Strategic Management

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External Assesment

A note from David

The Nature of an External Audit

The purpose of an external audit is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. As the term finite suggests, the external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at identifying key variables that offer actionable responses. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats. Figure 3-1 illustrates how the external audit fits into the strategic-management process.

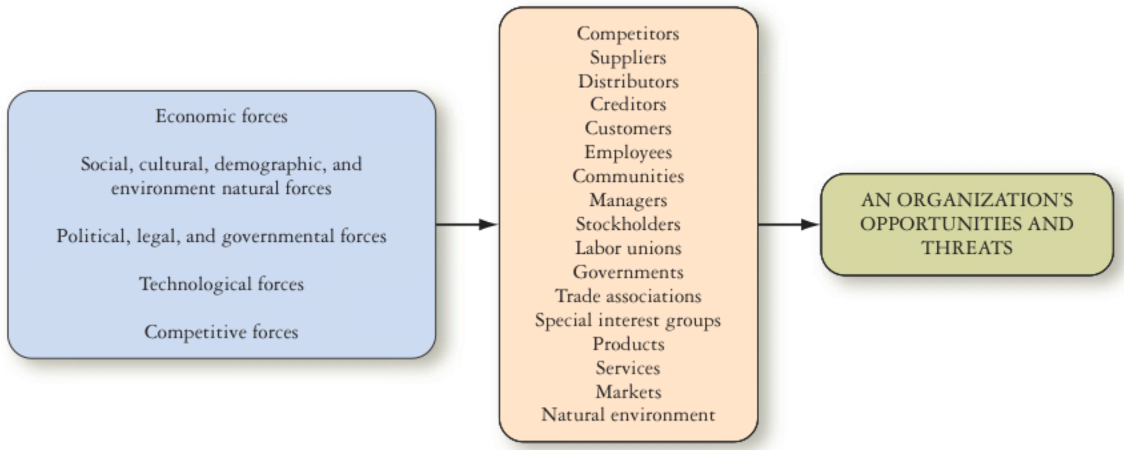
Key External Forces

External forces can be divided into five broad categories: (1) economic forces; (2) social, cultural, demographic, and natural environment forces; (3) political, governmental, and legal forces; (4) technological forces; and (5) competitive forces. Relationships among these forces and an organization are depicted in Figure 3-2. External trends and events, such as the global economic recession, significantly affect products, services, markets, and organizations worldwide. The U.S. unemployment rate climbed to over 9 percent in July 2009 as more than 2.5 million jobs were lost in the United States in 2008—the most since 1945 when the country downsized from the war effort. The rate is expected to rise to 10.1 percent. All sectors witness rising unemployment rates, except for education, health-care services, and government employment. Many Americans are resorting to minimum wage jobs to make ends meet.

Changes in external forces translate into changes in consumer demand for both industrial and consumer products and services. External forces affect the types of products developed, the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

The increasing complexity of business today is evidenced by more countries developing the capacity and will to compete aggressively in world markets. Foreign businesses and countries are willing to learn, adapt, innovate, and invent to compete successfully in the marketplace. There are more competitive new technologies in Europe and Asia today than ever before.

Relationships Between Key External Forces and an Organization



The Process of Performing an External Audit

The process of performing an external audit must involve as many managers and employees as possible. As emphasized in earlier chapters, involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms' industry, competitors, and markets.

To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends. Individuals can be asked to monitor various sources of information, such as key magazines, trade journals, and newspapers. These persons can submit periodic scanning reports to a committee of managers charged with performing the external audit. This approach provides a continuous stream of timely strategic information and involves many individuals in the external-audit process. The Internet provides another source for gathering strategic information, as do corporate, university, and public libraries. Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information.

Once information is gathered, it should be assimilated and evaluated. A meeting or series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm. These key external factors should be listed on flip charts or a chalkboard. A prioritized list of these factors could be obtained by requesting that all managers rank the factors identified, from 1 for the most important opportunity/threat to 20 for the least important opportunity/threat. These key external factors can vary over time and by industry. Relationships with suppliers or distributors are often a critical success factor. Other variables commonly used include market share, breadth of competing products, world economies, foreign affiliates, proprietary and key account advantages, price competitiveness, technological advancements, population shifts, interest rates, and pollution abatement.

