Strategic Management Concepts Competitiveness and Globalization 12th edition Hitt Solutions Manual

SKU: 9781305502208-SOLUTIONS

Chapter 2
The External Environment: Opportunities, Threats, Industry Competition, and Competitor Analysis

LEARNING OBJECTIVES

1. Explain the importance of analyzing and understanding the firm's external environment.
2. Define and describe the general environment and the industry environment.
3. Discuss the four parts of the external environmental analysis process.
4. Name and describe the general environment's seven segments.
5. Identify the five competitive forces and explain how they determine an industry's profit potential.
6. Define strategic groups and describe their influence on firms.
7. Describe what firms need to know about their competitors and different methods (including ethical standards) used to collect intelligence about them.

CHAPTER OUTLINE

Opening Case: Are There Cracks in the Golden Arches?
THE GENERAL, INDUSTRY, AND COMPETITOR ENVIRONMENTS
EXTERNAL ENVIRONMENTAL ANALYSIS
- Scanning
- Monitoring
- Forecasting
- Assessing

SEGMENTS OF THE GENERAL ENVIRONMENT
- The Demographic Segment
- The Economic Segment
- The Political/Legal Segment
- The Sociocultural Segment
- The Technological Segment
- The Global Segment

Strategic Focus: Target has lost its Sway Because Tar-zhey No Longer Drew the Customers
- The Physical Environment Segment

INDUSTRY ENVIRONMENT ANALYSIS
- Threat of New Entrants
- Bargaining Power of Suppliers
- Bargaining Power of Buyers

LECTURE NOTES

Chapter Introduction: This chapter can be introduced with a general statement regarding the importance of understanding what is happening outside of the firm itself and how what is happening can affect the firm's ability to achieve strategic competitiveness and earn above-average returns. This importance is illustrated by the *Opening Case*, which discusses the impact events in the external environment can have on a firm's performance.

OPENING CASE
Are There Cracks in the Golden Arches?

The opening case illustrates how McDonald's can use information from the general environment to develop plans for the future and how sociocultural factors affect their decision making. Over the years, McDonald's was a leader not only in market share but also with the introduction of new menu items to the fast food market. Recently, McDonald's problems have revolved around increased competition and changing consumer tastes.

Teaching Note
The opening case lays out how McDonald's uses information from the general environment to make strategic decisions. The case provides a vehicle for discussing how the environment affects both corporate-level strategy and business-level strategy. As an opening discussion question, ask students to identify and discuss examples of how McDonald's might base its strategies on information from the general environment that is NOT included in the text. Ask students how changing attitudes about food have affected McDonald's sales and how they are responding.

1 Explain the importance of analyzing and understanding the firm's external environment.

Teaching Note
Given that the external environment will continue to change - and that change may be unpredictable in terms of timing and strength - a firm's management is challenged to be aware of, understand the implications of, and identify patterns represented in these changes by taking actions to improve the firm's competitive position, to improve operational efficiency, and to be effective global competitors.

External environmental factors - like war and political unrest, variations in the strength of national economies, and new technologies - affect firm growth and profitability in the US and beyond.

Environmental conditions in the current global economy differ from those previously faced by firms:

- Technological advances require more timely and effective competitive actions and responses.
- Rapid sociological changes abroad affect labor practices and product demand of diverse consumers.
- Governmental policies and laws affect where and how firms may choose to compete.
- Changes to nations' financial regulatory systems.

Understanding the external environment helps build the firm's base of knowledge and information that can be used to: (1) help build new capabilities and core competencies, (2) buffer the firm from negative environmental impacts, and (3) pursue opportunities to better serve stakeholders' needs.

Teaching Note
This section introduces definitions, *Figure 2.1* (which deals with the external environment), and the competitor/industry environment. Because of the chapter layout, it is best to delay a detailed presentation or discussion of the general environment until after discussing the external environmental analysis process because the characteristics of the general environment are presented in more detail later in the chapter.

2 Define and describe the general environment and the industry environment.

Teaching Note
The firm's understanding of the external environment is matched with knowledge about its internal environment (discussed in Chapter 3) to form its vision, to develop its mission, and to take strategic actions that result in strategic competitiveness and above-average returns. This is an important point to make.

THE GENERAL, INDUSTRY, AND COMPETITOR ENVIRONMENTS

FIGURE 2.1
The External Environment

Figure 2.1 illustrates the three components of a firm's external environment and the elements or factors that are part of each component. They are:

1. The general environment

- Demographic
- Economic
- Political/Legal
- Technological
- Sociocultural
- Global
- Physical

2. The industry environment

- Threat of New Entrants
- Intensity of Rivalry
- Power of Buyers
- Product Substitutes
- Power of Suppliers

3. The competitor environment

(***Note:*** These components of the external environment and their elements or factors and how they are related to each and to firm performance will be discussed in detail in later sections of the chapter.)

The ***general environment*** is composed of elements in the broader society that can indirectly influence an industry and the firms within the industry. But firms cannot directly control the general environment's segments and elements.

TABLE 2.1
The General Environment: Segments and Elements

Table 2.1 lists elements that characterize each of the seven segments of the general environment: demographic, economic, political/legal, sociocultural, technological, global, and physical. Each of these segments is discussed in more detail later in this chapter, following a discussion of the external environmental analysis process.

The ***industry environment*** is the set of factors - threat of new entrants, suppliers, buyers, product substitutes, and the intensity of rivalry among competitors - that directly influence a firm and its competitive decisions and responses.

Competitor analysis represents the firm's understanding of its current competitors. This understanding will complement information and insights derived from investigating the general and industry environments.

The following are important distinctions to make regarding different external analyses:
- Analysis of the general environment focuses on the future.
- Industry analysis focuses on factors and conditions influencing firm profitability within its industry.
- Competitor analysis focuses on predicting the dynamics of rivals' actions, responses, and intentions.

Performance improves when the firm integrates the insights provided by analyses of the general environment, the industry environment, and the competitor environment.

Teaching Note
It should be noted that, although firms cannot directly control the elements of the external environment, they may be able to influence, and will be influenced by, these factors.

The strategic challenge is to develop an understanding of the implications of these elements and factors for a firm's competitive position. Processes and frameworks for the analysis of the external environment are provided in this chapter.

Teaching Note
Global implications should be - and are - integrated into the discussion of the general environment whereas global issues related to a firm's industry environment are integrated throughout the text. Chapter 8 covers this topic in detail.

3	Discuss the four activities of the external environmental analysis process.

EXTERNAL ENVIRONMENTAL ANALYSIS

In addition to increasing a firm's awareness and understanding of an increasingly turbulent, complex, and global general environment, external environmental analysis also is necessary to enable the firm's managers to interpret information to identify opportunities and threats.

Opportunities represent conditions in the general environment that may help a company achieve strategic competitiveness by presenting it with possibilities, whereas ***threats*** are conditions that may hinder or constrain a company's efforts to achieve strategic competitiveness.

Information used to analyze the general environment can come from multiple sources: publications, observation, attendance at trade shows, or conversations with customers, suppliers, and employees of public-sector organizations. And this information can be formally gathered by individuals occupying traditional "boundary spanning" roles (such as a position in sales, purchasing, or public relations) or by assigning information-gathering responsibility to a special group or team.

> ***Teaching Note***
> According to a recent comment by an industry analyst from a national firm, the Internet is becoming an increasingly valuable source of data and information for analyzing the general environment. Showing students how to do this in class or via an assignment can be a very helpful exercise.

One strategy that firms can use to enhance their awareness of conditions in the external environment is to establish an analysis process involving scanning, monitoring, forecasting, and assessing (see Table 2.2).

TABLE 2.2
Parts of the External Environmental Analysis

Table 2.2 identifies the four parts of the external environmental analysis: scanning, monitoring, forecasting, and assessing.

Scanning

Scanning entails the study of all segments in the general environment. Firms use the scanning process to either detect early warning signals regarding potential changes or to detect changes that are already underway. In most cases, information and data being collected or observed are ambiguous, incomplete, and appear to be unconnected. Scanning is most important in highly volatile environments, and the scanning system should fit the organizational context (e.g., scanning systems designed for volatile environments are not suitable for firms competing in a stable environment).

Teaching Note

Scanning may signal a future change in the needs and lifestyles of baby boomers as they approach retirement age. This may not only provide opportunities for financial institutions as they prepare for an increase in the number of retirees, but also may provide opportunities for packagers and marketers of retirement communities and other products specifically targeted to this segment.

The Internet provides significant opportunities to obtain information. For example, Amazon.com records significant information about individuals visiting its website, particularly if a purchase is made. Amazon then welcomes the individual by name when he or she visits the website again. It even sends messages to the individual about specials and new products similar to that purchased in previous visits. Additionally, many websites and advertisers on the Internet obtain information surreptitiously from those who visit their sites via the use of "cookies."

Monitoring

Monitoring represents a process whereby analysts observe environmental changes over time to see if, in fact, an important trend begins to emerge. The critical issue in monitoring is that analysts be able to detect meaning from the data and information collected during the scanning process. (Remind students that these data are generally ambiguous, incomplete, and unconnected.)

Effective monitoring requires the firm to identify important stakeholders. Because the importance of different stakeholders can vary over a firm's life cycle, careful attention must be given to the firm's needs and its stakeholder groups over time. Scanning and monitoring can also provide information about successfully commercializing new technologies.

Forecasting

The next step is for analysts to take the information and data gathered during the scanning and monitoring phases and attempt to project forward. ***Forecasting*** represents the process where analysts develop feasible projections of what might happen - and how quickly - as a result of the changes and trends detected through scanning and monitoring. Because of uncertainty, forecasting events and outcomes accurately is a challenging task.

Assessing

Assessing represents the step in the external analysis process where all of the other steps come together. The objective of ***assessing*** is to determine the timing and significance of the effects of changes and trends in the environment on the strategic management of a firm. Getting the strategy right will depend on the accuracy of the assessment.

> ***Teaching Note***
> It is good to alert students to the fact that a major challenge for managers and firms engaging in the process of external analysis is to recognize biases and assumptions that may affect the analysis process. This is important because these may limit the accuracy of forecasts and assessments. For example, managers may choose to disregard certain information, thus missing critical indicators of future environmental changes. Or, past experiences may prejudice the ways that opportunities or threats are perceived - if they are perceived at all. One solution might be to solicit multiple inputs so a single source is not able to manipulate the information and to seek frequent feedback regarding the accuracy or usefulness of forecasts and assessments.

4 Name and describe the general environment's seven segments.

SEGMENTS OF THE GENERAL ENVIRONMENT

As outlined in *Table 2.1*, the general environment consists of seven segments: demographic, economic, political/legal, sociocultural, global, technological, and the physical environment. The challenge is to scan, monitor, forecast, and assess all six segments of the general environment, focusing the primary effort on those elements in each segment of the general environment that have the greatest potential impact on the firm.

