

# Business Strategy

## Chapter 2

### The External Environment: Opportunities, Threats, Industry Competition, and Competitor Analysis

H. Volberda, R. Morgan, P. Reinmoller, R. Ireland, R. Hoskisson,  
Strategic Management. Competitiveness and Globalization. Concepts and Cases,  
Cengage Learning, 2011

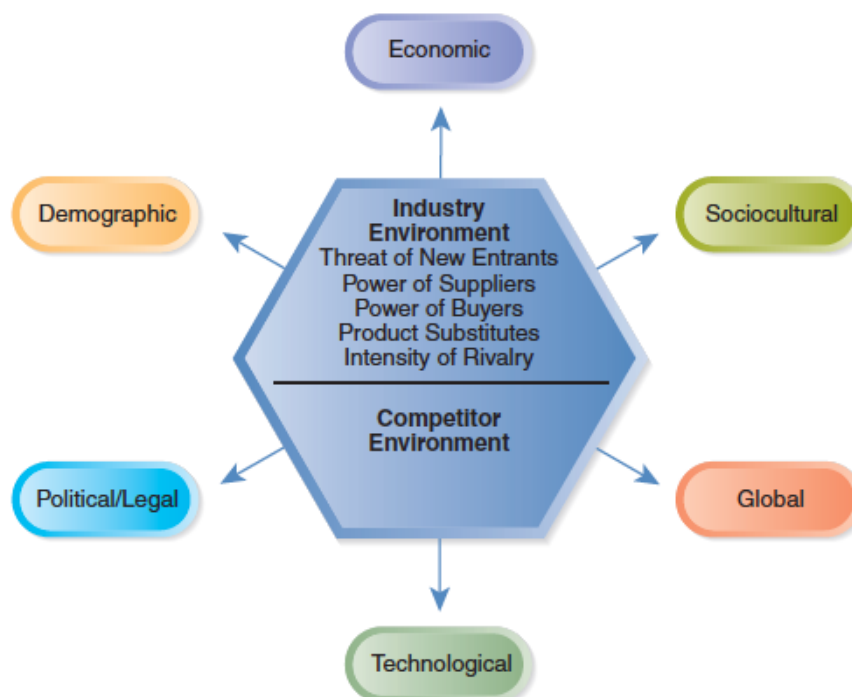
## KNOWLEDGE OBJECTIVES

- Explain the importance of firm's **external** environment
- Describe the general **environment** and the **industry environment**.
- Describe the general environment's six segments.
- Define the five competitive forces
- Define **strategic groups**
- Methods for competitors

# The External Environment

- The **general environment** is composed of dimensions in the broader society that influence an industry and the firms within it. Firms cannot directly control the general environment's segments and elements.
- The **industry environment** is the set of factors that directly influences a firm and its competitive actions and competitive responses. The challenge is to locate a position within an industry where a firm can favorably influence those factors or where it can successfully defend against their influence.
- The **competitor environment** relates to the specific competitors and gathering and interpreting information about competitors is called competitor analysis.

