STRATEGIC ANALYSIS

What does **strategic analysis** comprise?
Evaluate the company's current situation and environment it is operating in.

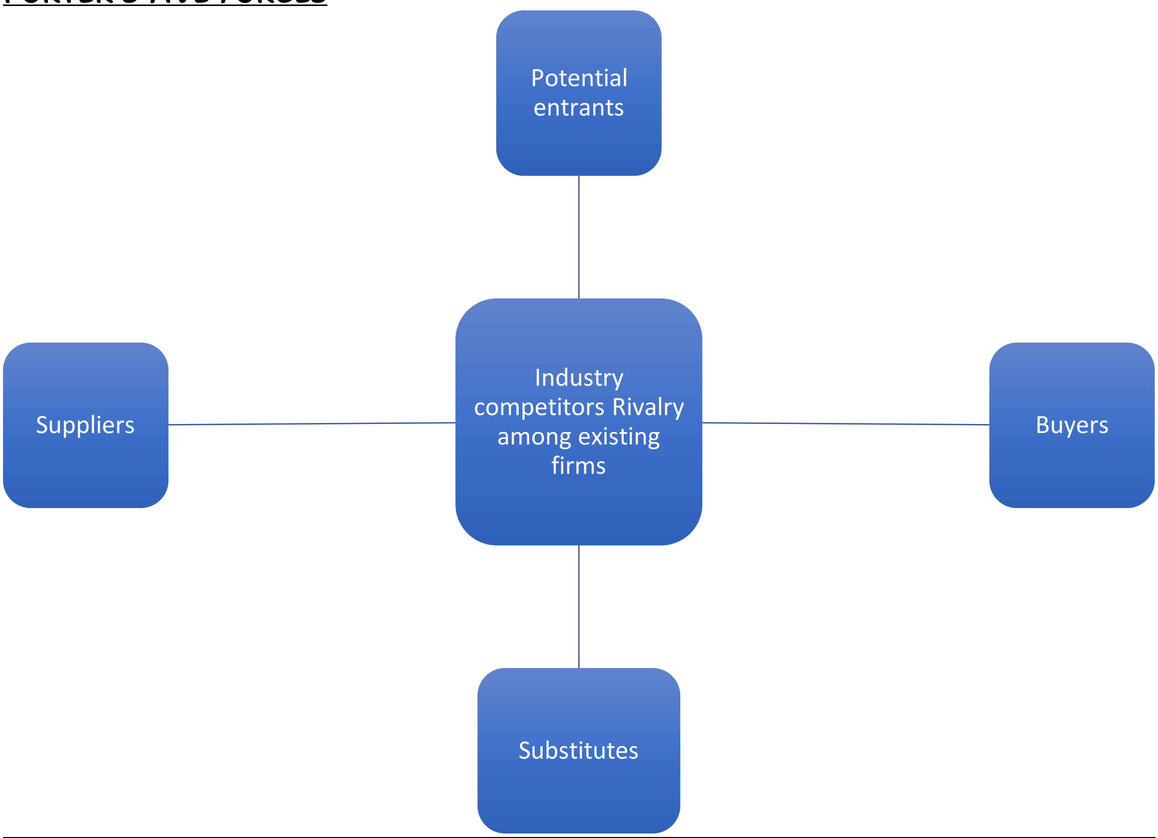
Finding answers to **3 key questions** –

1. Where is the business now?
2. How might events around impact the business?
3. How could the business respond to these changes?

Key tools:

1. SWOT - Strengths, Weaknesses Opportunities, Threats
2. PEST - Political, Economical, Social, Technological
3. BCG Matrix - analysis of product portfolio on its performance taking into account the market share in a market that's growing (either fast or slow)
4. Porter's Five forces. -to be covered in this lesson
5. Core competencies - identifying and building core competencies to be more competitive

