

Chapter 3

External Analysis

WPC 480

Learning Objectives

- LO 3-1 Generate a PESTEL analysis to evaluate the impact of external factors on the firm.
 - LO 3-2 Differentiate the roles of firm effects and industry effects in determining firm performance.
 - LO 3-3 Apply Porter's five competitive forces to explain the profit potential of different industries.
 - LO 3-4 Explain how competitive industry structure shapes rivalry among competitors.
 - LO 3-5 Describe the strategic role of complements in creating positive-sum co-opetition.
 - LO 3-6 Explain the five choices required for market entry.
 - LO 3-7 Appraise the role of industry dynamics and industry convergence in shaping the firm's external environment.
 - LO 3-8 Generate a strategic group model to reveal performance differences between clusters of firms in the same industry.
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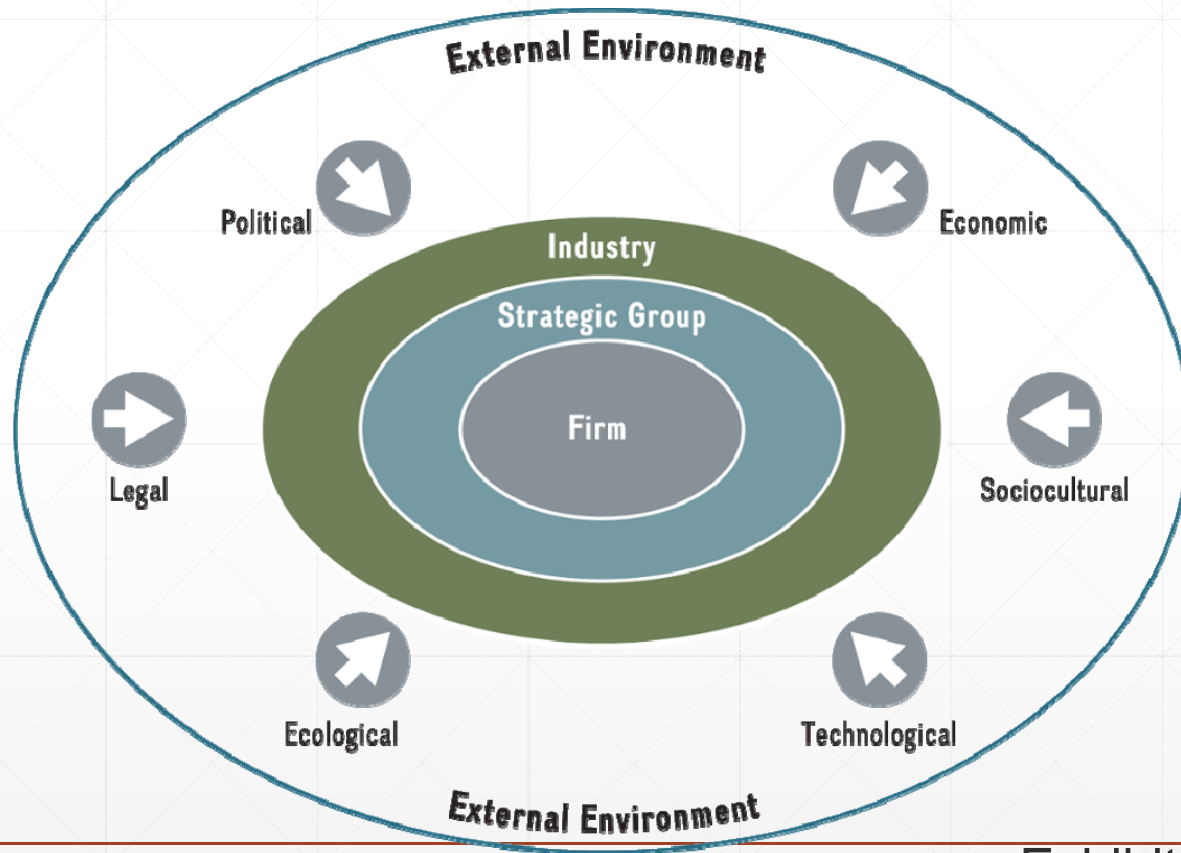
The PESTEL Model

Groups environmental factors into six segments:

1. Political
2. Economic
3. Sociocultural
4. Technological
5. Ecological
6. Legal

A straightforward way to scan, monitor, and evaluate

The Firm Within Its External Environment



[Jump to Appendix 2 long image description](#)

Exhibit 3.1

Political Factors

Processes & actions of government bodies

Can be shaped through:

- Lobbying
- Public Relations
- Contributions
- Litigation

Political and legal forces are closely related.

