Components of External Analysis

- **Scanning**
  - Identifying early signals of environmental changes and trends

- **Monitoring**
  - Detecting meaning through observations of changes and trends

- **Forecasting**
  - Developing projections of outcomes based on changes and trends

- **Assessing**
  - Determining timing and importance of changes and trends for firm’s strategies and management

The General Environment

- **Demographic**
- **Sociocultural**
- **Political/Legal**
- **Macroeconomic**
- **Technological**
- **Global**
The General Environment

**Demographic Segment**
- Population size
- Age structure
- Geographic distribution
- Ethnic mix
- Income distribution
- Education levels

**Economic Segment**
- Inflation rates
- Interest rates
- Trade deficits/surpluses
- Budget deficits/surpluses
- Personal/Business saving rates
- Gross Domestic Product

**Political/Legal Segment**
- Anti-trust laws
- Tax laws
- Deregulation
- Labor laws
- Educational policies
- Political action committees
- Term limitations
- Balanced budgets
The General Environment

Sociocultural Segment

- Women in work force
- Work force diversity
- Quality of work life
- Environmental concerns
- Work/career preferences
- Product/service preferences
- Religious influences (or lack thereof)
- Crime rates

The General Environment

Technological Segment

- Product innovations
- Process innovations
- Applications of knowledge in new arenas
- R&D investment
- Communication technologies

Porter’s 5 Forces Model

- Based on the IO Model
- Harvard 1980 and on
- Boston Consulting Group
- All U.S. MBA curricula
- Recruiters
- Common language
Porter’s 5 Forces Model

Threat of New Entrants
- Barriers to Entry
  - Economies of Scale
  - Product Differentiation
  - Capital Requirements
  - Switching Costs
  - Access to Distribution Channels
  - Government Policy
- Expected Retaliation
- Entry Deterring Price

Bargaining Power of Suppliers
- Dominated by a few large companies; more concentrated than buyer industry
- Substitute products unavailable
- Buyers not significant customers
- High switching costs
- Credible threat of forward integration
Porter’s 5 Forces Model
Bargaining Power of Buyers
- Purchase a large portion of industry’s total output
- Product accounts for a large portion of the buyers’ costs
- Low or no switching costs
- Products undifferentiated or standardized
- Credible threat of backward integration

Porter’s 5 Forces Model
Threat of Substitute Products
- Subject to trends improving price-performance tradeoff
- Produced by an industry earning high profits

Porter’s 5 Forces Model
Intensity of Rivalry
- Numerous or balanced competitors
- Slow industry growth
- High fixed or storage costs
- Products undifferentiated or standardized
Competition Continuum

- Pure Monopoly
- Avoided Competition
- Hyper-competition
- Perfect Competition

Factors Affecting Rivalry

- The Industry's Structure
- The Possibility for Implicit Collusion
- The Sustainability of Competitive Advantage
- The Stability of the Environment
- The Strategies Pursued

- Tendency Toward Avoided Competition
- The Emphasis Observed in Any Particular Market
- Tendency Toward Hypercompetition

Competition and Industry Life Cycle

- Fragmented → Consolidated
- Growth Industries
- Mature Industries
- Emerging Industries
Strategic Groups

- Groups of firms in an industry following the same or similar strategies
- Analytical tool
- Strategic dimensions important

High Price
- Cadillac
- Buick
- Oldsmobile
- Lincoln
- Maserati
- Porsche
- Toyota
- Chevrolet
- Nissan
- Pontiac

Low Price
- Toyota
- Chevrolet
- Dodge
- Nissan
- Pontiac

Price Image
- Family-Oriented
- Conservative
- Sporty-Oriented
- Expressive

Strategic Groups

Merrill Lynch
Smith Barney
Paine Webber
Bear Stearns
Goldman Sachs
Salomon Bros.

