual enterprise.

Business is highly guided and controlled by government policies. Hence the type of government running a country is a powerful influence on business. A business has to consider the changes in the regulatory framework and their impact on the business. Taxes and duties are other critical areas that may be levied and affect the business.

Businesses prefer to operate in a country where there is a sound legal system. However, in any country businesses must have a good working knowledge of the major laws protecting consumers, competitions and organizations. Businesses must understand the relevant laws relating to companies, competition, intellectual property, foreign exchange, labour and so on.

Nationalism supports measures aimed at enhancing the position of a country in International business. Presently, there is immense thrust on nationalism in Indian business through policies like Make in India and Aatmanirbhar Bharat. Production Linked Incentives scheme, another step in the direction, rewards businesses for increased sales of goods produced domestically. The scheme encourages foreign businesses to open businesses in India, and at the same time incentivises domestic businesses to open or expand their manufacturing facilities, create more jobs, and lessen India's reliance on imports.

Technological Environment

A highly important factor in the present times is technology. Technology has changed the way people communicate and do things. Technology has also changed the ways of how businesses operate now. Technology and business are linked and are interdependent on one another. Businesses help society access the outcomes of technological research and development, raising everyone's standard of living.

As a result, business leverages technology. Businesses use new discoveries to adapt themselves for the advancement of society.

Technology has impacted on how businesses are conducted. With use of technology, many organisations are able to reduce paperwork, schedule payments more efficiently, are able to coordinate inventories efficiently and effectively. This helps to reduce costs of companies, and shrink time and distance, thus, capturing a competitive advantage for the company.

Changes in technology have an effect on how a business runs its operations. The technological advancements might require a business to drastically alter its operational, production and marketing strategies.

Technology is leading to many new business opportunities as well as making obsolete most of the existing business products and services. Technology can act as opportunity, when a business effectively adopts technological innovations to their strategic advantage. However, at the same time technology can act as a threat too. Artificial intelligence, machine learning, robotic process automation is some of the new technological tools that businesses are adopting and can act as both opportunity and threat to a business.

2.3.3 PESTLE– A tool to Analyse Macro Environment

The term PESTLE is often used to describe a framework for analysis of macro environmental factors. PESTEL analysis is frequently used to assess the business environment in which a firm operates. Political, economic, social, and technological (PEST) analysis was the name given to the framework in the past; however, later, the framework has been expanded to include environmental and legal factors as well. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.

'PESTLE analysis is an increasingly used and recognized analytical tool, and it is an acronym for:

P- political
E- economic
S- socio-cultural
T- technological
L- legal
E- environmental

The PESTLE analysis is simple to understand and quick to implement. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

The Key Factors

- ***Political factors*** are how and to what extent the government intervenes in the economy and the activities of business firms. Political factors may also influence goods and services which the government wants to provide or be provided and those that the government does not want to be provided. Furthermore, governments have great influence on the health, education and infrastructure of a nation.
- ***Economic factors*** have major impacts on how businesses operate and take decisions. **For example**, interest rates affect a firm's cost of capital and therefore to what extent a business grows and expands. Exchange rates affect the costs of exporting goods and the supply and price of imported goods in an economy. The money supply, inflation, credit flow, per capita income, growth rates have a bearing on the business decisions.
- ***Social factors*** affect the demand for a company's products and how that company operates.
- ***Technological factors*** can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.
- ***Legal factors*** affect how a company operates, its costs, and the demand for its products, ease of business.

- ***Environmental factors*** affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer--it is both creating new markets and diminishing or destroying existing ones.

On the basis of these, it should be possible to identify a number of key environmental influences, which are in effect, the drivers of change. These are the factors that require to be considered in making meaningful decisions. Take a look at the table given below:

Political	**Economic**
♦ Political stability ♦ Political principles and ideologies ♦ Current and future taxation policy ♦ Regulatory bodies and processes ♦ Government policies ♦ Government term and change ♦ Thrust areas of political leaders	♦ Economy situation and trends ♦ Market and trade cycles ♦ Specific industry factors ♦ Customer/end-user drivers ♦ Interest and exchange rates ♦ Inflation and unemployment ♦ Strength of consumer spending
Social	**Technological**
♦ Lifestyle trends ♦ Demographics ♦ Consumer attitudes and opinions ♦ Brand, company, technology image ♦ Consumer buying patterns ♦ Ethnic/religious factors ♦ Media views and perception	♦ Replacement technology/solutions ♦ Maturity of technology ♦ Manufacturing maturity and capacity ♦ Innovation potential ♦ Technology access, licensing, patents, property rights and copyrights
Legal	**Environmental**
♦ Business and Corporate Laws ♦ Employment Law ♦ Competition Law ♦ Health & Safety Law ♦ International Treaty and Law ♦ Regional Legislation	♦ Ecological/environmental issues ♦ Environmental hazards ♦ Environmental legislation ♦ Energy consumption ♦ Waste disposal

2.3.4 Internationalization of Business

Internationalization has emerged as the dominant commercial trend over the last couple of decades. It enables a business to enter new markets in search of greater earnings and less expensive resources. Additionally, expanding internationally enable a business to achieve greater economies of scale and extend the lifespan of its products.

The strategic-management process is essentially the same for global firms as it is for domestic firms; nevertheless, international processes are much more complicated due to additional variables and linkages. A business can approach internationalisation systemically with the aid of international strategy planning. One method for an organization to identify opportunities and threats in global markets is by scanning the external environment. The development of effective strategies and the formulation of global strategic objectives are made feasible by internationalisation.

Characteristics of a global business

To be specific, a global business has three characteristics:

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

Developing internationally

International development is expensive and challenging. Moving on in a thorough and structured manner is thus the ideal approach to adopt. The steps in international strategic planning are as follows:

- Evaluate global opportunities and threats and rate them with the internal capabilities.
- Describe the scope of the firm's global commercial operations.
- Create the firm's global business objectives.

- Develop distinct corporate strategies for the global business and whole organisation.

Why do businesses go global?