Economic Factors

Largely macro-economic

Economy-wide phenomena

Examples include:

- Growth rates
 - Levels of employment
 - Interest rates
 - Price stability
 - Currency exchange rates
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Sociocultural Factors

Society's cultures, norms, and values

- Are constantly in flux
- Differ across groups

Demographic trends

- Population characteristics
 - Age, gender, family size, ethnicity, sexual orientation, religion, and socioeconomic class
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Technological Factors

Application of knowledge

- New processes and products

Innovations in process technology:

- Lean manufacturing and Six Sigma quality

Innovations in product technology:

- Smartphones and wearable devices
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Ecological Factors

Broad environmental issues:

- Natural environment
- Global warming
- Sustainable economic growth

Can provide business opportunities

- Tesla cars have zero emissions
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Legal Factors

Official outcomes of political processes:

- Laws
- Mandates
- Regulations
- Court decisions

Many industries have been deregulated:

- Airlines, telecom, energy, and trucking
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Industry vs. Firm Effects

Industry Effects

- Elements in common to all
 - Entry and exit barriers, number and size of companies, and types of products and services offered

Firm Effects

- The actions managers take
 - More important than firm effects
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Industry & Industry Analysis

Industry:

- Group of incumbent companies
- Relatively similar suppliers and buyers
- Similar products and services

Industry analysis, a method to:

- Identify an industry's profit potential
 - Derive implications for a firm's strategic position
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Porter's Five Forces Model

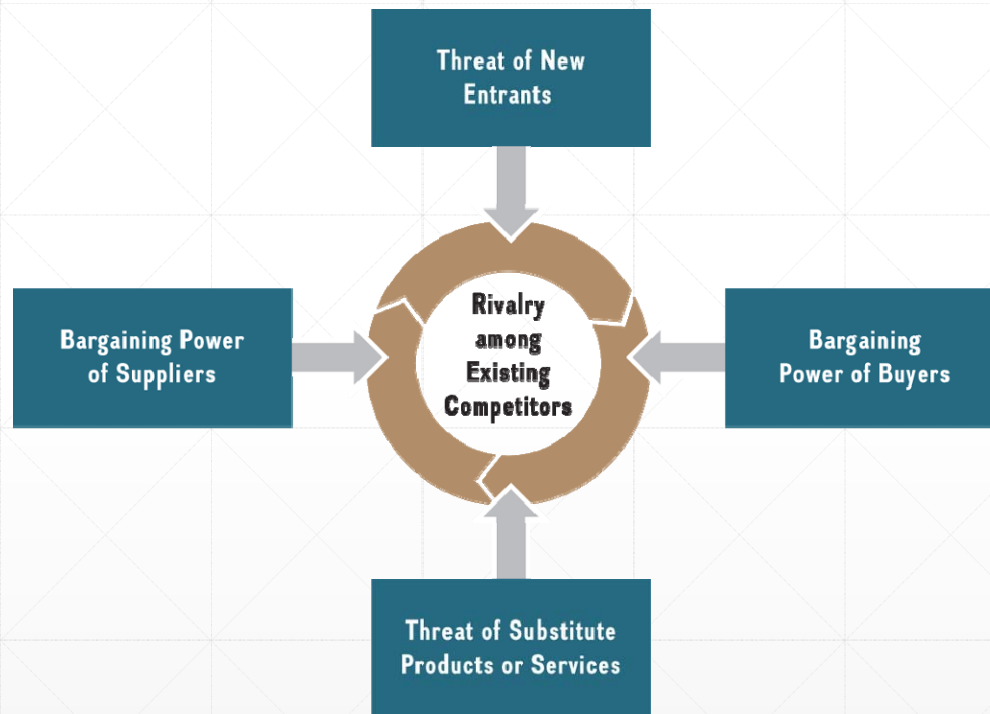


Exhibit 3.3

SOURCE: Michael E. Porter, "The five competitive forces that shape strategy," Harvard Business Review, January 2008.