Charles Schwab
Quick & Reilly
A.G. Edwards

Price
Service
Scenario Analysis

- Dealing with uncertainty
- Planning tool
- Creating internally consistent views of what the future may bring

Scenario Analysis: Process

• Identify Uncertainties
• Determine causal factors
• Make range of plausible assumptions
• Combine assumptions into scenarios
• Analyze industry behavior under each scenario
• Determine strengths/weaknesses under each scenario
• Predict competitor behavior

Scenario Analysis

Chain Saw Industry Example
Chain Saw Industry
Scenario Analysis

Context

- Domestic Chainsaw Industry
- 1970s

TABLE 13-1  Evolutionary Forces
Driving Industry Structural Change

- Long-run changes in growth
- Changes in buyer segments served
- Buyer learning
- Reduction of uncertainty
- Diffusion of proprietary knowledge
- Accumulation of experience
- Expansion (or contraction) in scale
- Changes in input and currency costs
- Product innovation
- Marketing innovation
- Process innovation
- Structural change in adjacent industries
- Government policy changes
- Entries and exits

TABLE 13-2  Uncertain Elements of Structure in the U.S. Chain Saw Industry

- New Entrants
- Buyer Power
- Rivalry
- Substitute Products
- Supplier Power
Uncertain Elements of Structure

U.S. Chainsaw Industry

New Entrants/Entry Barriers

• Will there be new proprietary product designs?
• How high will future scale economies be in manufacturing? In marketing?
• How difficult will gaining access to each channel be?
• What safety regulations will be enacted?

Buyer Power

• What will casual user demand be?
• What will professional/farm demand be?
• What will be the mix of dealer versus nondealer sales?
• How significant will private labeling be outside of the servicing dealer channel?
• Will distribution be direct or through distributors?
• How price sensitive will buyers be?

Rivalry

• What will be the shape of the casual user penetration curve?
• How will traditional competitors behave?
• How will newly acquired competitors behave?
• Will additional foreign firms be attracted to the U.S. Industry?
• How high will fixed costs be?
• How committed is each competitor to chain saws?
Scenario Variables in Chainsaws

Table 13-3

- Most Important Scenario Variables
  - Level of casual user demand
  - Shape of casual user penetration curve
  - Mix of dealer versus non-dealer sales
  - Extent of private label versus branded sales through nondealers

- Less Important Scenario Variables
  - Professional and farm demand
  - Penetration of electric saws

Causal Factors Determining Uncertainties in Chainsaws

Table 13-4

- Level of casual user demand
- Shape of the casual user penetration curve
- Mix of dealer versus non-dealer sales
- Extent of private label versus branded sales through non-dealers

Determinants of Future Industry Structure
### Range of Assumptions

**Table 13-5**

<table>
<thead>
<tr>
<th>Scenario Variables</th>
<th>Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level of casual unit demand</td>
<td>Low</td>
</tr>
<tr>
<td>Shape of casual user penetration curve</td>
<td>Steady</td>
</tr>
<tr>
<td>Mix of dealer versus nondealer sales</td>
<td>Dealers dominate</td>
</tr>
<tr>
<td>Extent of private label versus branded sales through nondealers</td>
<td>High percent branded</td>
</tr>
</tbody>
</table>

### Consistency

**Eliminating Implausible Scenarios**

#### Casual User Demand

<table>
<thead>
<tr>
<th>Casual User Demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Steady Rise</td>
</tr>
<tr>
<td>Low Peaked</td>
</tr>
</tbody>
</table>

#### Casual User Demand/Penetration

<table>
<thead>
<tr>
<th>Channel Mix</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dealers Steady</td>
</tr>
<tr>
<td>Dealers Peaked</td>
</tr>
<tr>
<td>Non-Dealer Share</td>
</tr>
<tr>
<td>Short-term Shift to Non-dealers</td>
</tr>
</tbody>
</table>
TABLE 13-6      Analysis of Chain Saw Scenarios