Technological developments and evolving political views are two important factors in the rapid rise of multinational organisations. Because of technological advances, the process of internationalisation is now simpler than it was previously. Worldwide communication makes it easier to define and implement global strategy by linking corporate headquarters with their abroad operations. In addition, introduction of improved transportation has increased the mobility of money, people, raw materials, and finished items. There are several reasons why companies go global. These are explained as follows:

- The first and foremost reason is the need to grow. It is basic need of every organisation. Often finding opportunities in the other parts of the globe, organisations extend their businesses and globalise their operations.
- There is rapid shrinking of time and distance across the globe, because of faster communication, speedier transportation, growing financial flow of funds and rapid technological changes.
- It is being realised that the domestic markets are no longer adequate. The competition present domestically may not exist in some of the international markets.
- There can be varied other reasons such as need for reliable or cheaper source of raw-materials, cheap labour, etc. Many foreign businesses shift and set up some of their operations to take advantage of availability of vast pool of talent.
- Companies often set up overseas plants to reduce high transportation costs. It may be cheaper to produce near the market to reduce the time and costs involved in transportation.
- When exporting organisations find foreign markets to open up or grow big, they may naturally look at overseas manufacturing plants and sales branches to generate higher sales and better cash flow.
- The rise of services to constitute the largest single sector in the world economy; and regional economic integration, which has involved both the world’s largest economies as well as certain developing economies.

- The apparent and real collapse of international trade barriers redefines the roles of state and industry. The trend is towards increased privatization of manufacturing and services sectors, less government interference in business decisions and more dependence on the value-added sector to gain marketplace competitiveness. The trade tariffs and custom barriers are getting lowered, resulting in increased flow of business.
- Globalization has made companies in different countries to form strategic alliances to ward off economic and technological threats and leverage their respective comparative and competitive advantages.

2.3.5 International Environment

The social, cultural, demographic, environmental, political, governmental, legal, technological factors that an international organisation faces are nearly limitless, and the number and complexity of these factors increase manifold as the number of products produced and geographic areas served increase. An assessment of the external environment is the first step toward internationalisation. Analysing international environment is important since it allows organisation to discover opportunities in the global market and evaluate feasibilities of capitalising on these opportunities. Assessments of the international environment can be done at three levels: multinational, regional, and country.

Multinational environmental **analysis** involves identifying, anticipating, and monitoring significant components of the global environment on a large scale. Understanding global developments covering economic and other macro elements is important. Governments may have free or interventionist tendencies in economies that needs to be carefully considered. These characteristics are evaluated based on their present and expected future impact.

Regional environmental **analysis** is a more in-depth evaluation of the critical factors in a specific geographical area. The emphasis would be on discovering market opportunities for a goods, services, or innovations in the chosen location.

Country environmental analysis has to take a deeper look at the important environmental factors. Study of economic, legal, political, and cultural dimensions is required in order for planning to be successful. The analysis must be customised for each of the countries to develop effective market entrance strategies.

International environment has become an inherent part of strategic management for businesses of all sizes with global interests. It essentially involves various global aspects like political risks, cultural differences, exchange rate fluctuations, legal compliances and taxation issues. Thus, it becomes more important for the people at the decision-making levels to focus on factors comprising the international environment.

2.4 UNDERSTANDING PRODUCT AND INDUSTRY

Businesses sell products. A product can be either a good or a service. It might be physical good or a service, an experience. Business products have certain characteristics as follows:

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

  On account of competition, businesses are not able to fix market price by adding profit margin on the costs. Rather, they work on reducing the costs given the prevailing market price.

- *Products have certain features that deliver satisfaction.* A product feature is a component of a product that satisfies a consumer need. Features determine product pricing, and businesses alter features during the development process to optimise the user experience. Products should be able to provide value satisfaction to the customers for whom they are meant. Features of the product will distinguish it in terms of its function, design, quality and experience. A customer's cumulative experience with a product from its purchase to the end of its useful life is an important component of a product feature.

- *Product is pivotal for business.* The product is at the centre of business around which all strategic activities revolve. The product enables production, quality, sales, marketing, logistics and other business processes. Product is the driving force behind business activities.
- *A product has a useful life.* Every product has a usable life after which it must be replaced, as well as a life cycle after which it is to be reinvented or may cease to exist. We have observed that fixed line telephone instruments have largely been replaced by mobile phones.

2.4.1 Product Life Cycle

An important concept in strategic choice is that of product life cycle (PLC). It is a useful concept for guiding strategic choice. Essentially, PLC is an S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages of introduction, growth, maturity and decline. If businesses are substituted for product, the concept of PLC could work just as well.

The first stage of PLC is the introduction stage with slow sales growth, in which competition is almost negligible, prices are relatively high, and markets are limited. The growth in sales is at a lower rate because of lack of awareness on the part of customers.

The second phase of PLC is growth stage with rapid market acceptance. In the growth stage, the demand expands rapidly, prices fall, competition increases, and market expands. The customer has knowledge about the product and shows interest in purchasing it.

The third phase of PLC is maturity stage where there is slowdown in growth rate. In this stage, the competition gets tough, and market gets stablised. Profit comes down because of stiff competition. At this stage, organisations have to work for maintaining stability.

In the fourth stage of PLC is declines with sharp downward drift in sales. The sales and profits fall down sharply due to some new product replaces the existing product. So, a combination of strategies can be implemented to stay in the market either by diversification or retrenchment.