# The External Environment



**FIGURE 2.1** The External Environment

# External Environmental Analysis

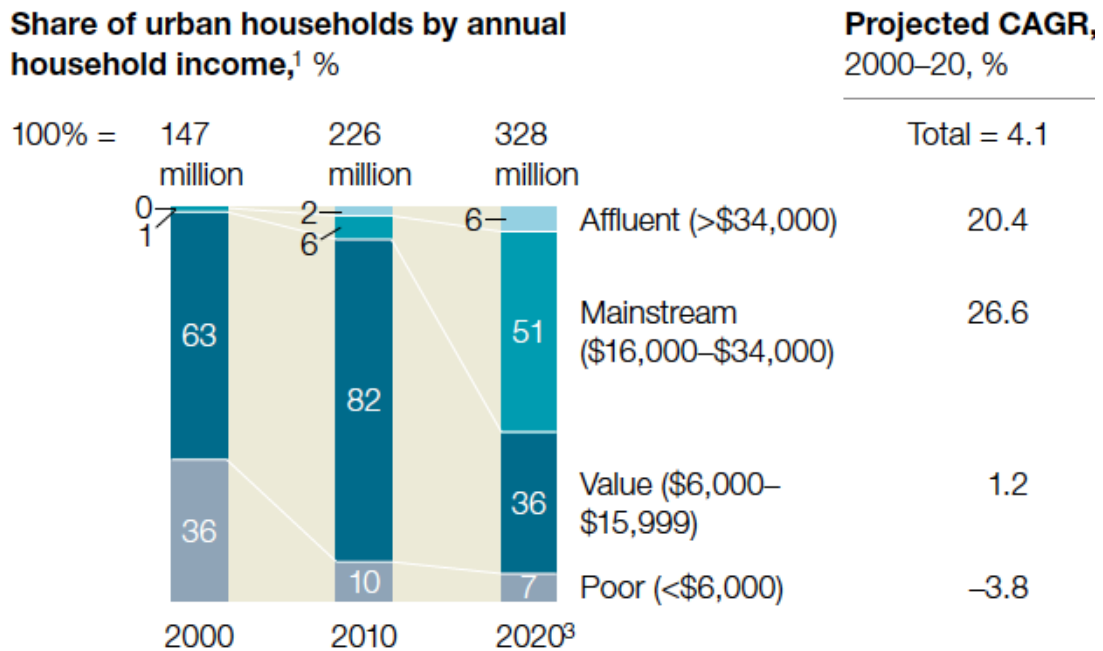
- Most firms face highly turbulent/complex external environments. To increase their understanding of the general environment, firms engage in a process of **external environmental analysis**.
- An **opportunity** is a condition in the general environment that, if exploited, helps a company achieve strategic competitiveness.
- A **threat** is a condition in the general environment that may hinder a company's efforts to achieve strategic competitiveness.

## External Environmental Analysis Activities

Scanning	Identifying early signals of environmental changes and trends
Monitoring	Detecting meaning through ongoing observations of environmental changes and trends
Forecasting	Developing projections of anticipated outcomes based on monitored changes and trends
Assessing	Determining the timing and importance of environmental changes and trends for firms' strategies and their management

