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Environment Analysis & Strategic Position

Part 1

Chartered Accountancy
Strategic Level

Strategic Management & Leadership (SML)

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STRATEGIC MANAGEMENT

&

LEADERSHIP

CA - STRATEGIC LEVEL

Environment Analysis & Strategic Position (01)

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Environment Analysis & Strategic Position – (10%)

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INTRODUCTION

In this chapter we look outside the organisation to consider the external environments it inhabits before we can design an effective strategy. A thorough understanding of an organisation's environments is an essential part of the strategic planning process.

1.0 ENVIRONMENTAL SCANNING

In order to properly identify the strategic openings and chances of the market, organization should have a better understanding about the environment in which it's located. This can take place in two forms. Organization may scan the general business environment around the business or may study the specific industry or market environment which is directly related to the business.

2.0 PESTEL ANALYSIS

PESTEL Analysis - Study of the Broader Business Environment

- Political Environment

- Economic Environment

- Social & Cultural Environment

- Technological Environment

- Ecological Environment

- Legal Environment

3.0 PORTER's FIVE FORCES MODEL

According to Michael Porter an organization must evaluate the following 5 factors before entering into new markets, making a strategic market move or before implementing new strategies.

By 5 force theory organization can identify the attractiveness of a particular market or the attractiveness of a particular industry and the impact of competition and related market factors for the level of overall market attractiveness and profitability perspectives.
Michael potter recommends organizations to evaluate these environmental factors prior to making the final decision. Further he emphasized that organization must enter into attractive industries by ignoring the unattractive ones specially where all these forces are for the best interest of the company.

1) Threat of new entrance

2) Bargaining power of customers

3) Bargaining power of suppliers

4) Threat of substitutes

5) Competitor rivalry

Threat of New Entrance

Under this force organization is evaluating the possibility of a new player coming into the market and the subsequent impact it can create.

When the threat of new entrance is high the attractiveness of the industry will be low.

Different industries have different barriers in entering.

i. Economies of scale

ii. Capital investment requirement

iii. Rules & Regulations

iv. Patent Rights

v. Access to distributors or suppliers

vi. Differentiation (the unique features developed by the existing players.)

Bargaining Power of Customers

Under this the ability of a customer to demand against the organization offer will be considered. under high bargaining power organizational choice will be limited & will have to act according to customer demand which creates a direct negative impact over the profitability.

When the bargaining power of the customer is high the attractiveness if the industry is low.

Following factors will decide the bargaining power of customers.

i. No. of customers in the market

ii. No. of organizations in the market

iii. Switching cost

iv. Differentiation

Bargaining Power of Suppliers

Under this organization will evaluate the ability of a supplier to demand and to what extent the supplier can bargain for the best offer.

When the bargaining power of the supplier is high those industries are less attractive.

Factors effecting the bargaining power of the customer will be relevant to this force as well.

Threat of Substitutes

This is the possibility of replacing the functions of a particular product or service by another product or service which is ideally a low cost alternative inferior solution.

When the threat of substitutes is high the attractiveness of the industry is low

This will be mainly determined by following factors;

i. Availability of substitutes

ii. Nature of differentiation

iii. Importance of the original product

<u>Competitor Rivalry</u>

This is the level of competition within a particular industry when there are more competitors the competitor rivalry will be very high.

When the Competitor Rivalry is high the attractiveness of the industry is low

3.1 Limitations of 5 Force Theory

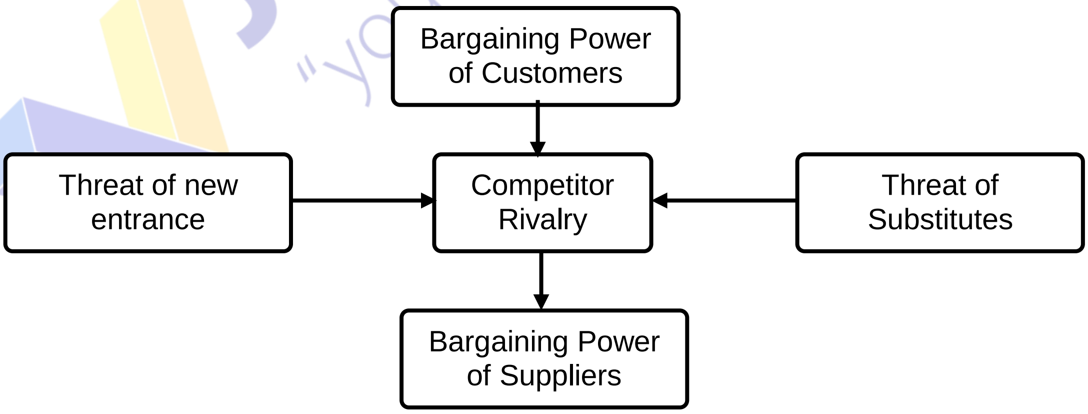
1) This model is too simple because only limited factors are identified. There are more & enough other factors.