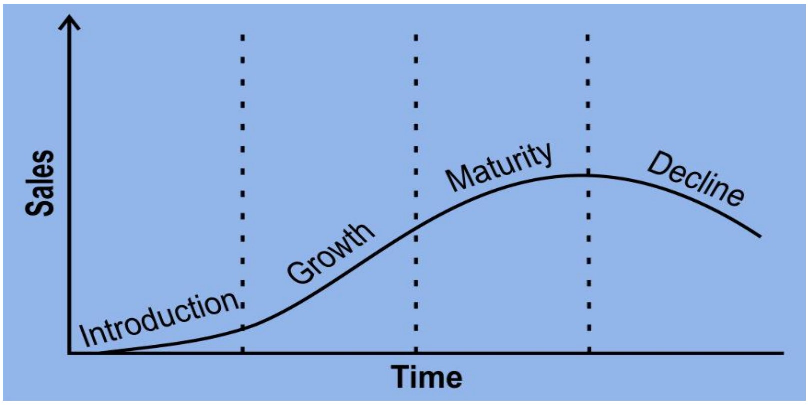


Figure: Product Life Cycle

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

2.4.2 Value Chain Analysis

With each transaction, successful businesses produce value for their consumers in the form of satisfaction and profits for themselves and their shareholders. Companies that generate more value are more likely to profit than those that generate less value. Understanding value chain of an organisation is critical for evaluating how much value it generates. Value chain analysis is a method used by strategists to break down each process that their business employs. This analysis could be used to improve the sequence of operations, enhancing efficiency and creating a competitive advantage. Value chain analysis can be used by businesses of all sizes, from sole proprietorships to multinational organisations. Each organisation has a unique set of procedures to perform its duties, and they may all benefit from value chain analysis to evaluate and optimise their processes.

Value chain analysis is a method of examining each activity in value chain of a business in order to identify areas for improvements. When you do a value chain analysis, you must analyse how each stage in the process adds or subtracts value from the end product or service.

Value chain analysis has been widely used as a means of describing the activities within and around an organization and relating them to an assessment of the competitive strength of an organization (or its ability to provide value-for-money products or services). Value chain analysis was originally introduced as an accounting analysis to shed light on the 'value added' of separate steps in complex manufacturing processes, in order to determine where cost improvements could be made and/or value creation improved. The two basic steps of identifying separate activities and assessing the value added from each were linked to an analysis of an organization's competitive advantage by Michael Porter.

Figure: Value Chain (Michael Porter)

One of the key aspects of value chain analysis is the recognition that organizations are much more than a random collection of machines, material, money and people. These resources are of no value unless deployed into activities and organised into systems and routines which ensure that products or services are produced which are valued by the final consumer/user. In other words, it is these competences to perform particular activities and the ability to manage linkages between activities which are the source of competitive advantage for organizations. Porter argued that an understanding of strategic capability must start with an identification of these separate value activities.

The primary activities of the organization are grouped into five main areas: inbound logistics, operations, outbound logistics, marketing and sales, and service.

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

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

- ***Procurement:*** This refers to the processes for acquiring the various resource inputs to the primary activities (not to the resources themselves). As such, it occurs in many parts of the organization.
- ***Technology development:*** All value activities have a 'technology', even if it is simply know-how. The key technologies may be concerned directly with the

product (e.g. R&D product design) or with processes (e.g. process development) or with a particular resource (e.g. raw materials improvements).

- ***Human resource management:*** This is a particularly important area which transcends all primary activities. It is concerned with those activities involved in recruiting, managing, training, developing and rewarding people within the organization.
- ***Infrastructure:*** The systems of planning, finance, quality control, information management, etc. are crucially important to an organization's performance in its primary activities. Infrastructure also consists of the structures and routines of the organization which sustain its culture.

2.5 INDUSTRY ENVIRONMENT ANALYSIS

A combination of ideas and methodologies may be utilised to create a clear picture of key industry traits, competition intensity, industry change drivers, rival firms' market positions and tactics, competitive success, and profit forecasts. Industry analysis enable strategic understanding about the entire state of any industry and make decisions about whether the industry is a lucrative or not.

> The goal of the industry environment analysis, which is typically an important step of strategic analysis, is to estimate the amount of competitive pressures the business is presently facing and is expected to face in the near future.

The analysis entails seeing the firm in the context of a bigger framework. The purpose of industrial analysis is to get insight into a wide range of elements within and outside the business. Analysing these elements enhances knowledge of surrounding and serves as the foundation for aligning strategy with changing industry circumstances and realities.

2.5.1 Porter's Five Forces Model

Every business operates in the competitive environment. Competitive state of an industry applies a strong influence on how firms develop their strategies. Porter's Five Forces analysis is a simple but efficient way for determining the key sources of competition in business or industry. It is a powerful and widely used tool to systematically diagnose the significant competitive pressures in a market and assess the strength and importance of each. Understanding the variables that affect industry helps to adapt strategy, boost profitability, and stay ahead of the competition. Strategist may use a strong position to organizational advantage or reinforce a weak one to avoid making mistakes in the future.

Michael Porter believes that the basic unit of analysis for understanding is a group of competitors producing goods or services that compete directly with each other. It is the industry where competitive advantage is ultimately won or lost. It is through competitive strategy that the organisation attempts to adopt an approach to compete in the industry.

The character, mix, and intricacies of competitive forces are never the same from one industry to another. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with the threat of new entrants into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
- Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