PORTER'S FIVE FORCES



Industry competitors

- Rivalry increases when they come under pressure
- What happens - Price wars, advertising battles, product introductions, increased customer service or warranties
- If moves and countermoves escalate, it may adversely impact all firms and leave the entire industry worse off.
- Number of firms with similar market share – with a number of players of equal standing
  - there could be a few mavericks who think they can make moves that others won't notice.
  - Even otherwise, it is more likely to have a fierce fight amongst equals
  - If there is imbalance, there are clear leaders, who discipline the industry and there is lesser disturbance
- How high or slow the market growth is – if slow, then extra effort to increase sales and market share and more volatile the market reaction would be to changes. In a rapidly growing industry, there is more space and companies can improve by simply keeping up with the industry.
- High fixed costs that push firms to develop economies of scale – firms try to fill capacity by producing more to break-even & this could lead to price cuts to sell. Typically, basic materials like paper & aluminium suffer from this problem
  - Paper - low market growth, very high cost machinery
- High storage costs of finished goods could also apply pressure to cut costs – this sort of pressure is high in industry such as lobster fishing or manufacturers of hazardous chemicals
- Lack of differentiation of switching costs – competition gets more intense
- Diverse competitors – competitors diverse in strategies, origins, personalities & relationships to their parent companies – have different goals and strategies – have a hard time understanding each other's intentions accurately. Strategic choices for one may be wrong for the other
- High exit barriers –
  - high-end, expensive machines with low liquidation values.
  - Strategic interrelationships between business units and rest of the company – sharing of facilities, marketing abilities, access to financial market – forms high strategic importance of staying in the business
  - Emotional barriers
  - Government and social restrictions – job loss, regional economic effects
  - Simple eg. - For example, a retailer may wish to eliminate underperforming stores in certain geographic markets, particularly if the competition has established a dominant presence that makes further growth unlikely. A retailer might also wish to leave one location for another that offers potentially higher foot traffic or access to a demographic with customers with higher salaries. Before making such moves, the retailer might be locked into a lease with terms that make it prohibitive to shut down or leave their current locations

Barriers to entry

Entry barrier high or low? – threat is high if barrier is low

→ Economies of scale – forces entrant to come in at large scale and risk strong reaction from existing firms, or come in at small scale and accept a cost disadvantage.

→ Brand identity – product differentiation – will involve heavy spends to overcome existing customer loyalties

→ Capital requirements – need to invest large financial resources in order to compete, particularly if the capital is required for risky or unrecoverable upfront advertisement

→ Access to distribution channels – new firm must persuade channels to accept its product through price breaks, cooperative advertising allowances etc., reducing profitability (*sharing of costs for locally placed **advertising** between a retailer or wholesaler and a manufacturer*)

→ Proprietary technology, patent

→ Favourable access to raw materials, location, government subsidies, learning or experience curve (leading to improved systems, processes, leading to reduced costs)

→ Government policies – Govt. can limit or even foreclose entry into industries with controls such as licensing requirements and limits on access to raw materials – like coal lands, mountains on which to build ski areas. Other eg.s – liquor retailing, freight forwarding.
  - Pollution control requirements
  - Product testing standards – esp. in food industry
  - Rural area policy

→ Expected retaliation -
  - established firms with substantial resources to fight back
  - established firms with great commitment to the industry and highly illiquid assets employed in it

Threat of substitutes

- Substitutes do not stand of a rival brand, but a different product that can be used instead. Eg. Plastic to glass
- New technology – satellite vs. antenna. Different electronic devices
- Price pushes choice of other products – Eg. with low-fare airfares, flights were chosen over trains. More recently, what impact will the Ahmedabad-Mumbai High-speed rail have on flights between the two cities?
- Significant new product leads to lesser spends on other items

Supplier power

- Suppliers are concentrated into fewer companies
  - Customers are smaller and fragmented compared to suppliers – supplier power is high
- Ability of/cost to customers to switch – if cost is high, supplier is more powerful
- Threat of forward integration of supplier
- Supplier has built up differentiation, which has built up switching costs
- Presence of substitute inputs, lowers the supplier's power

Buyer power

- Many undifferentiated products
- Large volume buyer has more power
- Cost of switching power is high if cost is low
    - Eg. – in the past, mobile service providers charged a high cancellation fee for cancelling connections. Others started compensating them for it, nullifying the cost.
    - Eg. of low cost – apparels – buyers can easily walk around & compare prices
- If product forms a significant fraction of the buyer's cost/purchases, buyer is more price-sensitive
- If buyers earn low profits, they tend to force purchasing price down. Highly profitable buyers are less price-sensitive, unless it is a substantial fraction of their costs.
- Threat of backward integration – Eg., GM and Ford are well-known to use this to bargaining lever.
    - Some firms practice ***tapered integration*** i.e., manufacture a few of the parts themselves and buy the others. This means that they are quite capable of manufacturing the others also. Plus, they have higher knowledge of the costs of these parts and thus their negotiating power increases.
- Buyer has full information and thus more negotiating power.

Criticism:

- Static and at-the-moment in nature - Does not take into account the dynamic environment – global and technological... ***I tend to disagree, as the nature of analysis seems to consider this as well***
- Model can become very complex when analysing joint ventures, multiple product /segment businesses

SWOT vs. 5 forces

While they both help in assessing your company's strengths and weaknesses relative to industry opportunities and challenges, a primary **difference** is that **SWOT** focuses more on **company-specific elements** while **Five Forces** involves a look at **five** important competitive factors when making a strategic decision.

PEST vs. 5 forces

The major **difference between Porter's five forces** and **PEST** analysis is that **PEST** analysis is designed more for the company that wishes to perform **market research on its products** and industry. **Porter's five forces** is geared for **those examining competition in the market** and relating it to profitability.

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