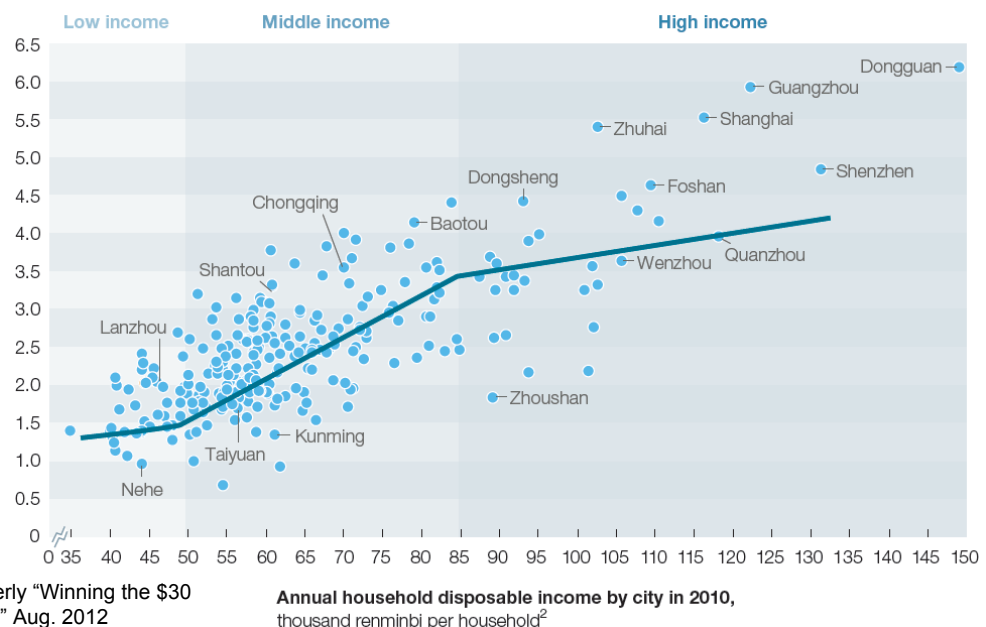
# Scanning the emerging markets

- Income distribution in China is changing rapidly



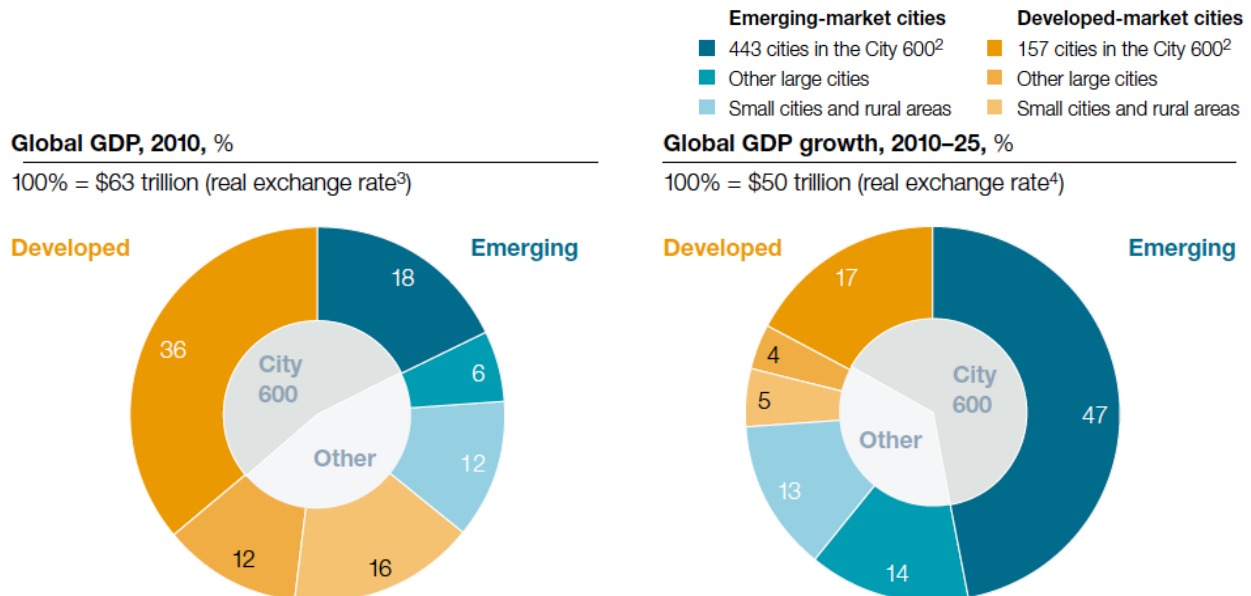
# Monitoring the emerging markets

- In emerging market demand for household appliance follow an S-shapes curve based on income



# Forecasting the emerging markets

- 443 emerging-market cities are expected to deliver almost 50% of the global GDP growth



Source: McKinsey Quarterly "Winning the \$30 trillion decathlon" Aug. 2012

# Assessing "western" companies' position in the emerging markets

- Leading companies in the developed world earn just 17% of total revenues from emerging markets, even though these markets represent 36% of global GDP

Markets' contribution to global GDP vs leading global companies' share of total revenues<sup>1</sup> from given markets, 2010, %

	Developed markets	Emerging markets
Share of global GDP	64	36
Share of revenues	83	17

Source: McKinsey Quarterly "Winning the \$30 trillion decathlon" Aug. 2012



## Segments of the General Environment

- The **demographic segment** is concerned with a population's size, age structure, geographic distribution, ethnic mix, and income distribution.
- The **economic environment** refers to the nature and direction of the economy in which a firm competes or may compete.
- The **political/legal segment** is the arena in which organizations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding the interactions among nations.