Threat of Entry (2 of 2)

The risk that potential competitors will enter the industry

Entry barriers:

- Economies of scale
 - Network effects
 - Customer switching costs
 - Capital requirements
 - Advantages independent of size
 - Government policy
 - Credible threat of retaliation
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Power of Suppliers

Pressures that industry suppliers can exert on an industry's profit potential

Lowers industry profit potential if:

- Suppliers demand higher prices for their inputs
 - Suppliers reduce quality
-

Power of Buyers (Customers)

Pressure customers put on an industry

Lowers industry profit potential if:

- Buyers obtain price discounts
 - Reduces revenue
 - Buyers demand higher quality / service
 - Raises production costs
-

Threat of Substitutes

Meet the same basic customer need

- But in a different way
- Available from outside the given industry

Examples:

- Energy drinks vs. coffee
 - Videoconferencing vs. business travel
 - E-mail vs. express mail
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Rivalry Among Competitors

The intensity with which companies in the same industry jockey for market share and profitability

Other forces pressure this rivalry

Examples of tactics:

- Price discounting
 - After sales service
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Competitive Industry Structure

Number and size of competitors

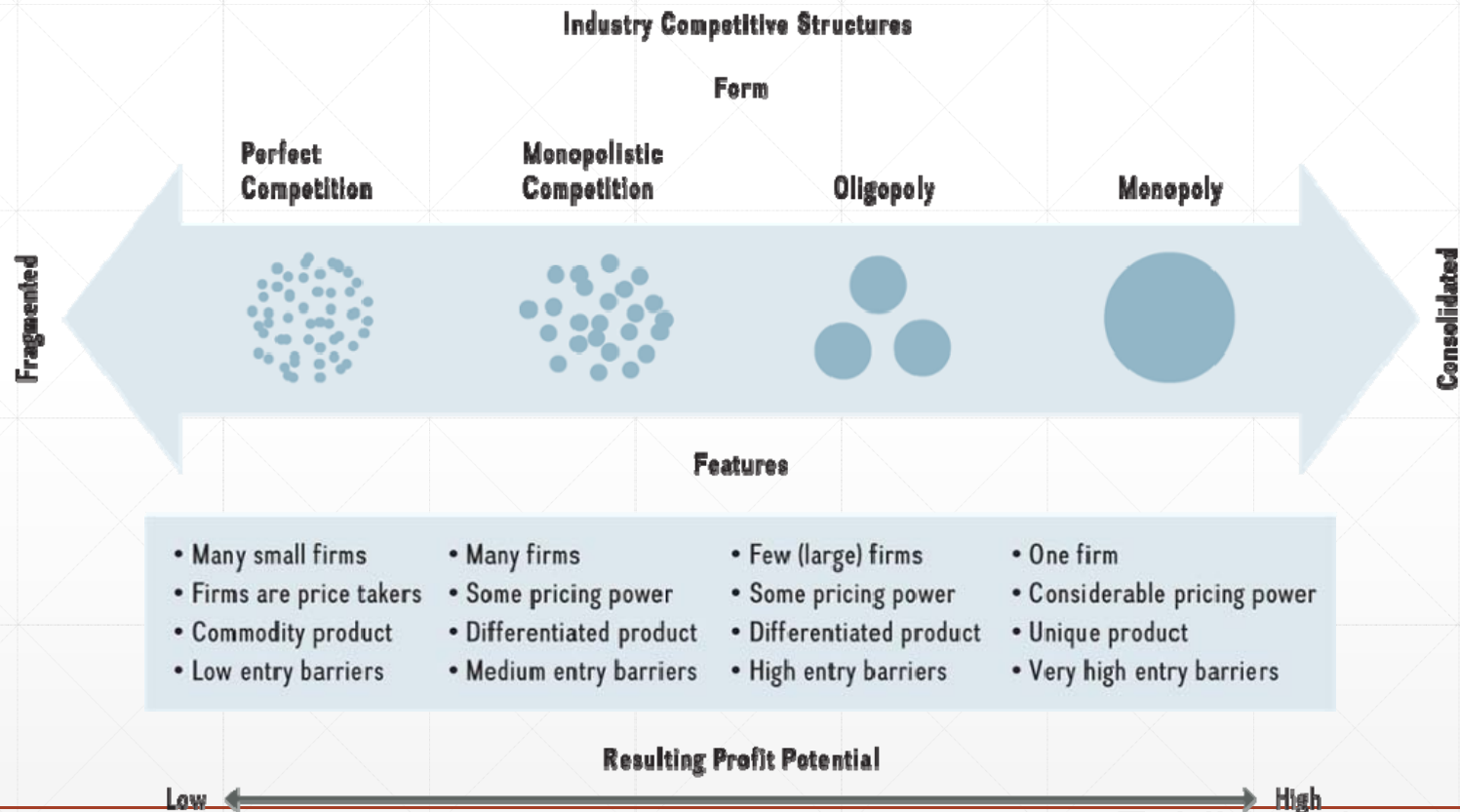
Firm's degree of pricing power

Type of product or service

- Commodity or differentiated

Height of entry barriers