Freund emphasized that these key external factors should be (1) important to achieving long-term and annual objectives, (2) measurable, (3) applicable to all competing firms, and (4) hierarchical in the sense that some will pertain to the overall company and others will be more narrowly focused on functional or divisional areas. 1 A final list of the most important key external factors should be communicated and distributed widely in the organization. Both opportunities and threats can be key external factors.

The Industrial Organization (I/O) View

The Industrial Organization (I/O) approach to competitive advantage advocates that external (industry) factors are more important than internal factors in a firm achieving competitive advantage. Proponents of the I/O view, such as Michael Porter, contend that organizational performance will be primarily determined by industry forces. Porter's FiveForces Model, presented later in this chapter, is an example of the I/O perspective, which focuses on analyzing external forces and industry variables as a basis for getting and keeping competitive advantage. Competitive advantage is determined largely by competitive positioning within an industry, according to I/O advocates. Managing strategically from the I/O perspective entails firms striving to compete in attractive industries, avoiding weak or faltering industries, and gaining a full understanding of key external factor relationships within that attractive industry. I/O research provides important contributions to our understanding of how to gain competitive advantage.

I/O theorists contend that external factors in general and the industry in which a firm chooses to compete has a stronger influence on the firm's performance than do the internal functional decisions managers make in marketing, finance, and the like. Firm performance, they contend, is primarily based more on industry properties, such as economies of scale, barriers to market entry, product differentiation, the economy, and level of competitiveness than on internal resources, capabilities, structure, and operations. The global economic recession's impact on both strong and weak firms has added credence of late to the notion that external forces are more important than internal. Many thousands of internally strong firms in 2006–2007 disappeared in 2008–2009.

The I/O view has enhanced our understanding of strategic management. However, it is not a question of whether external or internal factors are more important in gaining and maintaining competitive advantage. Effective integration and understanding of both external and internal factors is the key to securing and keeping a competitive advantage. In fact, as discussed in Chapter 6, matching key external opportunities/threats with key internal strengths/weaknesses provides the basis for successful strategy formulation.

Economic Forces

Increasing numbers of two-income households is an economic trend in the United States. Individuals place a premium on time. Improved customer service, immediate availability, trouble-free operation of products, and dependable maintenance and repair services are becoming more important. People today are more willing than ever to pay for good service if it limits inconvenience.

Economic factors have a direct impact on the potential attractiveness of various strategies. For example, when interest rates rise, funds needed for capital expansion become more costly or unavailable. Also, when interest rates rise, discretionary income declines, and the demand for discretionary goods falls. When stock prices increase, the desirability of equity as a source of capital for market development increases. Also, when the market rises, consumer and business wealth expands. A summary of economic variables that often represent opportunities and threats for organizations is provided in Table 3-1.

An economic variable of significant importance in strategic planning is gross domestic product (GDP), especially across countries. Table 3-2 lists the GDP of various countries in Asia for all of 2009. Unlike most countries in Europe and the Americas, most Asian countries expect positive GDP growth in 2009.

Trends in the dollar's value have significant and unequal effects on companies in different industries and in different locations. For example, the pharmaceutical, tourism, entertainment, motor vehicle, aerospace, and forest products industries benefit greatly when the dollar falls against the yen and euro. Agricultural and petroleum industries are hurt by the dollar's rise against the currencies of Mexico, Brazil, Venezuela, and Australia. Generally, a strong or high dollar makes U.S. goods more expensive in overseas markets. This worsens the U.S. trade deficit. When the value of the dollar falls, tourism-oriented firms benefit because Americans do not travel abroaas much when the value of the dollar is low; rather, foreigners visit and vacation more in the United States.