## Segments of the General Environment

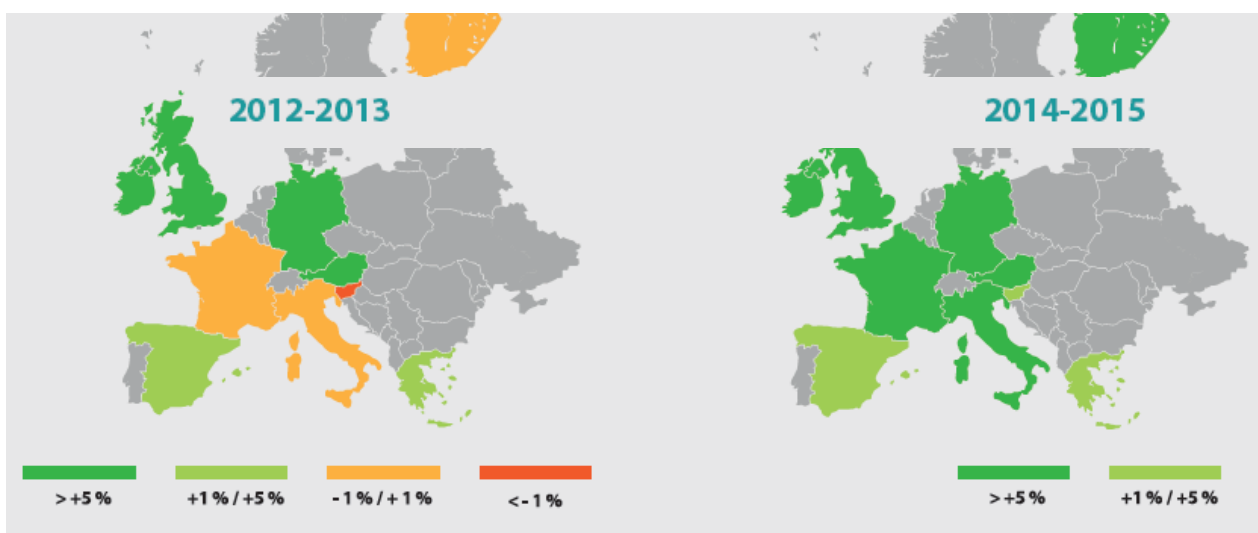
- The **sociocultural segment** is concerned with a society's attitudes and cultural values.
- The **technological segment** includes the institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes, and materials.
- The **global segment** includes relevant new global markets, existing markets that are changing, important international political events, and critical cultural and institutional characteristics of global markets.

# Segments of the General Environment

Demographic Segment	<ul style="list-style-type: none"> <li>Population size</li> <li>Age structure</li> <li>Geographic distribution</li> </ul>	<ul style="list-style-type: none"> <li>Ethnic mix</li> <li>Income distribution</li> </ul>
Economic Segment	<ul style="list-style-type: none"> <li>Inflation rates</li> <li>Interest rates</li> <li>Trade deficits or surpluses</li> <li>Budget deficits or surpluses</li> </ul>	<ul style="list-style-type: none"> <li>Personal savings rate</li> <li>Business savings rates</li> <li>Gross domestic product</li> </ul>
Political/Legal Segment	<ul style="list-style-type: none"> <li>Antitrust laws</li> <li>Taxation laws</li> <li>Deregulation philosophies</li> </ul>	<ul style="list-style-type: none"> <li>Labor training laws</li> <li>Educational philosophies and policies</li> </ul>
Sociocultural Segment	<ul style="list-style-type: none"> <li>Women in the workforce</li> <li>Workforce diversity</li> <li>Attitudes about the quality of work life</li> </ul>	<ul style="list-style-type: none"> <li>Concerns about the environment</li> <li>Shifts in work and career preferences</li> <li>Shifts in preferences regarding product and service characteristics</li> </ul>
Technological Segment	<ul style="list-style-type: none"> <li>Product innovations</li> <li>Applications of knowledge</li> </ul>	<ul style="list-style-type: none"> <li>Focus of private and government-supported R&amp;D expenditures</li> <li>New communication technologies</li> </ul>
Global Segment	<ul style="list-style-type: none"> <li>Important political events</li> <li>Critical global markets</li> </ul>	<ul style="list-style-type: none"> <li>Newly industrialized countries</li> <li>Different cultural and institutional attributes</li> </ul>