External analysis efforts should focus on segments most important to the firm's strategic competitiveness to identify environmental changes, trends, opportunities, and threats that can be matched with the firm's core competencies so that it can achieve strategic competitiveness and earn above-average returns.

The Demographic Segment

The demographic segment is concerned with a population's size, age structure, geographic distribution, ethnic mix, and distribution of income.

Teaching Note
Though each of the elements of this segment are discussed below, you might note that the challenge for analysts (and managers) is to determine what the changes that have been identified in the demographic characteristics or elements of a population imply for the future strategic competitiveness of the firm.

Population Size

Though population size itself may be important to firms that require a "critical mass" of potential customers, changes in the specific make-up of a population's size may have even more critical implications. One of the most important changes in a population's size is changes in a nation's birth rate and/or family size, as well as demographic changes in the population of developed versus developing countries.

Age Structure

Changes in a nation's birth rate or life expectancy can have important implications for firms. Are people living longer? What is the life expectancy of infants? These will impact the health care system (and firms serving that segment) and the development of products and services targeted to an older (or younger) population.

Geographic Distribution

Population shifts - as have occurred in the US - from one region of a nation to another or from metropolitan to non-metropolitan areas may have an impact on a firm's strategic competitiveness. Issues that should be considered include:

- The attractiveness of a firm's location may be influenced by governmental support, and a shrinking population may imply a shrinking tax base and a lesser availability of official financial support.
- Firms may have to consider relocation if tax demands require it.
- Advances in communications technology will have a profound effect on geographic distribution and the workforce.

Ethnic Mix

This reflects the changes in the ethnic make-up of a population and has implications both for a firm's potential customers and for the workforce. Issues that should be addressed include:

- Will new products and services be demanded or can existing ones be modified?
- How will changes in the ethnicity of a population affect the composition of the workforce?
- Are managers prepared to manage a more culturally diverse workforce?

- How can the firm position itself to take advantage of increased workforce heterogeneity?

Income Distribution

Changes in income distribution are important because changes in the levels of individual and group purchasing power and discretionary income often result in changes in spending (consumption) and savings patterns. Tracking, forecasting, and assessing changes in income patterns may identify new opportunities for firms.

The Economic Segment

The ***economic segment*** of the general environment refers to the nature and direction of the economy in which a firm competes or may compete. Analysts must scan, monitor, forecast, and assess a number of key economic indicators or elements for both domestic and key international markets, including levels and trends of:

- Inflation rates and interest rates
- Trade deficits and surpluses
- Budget deficits and surpluses
- Personal savings rates
- Business savings rates
- Gross domestic product
- Currency valuation
- Unemployment rates
- Energy and commodity prices

In addition, the implications of changes and trends in the economic segment may affect the political/legal segment both domestically and in other global markets. This may be of critical importance as nations eliminate or reduce trade barriers and integrate their economies.

The Political/Legal Segment

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 as well as between firms and various local governmental agencies. In other words, this segment is concerned with how interest groups and organizations attempt to influence representatives of governments (and governmental agencies) and how they, in turn, are influenced by them. This segment is also concerned with the outcomes of legal proceedings in which the courts interpret the various laws and regulations.

Because of the influence that this segment can have on the nature of competition as well as on the overall profitability of industries and individual firms, analysts must assess changes and trends in administration philosophies regarding:

- Anti-trust regulations and enforcement
- Tax laws
- Industry deregulation
- Labor training laws
- Commitments to education
- Free trade versus protectionism

> ***Teaching Note***
> It would be good to comment (using examples from the text or examples that may be even more current) on strategies followed by firms as they attempt to manage or influence the political/legal segment.
> - How can firms in the electric utility industry manage the costs of deregulation, including write-offs of inefficient plants? Who will pay these costs? Consumers? Governmental units? Stockholders? Bondholders?
> - How can individual firms and industries manage the effects of free trade that will lower entry barriers for new, lower-cost competitors? How might firms position themselves to take advantage of emerging, free-market economies?
> - What is likely to be the competitive impact of loosening governmental controls in the entertainment industry? In the telecommunications industry? What strategies can firms use to manage or influence deregulation to their advantage?

The Sociocultural Segment

The ***sociocultural segment*** is concerned with different societies' social attitudes and cultural values. This segment is important because the attitudes and values of society influence and thus are reflected in changes in a society's economic, demographic, political/legal, and technological segments.

Analysts are especially cautioned to pay attention to sociocultural changes and effects that they may have on:

- Workforce composition, and the implications for managing, resulting from an increase in the number of women, and increased ethnic and cultural diversity
- Changes in attitudes about the growing number of contingency workers
- Shifts in population toward suburban life, and resulting transportation issues
- Shifts in work and career preferences, including a trend to work from home made possible by technology advances

The Technological Segment

As noted in many of the other segments of the general environment, and as discussed in Chapter 1 as a key driver of the new competitive landscape, technological changes can have broad effects on society. The ***technological segment*** includes institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes, and materials.

Firms should pay careful attention to the technological segment, since early adopters can gain market share and above-average returns.

Important technology-related issues that might affect a broad variety of firms include:
- Increasing plant automation
- Internet technologies and their application to commerce and data gathering
- Uses of wireless technology

The Global Segment

Among the global factors that should be assessed are:
- The potential impact of significant international events such as peace in the Middle East or the recent entry of China into the WTO
- The identification of both important emerging global markets and global markets that are changing
- The trend toward increasing global outsourcing
- The differences between cultural and institutional attributes of individual global markets (the focus in Korea on *inhwa*, or harmony, based on respect for hierarchical relationships and obedience to authority; the focus in China on *guanxi*, or personal relationships; the focus in Japan on *wa*, or group harmony/social cohesion)
- Global market expansion opportunities
- The opportunities to learn from doing business in other countries
- Expanding access to the resources firms need for success (e.g., capital)

Teaching Note
Globalfocusing is a cautious approach to globalization in which firms with a moderate level of international operations increase their internationalization by focusing on global niche markets (and/or limiting operations/sales to one geographical region of the world). This approach allows firms to build on and use their core competencies while limiting their risks within the niche market.

STRATEGIC FOCUS
Target has lost Its Sway Because Tar-zhey No Longer Drew the Customers

Target became known by consumers as Tar-zhey, the retailer of cheaper but 'chic' products. The firm offered a step up in quality goods at a slightly higher price than discount retailers such as Walmart, but was 'targeted below major first line retailers such Macys and Nordstrom's. But, the company took its eye off the target and began losing market share (along with other poor strategic actions).

> ***Teaching Note***
> The Strategic Focus introduces students to the concept of the general environment and how companies need to be aware of their position in the industry, and threat of new entrants. Ask students to identify strategic actions Target took to regain its customer base..

The Physical Environment Segment

The ***physical environment segment*** refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to and deal with those changes. Ecological, social, and economic systems interact to influence what happens in this segment. Global warming, energy consumption, and sustainability are all examples of issues related to the physical environment.

5	Identify the five competitive forces and explain how they determine an industry's profit potential.

INDUSTRY ENVIRONMENT ANALYSIS

An ***industry*** is a group of firms producing products that are close substitutes for each other. As they compete for market share, the strategies implemented by these companies influence each other and include a broad mix of competitive strategies as each company pursues strategic competitiveness and above-average returns.

It should be noted that, unlike the general environment, which has an *indirect* effect on strategic competitiveness and firm profitability, the effect of the industry environment is more *direct*. Industry - and individual firm - profitability and the intensity of competition in an industry are a function of five competitive forces as presented in *Figure 2.2*.

***Figure Note*:** Students should refer to *Figure 2.2* as it provides a framework that can be used to analyze competition in an industry. A broader discussion of the five competitive forces and other factors follows *Figure 2.2*.

FIGURE 2.2
The Five Forces Model of Competition

The Five Forces Model of Competition indicates that these forces interact to determine the intensity or strength of competition, which ultimately determines the profitability of the industry.

- Threat of New Entrants
- Threat of Substitute Products
- Bargaining Power of Buyers (Customers)
- Bargaining Power of Suppliers
- Rivalry Among Competing Firms in an industry

Assessing the relative strength of the five competitive forces is important to a firm's ability to achieve strategic competitiveness and earn above-average returns.

Viewed differently, competition should be seen as groupings of alternative ways that customers can obtain desired results. Thus, any analysis of an industry must expand beyond the traditional practice of concentrating on direct competitors to include *potential* competitors. For example:

- Suppliers can become competitors by integrating forward.
- Buyers or customers can become competitors by integrating backward.
- Firms that are not competitors today could produce products that serve as substitutes for existing products offered by firms in an industry, transforming themselves into competitors.

Threat of New Entrants

New entrants to an industry are important because with new competitors, the intensity of competitive rivalry in an industry generally increases. This is because new competitors may bring substantial resources into the industry and may be interested in capturing a significant market share. If a new competitor brings additional capacity to the industry when product demand is not increasing, prices that can be charged to consumers generally will fall. One result may be a decline in sales and lower returns for many firms in the industry.

Teaching Note

To help students grasp the potential impact of new entrants on an industry, it is helpful to illustrate this effect by referring to a number of examples that may be familiar to them, such as:

- The transformation of the steel industry when mini-mills (such as Nucor and Birmingham Steel) entered the industry in competition with integrated domestic producers such as US Steel and Bethlehem Steel
- The impact of the increase in the number of cell phone providers on the cost of having a cell phone (and the long-range, potential impact on the cost of local telephone service)
- The increase in the number of Internet access providers and the effects of increased competition on such firms as CompuServe and America Online

The seriousness or extent of the threat of new entrants is affected by two factors: barriers to entry and expected reactions from - or the potential for retaliation by - incumbent firms in the industry.

Barriers to Entry

Barriers to entering an industry are present when entry is difficult or when it is too costly and places potential entrants at a competitive disadvantage (relative to firms already competing in the industry). Seven factors represent potentially significant entry barriers that can emerge as an industry evolves or might be explicitly “erected” by current participants in the industry to protect profitability by deterring new competitors from entry.

Economies of Scale refers to the relationship between quantity produced and unit cost. As the quantity of a product produced during a given time period increases, the cost of manufacturing each unit declines.

Economies of scale can serve as an entry barrier when existing firms in the industry have achieved these scale economies and a potential new entrant is only able to enter the industry on a small scale (and produce at a higher cost per unit).

Economies of scale can be overcome as a potential entry barrier by firms that produce multiple customized products or that enter an industry on a large-enough scale. New manufacturing technology facilitated by advanced information systems has allowed the development of "mass customization" in an increasing number of industries, and online ordering has enhanced the ability of customers to obtain customized products (often referred to as "markets of one").