A low value of the dollar means lower imports and higher exports; it helps U.S. companies' competitiveness in world markets. The dollar has fallen to five-year lows against the euro and yen, which makes U.S. goods cheaper to foreign consumers and combats deflation by pushing up prices of imports. However, European firms such as Volkswagen AG, Nokia Corp., and Michelin complain that the strong euro hurts their financial performance. The low value of the dollar benefits the U.S. economy in many ways. First, it helps stave off the risks of deflation in the United States and also reduces the U.S. trade deficit. In addition, the low value of the dollar raises the foreign sales and profits of domestic firms, thanks to dollar-induced gains, and encourages foreign countries to lower interest rates and loosen fiscal policy, which stimulates worldwide economic expansion. Some sectors, such as consumer staples, energy, materials, technology, and health care, especially benefit from a low value of the dollar. Manufacturers in many domestic industries in fact benefit because of a weak dollar, which forces foreign rivals to raise prices and extinguish discounts. Domestic firms with big overseas sales, such as McDonald's, greatly benefit from a weak dollar.

Between March and June 2009, the U.S. dollar weakened 11.0 percent against the euro, due to the growing United States debt, which may soon exceed $12 trillion. Table 3-3 lists some advantages and disadvantages of a weak U.S. dollar for American firms.

Rising unemployment rates across the United States have touched off a race among states to attract businesses with tax breaks and financial incentives. New Jersey has promised to send a $3,000 check to every small business that hires a new employee. Minnesota is offering tax-free zones for companies that create "green jobs." Colorado has created a $5 million fund for banks that open credit lines for small businesses. To minimize risk in incentive deals, may states write in claw-back provisions that require companies to return funds if they fail to create the promised number of jobs.

The slumping economy worldwide and depressed prices of assets has dramatically slowed the migration of people from country to country and from the city to the suburbs. Because people are not moving nearly as much as in years past, there is lower and lower demand for new or used houses. Thus the housing market is expected to remain very sluggish well into 2010 and 2011.

Key Economic Variables to Be Monitored

Shift to a service economy in the United States	Import/export factors
Availability of credit	Demand shifts for different categories of goods and services
Level of disposable income	Income differences by region and consumer groups
Propensity of people to spend	Price fluctuations
Interest rates	Export of labor and capital from the United States
Inflation rates	Monetary policies
Money market rates	Fiscal policies
Federal government budget deficits	Tax rates
Gross domestic product trend	European Economic Community (EEC) policies
Consumption patterns	Organization of Petroleum Exporting Countries (OPEC) policies
Unemployment trends	Coalitions of Lesser Developed Countries (LDC) policies
Worker productivity levels	
Value of the dollar in world markets	
Stock market trends	
Foreign countries' economic conditions	

Environment Forces

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats arising from changes in social, cultural, demographic, and environmental variables. In every way, the United States is much different today than it was yesterday, and tomorrow promises even greater changes.

The United States is getting older and less white. The oldest members of America's 76 million baby boomers plan to retire in 2011, and this has lawmakers and younger taxpayers deeply concerned about who will pay their Social Security, Medicare, and Medicaid. Individuals age 65 and older in the United States as a percentage of the population will rise to 18.5 percent by 2025. The five "oldest" states and five "youngest" states in 2007 are given in Table 3-4.

By 2075, the United States will have no racial or ethnic majority. This forecast is aggravating tensions over issues such as immigration and affirmative action. Hawaii, California, and New Mexico already have no majority race or ethnic group.

The population of the world surpassed 7.0 billion in 2010; the United States has just over 310 million people. That leaves billions of people outside the United States who may be interested in the products and services produced through domestic firms. Remaining solely domestic is an increasingly risky strategy, especially as the world population continues to grow to an estimated 8 billion in 2028 and 9 billion in 2054.

Social, cultural, demographic, and environmental trends are shaping the way Americans live, work, produce, and consume. New trends are creating a different type of consumer and, consequently, a need for different products, different services, and different strategies. There are now more American households with people living alone or with unrelated people than there are households consisting of married couples with children. American households are making more and more purchases online. Beer consumption in the United States is growing at only 0.5 percent per year, whereas wine consumption is growing 3.5 percent and distilled spirits consumption is growing at 2.0 percent. 2 Beer is still the most popular alcoholic beverage in the United States, but its market share has dropped from 59.5 percent in its peak year of 1995 to 56.7 percent today. For a wine company such as Gallo, this trend is an opportunity, whereas for a firm such as Adolph Coors Brewing, this trend is an external threat.