2) This model is not realistic because there are no businesses without the influence of these factors.

3) This model ignores the external environmental factors such as PESTEL factors.

4) Organization is neglecting the internal capabilities

5) This model is a backward model for strategy formulation which is not proactive.



3.2 Micro Environment

The micro-environment is the operating environment of the firm – it includes those external entities that have the most direct impact on how the organisation performs, and for that reason is often linked to Porter's five forces analysis. It is typically made up of the following elements;

1. Customers

2. Competitors

3. Employees

4. Shareholders

5. Suppliers

6. Media

4.0 PRODUCT LIFE CYCLE & BCG MATRIX

4.1 Product Life Cycle

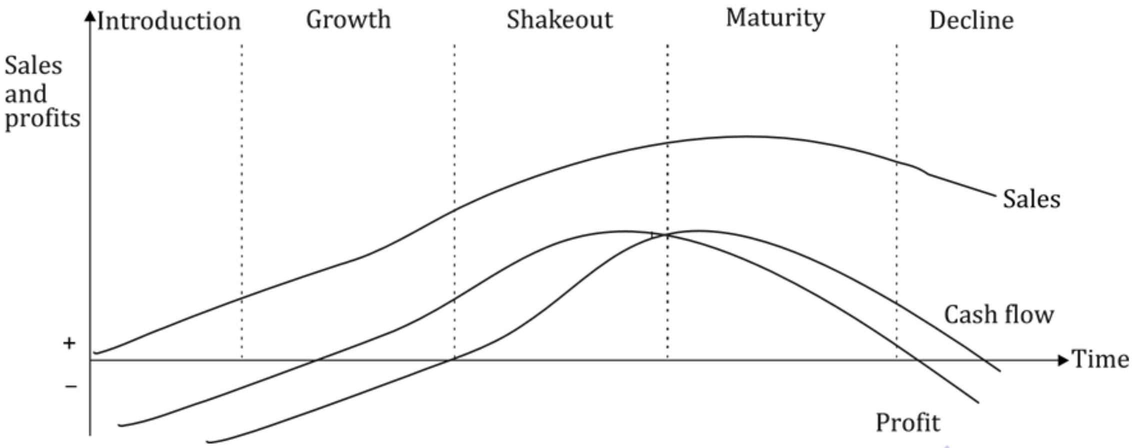
A Product can be defined in any of the following ways;

Product Class	
Product Form	
Brand or Specific Model	

The **product life cycle** is an attempt to recognize distinct stages in a product's sales history, from introduction to the market, through periods of growth and maturity to eventual decline

Like the life period of an animal or the life period of an event, every product and service in the market inherits a unique life cycle which they experience throughout the effective life time of that particular product or service.

Product life cycle is the concept which focuses on different stage a product may go through with in its valid economical lifetime. Namely a product will go through following stages during its effective life time.



4.1.1 Introduction Stage

A new product takes time to be accepted when it is first introduced to the market. There is a slow growth in sales. Unit costs are high due to low output and costly sales promotions. Marketing costs are high in order to get the product recognised by customers.

- At this stage, the product range is limited. With only one or a small number of manufacturers making the product, the number of available product models is small.
- The product for the time being is a loss-maker, and has negative cash flows.
- The product is high risk because it is new and has not yet been accepted by the market.
- The product has few, if any, competitors.
- The product is only likely to be purchased by customers who like innovative products and are interested in trying them out.
- At this stage, there is an opportunity for a company to establish a name for itself, possibly as a brand, in the market.

4.1.2 Growth Stage

If the new product gains market acceptance, sales will eventually rise. The market will grow and at some stage in this growth phase, the product will start to be profitable.

- Capital investment may be needed to meet the rising demand. If so, cash flows may remain negative even when the product is making a profit. However, cash flows improve as sales increase further.
- Growth in the market is achieved by attracting new customers.
- Competitors are attracted to the market and offer similar products, but as sales and production volumes continue to rise for the market as a whole and for individual producers in the market, unit costs fall.

- Manufacturers introduce additional features to their product, to differentiate it from the products of competitors. Product complexity is likely to rise as product differentiation increases. Alternatively, a company may attempt to be the least-cost producer and compete by offering a basic product at the lowest price.

- Continued marketing expenditure is required to differentiate the company's product from those of competitors.

- As the market grows, companies may identify new market segments and target these segments.

4.1.3 Shakeout Stage

Shakeout refer to the consolidation of an industry. Some companies will be naturally eliminated from the market as they are unable to grow alone with the industry or are still under performing by generating negative cash flows. In this stage, growth or revenue, cash flows and profits starts slowing down as industry is in the verge of being declining.