Product Differentiation: Customers may perceive that products offered by existing firms in the industry are unique as a result of service offered, effective advertising campaigns, or being first to offer a product of service to the market. If customers perceive a product or service as unique, they generally are loyal to that brand. Thus, new entrants may be required to spend a great deal of money over a long period of time to overcome customer loyalty to existing products.

Though new entrants may be able to overcome perceived uniqueness and brand loyalty, the cost of such strategies generally will be high: offering lower prices, adding additional features, or allocating significant funds to a major advertising and promotion campaign. In the short run, new entrants that try to overcome uniqueness and brand loyalty may suffer lower profits or may be forced to operate at a loss.

Capital Requirements: Firms choosing to enter any industry must commit resources for facilities - to purchase inventory, to pay salaries and benefits, etc. Though entry may seem attractive (because there are no *apparent* barriers to entry) a potential new entrant may not have sufficient capital to enter the industry.

Switching Costs: These are the one-time costs customers will incur when buying from a different supplier. They can include such explicit costs as retraining of employees or retooling of equipment as well as the psychological cost of changing relationships. Incumbent firms in the industry generally try to establish switching costs to offset new entrants that try to win customers with substantially lower prices or an improved (or, to some extent, different) product.

Access to Distribution Channels: As existing firms in an industry generally have developed effective channels for distributing products, these same channels may not be available to new firms entering an industry. Thus, access (or lack thereof) may serve as an effective barrier to entry.

This may be particularly true for consumer nondurable goods (because of the limited amount of shelf space available in retail stores) and in international markets. In the case of some durable goods or industrial products, to overcome the barrier, new entrants must again incur costs in excess of those paid by existing firms, either through lower prices or price breaks, costly promotion campaigns, or advertising allowances. New entrants may have to incur significant costs to establish a proprietary distribution channel. As in the case of product differentiation or uniqueness barriers, new entrants may suffer lower profits or operate at a loss as they battle to gain access to distribution channels.

Cost Disadvantages Independent of Scale: Existing firms in an industry often are able to achieve cost advantages that cannot be duplicated by new entrants (i.e., other than those related to economies of scale and access to distribution channels). These can include proprietary process (or product) technology, more favorable access to or control of raw materials, the best locations, or favorable government subsidies.

Potential entrants must find ways to overcome these disadvantages to be able to effectively compete in the industry. This may mean successfully adapting technologies from other industries and/or non-competing products for use in the target industry, developing new sources of raw materials, making product (or service) enhancements to overcome location-related disadvantages, or selling at a lower price to attract customers.

Government Policy: Governments (at all levels) are able to control entry into an industry through licensing and permit requirements. For example, at the firm level, entry into the banking industry is regulated at both the federal and state levels, whereas liquor sales are regulated at the state and local levels. In some cases, state and/or federal licensing requirements limit entry into the personal services industry (securities sales and law), while in others, only state requirements may limit entry (barbers and beauticians).

> ***Teaching Note***
> Students should be reminded of the monopolistic nature (on a market-by-market basis) of the public utility industry, including local telephone service, water, electric power, and cable television. The "regulated monopolies" will provide helpful illustrations to make sense of this section.

Expected Retaliation

Even if a firm concludes that it can successfully overcome all of the entry barriers, it still must take into account or anticipate reactions that might be expected from existing firms.

Strong retaliation is likely when existing firms have a heavy investment in fixed assets (especially when there are few alternative uses for those assets) or when industry growth is slow or declining. Retaliation could take the form of announcements of anticipated future investments to increase capacity, new product plans, price-cutting or a study to assess the impact of lower prices (this might imply price-cutting as a "promised" entry barrier-creation strategy by existing firms).

Small entrepreneurial firms can avoid retaliation by identifying and serving neglected market segments. For example, Honda first entered the US market by concentrating on small-engine motorcycles, a market that firms such as Harley-Davidson ignored. After consolidating its position, Honda went on the offensive by introducing larger motorcycles and competing in the broader market.

Bargaining Power of Suppliers

The bargaining power of suppliers depends on suppliers' economic bargaining power relative to firms competing in the industry. Suppliers are powerful when firm profitability is reduced by suppliers' actions. Suppliers can exert their power by raising prices or by restricting the quantity and/or quality of goods available for sale.

Suppliers are powerful relative to firms competing in the industry when:
- The supplier segment of the industry is dominated by a few large companies and is more concentrated than the industry to which it sells
- Satisfactory substitute products are not available to industry firms
- Industry firms are not a significant customer group for the supplier group
- Suppliers' goods are critical to buyers' marketplace success
- Effectiveness of suppliers' products has created high switching costs for buyers
- Suppliers represent a credible threat to integrate forward into the buyers' industry, especially when suppliers have substantial resources and provide highly differentiated products

In the airline industry, suppliers' bargaining power is changing. There are few suppliers, but demand for the major aircraft is also low. Boeing and Airbus compete strongly for most orders of major aircraft. However, China recently announced plans to enter the market by building large commercial aircraft, significant in a country that is projected to purchase thousands.

Bargaining Power of Buyers

While firms seek to maximize their return on invested capital, buyers are interested in purchasing products at the lowest possible price (the price at which sellers will earn the lowest acceptable return). To reduce cost or maximize value, customers bargain for higher quality or greater levels of service at the lowest possible price by encouraging competition among firms in the industry.

Buyer groups are powerful relative to firms competing in the industry when:

- Buyers are important to sellers because they purchase a large portion of the supply industry's total sales
- Products purchased from a supply industry represent a significant portion of the seller's annual revenues
- Buyers are able to switch to another supplier's product at little, if any, cost
- Suppliers' products are undifferentiated and standardized, and the buyers represent a real threat to integrate backward into the suppliers' industry using resources or expertise

Armed with greater amounts of information about the manufacturer's costs and the power of the Internet as a shopping and distribution alternative, consumers appear to be increasing their bargaining power in many industries. One reason for this shift is that individual buyers incur virtually zero switching costs when they decide to purchase from one manufacturer rather than another or from one dealer as opposed to a second or third one.

Threat of Substitute Products

All firms must recognize that they compete against firms producing ***substitute products***, those products that are capable of satisfying similar customer needs but come from outside the industry and thus have different characteristics. In effect, prices charged for substitute products represent the upper limit on the prices that suppliers can charge for their products.

The threat of substitute products is greatest when:

- Buyers or customers face few, if any switching costs
- Prices of the substitute products are lower
- Quality and performance capabilities of substitutes are equal to/greater than those of the industry's products

Firms can offset the attractiveness of substitute products by differentiating their products in ways that are perceived by customers as relevant. Viable strategies might include price, product quality, product features, location, or service level.

Examples of Traditional and Substitute Products and Their Usage

Traditional product	***Substitute product***	***Usage***
Overnight delivery	Fax machines/e-mail	
	Document delivery	
Sugar	NutraSweet	Sweetener
Glass	Plastic	Containers
Coffee	Tea	Beverages
Paper bags	Plastic bags	Flexible packaging

Intensity of Rivalry Among Competitors

The intensity of rivalry in an industry depends on the extent to which firms in an industry compete with one another to achieve strategic competitiveness and earn above-average returns because success is measured relative to other firms in the industry. Competition can be based on price, quality, or innovation.

Because of the interrelated nature of firms' actions, action taken by one firm generally will result in retaliation by competitors (also known as competitive response). In addition to actions and reactions that result as firms attempt to offset the other competitive forces in the industry - threat of new entry, power of suppliers and buyers, and threat of substitute products - the intensity of competitive rivalry is also a function of a number of other factors.

Numerous or Equally Balanced Competitors

Industries with a high number of firms can be characterized by intense rivalry when firms feel that they can make competitive moves that will go unnoticed by other firms in the industry. However, other firms will generally notice these moves and offer countermoves of their own in response. Patterns of frequent actions and reactions often result in intense rivalry, such as in local restaurant, retailing, or dry-cleaning industries.

Rivalry also is intense in an industry that has only a few firms of equivalent resources and power. The firms' resource bases enable each to take frequent action to improve their competitive positions which, in turn, produce a reaction or countermove by competitors. Battles for market share in the fast food industry between McDonald's and Burger King; in the automobile industry between such firms as General Motors, Ford, and Toyota; and in athletic shoes between Nike and Reebok are examples of intense rivalry between relatively equivalent competitors. Of course, Boeing versus Airbus is an especially useful example.

Slow Industry Growth

When a market is growing at a level where there seem to be "enough customers for everyone," competition generally centers around effective use of resources so that a firm can effectively serve a larger, growing customer base. Because of sufficient growth in the market, firms do not concentrate on taking customers away from other firms.

The intensity of competition often results in a reduction in industry profitability as observed in the fast-food industry with the battle for a slower growing traditional, US customer base between McDonald's, Burger King, and Wendy's. The intensity of competition can be illustrated by the various competitive strategies followed by firms in the fast-food industry:

- Rapid and continuous introduction of new products and new packaging schemes
- The introduction of innovative-pricing strategies
- Product and/or service differentiation

High Fixed Costs or High Storage Costs

When an industry is characterized by high fixed costs relative to total costs, firms produce in quantities that are sufficient to use a large percentage if not all of their production capacity so that fixed costs can be spread over the maximum volume of output. Though this may lower per unit costs, it also can result in excess supply if market growth is not sufficient to absorb the excess inventory. The intensity of competitive rivalry increases as firms use price reductions, rebates, and other discounts or special terms to reduce inventory as observed in the automobile industry from the 1980s to the present.

High storage costs, especially those related to perishable or time-sensitive products (such as fruits and vegetables) also can result in high levels of competitive intensity as such products rapidly lose their value if not sold within a given time period. Pricing strategies often are used to sell such products.

Lack of Differentiation or Low Switching Costs

Products that are not characterized by brand loyalty or perceived uniqueness are generally viewed by buyers as commodities. For such products, industry rivalry is more intense and competition is based primarily on price, service, and other features of interest to consumers.

Switching costs can be used to decrease the likelihood that customers will switch to competitors' products. Products for which customers incur no or few switching costs are subject to intense price- and service-based competition, similar to undifferentiated products.

High Strategic Stakes

The intensity of competitive rivalry increases when success in an industry is important to a large number of firms (such as the domestic airline industry following deregulation). For example, the success of a diversified firm may be important to its effectiveness in other industries, especially when the firm is in interdependent or related industries.

Geographic stakes may also be high. The importance of geographic stakes can be illustrated by the intense rivalry in the US automobile industry as Japanese manufacturers recognized the strategic importance of a US marketplace presence and US manufacturers responded.

High Exit Barriers

Exit barriers - created by economic, strategic, and emotional factors that cause companies to remain in an industry even though the profitability of doing so is in question - also can increase the intensity of competition in an industry. The higher the barriers to exit, the greater the probability that competitive actions and reactions will include price cuts and extensive promotions.