The trend toward an older America is good news for restaurants, hotels, airlines, cruise lines, tours, resorts, theme parks, luxury products and services, recreational vehicles, home builders, furniture producers, computer manufacturers, travel services, pharmaceutical firms, automakers, and funeral homes. Older Americans are especially interested in health care, financial services, travel, crime prevention, and leisure. The world's longest-living people are the Japanese, with Japanese women living to 86.3 years and men living to 80.1 years on average. By 2050, the Census Bureau projects that the number of Americans age 100 and older will increase to over 834,000 from just under 100,000 centenarians in the United States in 2000. Americans age 65 and over will increase from 12.6 percent of the U.S. population in 2000 to 20.0 percent by the year 2050.

The aging American population affects the strategic orientation of nearly all organizations. Apartment complexes for the elderly, with one meal a day, transportation, and utilities included in the rent, have increased nationwide. Called lifecare facilities, these complexes now exceed 2 million. Some well-known companies building these facilities include Avon, Marriott, and Hyatt. Individuals age 65 and older in the United States comprise 13 percent of the total population; Japan's elderly population ratio is 17 percent, and Germany's is 19 percent.

Americans were on the move in a population shift to the South and West (Sunbelt) and away from the Northeast and Midwest (Frostbelt), but the recession and housing bust nationwide has slowed migration throughout the United States. More Americans are staying in place rather than moving. New jobs are the primary reason people move across state lines, so with 3 million less jobs in the United States in 2008–2009 alone, there is less need to move. Falling home prices also have prompted people to avoid moving. The historical trend of people moving from the Northeast and

Midwest to the Sunbelt and West has dramatically slowed. The worldwide recession is also reducing international immigration, down roughly 10 percent in both 2008 and 2009. Hard number data related to this information can represent key opportunities for many firms and thus can be essential for successful strategy formulation, including where to locate new plants and distribution centers and where to focus marketing efforts.

A summary of important social, cultural, demographic, and environmental variables that represent opportunities or threats for virtually all organizations is given in Table.

Key Social, Cultural, Demographic, and Natural Environment Variables

Childbearing rates	Attitudes toward retirement
Number of special-interest groups	Attitudes toward leisure time
Number of marriages	Attitudes toward product quality
Number of divorces	Attitudes toward customer service
Number of births	Pollution control
Number of deaths	Attitudes toward foreign peoples
Immigration and emigration rates	Energy conservation
Social Security programs	Social programs
Life expectancy rates	Number of churches
Per capita income	Number of church members
Location of retailing, manufacturing, and service businesses	Social responsibility
Attitudes toward business	Attitudes toward careers
Lifestyles	Population changes by race, age, sex, and level of affluence
Traffic congestion	Attitudes toward authority
Inner-city environments	Population changes by city, county, state, region, and country
Average disposable income	Value placed on leisure time
Trust in government	Regional changes in tastes and preferences
Attitudes toward government	Number of women and minority workers
Attitudes toward work	Number of high school and college graduates by geographic area
Buying habits	Recycling
Ethical concerns	Waste management
Attitudes toward saving	Air pollution
Sex roles	Water pollution
Attitudes toward investing	Ozone depletion
Racial equality	Endangered species
Use of birth control	
Average level of education	
Government regulation	

Political, Governmental, and Legal Forces

Federal, state, local, and foreign governments are major regulators, deregulators, subsidizers, employers, and customers of organizations. Political, governmental, and legal factors, therefore, can represent key opportunities or threats for both small and large organizations.

For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit. Changes in patent laws, antitrust legislation, tax rates, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies.