4 Main Competitive Industry Structures



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Exhibit 3.4

Industry Growth

Affects intensity of rivalry among competitors

During periods of high growth:

- Consumer demand rises
- Price competition among firms decreases

During periods of negative growth:

- Rivalry is fierce
 - Rivals can only gain at the expense of one another
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Strategic Commitments

Firm actions that are:

- Costly
- Long-term oriented
- Difficult to reverse

Affects intensity of rivalry among competitors

Example: airline industry

- Hub and spoke model requires significant investment
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Exit Barriers

Obstacles that determine how easily a firm can leave that industry

Mainly economic and social factors

Examples:

- Contractual obligations
 - Emotional attachments
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A Sixth Force: Complements and Co-Opetition

Complements:

- A product, service, or competency
- Adds value when used with the original product

Co-opetition:

- Cooperation by competitors to achieve a strategic objective
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Entry Choices

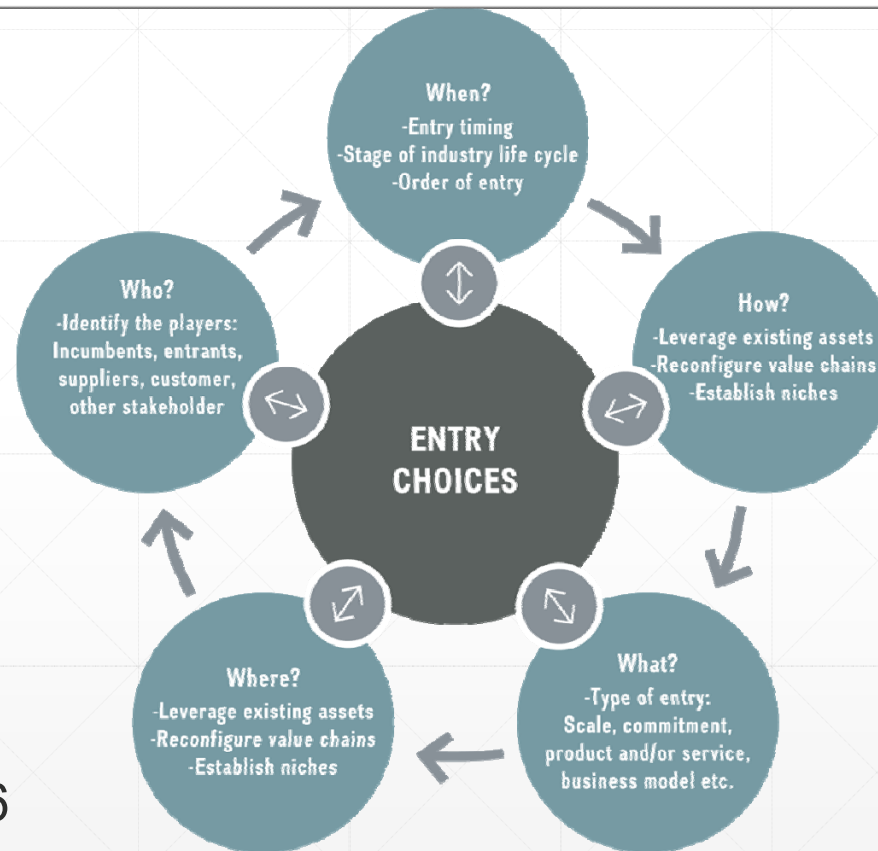


Exhibit 3.6

Source: Based on and adapted from Zachary M.A., Gianiodis P.T., Tyge Payne G., and G.D. Markman (2014), Entry timing: enduring lessons and future directions, *Journal of Management*, 41: 1409; and Bryce D.J. and J.H. Dyer (2007), Strategies to crack well-guarded markets, *Harvard Business Review*, May: 84-92.