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

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

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

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

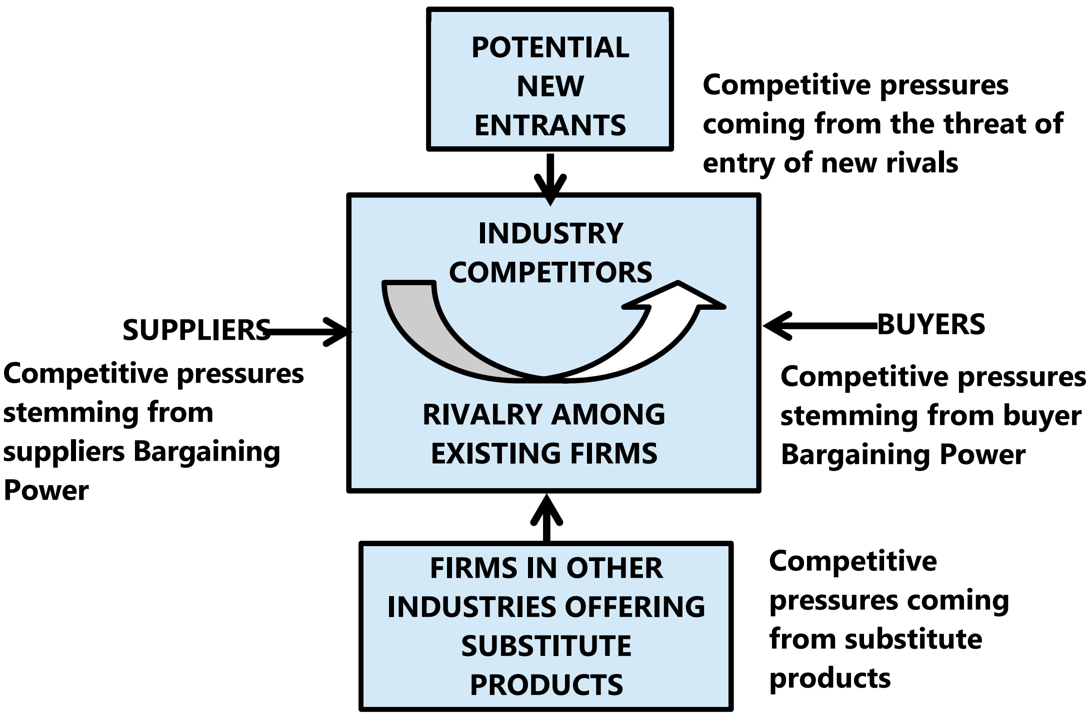


Figure: Porter's Five Force Model of Competition

Porter's five forces model is one of the most effective and enduring conceptual frameworks used to assess the nature of the competitive environment and to describe an industry's structure. The interrelationship among these five forces gives each industry its own particular competitive environment. By applying Porter's five forces model of industry attractiveness to their own industries, the manager can gauge their own firm's strengths, weaknesses, and future opportunities.

I. The Threat of New Entrants

New entrants can reduce industry profitability because they add new production capacity leading to an increase supply of the product even at a lower price and can substantially erode existing firm's market share position. New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up new competitive pressure. And the bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players. A firm's profitability tends to be higher when other firms are blocked from entering the industry.

To discourage new entrants, existing firms can try to raise barriers to entry. Barriers to entry represent economic forces (or 'hurdles') that slow down or impede entry by other firms. Common barriers to entry include, capital requirements, economies of scale, product differentiation, switching costs, brand identity, access to distribution channels and possibility of aggressive retaliation by existing players. These are explained as follows:

(i) **Capital Requirements:** When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from the industry, thus enhancing the profitability of existing firms in the industry.

(ii) **Economies of Scale:** Many industries are characterized by economic activities driven by economies of scale. Economies of scale refer to the decline in the per-unit cost of production (or other activity) as volume grows. A large firm that enjoys economies of scale can produce high volumes of goods at successively lower costs. This tends to discourage new entrants.

(iii) **Product Differentiation:** Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers. Firms in the personal care products and cosmetics industries actively engage in product differentiation to enhance their products' features. Differentiation works to reinforce entry barriers because the cost of creating genuine product differences may be too high for the new entrants.

(iv) **Switching Costs:** To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products. To make a switch, buyers may need to test a new firm's product, negotiate new purchase contracts, and train personnel to use the equipment, or modify facilities for product use. Buyers often incur substantial financial (and psychological) costs in switching between firms. When such switching costs are high, buyers are often reluctant to change.

(v) **Brand Identity:** The brand identity of products or services offered by existing firms can serve as another entry barrier. Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer. New entrants often encounter significant difficulties in building up the brand identity, because to do so they must commit substantial resources over a long period.

(vi) **Access to Distribution Channels:** The unavailability of distribution channels for new entrants poses another significant entry barrier. Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals. Often, existing firms have significant influence over the distribution channels and can retard or impede their use by new firms.

(vii) **Possibility of Aggressive Retaliation:** Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry. **For example**, introduction of products by a new firm may lead incumbents firms to reduce their product prices and increase their advertising budgets.

II. Bargaining Power of Buyers

This is another force that influences the competitive condition of the industry. This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.

Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This leverage is particularly evident when:

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

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

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

III. Bargaining Power of Suppliers

Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialised the offering from the supplier, greater is his clout. And, if the suppliers are also limited in number, they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.

Suppliers can influence the profitability of an industry in a number of ways. Suppliers can command bargaining power over a firm when:

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

(ii) They can erect high switching costs.

(iii) They are more concentrated than their buyers.

IV. The Nature of Rivalry in the Industry

The rivalry among existing players is quite obvious. This is what is normally understood as competition. For any player, the competitors influence strategic decisions at different strategic levels. The impact is evident more at functional level in the prices being charged, advertising, and pressures on costs, product and so on.

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

(i) Industry Leader: A strong industry leader can discourage price wars by disciplining initiators of such activity. Because of its greater financial resources, a leader can generally outlast smaller rivals in a price war. Knowing this, smaller rivals often avoid initiating such a contest.

(ii) **Number of Competitors:** Even when an industry leader exists, the leader's ability to exert pricing discipline diminishes with the increased number of rivals in the industry as communicating expectations to players becomes more difficult.

(iii) **Fixed Costs:** When rivals operate with high fixed costs, they feel strong motivation to utilize their capacity and therefore are inclined to cut prices when they have excess capacity. Price cutting causes profitability to fall for all firms in the industry as firms seek to produce more to cover costs that must be paid regardless of industry demand. For this reason, profitability tends to be lower in industries characterized by high fixed costs.

(iv) **Exit Barriers:** Rivalry among competitors declines if some competitors leave an industry. Profitability therefore tends to be higher in industries with few exit barriers. Exit barriers come in many forms. Assets of a firm considering exit may be highly specialized and therefore of little value to any other firm. Such a firm can thus find no buyer for its assets. This discourages exit. When barriers to exit are powerful, competitors desiring exit may refrain from leaving. Their continued presence in an industry exerts downward pressure on the profitability of all competitors.

(v) **Product Differentiation:** Firms can sometimes insulate themselves from price wars by differentiating their products from those of rivals. As a consequence, profitability tends to be higher in industries that offer opportunity for differentiation. Profitability tends to be lower in industries involving undifferentiated commodities such as, memory chips, natural resources, processed metals and railroads.

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

V. Threat of Substitutes

Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden. **For example**, coir suffered at the hands of synthetic fibre. Wherever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

A final force that can influence industry profitability is the availability of substitutes for an industry's product. To predict profit pressure from this source, firms must search for products that perform the same, or nearly the same, function as their existing products. **For example**, Real estate, insurance, bonds and bank deposits for example are clear substitutes for common stocks, because they represent alternate ways to invest funds.