In the face of a deepening global recession, countries worldwide are resorting to protectionism to safeguard their own industries. European Union (EU) nations, for example, have tightened their own trade rules and resumed subsidies for various of their own industries while barring imports from certain other countries. The EU recently restricted imports of U.S. chicken and beef. India is increasing tariffs on foreign steel. Russia perhaps has instituted the most protectionist measures in recent months by raising tariffs on most imports and subsidizing its own exports. Russia even imposed a new toll on trucks from the EU, Switzerland, and Turkmenistan. Despite these measures taken by other countries, the United States has largely refrained from "Buy American" policies and protectionist measures, although there are increased tariffs on French cheese and Italian water. Many economists say the current rash of trade constraints will make it harder for global economic growth to recover from the global recession. Global trade is expected to decrease 2.1 percent in 2009 compared to an increase of 6.2 percent in 2008. 3 Russia has said that "protective tariffs are necessary to allow Russian companies to survive the recession." This view unfortunately is also the view at an increasing number of countries.

Governments are taking control of more and more companies as the global economic recession cripples firms considered vital to the nation's financial stability. For example, France in 2009 took a 2.35 percent equity stake in troubled car-parts maker Valeo SA. President Nicolas Sarkozy of France has created a $20 billion strategic fund to lend cash to banks and carmakers as many governments become more protectionist. The United States of course also is taking equity stakes in financial institutions and carmakers and is "bailing out" companies too.

The UK government in 2009 took a 95 percent stake in the banking giant Royal Bank of Scotland Group PLC in a dramatic move toward nationalization. The government gave the bank $37 billion and insured another $300 billion of the bank's assets. The UK government also recently increased its stake in Lloyds Banking Group PLC to 75 percent. Similarly, the U.S. government has taken over Fannie Mae and Freddie Mac and has raised its stake even in Citigroup to 40 percent.

As more and more companies around the world accept government bailouts, those companies are being forced to march to priorities set by political leaders. Even in the United States, the federal government is battling the recession with its deepest intervention in the economy since the Great Depression. The U.S. government now is a strategic manager in industries from banking to insurance to autos. Governments worldwide are under pressure to protect jobs at home and maintain the nation’s industrial base. For example, in France, Renault SA’s factory in Sandouville is one of the most unproductive auto factories in the world. However, Renault has taken $3.9 billion in low-interest loans from the French government, so the company cannot close any French factories for the duration of the loan or resort to mass layoffs in France for a year.

Political relations between Japan and China have thawed considerably in recent years, which is good for the world economy because China’s low-cost manufactured goods have become essential for the functioning of most industrialized nations. Chinese premier Wen Jiabao addressed the Japanese parliament in 2007, something no Chinese leader has done for more than 20 years, and Japanese prime minister Shinzo Abe has visited Beijing. Japan’s largest trading partner is China, and China’s third-largest trading partner is Japan—after the European Union, number one, and the United States, number two.

Local, state, and federal laws; regulatory agencies; and special-interest groups can have a major impact on the strategies of small, large, for-profit, and nonprofit organizations. Many companies have altered or abandoned strategies in the past because of political or governmental actions. In the academic world, as state budgets have dropped in recent years, so too has state support for colleges and universities. Due to the decline in monies received from the state, many institutions of higher learning are doing more fundraising on their own—naming buildings and classrooms, for example, for donors. A summary of political, governmental, and legal variables that can represent key opportunities or threats to organizations is provided in Table

Some Political, Governmental, and Legal Variables

Government regulations or deregulations	Sino-American relationships
Changes in tax laws	Russian-American relationships
Special tariffs	European-American relationships
Political action committees	African-American relationships
Voter participation rates	Import–export regulations
Number, severity, and location of government protests	Government fiscal and monetary policy changes
Number of patents	Political conditions in foreign countries
Changes in patent laws	Special local, state, and federal laws
Environmental protection laws	Lobbying activities
Level of defense expenditures	Size of government budgets
Legislation on equal employment	World oil, currency, and labor markets
Level of government subsidies	Location and severity of terrorist activities
Antitrust legislation	Local, state, and national elections

Technological Forces

Revolutionary technological changes and discoveries are having a dramatic impact on organizations. CEO Chris DeWolfe of MySpace is using technology to expand the firm’s 1,600-person workforce in 2009 even as the economic recession deepens. MySpace expects a 17 percent increase in revenue in 2009. Nearly half of the site’s 130 million members worldwide are 35 and older, and 76 million of the members are from the United States. This compares to rival Facebook that has 150 million members worldwide but only 55 million in the United States. MySpace is continually redesigning the site and revamping the way its members can manage their profiles and categorize their friends, and enabling consumers to listen to free streaming audio and songs. Doug Morris, CEO of Universal Music Group, says, “There is a lot of conflict between technology and content, and Chris has successfully brought both together.” 4

The Internet has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility. The Internet is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors.