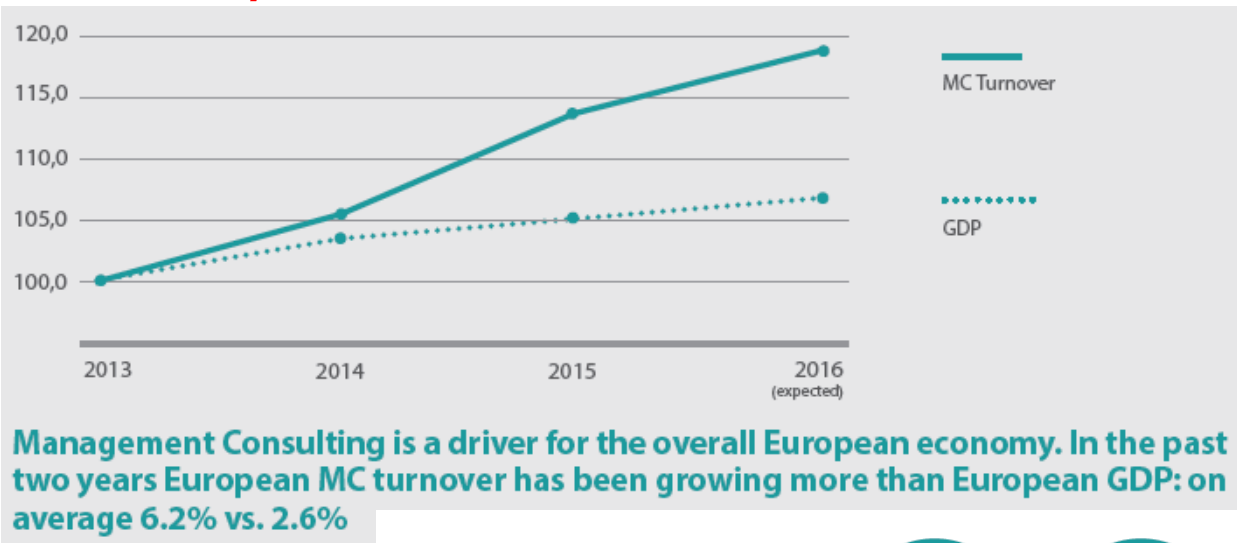
## Assessing the Management Consulting industry

- Management Consulting industry in Europe fully recovered from the crisis (MC turnover trend)



Source: Tor Vergata-FEACO "Management Consulting in Europe" February 2017

# Assessing the Management Consulting industry (benchmark to the overall economy)



Source: Tor Vergata-FEACO  
"Management Consulting in Europe"  
February 2017

The Management Consulting industry is also expected to achieve positive trends in 2016.



## Industry Environment Analysis

- An **industry** is a group of firms producing products that are close substitutes.