Some sources of exit barriers include:

- Investments in *specialized assets*, or assets whose value is linked to use in a particular industry or location, with little or no value as salvage or in other uses
- *Fixed costs of exit*, such as labor agreements or a requirement to repay federal, state, or local aid packages
- *Strategic relationships*, interdependencies within the organization (e.g., shared facilities, market access)
- *Emotional barriers*, such as loyalty to employees or fear for one's own career
- *Government and/or social restrictions* based on concern for job losses or the economic impact of exit

> ***Teaching Note***
> One way to get students to recognize the industry forces Porter presents is to allow them to learn about a given industry and report on these forces as they see them and assess their strength. For example, one adopter of the text shows students the first segment of a PBS video series by Daniel Yergin called "The Prize." This one-hour video profiles the formation of the oil industry and its rapid transformation in the early days. Students are asked to identify the many illustrations of "Porter's Five Forces in action" as they watch the video (e.g., profits were much greater early in the first part of the industry's first decade than in the last years of that period because barriers to entry were low and the rapid influx of new entrants expanded supply and depressed prices). As an incentive for diligent observation, the student who identifies the greatest number of legitimate illustrations is rewarded with bonus points.

INTERPRETING INDUSTRY ANALYSES

Effective industry analyses are products of careful study and interpretation of data from multiple sources. Because of globalization, international markets and rivalry must be included in the firm's analyses; in fact, research shows international variables may have more impact on strategic competitiveness than domestic ones, in some cases.

Following a study of the five industry forces, the firm has the insights required to determine an industry's attractiveness in terms of the potential to earn adequate or superior returns on its invested capital. In general, the stronger the competitive forces, the lower the profit potential for an industry's firms. An unattractive industry has low entry barriers, suppliers and buyers with strong bargaining positions, strong competitive threats from product substitutes, and intense rivalry among competitors, which make it difficult for firms to achieve strategic competitiveness and earn above-average returns. An attractive industry has the mirror image of these features and offers little potential for favorable performance.

Characteristics of attractive and unattractive industries are summarized below.

Industry Characteristic	***Attractive***	***Unattractive***
Threat of New Entry	Low	High
Bargaining Power of Suppliers	Low	High
Bargaining Power of Buyers	Low	High
Threat of Substitute Products	Low	High
Intensity of Competitive Rivalry	Low	High

Teaching Note

It may be helpful to explain that the relationship between the strength of industry forces and prices/profits in the industry is an inverse one. When the forces are strong, prices/profits in the industry tend to be low, whereas weak forces usually lead to higher prices/profits. The mental image is one of a playground "teeter-totter" or balance scale.

6 Define strategic groups and describe their influence on firms.

STRATEGIC GROUPS

As implied by the previous discussion, not all firms in an industry may adopt the same strategies in their quest for strategic competitiveness and above-average returns. However, many firms in an industry may follow similar strategies. These firms are generally classified as ***strategic groups***, or groups of firms in an industry following the same or similar strategies along the same strategic dimensions.

Membership in a particular strategic group is determined by the essential characteristics of a firm's strategy, which may include the

- Extent of technological leadership
- Degree of product quality
- Pricing policies
- Choice of distribution channels
- Degree and type of customer service

Teaching Note
It may be helpful to assign students (or student teams) the task of developing a strategic group map of an industry with which they are familiar (e.g., fast food, automobile manufacturing, computers, or the financial services industry).

Teaching Note
Many strategy experts believe that the strategic group concept provides a useful tool for analyzing an industry from firm-specific perspectives in order to learn how to compete successfully. However, some critics indicate that there is no convincing evidence that (1) strategic groups exist or (2) that firm performance is dependent on membership in a particular group. Others contend that little additional understanding can be gained from industry analysis by looking at strategic groups, but recent research provides some evidence to support the usefulness of this analysis.

The strategic group concept can be useful in analyzing the competitive structure of an industry and can serve as a framework for assessing competition, positioning alternatives, and potential profitability of firms in an industry.

High mobility barriers, high rivalry, and low resources among the firms within an industry will limit the formation of strategic groups. However, research suggests that once formed, strategic group membership remains relatively stable over time, making analysis easier and more useful.

Use of the strategic group concept requires that analysts be aware of several implications:

- A firm's major or primary competitors are those in its strategic group, thus competitive rivalry within the strategic group is expected to be more intense than rivalry with other firms in the industry.
- The relative strengths of the five competitive forces will differ among groups, thus firms in different groups may adopt different competitive strategies.

- The closer the strategic groups on the relevant dimensions, the greater the likelihood of their rivalry.

STRATEGIC FOCUS
Watch Out Retailers, Here Comes Amazon; Watch Out Amazon, Here Comes Jet.com

The Strategic Focus profiles the strategic group consisting of brick & mortar retailers, Amazon, and Jet.com. Amazon's sales in 2014 were $88.99 billion, an increase of 19.4 percent over 2013. In fact, its sales in 2014 were a whopping 160 percent more than its sales in 2010, four years prior. Amazon has been able to achieve remarkable gains in sales by providing high quality, rapid and relatively inexpensive (relative to competitors) service. Amazon has taken on such formidable competitors as Walmart, Google and Barnes & Noble, among others and come out of it as a winner, particularly in the last 4-5 years. Walmart has been making progress in its online sales. In 2014, it grew its online sales by about $3 billion, for a 30 percent increase. That is until one compares it to Amazon's sales increase in 2014 of about $14.5 billion. While Amazon dominates in online sales, a new entrant Jet.com is trying to gain market share.

Teaching Note
The Strategic Focus provides a good discussion vehicle for competitor analysis with a strategic group. How do traditional retailers compete with online competitors? What can online retailers do to compete against new entrants?

7 Describe what firms need to know about their competitors and different methods (including ethical standards) used to collect intelligence about them.

COMPETITOR ANALYSIS

Competitor analysis represents a necessary adjunct to performing an industry analysis. An industry analysis provides information regarding potential sources of competition (including the possible strategic actions and reactions and effects on profitability for all firms competing in an industry). However, a structured competitor analysis enables the firm to focus its attention on those firms with which it will *directly* compete, and is especially important when a firm faces a few powerful competitors.

Competitor analysis is interested ultimately in developing a profile on how competitors might be expected to respond to a firm’s strategic moves. The process involves developing answers to a series of questions about competitors such as:

- Competitors’ future objectives

- Competitors' current strategy
- Competitors' assumptions about the industry
- Capabilities, as shown by competitors' strengths and weaknesses

Competitor intelligence is critical to competitor analysis because it helps a firm understand competitors' intentions and the strategic implications resulting from them. Competitor intelligence is performed both for domestic and international competitors.

FIGURE 2.3
Competitor Analysis Components

Figure 2.3 shows how the components of competitor analysis help the firm prepare an anticipated response profile for each competitor.

Components	Response
Future Objectives	What will our competitors do in the future?
Current Strategy	Where do we hold an advantage over our competitors?
Assumptions	How will this change our relationship with our
Capabilities	competitors?

Teaching Note
To help students understand the usefulness of competitor analysis, have them develop a profile of another university or college, assume the role of a Pepsi product manager and develop a competitive profile of Coca-Cola, or take the perspective of Intel and describe AMD's competitive characteristics. A specific case that contains the bulk of the required information also could be used to perform an in-class competitor analysis.

Other significant components are the **complementors** of a firm's products and strategy. These are the networks of companies that sell goods and services compatible with the firm's own product or service.

ETHICAL CONSIDERATIONS

A major concern of many managers is the methods used to gather data on competitors, a process generally referred to as ***competitor intelligence***. The illustration of Microsoft's struggle to understand Google is especially helpful in explaining this concept. It is a great managerial challenge to ensure that all data and information related to competitors are gathered both legally and ethically. This is important because many employees may feel pressure to rely on techniques that are questionable from an ethical perspective to gather information that may be valuable to their firm, especially if they perceive value to their own careers from successfully obtaining such information.

It seems obvious that information that (1) is either publicly available (annual reports, regulatory filings, brochures, advertising and promotional materials) or (2) is obtained by attending trade shows and conventions can be used without ethical or legal implications. However, information obtained illegally (as a result of activities such as theft, blackmail, or eavesdropping) cannot - or, at least, should not - be used since its use is unethical as well as illegal.

Teaching Note

It might be useful and insightful to require students to develop (and bring to class) their own lists of questionable intelligence-gathering techniques or formulate an argument as to the circumstances (if any) under which these techniques might be considered ethical. This could make for a lively discussion of the issue.

ANSWERS TO REVIEW QUESTIONS

1. **Why is it important for a firm to study and understand the external environment?**

The external environment influences the firm's strategic options as well as the decisions made in light of them. The firm's understanding of the external environment is especially useful when it is matched with knowledge about its internal environment. Matching the conditions of the two environments is the foundation the firm needs to form its vision, mission, and to take strategic actions in the pursuit of strategic competitiveness and above-average returns. The importance of understanding the external environment is further underscored by the fact that the environmental conditions facing firms in the global economy of the 21st century differ from those firms faced previously. For example, technological changes and the explosion in information gathering and processing capabilities demand more timely and effective competitive actions and responses. The rapid sociological changes occurring in many countries affect labor practices and the nature of products demanded by increasingly diverse consumers. Governmental policies and laws affect where and how firms choose to compete. Competitive advantage goes to those firms who know their external environment and plan their strategies so they are relevant to these conditions.

2. What are the differences between the general environment and the industry environment? Why are these differences important?

The *general environment* represents those elements in the broader society that can influence all (or most) industries and the firms that compete in those industries; it represents elements or segments that firms cannot directly control. The general environment is composed of the following segments: demographic, economic, political/legal, sociocultural, technological, and global.

The industry environment is the constellation of factors that directly influences a firm and its competitive actions and responses. Firms are influenced by these factors and should attempt to establish a position in the industry that enables the firm to favorably influence the factors or to successfully defend against the factors' influence. These factors are: threat of new entrants, bargaining power of suppliers, bargaining power of buyers, threat from substitute products, and intensity of rivalry among competitors.

3. What is the external environmental analysis process (four parts)? What does the firm want to learn when using this process?

The environmental analysis process represents an organized attempt by the firm to better understand turbulent, complex, and global environments. This is achieved by *scanning* (studying all segments of the general environment to identify existing or potential changes), *monitoring* (observing the pattern of changes over time in an attempt to detect meaning or identify trends), *forecasting* (developing feasible projections of what might happen, and how quickly, as a result of changes and trends identified from scanning and monitoring activities) and *assessing* (determining the timing and significance of environmental changes and trends on the strategic management of the firm). Stated differently, this analysis should examine and process external data on a continuous basis.