The five forces together determine industry attractiveness/ profitability. This is so because these forces influence the causes that underlie industry attractiveness/ profitability. **For example**, elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces. The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.

2.5.2 Attractiveness of Industry

The industry analysis culminates into identification of various issues and draw conclusions about the relative attractiveness or unattractiveness of the industry, both near-term and long-term. Strategists assess the industry outlook carefully, deciding whether industry and competitive conditions present an attractive business opportunity for the organisation or whether its growth and profit prospects are gloomy. This is important because companies invest capital, either the promoters or from the public and should be inherent careful in choosing an industry. The important factors on which the management may base such conclusions include:

♦ The industry's growth potential, is it futuristically viable?

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

As a general proposition, if an industry's overall profit prospects are above average, the industry can be considered attractive; if its profit prospects are below average, it is unattractive. However, it is a mistake to think of industries as being attractive or unattractive to all firms in the industry and all potential entrants. Attractiveness is relative, not absolute. Industry environments unattractive to weak competitors may be attractive to strong competitors.

An assessment that the industry is fundamentally attractive typically suggests that current industry participants employ strategies calculated to strengthen their long-term competitive positions in the business, expanding sales efforts and investing in additional facilities and equipment as needed. If the industry and competitive situation is judged relatively unattractive, more successful industry participants may choose to invest cautiously, look for ways to protect their long-term competitiveness and profitability, and perhaps acquire smaller firms if the price is right; over the longer term, strong companies may consider diversification into more attractive businesses. Weak companies in unattractive industries may consider merging with a rival to bolster market share and profitability or, alternatively, begin looking outside the industry for attractive diversification opportunities.

2.5.3 Experience Curve

Experience curve akin to a learning curve which explains the efficiency increase gained by workers through repetitive productive work. Experience curve is based on the commonly observed phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production. It is based on the concept, "we learn as we grow".

The implication is that larger firms in an industry would tend to have lower unit costs as compared to those for smaller companies, thereby gaining a competitive cost advantage.

Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production.

Experience curve has following features:

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

A typical experience curve may be depicted as follows:

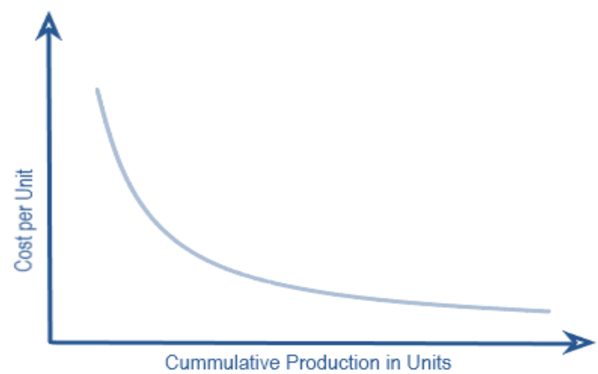


Figure: Experience curve

As a business grows, it understands the complexities and benefits from its experiences.

The concept of experience curve is relevant for a number of areas in strategic management. For instance, experience curve is considered a barrier for new firms contemplating entry in an industry. It is also used to build market share and discourage competition. In the contemporary Indian automobile industry, the experience curve phenomenon seems to be working in Maruti Suzuki. The likely strategic choice for competitors can be a market niche approach or segmentation based on demography or geography.

2.5.4 Value Creation

The concept of value creation was introduced primarily for providing products and services to the customers with more worth. Value is measured by a product's features, quality, availability, durability, performance and by its services for which customers are willing to pay. Further, the concept took more space in the business and organizations started discussing about the value creation for stakeholders.

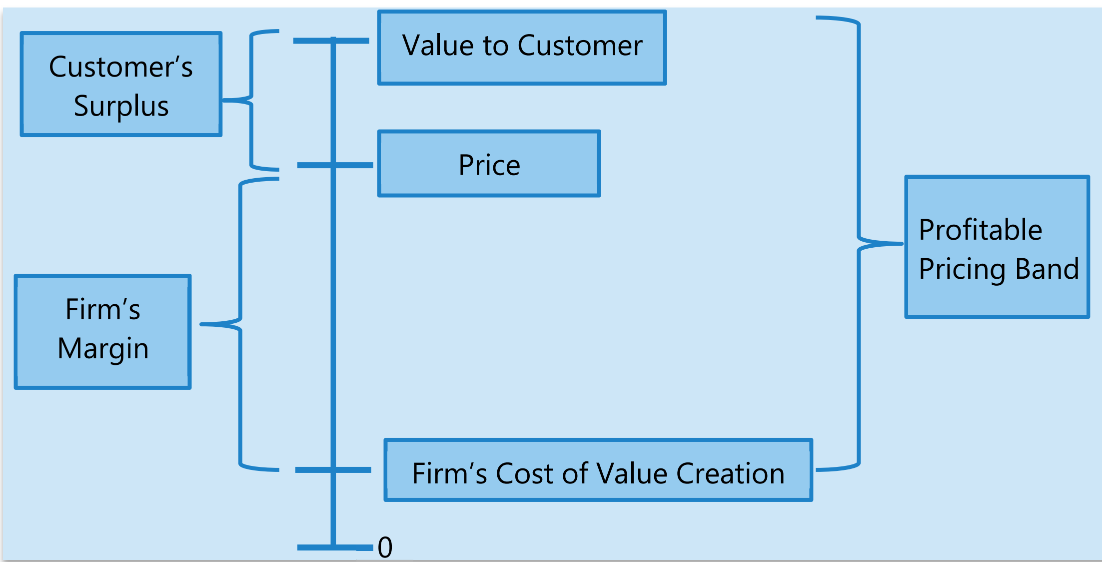


Figure: Value Creation

Thus, we can say that the value creation is an activity or performance by the firm to create value that increases the worth of goods, services, business processes or even the whole business system. Many businesses now focus on value creation both in the context of creating better value for customers purchasing its products and services, as well as for stakeholders in the business who want to see their investment in business appreciate in value. Ultimately, this concept gives business a competitive advantage in the industry and helps them earn above average profits/returns.