The Five Forces That Shape Industry Competition



**FIGURE 2.2** The Five Forces of Competition Model

Source: Porter, The five forces that shape the industry, HBR, 2008

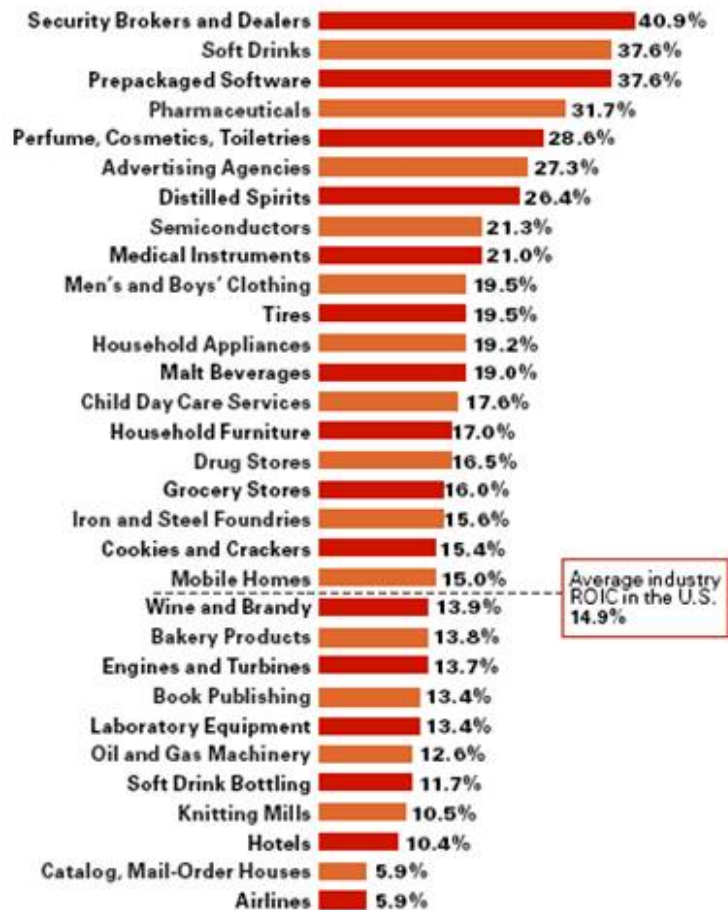


# Industry profitability

Return on Invested Capital (ROIC) is the appropriate measure for strategy formulation.

The average ROIC varies markedly from industry to industry (Porter, 2008)

Source: Porter, The five forces that shape the industry, HBR, 2008



## Threat of New Entrants

- New entrants pose such a threat is that they bring additional production capacity.
- **Barriers to Entry**
  - Economies of Scale
  - Access to Distribution Channels.
  - Product Differentiation
  - Capital Requirements
  - Switching Costs
  - Disadvantages Independent of Scale
  - Government Policy
- **Expected Retaliation**

## Bargaining Power of Suppliers

- Increasing prices and reducing the quality of their products are potential means used by suppliers to exert power over firms competing within an industry.
- A supplier group is powerful when
  - There are few suppliers.
  - No satisfactory substitute products.
  - The company is not the main customer.
  - Suppliers' goods are critical to buyers' marketplace success.
  - There are high switching costs.
  - It poses a credible threat to integrate forward into the buyers' industry. Credibility is enhanced when suppliers have substantial resources and provide a highly differentiated product.

## Bargaining Power of Buyers

- Buyers bargain for higher quality, greater levels of service, and lower prices.
- Customers (buyer groups) are powerful when
  - They purchase a large portion of an industry's total output.
  - The sales of the product being purchased account for a significant portion of the seller's annual revenues.
  - They could switch to another product at little, if any, cost.
  - The industry's products are undifferentiated or standardized, and the buyers pose a credible threat if they were to integrate backward into the sellers' industry.

## Threat of Substitute Products

- Substitute products are goods or services from outside a given industry that perform similar or the same functions as a product that the industry produces.
- Product substitutes present a strong threat to a firm when customers face few, if any, switching costs and when the substitute product's price is lower or its quality and performance capabilities are equal to or greater than those of the competing product.

## Intensity of Rivalry among Competitors

- Competitive rivalry intensifies when a firm is challenged by a competitor's actions or when a company recognizes an opportunity to improve its market position.
- The most prominent factors that experience shows to affect the intensity of firms' rivalries:
  - Numerous or Equally Balanced Competitors
  - Lack of Differentiation or Low Switching Costs
  - Slow Industry Growth
  - High Strategic Stakes
  - High Fixed Costs or High Storage Costs
  - High Exit Barriers

# Strategic Groups

- A strategic group is a set of firms emphasizing similar strategic dimensions to use a similar strategy.
- The strategic groups can be useful for analyzing an industry's competitive, and diagnosing competition, positioning, and the profitability of firms within an industry.
- The strengths of the five industry forces differ across strategic groups.
- The closer the strategic groups are in terms of their strategies, the greater is the likelihood of rivalry between the groups.