An important objective of the environmental analysis process is to identify potential threats (conditions that may hinder the firm's efforts to achieve strategic competitiveness) and opportunities (that may assist or help the firm in its efforts to achieve strategic competitiveness).

4. What are the seven segments of the general environment? Explain the differences among them.

The *demographic segment* is concerned with characteristics of the population or society that makes up the general environment. Characteristics of interest are size, age, structure, geographic distribution, ethnic mix, and income distribution.

The *economic segment* refers to the nature and direction of the economy in which a firm competes or may compete in the future. Important characteristics include inflation and interest rates, trade deficits (or surpluses), budget deficits (or surpluses), individual and business savings and investment rates, and gross domestic product.

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 interactions between nations. In other words, this segment is concerned with how firms and other organizations attempt to influence government and how governmental entities in turn influence them.

The *sociocultural segment* is concerned with the social attitudes and cultural values of different societies.

The *technological segment* is made up of the institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes, or materials.

The *global segment* includes relevant new global markets and existing ones that are changing, important international political events, and critical cultural and institutional characteristics of relevant global markets. This segment recognizes that firms now compete in a competitive landscape where both competitors and customers are global, due in part to the rapid diffusion of both information and technology. Competitors will no longer be domestic; they can originate from industrialized, newly industrialized, or emerging countries. Customer demands and expectations have changed; they are based on an ever-increasing awareness of global products and services.

The *physical environment segment* refers to potential and actual changes in the physical environment and business practices that are intended to positively respond to and deal with those changes. Ecological, social, and economic systems interact to influence what happens in this segment. Global warming, energy consumption, and sustainability are all examples of issues related to the physical environment.

5. How do the five forces of competition in an industry affect its profit potential? Explain.

An industry's competitive intensity and profit potential can be determined by the relative strengths of five competitive forces. This model of industry competition recognizes that suppliers can influence industry profitability by raising prices or reducing the quality of goods sold if industry participants are unable to recover cost increases through pricing structures. Buyers can influence the profit potential of an industry if the buyer group is able to successfully bargain for higher quality, greater levels of service, and lower prices.

Substitute products influence an industry's profit potential by placing an upper limit on prices that can be charged. New entrants to an industry influence industry profitability because they bring additional production capacity to the industry. Unless product demand is increasing, additional capacity holds down (or reduces) buyers' costs. This reduces profitability for all firms in the industry. The intensity of rivalry among competitors reflects competitor actions and responses as firms initiate moves to improve their competitive position or when they act in retaliation for competitive pressures brought about by the strategic actions of rival firms. Generally, the greater the intensity of competitive rivalry, the lower the overall profitability of an industry.

6. What is a strategic group? Of what value is knowledge of the firm's strategic group in formulating that firm's strategy?

A strategic group is a group of firms within an industry that generally follow the same (or a similar) strategy, competing along the same strategic dimensions (such as product quality, pricing policy, distribution channels, or level of customer service).

The strategic group concept is valuable to a firm's strategic decision makers because a firm's primary competitors are those within its strategic group (all group members are selling similar products to a similar group of customers), the strengths of the five competitive forces varies across strategic groups, and strategic groups that are similar (in terms of strategies followed and competitive dimensions emphasized) increase the possibility of increased competitive rivalry between the groups.

The notion of strategic groups can be useful for analyzing an industry's competitive structure. Such analyses can be helpful in diagnosing competition, positioning, and the profitability of firms within an industry. Strategic group analysis shows which companies are competing similarly in terms of how they use similar strategic dimensions. At the same time, research has found that strategic groups differ in performance, suggesting their importance. Strategic group membership also remains relatively stable over time, making analysis easier and more useful.

Strategic groups have several implications. First, because firms within a group offer similar products to the same customers, the competitive rivalry among them can be intense. The more intense the rivalry, the greater the threat to each firm's profitability. Second, the strengths of the five industry forces (the threats posed by new entrants, the power of suppliers, the power of buyers, product substitutes, and the intensity of rivalry among competitors) differ across strategic groups. Third, the closer the strategic groups are in terms of their strategies, the greater is the likelihood of rivalry between the groups. In the end, having a thorough understanding of primary competitors helps a firm formulate and implement an appropriate strategy.

7. What is the importance of collecting and interpreting data and information about competitors? What practices should a firm use to gather competitor intelligence and why?

Competitor analysis can help the firm understand and better anticipate competitors' future objectives, current strategies, assumptions, and capabilities. The firm should gather intelligence about its competitors as well as about public policies in countries across the world, which can serve as an early warning of threats and opportunities emerging from the global public policy environment that may affect the achievement of the company's strategy. Through effective competitive and public policy intelligence, the firm gains the insights needed to create a competitive advantage and to increase the quality of the strategic decisions it makes when deciding how to compete against its rivals.

Firms want to know how competitor intelligence is gathered to determine whether the practices employed are legal and, further, to assess whether these methods are ethical, given the firm's culture and the image it desires as a corporate citizen. The line between legal and ethical practices can be difficult to ascertain, especially when it comes to electronic transmissions. Often it is difficult for a firm to know how to gather intelligence and how to prevent competitors from gathering competitive intelligence that may threaten its own competitive advantage.

Openly discussing intelligence-gathering techniques that the firm employs goes a long way toward assuring that people understand the firm's convictions about what is ethical and acceptable for use and what is not ethical and is unacceptable for use when gathering competitor intelligence. The firm can frame these practices in terms of respect for the principles of common morality and the right of competitors not to reveal information about their products, operations, and strategic intentions.

Despite its importance, evidence suggests that a relatively small percentage of firms use formal processes to study competitors. Beyond this, some firms fail to analyze a competitor's future objectives when trying to understand its current strategy, assumptions, and capabilities, but it is important to study the present and the future when examining competitors. Failure to do so may lead to incomplete or distorted insights about competitors.

ADDITIONAL QUESTIONS AND EXERCISES

The following questions and exercises can be presented for in-class discussion or assigned as homework.

Application Discussion Questions

1. Given the importance of understanding the external environment, why do some firms fail to do so? Students can provide examples of firms that did not understand their external environment. What were the implications of the firm's failure to understand that environment?
2. Have students select a firm and describe its external environment. What actions do you believe the firm should take, given its external environment, and why?
3. How is it possible that one firm could see a condition in the external environment as an opportunity whereas a second firm sees it as a threat?
4. Select a firm in the local community. What materials would help one understand the firm's external environment? How could the Internet be used to complete this activity?
5. Have students select an industry that is of interest to them. What actions could firms take to erect barriers of entry to this industry?
6. What conditions would cause a firm to retaliate aggressively against a new entrant to the industry?

Ethics Questions

1. How can a firm use its "code of ethics" to analyze the external environment?
2. What ethical issues, if any, may be relevant to a firm's monitoring of its external environment? Does use of the Internet to monitor the environment lead to additional ethical issues? If so, what are they?
3. Think of each segment in a firm's general environment. What is an ethical issue associated with each segment? Are firms across the globe doing enough to deal with the issue?
4. What is the importance of using ethical practices between a firm and its suppliers?
5. In an intense rivalry, especially one that involves competition in the global marketplace, how can the firm gather competitor intelligence ethically while maintaining its competitiveness?
6. Ask the class what they believe determines whether an intelligence-gathering practice is or is not ethical? Do they see this changing as the world's economies become more interdependent? If so, why? Do they see this changing because of the Internet? If so, how?

INSTRUCTOR'S NOTES FOR MINDTAP

Cengage offers additional online activities, assessments and resources inside MindTap, our online learning platform. The following activities can be assigned within MindTap for students to complete.

INSTRUCTOR'S NOTES FOR BRANCHING EXERCISES

Branching Exercises are real-world activities that allow each student to work through challenges by choosing from different decision-making options. These exercises provide students with the opportunity to practice strategic management in a business scenario utilizing company case studies. Students are placed in the role of a decision maker and asked to consider the needs and priorities of stakeholders as they determine strategy recommendations for a company.

The Movie Exhibition Industry

The movie cinematic industry is not what it once was. Back in the 1940s, a trip out to the theater was a common occurrence. The typical American saw 28 films a year in the theater. Now, that number has dropped dramatically to 4. It is your duty to help turn the movie industry around and return it to the popularity it once was.

Hired as consultants for one of the largest movie theater circuits, AMC, students have been charged with developing a plan that will help AMC's efforts to help revitalize the industry. Your first order of business is to become familiar with the industry and start by identifying early signals of environmental changes and trends.

Students will review these concepts:

- General environments and industry environments
- External environmental analysis process
- The five forces of competition

The ideal path that earns a perfect score is the following:

- Scanning the general environment
- While performing the industry analysis, two threats have presented themselves: the

threat of substitution and the threat of new entrants. You choose to neutralize the threats

- You recommend competing with the threat of substitution
- By neutralizing the threat, you recommend theaters leverage their buying power with studios to put limits on the catalog available to streaming services.

Correct Answer: Your decisions have given AMC and the industry as a whole a massive bump in revenue. Your first decision was to start with a scan of the external environment. The insights led you to focus on the industry environment. Then, deciding to neutralize threats of substitution was correct because it was a safer route that would give the industry an advantage. Then, deciding to neutralize threats was correct because it was a safer route that would give the industry an advantage.

INSTRUCTOR'S NOTES FOR EXPERIENTIAL EXERCISES

Going Back to the Future: Researching the Past to Predict the Future

A critical ingredient to studying the general environment is identifying opportunities and threats. An opportunity is a condition in the environment that, if exploited, could help a company achieve strategic competitiveness. In order to identify opportunities, you must be aware of trends that affect the world around you today or that are projected to affect it in the future. The purpose of this exercise is to sort through the opportunities and threats lurking around a business currently and in the future. The evolution of business and the way business is conducted is an ongoing process. Students will discuss an industry that you would like to research and review. Your challenge is to identify trends in an area that will likely alter the way in which business is conducted in the future. Gather with your group and pick an industry from one of the following to serve as your focus: Health and Beauty Products, Manufacturing, Retail. Use the four-step environmental analysis process to help you identify how the segment trends may provide your industry with an opportunity. Detail your conclusions for each of the four steps. You will be preparing a partial environmental analysis for your industry. A full environmental analysis would review all of the seven segments and address all four steps in great detail. For purposes of this project, you are conducting a mini-analysis that will concentrate on just a few of the segments and complete the steps for only your focus environmental factors. Prepare a 15-20 slide presentation of your research findings and the poll results. Use the bold words as your outline and be sure to include the following points:

- Which of the seven dimensions of the general environment did you analyze?
- Describe the effect on businesses in this industry.
- List some business opportunities that may come from these trends.

- Identify some existing businesses that stand to benefit from the trends.