<table>
<thead>
<tr>
<th>Scenario 1</th>
<th>Scenario 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Casual User Market Never Materializes&quot;</td>
<td>&quot;Private Label Dominates&quot;</td>
</tr>
<tr>
<td>Future Industry Structure</td>
<td>Same as currently</td>
</tr>
<tr>
<td>Structural Attractiveness</td>
<td>High</td>
</tr>
<tr>
<td>Sources of Competitive Advantage</td>
<td>Basically unchanged</td>
</tr>
<tr>
<td>Entry barriers shift toward scale economies and absolute cost advantages</td>
<td>Market share of casual units</td>
</tr>
<tr>
<td>Channels increase in power and price sensitivity</td>
<td>Low-cost product designs</td>
</tr>
<tr>
<td>Rivalry pressures increase</td>
<td>Scale economies in advertising</td>
</tr>
<tr>
<td>Electric saws become a major product line</td>
<td>Automated plants in low-labor cost areas</td>
</tr>
<tr>
<td>Mediocre on average, though a leader can be profitable</td>
<td>Strength in professional/farm segment to insulate a firm from the battle in the casual user segment</td>
</tr>
<tr>
<td>Basically unchanged</td>
<td>Basically unchanged</td>
</tr>
</tbody>
</table>

Competitor Behavior

Scenario 1
"Casual Market Never Materializes"

- Will McCulloch and Beaird-Poulan react correctly?
- Maintain Current Strategies
- Invest in the casual user market anyway

Scenario 7
"Private Label Dominates"

- How will Homelite behave?
- Homelite seeks leadership in all casual user segments
- Homelite retreats to traditional segments
### Scenario 9: “Casual User Saws Are a Fad”

- **Future Industry Structure**: Entry barriers shift but not to the extent of Scenario 7. Buyer power varies over time as the mix of channel shifts. Rivalry becomes vicious after the growth spurt is over. 
  
- **Structural Attractiveness**: Moderate in the long term. 
  
- **Sources of Competitive Advantage**: 
  - Capacity to reap short-term profits on casual saws. 
  - Brand awareness with professional users. 
  - Low cost position to cope with rivalry. 
  - Maintaining dealer loyalty. 
  - Avoiding excess capacity. 
  - Maintaining traditional strengths. 
  
- **Competitor Behavior**: 
  - How aggressively will McCulloch and Beaird-Poulan invest? 
  - Aggressive vs. Cautious. 

### Figure 13.7. Analysis of an Intermediate Chain Saw Industry Scenario

<table>
<thead>
<tr>
<th>Industry Scenario and Competitive Strategy under Uncertainty</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scenario 9</strong></td>
</tr>
<tr>
<td><strong>Casual User Saws Are a Fad</strong></td>
</tr>
<tr>
<td>Future Industry Structure</td>
</tr>
<tr>
<td>Structural Attractiveness</td>
</tr>
<tr>
<td>Competitor Behavior</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

### Strategy Matrix

<table>
<thead>
<tr>
<th><strong>Scenario 1</strong></th>
<th><strong>Scenario 7</strong></th>
<th><strong>Scenario 9</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Casual User Market Never Materializes</em></td>
<td><em>Private Label Dominates</em></td>
<td><em>Casual Users Saws Are a Fad</em></td>
</tr>
<tr>
<td><strong>OPTIMAL STRATEGY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Strategies TOTALLY INCONSISTENT for Leaders</strong></td>
<td>Aggressively seek cost leadership. Early entry into new channels. Emphasize direct sales. Force focus strategies or disinvest.</td>
<td>Do not overreact to the casual segment. Avoid alienating dealers or eroding reputation/franchise with professional users. Pick up dealers alienated by competitors.</td>
</tr>
<tr>
<td><strong>Strategies LARGELY INCONSISTENT</strong></td>
<td>First mover advantages. Make timing important.</td>
<td>Reduce costs to defend against price competition by firms who invested in the casual segment.</td>
</tr>
</tbody>
</table>