Competitive advantage leads to superior profitability. At the most basic level, how profitable a company becomes depends on three factors:

(1) the value customers place on the company's products;

(2) the price that a company charges for its products; and

(3) the costs of creating those products.

The value customers place on a product reflects the utility they get from a product—the happiness or satisfaction gained from consuming or owning the product. Utility must be distinguished from price. Utility is something that customers get from a product. It is a function of the attributes of the product, such as its performance, design, quality, and point-of-sale and after-sale service.

Companies are ultimately aiming to achieve sustainable competitive advantage, which enables them to succeed in the long run. Michael Porter argues that a company can generate competitive advantage in two different ways, either through differentiation or cost advantage. According to Porter's, differentiation means the capability to provide customers superior and special value in the form of product's special features and quality or in the form of aftersales customer service. As a result of differentiation, a company can demand higher price for its products or services. A company will earn higher profits due to differentiation in case the expenses stay comparable to the costs of competitors.

The above-mentioned differentiation and cost advantage will affect a company's ability to achieve competitive advantage, but there are many different organizational functions that will influence whether a company can achieve cost advantage or differentiation advantage. Michael Porter used the concept of value chain to explore closer different functions of the organisations and mutual interactions among those functions. Value chain analysis provides an excellent tool to examine the origin of competitive advantage. It divides the organisations into two different strategically important group of activities, namely, primary activities and supporting activities, which can help to comprehend the potential sources for differentiation and to understand an organisation's costs behaviour.

It is basically the value consumer wants to pay, over and above the price that the business wants to charge from the consumer. This excess amount is called value creation, wherein the consumers value the product or service more than it actually costs them.

2.6 MARKET AND CUSTOMER

A market is a place for interested parties, buyers and sellers, where items and services can be exchanged for a price. The market might be physical, such as a departmental store where people engage in person. They may also be virtual, such as an online market where buyers and sellers do not meet in person but tools of technology to strike a deal. In addition to this broad definition, the term market can apply to a wide range of contexts. **For example**, it might be used to describe the stock exchange, where securities are traded. It may also refer to a group of individuals trying to buy a specific commodity or service in a specific place, such as grain or vegetable market where farmers come to sell their produce. It may also be used to define a business or industry, such as the global oil market.

While the market is a place, business strategist work on marketing to improve the chances of success. The term "marketing" encompasses a wide range of operations, including research, designing, pricing, promotion, transportation, and distribution. Often market activities are categorised and explained in terms of four Ps of marketing – product, place, pricing, and promotion. These four kinds of marketing activities help marketers identify customer needs so they may meet their demands and deliver satisfaction. Delivering the best customer experience and establishing, maintaining, and growing relationships with customers are the main goals of marketing.

The orientation of product marketing has evolved and acquired different dimensions centred around product, production, sales and customers. Businesses that have product orientation think that buyers will choose those products that have the best quality, performance, design, or features. Next, there are production-oriented businesses that believe that customers choose low price products. Salesoriented businesses believe that if they spend enough money on advertisement, sales and promotion, customers can be persuaded to make a purchase.

In a customer or market-oriented approach strategists prioritise efforts on their customers. In order to create better value propositions for customers, businesses gather, disseminate, and use customer and competitive information. A customer-centric business is one that continuously learn from its customers' needs and market dynamics. In the present times success, many business lies in customer centric approaches.

2.6.1 Customer

A customer is a person or business that buys products or services from another organisation. Customers are important because they provide revenue and organisations cannot exist without them. All businesses vie for customers, either by aggressively marketing their products or by lowering their pricing to boost their customer bases. The terms customer and consumer are practically synonymous and are frequently used interchangeably. There is, however, a thin distinction. Individuals or businesses that consume or utilise products and services are referred to as consumers. Customers are the purchasers of products and services in the economy, and they might exist as consumers or only as customers. In homes groceries are often bought by a parent and consume by all the members of family.

Businesses routinely research the characteristics of their consumers in order to fine-tune their marketing strategies and adjust their inventory to attract the most customers. Customers are frequently categorised based on demographics like as age, race, gender, ethnicity, economic level, and geographic region, which may all assist businesses in developing a profile of a perfect customer.

2.6.2 Customer Analysis

Customer analysis is an essential marketing component of any strategic business plan. It identifies target clients, determines their wants, and then defines how the product meets those needs. Thus, it involves the examination and evaluation of consumer needs, desires, and wants.

Customer analysis includes the administration of customer surveys, the study of consumer data, the evaluation of market positioning strategies, development of customer profiles, and the selection of the best market segmentation techniques. Using the facts generated by customer analysis, an effective profiling of customers may be established. Customer profiles can reveal demographic information about customers. A number of parties, including buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors, can assist in gathering information to effectively assess the needs and desires of consumers. Successful businesses constantly monitor the behaviour of existing and prospective customers.

2.6.3 Customer Behaviour

Customer behaviour moves beyond the identification of customers to explain how they purchase products. It examines elements like shopping frequency, product preferences, and the perception of your marketing, sales, and service offerings. Understanding these details allows businesses to communicate with customers in an effective manner. Understanding the behaviours of customers enables businesses to establish effective marketing and advertising campaigns, provide products and services that meet their needs, and retain customers for repeat sales.

Consumer behaviour may be influenced by a number of things. These elements can be categorised into the following three conceptual domains:

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

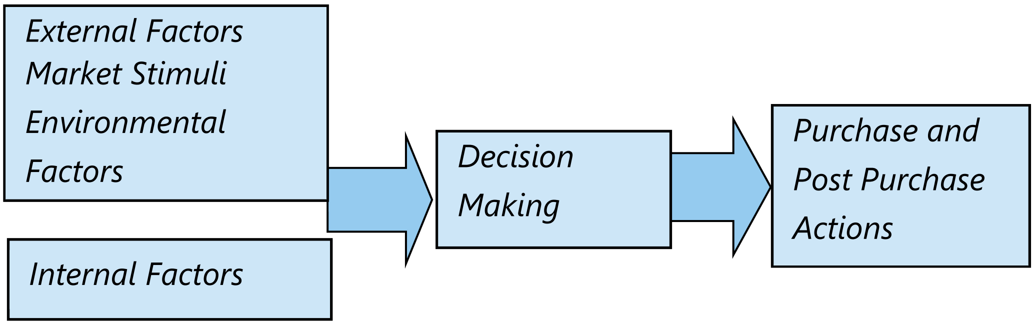


Figure: Process of consumer behaviour

- **Decision Making:** A rational consumer, as decision maker would seek information about potential decisions and carefully integrate this with the existing knowledge about the product. After weighing the advantages and disadvantages of each option, they would make a decision. The stages of decision making process can be described as:

    - Problem recognition, i.e., identify an existing need or desire that is unfulfilled
    - Search for desirable alternative and list them
    - Seeking information on available alternatives and weighing their pros and cons.
    - Make a final choice

    This behaviour of making decisions happens very frequently. However, it mostly applies when the purchase is one that is significant to the customer, such as when the product could have a significant influence on their health or self-image. The process is extremely valid when purchasing a car, television or a refrigerator in contrast to purchase of ice creams or soft drinks.

- **Post-decision Processes:** After making a decision and purchasing a product, the final phase in the decision-making process is evaluating the outcome. The consumer's reaction may vary depending upon the satisfaction. While a happy customer may make repeat purchase and recommend to others, customer with dissonance will neither purchase the product again nor recommend it to others.

2.7 COMPETITIVE STRATEGY

Competition is a fundamental attribute of economic systems and business, and it is frequently connected with small and large organisations. Businesses compete with each other for the same set of resources and customers. Within a industry, competition is frequently encouraged with the wider goal of attaining and achieving higher quality services or superior goods that the firm may manufacture or develop.

The competitive strategy of a business is concerned with how to compete in the business areas in which the organization operates. In other words, competitive strategy defines how a firm expects to create and sustain a competitive advantage over competitors. Having a competitive advantage over competitors means being more profitable in the long run. The competitive strategy of a firm within a certain business field is analysed using two criteria: **the creation of competitive advantage and the protection of competitive advantage.**

An important component of industry and competitive analysis involves delving into the industry's competitive process to discover what the main sources of competitive pressure are and how strong each competitive force is. This analytical step is essential because managers cannot devise a successful strategy without in-depth understanding of the industry's competitive character. Even though competitive pressures in various industries are never precisely the same, the competitive process works similarly enough to use a common analytical framework in gauging the nature and intensity of competitive forces.

Porter's five forces model is useful in understanding the competition. It is a powerful tool for systematically diagnosing the main competitive pressures in a market and assessing how strong and important each one is. Not only is it the widely used technique of competition analysis, but it is also relatively easy to understand and apply.

2.7.1 COMPETITIVE LANDSCAPE

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

An in-depth investigation and analysis of a firm's competition allows it to assess the competitor's strengths and weaknesses in the marketplace and helps it to choose and implement effective strategies that will improve its competitive advantage. Thus, understanding the competitive landscape is important to build upon a competitive advantage.

Steps to understand the Competitive Landscape

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

   This answers the question:

   - Who are the competitors and how big are they?

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

   This answers the question:

   - What are their product and services?

iii. **Determine the strengths of the competitors:** What are the strengths of the competitors? What do they do well? Do they offer great products? Why are consumers liking their product/service? Do they utilize marketing in a way that comparatively reaches out to more consumers? Why do customers give them their business?

   This answers the questions:

   - What are their financial positions?
   - What gives them cost and price advantage?
   - What are they likely to do next?
   - How strong is their distribution network?
   - What are their human resource strengths?

iv. **Determine the weaknesses of the competitors:** Identify the areas where the competitor is lacking or is weak. Weaknesses (and strengths) can be identified by going through consumer reports and reviews appearing in various media. Financial strength and weakness can always be learnt from annual reports.

This answers the question.

➢ Where are they lacking?

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

This answers the questions:

➢ What will the business do with this information?

➢ What improvements does the firm need to make?

➢ How can the firm exploit the weaknesses of competitors?

2.7.2 Key factors for competitive success

An industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace - the particular strategy elements, product attributes, resources, competencies, competitive capabilities, and business outcomes that spell the difference between profit and loss and, ultimately, between competitive success or failure. KSFs by their very nature are so important that all firms in the industry must pay close attention to them.

Key success factors are the prerequisites for industry success or, to put it another way, KSFs are the factors that shape whether a company will be financially and competitively successful.

The answers to three questions help identify an industry's key success factors:

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

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

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

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

Determining the industry's key success factors, given prevailing and anticipated industry and competitive conditions, is a top-priority analytical consideration. At the very least, managers need to understand the industry situation well enough to know what is more important to competitive success and what is less important. They need to know what kind of resources are competitively valuable. Misdiagnosing the industry factors critical to long-term competitive success greatly raises the risk of a misdirected strategy. In contrast, an organisation with perceptive understanding of industry KSFs can gain sustainable competitive advantage by training its strategy on industry KSFs and devoting its energies to being distinctively better than rivals on one or more of these factors. Indeed, business organisations that stand out on a particular KSF enjoy a stronger market position for their, efforts- being distinctively better than rivals on one or more key success factors presents a golden opportunity for gaining competitive advantage. Hence, using the industry's KSFs as cornerstones for the company's strategy and trying to gain sustainable competitive advantage by excelling at one particular KSF is a fruitful competitive strategy approach.

Key success factors vary from industry to industry and even from time to time within the same industry as driving forces and competitive conditions change. Only rarely does an industry have more than three or four key success factors at any one time. And even among these three or four, one or two usually outrank the others in importance. Managers, therefore, have to resist the temptation to include factors that have only minor importance on their list of key success factors. The purpose of identifying KSFs is to make judgments about what things are more important to competitive success and what things are less important. To compile a list of every factor that matters even a little bit defeats the purpose of concentrating management attention on the factors truly critical to long-term competitive success.

SUMMARY

In this chapter, we learnt about the concept of strategic analysis, which is an important tool to appreciate and assess environment of business as it largely defines how an organisation conducts its operations. We have also discussed in detail the environmental influences on business functioning and competition. Employees, customer demands and expectations, supply and demand, management, clients, suppliers, owners, government actions, technological innovation, social trends, market trends, economic changes, and so on are all part of the business environment.