To effectively capitalize on e-commerce, a number of organizations are establishing two new positions in their firms: chief information officer (CIO) and chief technology officer (CTO). This trend reflects the growing importance of information technology (IT) in strategic management. A CIO and CTO work together to ensure that information needed to formulate, implement, and evaluate strategies is available where and when it is needed. These individuals are responsible for developing, maintaining, and updating a company’s information database. The CIO is more a manager, managing the firm’s relationship with stakeholders; the CTO is more a technician, focusing on technical issues such as data acquisition, data processing, decision-support systems, and software and hardware acquisition.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can dramatically affect organizations’ products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers. Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

Organizations that traditionally have limited technology expenditures to what they can fund after meeting marketing and financial requirements urgently need a reversal in thinking. The pace of technological change is increasing and literally wiping out businesses every day. An emerging consensus holds that technology management is one of the key responsibilities of strategists. Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

In practice, critical decisions about technology too often are delegated to lower organizational levels or are made without an understanding of their strategic implications. Many strategists spend countless hours determining market share, positioning products in terms of features and price, forecasting sales and market size, and monitoring distributors; yet too often, technology does not receive the same respect.

Not all sectors of the economy are affected equally by technological developments. The communications, electronics, aeronautics, and pharmaceutical industries are much more volatile than the textile, forestry, and metals industries. A recent article in the Wall Street Journal detailed how wireless technology will change 10 particular industries. 5 Table 3-7 provides a glimpse of this article.

Examples of the Impact of Wireless Technology

Airlines—Many airlines now offer wireless technology in flight.
Automotive—Vehicles are becoming wireless.
Banking—Visa sends text message alerts after unusual transactions.
Education—Many secondary (and even college) students may use smart phones for math because research shows this to be greatly helpful.
Energy—Smart meters now provide power on demand in your home or business.
Health Care—Patients use mobile devices to monitor their own health, such as calories consumed.
Hotels—Days Inn sends daily specials and coupons to hotel guests via text messages.
Market Research—Cell phone respondents provide more honest answers, perhaps because they are away from eavesdropping ears.
Politics—President Obama won the election partly by mobilizing Facebook and MySpace users, revolutionizing political campaigns. Obama announced his vice presidential selection of Joe Biden by a text message.
Publishing—eBooks are increasingly available.

Source: Based on Joe Mullich, "10 Industries That Wireless Will Change," *Wall Street Journal* (April 1, 2009): A12.

Competitive Forces

The top U.S. competitors in four different industries are identified in Table 3-8. An important part of an external audit is identifying rival firms and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table 3-9 is important in performing an external audit.

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family

Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers. Best Buy dropped prices wherever possible to finally put Circuit City totally out of business.

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether it's broke or not, fix it—make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology-driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

Key Questions About Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Competitive Intelligence Programs

What is competitive intelligence? Competitive intelligence (CI), as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP Web site).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

In April 2009, Starwood Hotels & Resorts Worldwide sued Hilton Hotels Corp. for allegedly stealing more than 100,000 confidential electronic and paper documents containing "Starwood's most competitively sensitive information." The complaint alleges that two Starwood executives, Ross Klein and Amar Lalvani, resigned from Starwood to join Hilton and took this information with them. The legal complaint says, "This is the clearest imaginable case of corporate espionage, theft of trade secrets, unfair competition and computer fraud." In addition to monetary awards, Starwood is seeking to force Hilton to cancel the rollout of the Denizen hotel chain. Hilton is owned by Blackstone Group.

Hiring top executives from rival firms is also a way companies obtain competitive intelligence. Just two days after Facebook's COO, Owen Van Natta, left the company in 2009, he accepted the CEO job at MySpace, replacing then CEO and cofounder Chris DeWolfe. Van Natta had previously also been Facebook's COO, chief revenue officer, and vice president of operations. The MySpace appointment now pits CEO Van Natta against his old boss at Facebook, CEO Mark Zuckerberg. Facebook passed MySpace in visitors worldwide in 2008 and is closing in on leadership in the United States. Both firms are fierce rivals in the Internet social-networking business.