Present your results and be prepared to discuss your findings with the class.

INSTRUCTOR'S NOTES FOR VIDEO EXERCISES

The media quiz offers additional opportunities for students to apply the concepts in the chapter to a real-world scenario as it is described in news reports.

Title: **Craft Beer and Consolidation**
RT: 2:24
Topic Key: The Industry Environment, External Environmental Analysis, Five Forces of Competition,

Craft beer sales have been increasing while domestic beer sales have been declining. This video is an example of how smaller new entrants compete with larger more established brands and the external threats they face, including consolation.

Suggested Discussion Questions and Answers

1. Describe the general environment and industry environment in the craft beer market.
2. Discuss the set of factors that has a direct influence on a firm and its competitive actions and responses including: the power of suppliers, power of buyers, and the intensity of rivalry among competing firms. When Bill Butcher of Port City Brews discusses shelf space and the way that a merger could increase the leverage of potential of large brewers, he is discussing which competitive force?

Chapter 2
The External Environment: Opportunities, Threats, Industry Competition and Competitor Analysis

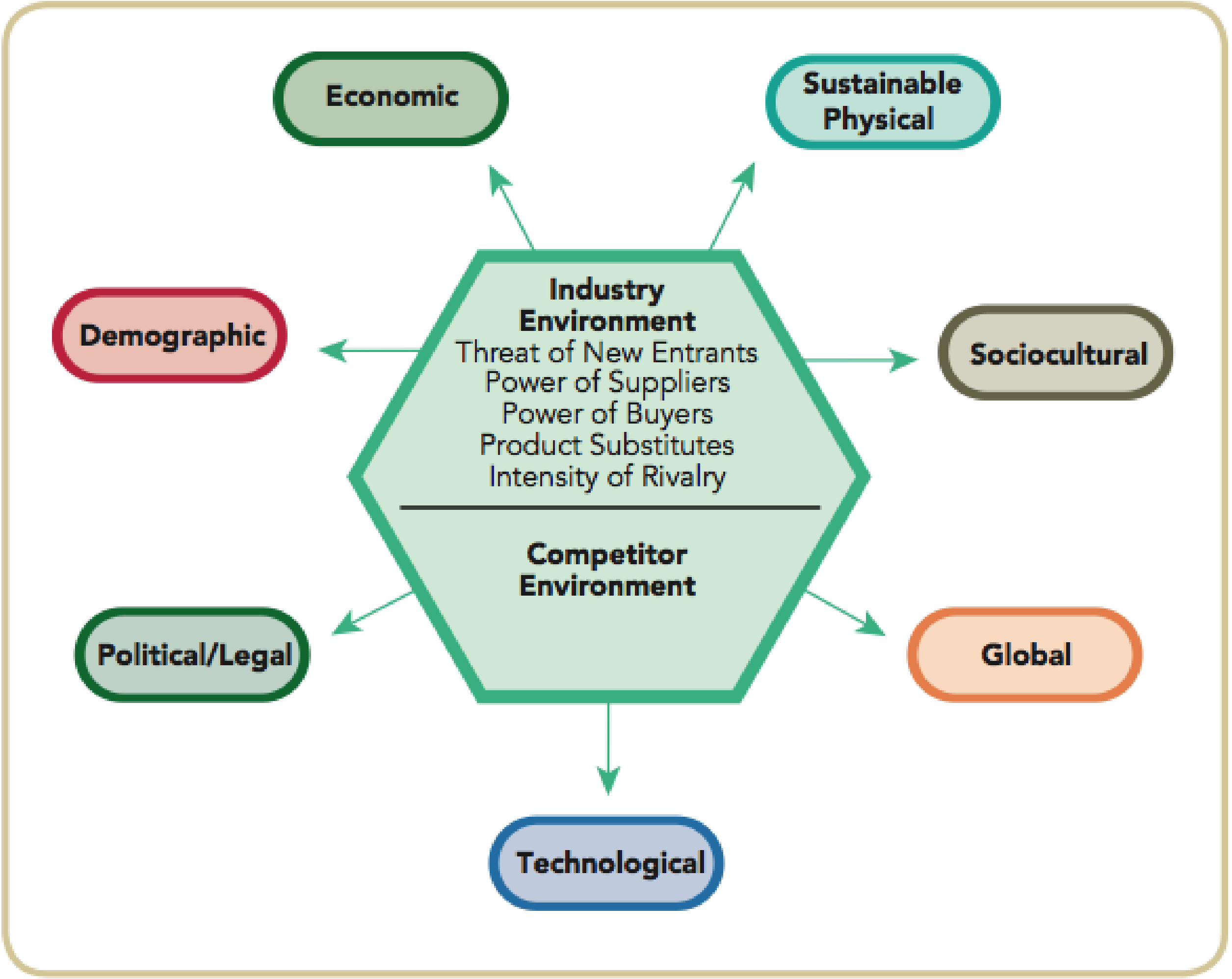
Learning Objectives

Studying this chapter should provide you with the strategic management knowledge needed to:

1. Explain the importance of analyzing and understanding the firm's external environment.
2. Define and describe the general environment and the industry environment.
3. Discuss the four activities of the external environmental analysis process.
4. Name and describe the general environment's seven segments.
5. Identify the five competitive forces and explain how they determine an industry's profitability potential.
6. Define strategic groups and describe their influence on firms.
7. Describe what firms need to know about their competitors and different methods (including ethical standards) used to collect intelligence about them.

The External Environment

Figure 2.1 The External Environment



General Environment

- Dimensions in the broader society that influence an industry and the firms within it:
  - demographic
  - economic
  - political/legal
  - sociocultural
  - technological
  - global
  - physical

The General Environment: Segments and Elements

Table 2.1 The General Environment: Segments and Elements

Demographic segment	• Population size • Age structure • Geographic distribution	• Ethnic mix • Income distribution
Economic segment	• Inflation rates • Interest rates • Trade deficits or surpluses • Budget deficits or surpluses	• Personal savings rate • Business savings rates • Gross domestic product
Political/Legal segment	• Antitrust laws • Taxation laws • Deregulation philosophies	• Labor training laws • Educational philosophies and policies
Sociocultural segment	• Women in the workforce • Workforce diversity • Attitudes about the quality of work life	• Shifts in work and career preferences • Shifts in preferences regarding product and service characteristics
Technological segment	• Product innovations • Applications of knowledge	• Focus of private and government-supported R&D expenditures • New communication technologies
Global segment	• Important political events • Critical global markets	• Newly industrialized countries • Different cultural and institutional attributes
Sustainable physical environment segment	• Energy consumption • Practices used to develop energy sources • Renewable energy efforts • Minimizing a firm's environmental footprint	• Availability of water as a resource • Producing environmentally friendly products • Reacting to natural or man-made disasters

Industry Environment

- The set of factors directly influencing a firm and its competitive actions and competitive responses:
  - threat of new entrants
  - power of suppliers
  - power of buyers
  - threat of product substitutes
  - intensity of rivalry among competitors

Competitor Analysis

- Gathering and interpreting information about all of the companies that the firm competes against.
- Understanding the firm's competitor environment complements the insights provided by studying the general and industry environments.

External Environmental Analysis

- General Environment
  – Focused on the future
- Industry Environment
  – Focused on factors and conditions influencing a firm's profitability within an industry
- Competitor Environment
  – Focused on predicting the dynamics of competitors' actions, responses and intentions

Components of the External Environmental Analysis

Table 2.2 Parts of the External Environment Analysis

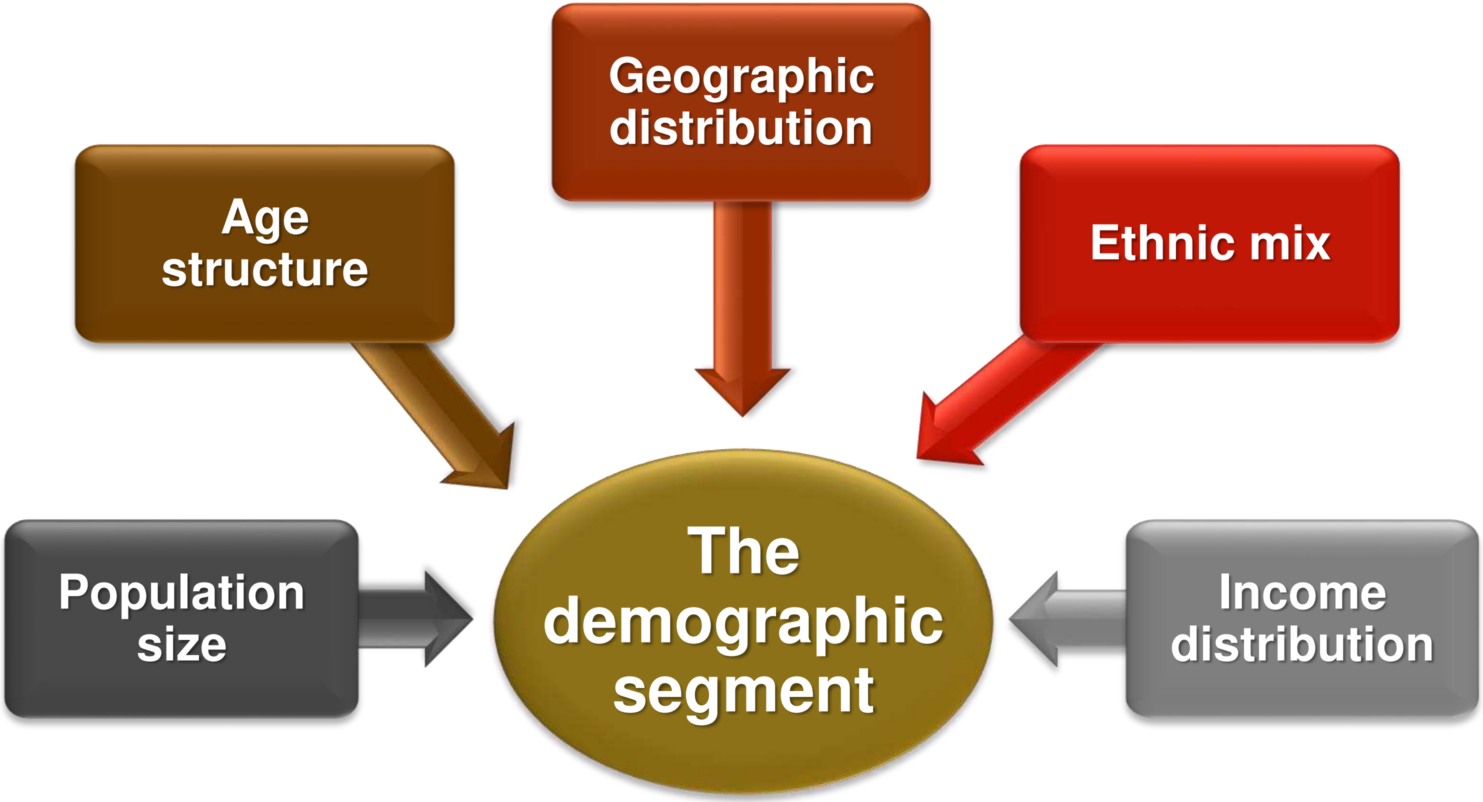
Scanning	• Identifying early signals of environmental changes and trends
Monitoring	• Detecting meaning through ongoing observations of environmental changes and trends
Forecasting	• Developing projections of anticipated outcomes based on monitored changes and trends
Assessing	• Determining the timing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

Opportunities and Threats

- Opportunity
  - A condition in the general environment that, if exploited effectively, helps a firm achieve strategic competitiveness.