Modern businesses face competitive challenges covering condition in a market in which businesses or sellers struggle for the attention of buyers in order to attain a certain commercial goal. We explored competition and competitive landscape, which is a business analysis to identify competitors, either direct or indirect. The chapter also covered PESTLE analysis, product life cycle, experience curve, competitive analysis and value chain analysis,

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *KSFs stand for:*

   (a) Key strategic factors

   (b) Key supervisory factors

   (c) Key success factors

   (d) Key sufficient factors

2. *Competitive landscape requires the application of-*

   (a) Competitive advantage

   (b) Competitive strategy

   (c) Competitive acumen

   (d) Competitive intelligence

3. *The term PESTLE analysis is used to describe a framework for analyzing:*
   - *(a) Macro Environment*
   - *(b) Micro Environment*
   - *(c) Both Macro and Micro Environment*
   - *(d) None of above*
4. *'Attractiveness of firms' while conducting industry analysis should be seen in-*
   - *(a) Relative terms*
   - *(b) Absolute terms*
   - *(c) Comparative terms*
   - *(d) All of the above*
5. *What is not one of Michael Porter's five competitive forces?*
   - *(a) New entrants*
   - *(b) Rivalry among existing firms*
   - *(c) Bargaining power of unions*
   - *(d) Bargaining power of suppliers*
6. *Which of the following constitute Demographic Environment?*
   - *(a) Nature of economy i.e. capitalism, socialism, Mixed*
   - *(b) Size, composition, distribution of population, sex ratio*
   - *(c) Foreign trade policy of Government*
   - *(d) Economic policy i.e. fiscal and monetary policy of Government*
7. *All are elements of Macro environment except:*
   - *(a) Society*
   - *(b) Government*
   - *(c) Competitors*
   - *(d) Technology*

8. *The emphasis on product design is very high, the intensity of competition is low, and the market growth rate is low in the ______ stage of the industry life cycle.*

   (a) *Maturity*

   (b) *Introduction*

   (c) *Growth*

   (d) *Decline*

Scenario Based Questions

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

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

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

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

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

3. *Baby Turtle is a children's clothing brand that has been created a new age demand for washable diapers. The major benefit for the brand has been that not many companies have shown interest in the product, thinking it is not viable, however, customers, majorly working mothers are loving their product. The core material needed for production is also used in many other water proofing products in various industries. Baby Turtle sources this material from a renowned supplier at comparatively low prices. Which of the five forces of competitive pressure would Baby Turtle experience due to above setup and what are major factors that create such pressure for a product? Do you think Baby Shark has an advantage in some way to fight off this pressure?*

Descriptive Questions

1. *Explain the concept of Experience Curve and highlight its relevance in strategic management.*

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

3. *Explain Porter's five forces model as to how businesses can deal with the competition.*

ANSWERS/SOLUTION

Answers to Multiple Choice Questions

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

Answers to Scenario Based Questions

1. Steps to understand the competitive landscape:

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

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

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

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

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

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

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

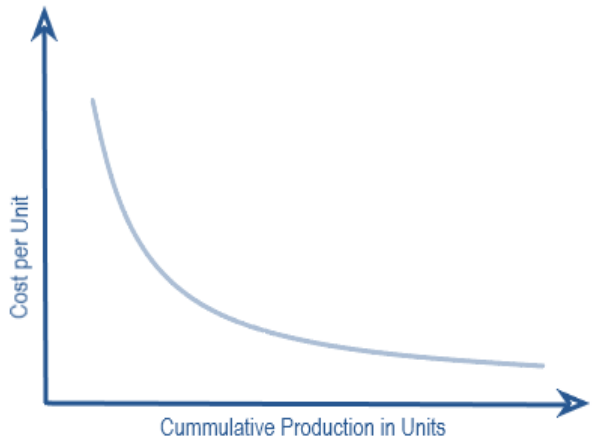
Further, other factors that lead to such pressure are:

1. Their products are crucial to the buyer and substitutes to the material required for production are not available.
2. Suppliers can manipulate switching cost as the brand is in inception stage and making margins are important.

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

Answers to Descriptive Questions

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



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

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

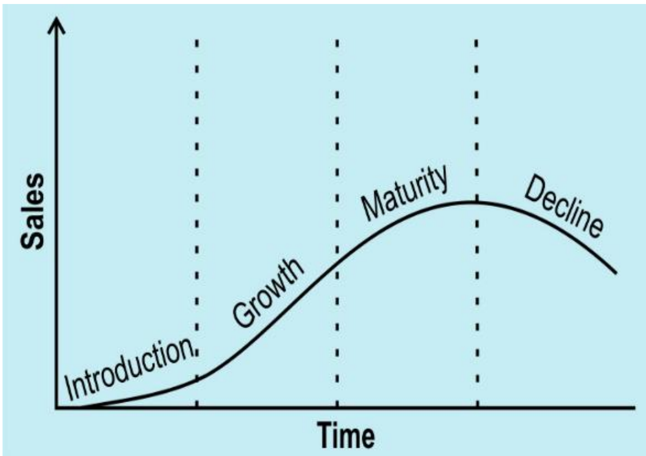
2. Product Life Cycle is an important concept in strategic choice and S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages.

The first stage of PLC is the introduction stage in which competition is almost negligible, prices are relatively high and markets are limited. The growth in sales is also at a lower rate.

The second stage of PLC is the growth stage, in which the demand expands rapidly, prices fall, competition increases and market expands.

The third stage of PLC is the maturity stage, where in the competition gets tough and market gets stabilized. Profit comes down because of stiff competition.

The fourth stage is the declining stage of PLC, in which the sales and profits fall down sharply due to some new product replaces the existing product.



Product Life Cycle

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

3. To gain a deep understanding of a company's industry and competitive environment, managers do not need to gather all the information they can find and waste a lot of time digesting it. Rather, the task is much more focused. A powerful and widely used tool for systematically diagnosing the significant competitive pressures in a market and assessing the strength and importance of each is the Porter's five-forces model of competition. This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with the threat of new entrants into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
- Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

NOTES