4.1.4 Maturity Stage

At some stage on the life cycle of a product form, the market will stop growing, or growth will slow down to a low rate.

- Purchases are now based on repeat or replacement purchases, rather than new customers buying for the first time.

- Although the rate of sales growth slows down, the maturity phase is often the longest period in the life cycle of a successful product's life.

- For producers, the product is profitable and generates positive cash flows.

- Prices may fall, as firms compete with one another to try to increase their share of a fixed-size market.

- Firms try to use the brand name they have established to extend their product range, and sell new products under the same brand name.

- The number of companies in industry falls, due to consolidation in the industry by means of takeovers and mergers.

4.1.5 Decline Stage

Eventually, sales of a product form will begin to decline so that there is overcapacity of production in the industry. There may be severe competition between manufacturers, possibly resulting in price reductions. Profits fall as sales volume and prices fall.

Some producers leave the market. Others look for ways of prolonging the life of the product, possibly by identifying different market segments and adapting the product to the needs of that segment.

Producers may be reluctant to leave the market, although some do so because of falling profits.

However, some products that have been in decline have received a boost and have experienced a new growth phase, as improvements in technology have enabled manufacturers to improve the appeal of the product to customers.

4.1.6 Problems with the PLC concept

There are practical difficulties with using the concept of a product life cycle.

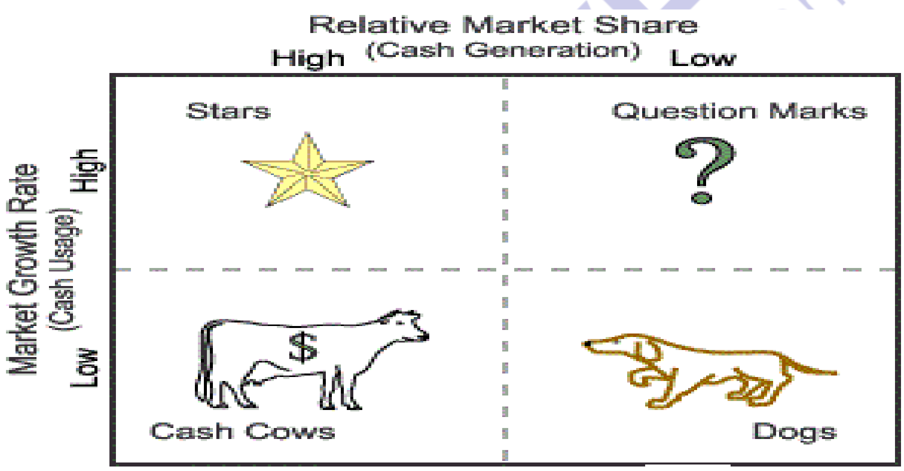
(a) With the speed of technological change, some products may have a very short life cycle. There is no time to change marketing strategies for each stage of the life cycle.

(b) **Recognition**. How can managers recognize what stage a product has reached in its life cycle?

(c) **Not always true**. The theoretical curve of a product life cycle does not always occur in practice. Some products never decline if they are marketed competitively: radio as a form of entertainment seems to have been such a product.

(d) **Changeable**. Strategic decisions can change or extend a product's life cycle.

4.2 BCG Matrix



4.2.1 Stars.

In the short term, these require capital expenditure in excess of the cash they generate, in order to maintain their market position, and to defend their position against competitors' attack strategies, but they promise high returns in the future.

4.2.2 Cash cows.

In time, stars will become cash cows as the market matures. Cash cows need very little capital expenditure (because opportunities for further growth in a mature market are low), and they generate high levels of cash income. Cash cows can be used to finance the stars or question marks that are in their development stage.

4.2.3 Question marks.
The question with these products is whether they justify considerable capital expenditure in the hope of increasing their market share and improve their market share. Or will they be squeezed out of the expanding market by rival products? Question marks have the potential to become stars if they are successfully developed. However, if their development is not successful, they may end up as 'dogs'.

4.2.4 Dogs.
These may be former cash cows that have fallen on hard times, or question marks that did not succeed. They may have a useful strategic role, either to complete a product range or to keep competitors out. However, the remaining life of dogs is unlikely to be long.

Although developed for use with a **product** portfolio, the BCG matrix is also used in diversified conglomerates to assess the strategic position of subsidiary strategic business units **(SBUs)**. This is an important point to note: the BCG matrix can be applied either to a **product portfolio** or a **business portfolio**.

The BCG matrix offers management a simple and convenient way of looking at the company's entire product range. It encourages management to look at the portfolio as a whole rather than simply assessing the needs and performance of each product individually with the view of building up a healthy portfolio.