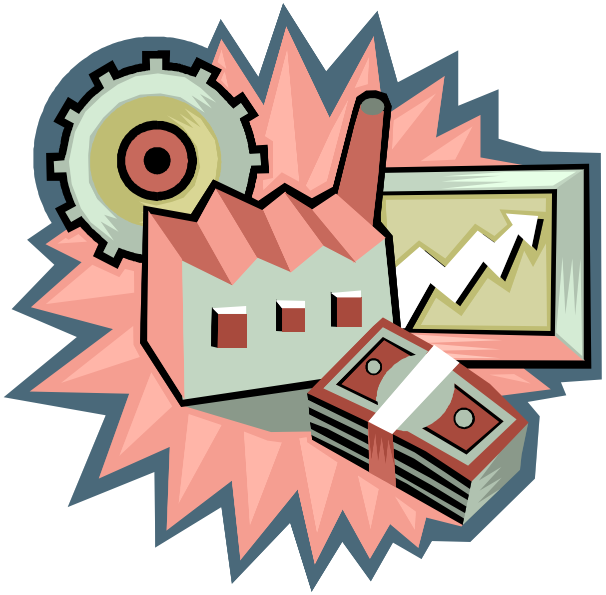
- Threat
  - A condition in the general environment that may hinder a firm's efforts to achieve strategic competitiveness.

Segments of the General Environment



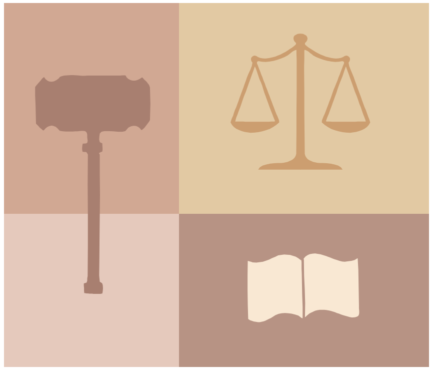
Segments of the General Environment (cont'd)

- The Economic Segment
  - Uncertainty in:
    - market growth rates
    - consumer demand
    - inflation and interest rates
    - trade deficits or surpluses
    - budget deficits or surpluses
    - personal and business savings rates
    - gross domestic product



Segments of the General Environment (cont'd)

- The Political/Legal Segment
  - Regulations
  - Consumer privacy laws
  - Lobbying
  - Antitrust, deregulation laws
  - Taxation



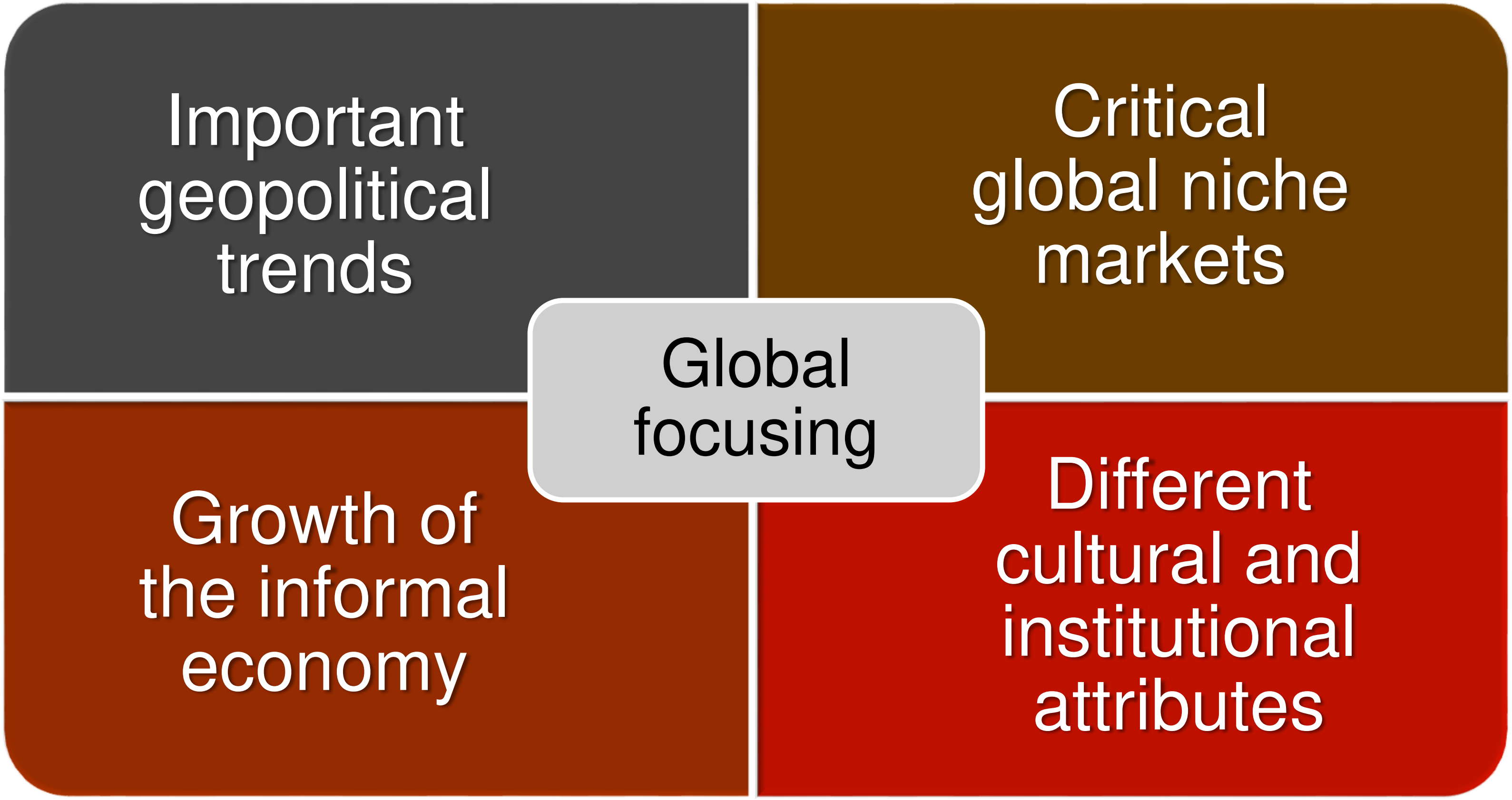
Segments of the General Environment (cont'd)

- The Sociocultural Segment
  - Changing attitudes and cultural values
    - Attitudes and approaches to health care
    - Attitudes about quality of worklife
    - Diverse and aging workforce
    - Women in the workplace
    - Concerns about environment
    - Shifts in work and career preferences
    - Shifts in product and service preferences

Segments of the General Environment (cont'd)

- The Technological Segment
  - Product innovations
  - Rapid technological change and the risk of disruption
  - Knowledge application
  - Growth of the Internet
  - New communication technologies

Segments of the General Environment (cont'd)



Segments of the General Environment (cont'd)

- The Physical Environment Segment
  - Emerging trends oriented to sustaining the world's physical environment
  - Recognition of the interactive influence of ecological, social, and economic systems
  - Growing concerns for sustainable industry development and increased corporate social responsibility for the future effects of globalized operations

Industry Environment Analysis

- Industry Defined
  - A group of firms producing products that are close substitutes
  - Competitive strategies to pursue above-average returns when competing in a particular industry
  - An industry's structural characteristics influence a firm's choice of strategies

The Five Forces of Competition Model

Figure 2.2 The Five Forces of Competition Model

Threat of New Entrants: Barriers to Entry

- Economies of scale
- Product differentiation
- Capital requirements
- Switching costs
- Access to distribution channels
- Cost disadvantages independent of scale
- Government policy
- Expected retaliation

Barriers to Entry

- Economies of Scale
  - Marginal improvements in efficiency that a firm experiences as it incrementally increases its size.
- Factors (advantages and disadvantages) related to large and small-scale entry include:
  - flexibility in pricing and market share
  - costs related to scale economies
  - competitor retaliation

Barriers to Entry (cont'd)

- Product Differentiation
  - Unique products
  - Customer loyalty
  - Products at competitive prices
- Capital Requirements
  - Physical facilities
  - Inventories
  - Marketing activities
  - Availability of capital
- Switching Costs
  - One-time costs customers incur buying from a different supplier:
    - new equipment
    - retraining employees
    - psychic costs of ending a relationship
- Distribution Channel Access
  - Stocking or shelf space
  - Price breaks
  - Cooperative advertising allowances

Barriers to Entry (cont'd)

- Cost Disadvantages Independent of Scale
  - Proprietary product technology
  - Favorable access to raw materials
  - Desirable locations
- Government Policy
  - Licensing and permit requirements
  - Deregulation of industries
- Expected Retaliation
  - Responses by existing competitors may depend on a firm's present stake in the industry (available business options)

Bargaining Power of Suppliers

- Supplier power increases when:
  - suppliers are large and few in number.
  - suitable substitute products are not available.
  - individual buyers are not large customers of suppliers and there are many of them.
  - suppliers' goods are critical to the buyers' marketplace success.
  - suppliers' products create high switching costs.
  - suppliers pose a threat to integrate forward into buyers' industry.

Bargaining Power of Buyers

- Buyer power increases when:
  - buyers are large and few in number.
  - buyers purchase a large portion of an industry's total output.
  - buyers' purchases are a significant portion of a supplier's annual revenues.
  - buyers' switching costs are low.
  - buyers can pose threat to integrate backward into the sellers' industry.

Threat of Substitute Products

- The threat of substitute products increases when:
  - buyers face few switching costs.
  - the substitute product's price is lower.
  - substitute product's quality and performance are equal to or greater than the existing product.
- Differentiated industry products that are valued by customers reduce this threat

Intensity of Rivalry Among Competitors

- Industry rivalry increases when:
  - there are numerous or equally balanced competitors.
  - industry growth slows or declines.
  - there are high fixed costs or high storage costs.
  - there is a lack of differentiation opportunities or low switching costs.
  - when the strategic stakes are high.
  - when high exit barriers prevent competitors from leaving the industry.