## Changes in industry structure

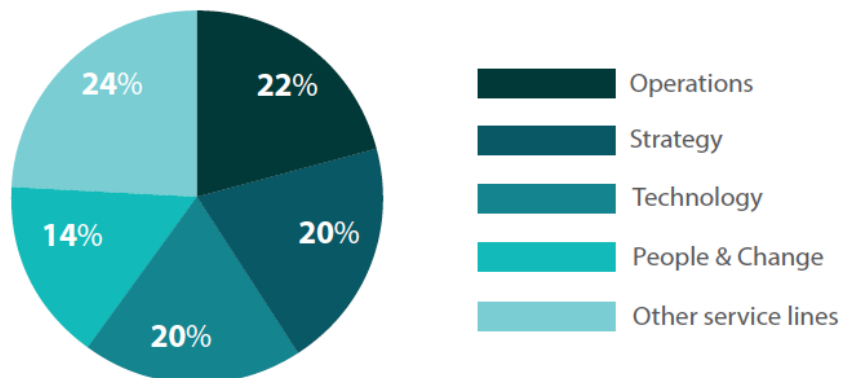
- Industry structure might change – even drastically – over time:
  - Shifting threat of new entry
  - Changing supplier or buyer power
  - Shifting threat of substitution
  - New basis of rivalry
- The company should take strategic actions with respect to these changes:
  - Repositioning the company
  - Exploiting industry change
  - Shaping the industry structure

# Disruption in the Consulting industry

**At traditional strategy-consulting firms, the share of work that is classic strategy is now about 20%—down from 60% to 70% some 30 years ago.**

Source: Christensen et al., Consulting on the cusp of disruption, Harvard Business Review, Oct. 2013

European MC turnover by Service Lines (2015)

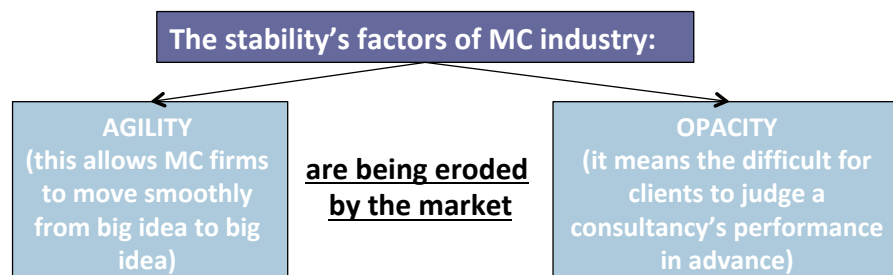


Source: Tor Vergata-FEACO  
"Management Consulting in Europe"  
February 2017

# Disruption in the Consulting industry

MC's fundamental **business model** has not changed in more 100 years. It has always involved sending smart outsiders into organizations for a finite period of time and asking them to recommend solutions for the most difficult problems confronting their clients.

Now, the **same forces** that disrupted so many businesses are starting to reshape the world of consulting. Early signs of this pattern in consulting industry include *increasingly sophisticated competitors* with **nontraditional business models** that are gaining acceptance. However, we are still early in the story of consulting's disruption.



Source: Christensen et al., Consulting on the cusp of disruption, Harvard Business Review, Oct. 2013

# Disruption in the Consulting industry

## THE CHALLENGE

The same forces that disrupted industries such as steel and publishing are starting to re-shape the consulting industry, with profound implications for its future.

## THE ANALYSIS

Established firms have traditionally relied on opacity and agility to maintain their industry leadership, but those two advantages are disappearing in the increasingly transparent and sophisticated business environment.

## THE FUTURE

Now those firms are starting to rethink their own service models and even to experiment with new models that could prove disruptive to the core business.