[Jump to Appendix 6 long image description](#)

Industry Dynamics

Provides insight about:

- Changing speed of an industry
- Rate of innovation

Analysis must repeat over time

- Industry structures aren't stable
 - They are dynamic
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Industry Convergence

When unrelated industries satisfy the same need
Caused by technological advances

Example: Media Industries

- Content going online
 - Newspapers, magazines, TV, movies, radio, music
 - Will print media become obsolete?
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Strategic Groups

Strategic groups:

- A set of companies
- Pursue a similar strategy
- In the same industry

The strategic group model (framework):

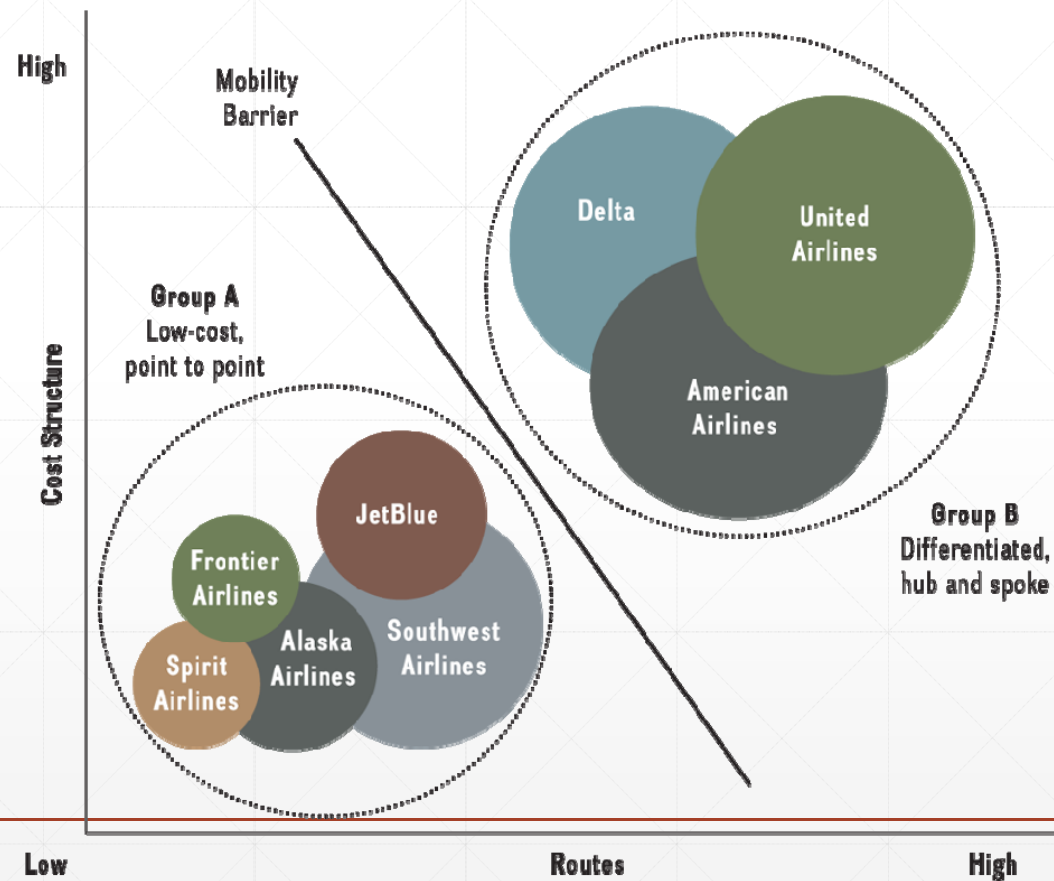
- Clusters different firms into groups
 - Is based on key strategic dimensions
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How to Create a Strategic Group Map

1. Identify the important strategic dimensions
 2. Choose two key dimensions
 - For horizontal and vertical axes
 - Ensure they're not highly correlated
 3. Graph the firms in the strategic group
 - Each firm's market share indicated by the size of the bubble
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Strategic Group Map: Domestic Airline Industry

Exhibit 3.7



[Jump to Appendix 7 long image description](#)

Insights from Strategic Group Mapping

1. Competitive rivalry:

- Strongest between firms in the same strategic group

2. External environment:

- Affects strategic groups differently

3. Five competitive forces:

- Affect strategic groups differently

4. Profitability:

- Some strategic groups more profitable than others