Interpreting Industry Analyses

Low entry barriers

Suppliers and buyers have strong positions

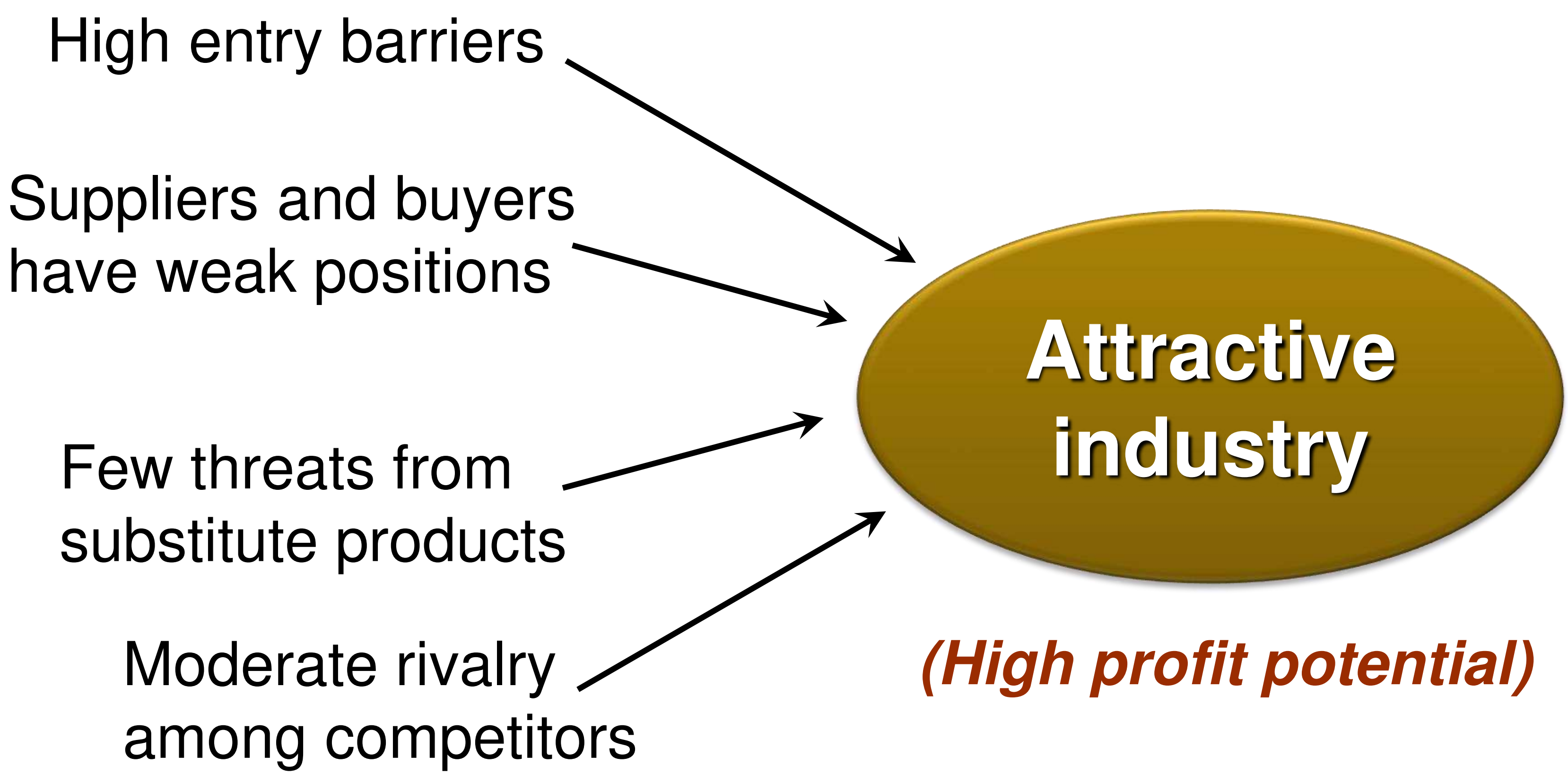
Strong threats from substitute products

Intense rivalry among competitors

Unattractive industry

(Low profit potential)

Interpreting Industry Analyses (cont’d)



Strategic Groups

- Strategic Group Defined
  - A set of firms emphasizing similar strategic dimensions and using similar strategies.
  - Intra-strategic group competition is more intense than is inter-strategic group competition due to similar:
    - market positions
    - products
    - strategic actions

Strategic Groups

- Strategic Dimensions
  - Extent of technological leadership
  - Product quality
  - Pricing policies
  - Distribution channels
  - Customer service
- Implications
  - Intense competitive rivalry within a group threatens profitability of all group members
  - Strengths of the five forces differ across strategic groups
  - The closer the groups are in their strategies, the greater the rivalry between groups

Competitor Analysis

- Competitor Intelligence
  - The ethical gathering of needed information and data that provides understanding of what:
    - drives the competitor, as shown by its future *objectives.*
    - the competitor is doing and can do, as revealed by its *current strategy.*
    - the competitor believes about the industry, as shown by its *assumptions.*
    - the competitor's capabilities are, as shown by its *strengths* and *weaknesses*.

Competitor Analysis (cont'd)

Future Objectives

- How do our goals compare with our competitors' goals?
- Where will the emphasis be placed in the future?
- What is the attitude toward risk?

Competitor Analysis (cont'd)

Future Objectives

Current Strategy

- How are we currently competing?
- Does this strategy support changes in the competitive structure?

Competitor Analysis (cont'd)

Future Objectives

Current Strategy

Assumptions

- Do we assume the future will be volatile?
- Are we operating under a status quo?
- What assumptions do our competitors hold about the industry and themselves?

Competitor Analysis (cont'd)

- Future Objectives
- Current Strategy
- Assumptions
- Capabilities
  - What are our strengths and weaknesses?
  - How do we rate compared to our competitors?

Competitor Analysis (cont'd)

Future Objectives

Current Strategy

Assumptions

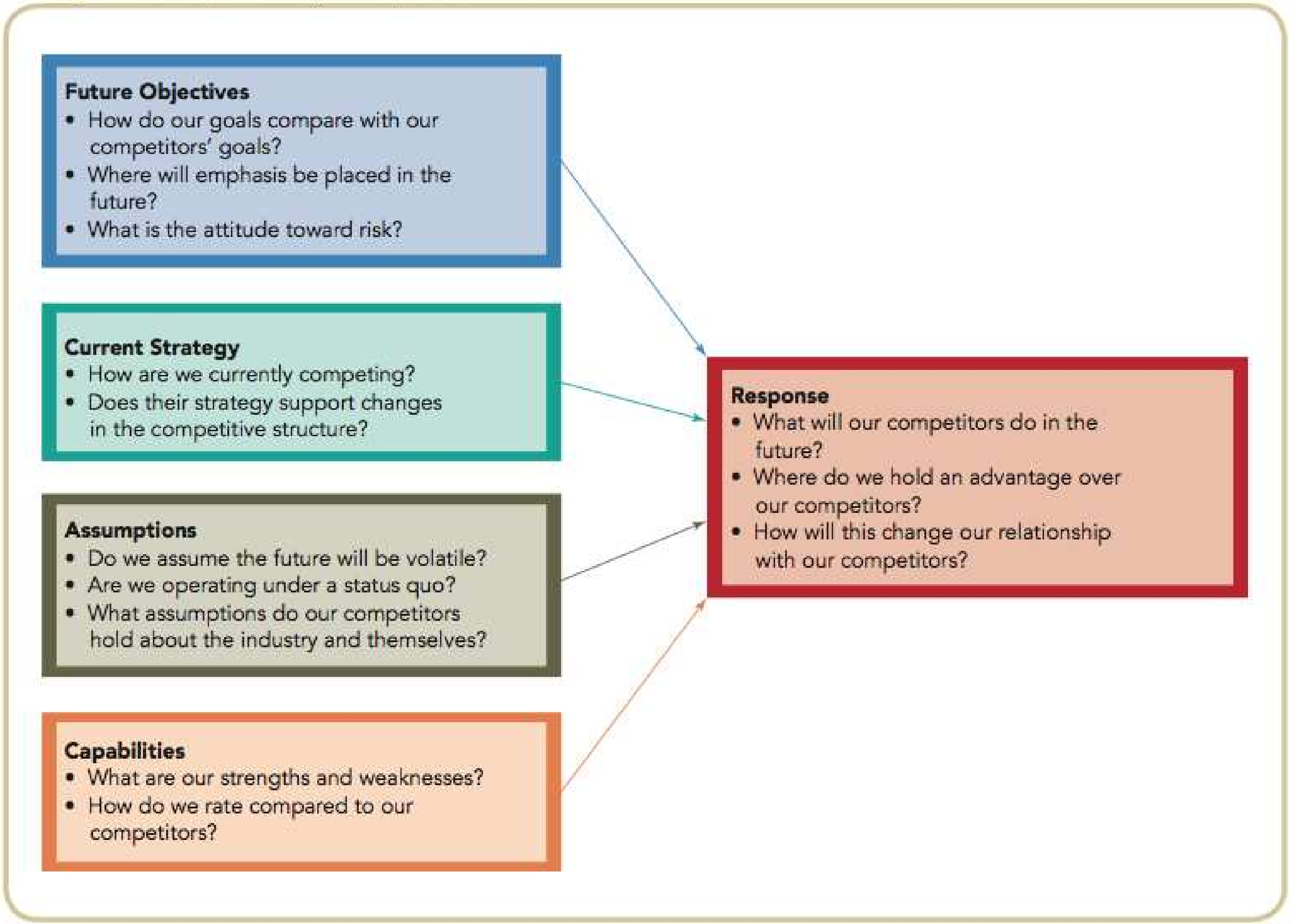
Capabilities

→ Response

- What will our competitors do in the future?
- Where do we hold an advantage over our competitors?
- How will this change our relationship with our competitors?

Competitor Analysis Components

Figure 2.3 Competitor Analysis Components



Complementors

- Complementors
  - The network of companies that sell complementary products or services or are compatible with the focal firm's own product or service.
    - If a complementor's product or service adds value to the sale of the focal firm's product or service, it is likely to create value for the focal firm.
    - However, if a complementor's product or service is in a market into which the focal firm intends to expand, the complementor can represent a formidable competitor.

Ethical Considerations

- Practices considered both legal and ethical:
  1. Obtaining publicly available information
  2. Attending trade fairs and shows to obtain competitors' brochures, viewing their exhibits, and listening to discussions about their products
- Practices considered both unethical and illegal:
  – Blackmail
  – Trespassing
  – Eavesdropping
  – Stealing drawings, samples, or documents