**1.**

Are you formally tracking the evolution of your clients' needs and how well you continue to serve them? Has it recently become harder to win clients and to satisfy them? Are you losing your small clients or your large ones?

**2.**

Are you being forced downstream in the proposal process with established clients, responding to rather than shaping requirements? Are clients having their procurement departments vet your proposals or monitor your progress?

**3.**

Are you competing against new rivals for business, even with established clients? Are these rivals increasingly specialized?

**4.**

Are your clients asking that you partner with nontraditional advisers or use their work products? Are these advisers leveraging automation, databases, and other technical assets?

**5.**

Are you revising your business model in order to manage smaller projects at acceptable profit? Is this activity looked down on in your firm?

Source: Christensen et al., Consulting on the cusp of disruption, Harvard Business Review, Oct. 2013

## Disruption in the Consulting industry: alternative business models

### SOLUTION SHOP

- Structured to diagnose and solve problems whose scope is undefined
- Delivers value primarily through consultants' judgment rather than through repeatable processes
- Customers pay high prices in the form of fee-for-service

#### EXAMPLES

McKinsey, Bain, BCG, IDEO

### VALUE-ADDED PROCESS BUSINESS

- Structured to address problems of defined scope with standard processes
- Processes are usually repeatable and controllable
- Customers pay for output only

#### EXAMPLES

Motista, Salesforce.com, McKinsey Solutions

Accenture, Deloitte (both moving toward solution shop)

### FACILITATED NETWORK

- Structured to enable the exchange of products and services
- Customers pay fees to the network, which in turn pays the service provider

#### EXAMPLES

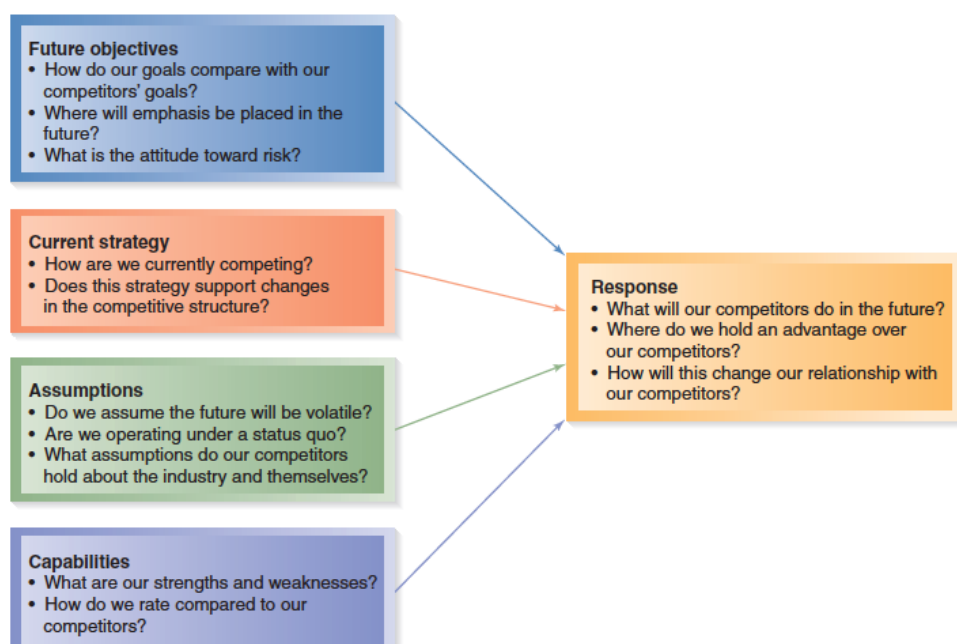
OpenIDEO, CEB, Gerson Lehrman Group, Eden McCallum, BTG

Source: Christensen et al., Consulting on the cusp of disruption, Harvard Business Review, Oct. 2013

# Competitor Analysis

- Competitor intelligence is the set of data and information the firm gathers to better understand and better anticipate competitors' objectives, strategies, assumptions, and capabilities.

## Competitor Analysis



**FIGURE 2.3** Competitor Analysis Components