A recent article in the Wall Street Journal detailed how computer spies recently broke into the Pentagon's $300 billion Joint Strike fighter project, one of the costliest weapons programs ever. 8 This intrusion and similar episodes of late have confirmed that any information a firm has available to anyone within the firm online may be at risk of being copied and/or siphoned away by adversaries or rival firms. A recent Pentagon report says the Chinese military in particular has made "steady progress" in developing online-warfare techniques, but rival firms in many industries have expert computer engineers who may be capable of similar unethical/unlawful tactics.

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering competitive intelligence did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

- Running an intelligence program requires lots of people, computers, and other resources.
- Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
- Intelligence gathering is an unethical business practice.

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and benefits of systematically collecting information about competitors for Strategic Planning purposes. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market. 10 Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organizationfrom the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on competitive analysis in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a director of competitive analysis include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information. Marriott and Motorola—two U.S. companies that do a particularly good job of gathering competitive intelligence—agree that all the information you could wish for can be collected without resorting to unethical tactics. They keep their intelligence staffs small, usually under five people, and spend less than $200,000 per year on gathering competitive intelligence.

Unilever recently sued Procter & Gamble (P&G) over that company's corporate-espionage activities to obtain the secrets of its Unilever hair-care business. After spending $3 million to establish a team to find out about competitors in the domestic hair-care industry, P&G allegedly took roughly 80 documents from garbage bins outside Unilever's Chicago offices. P&G produces Pantene and Head & Shoulders shampoos; Unilever has hair-care brands such as ThermaSilk, Suave, Salon Selectives, and Finesse. Similarly, Oracle Corp. recently admitted that detectives it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. Market commonality can be defined as the number and significance of markets that a firm competes in with rivals. 11 Resource similarity is the extent to which the type and amount of a firm's internal resources are comparable to a rival. 12 One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

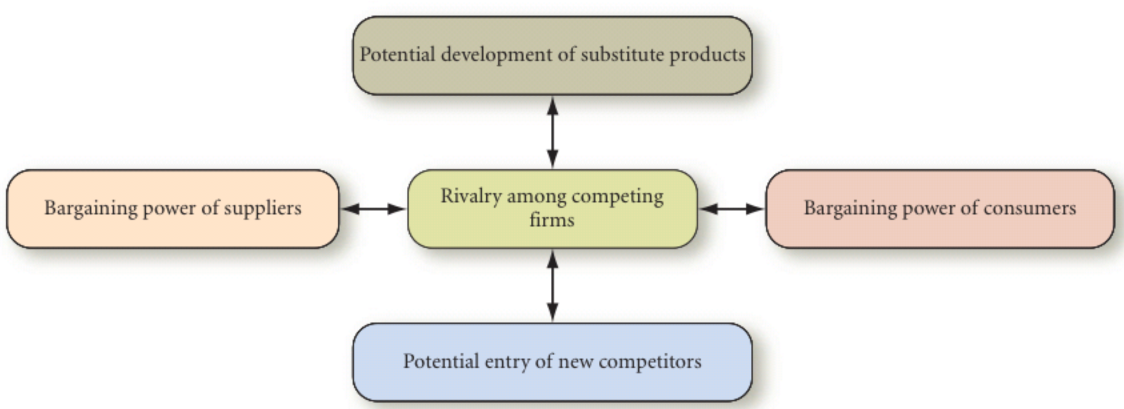
As illustrated in Figure 3-3, Porter's Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries. Table 3-10 reveals the average profit margin and return on investment for firms in different industries. Note the substantial variation among industries. For example, the range in profit margin goes from 0 to 18 for food production to computer software, respectively. Intensity of competition is highest in lower-return industries. The collective impact of competitive forces is so brutal in some industries that the market is clearly "unattractive" from a profit-making standpoint. Rivalry among existing firms is severe, new rivals can enter the industry with relative ease, and both suppliers and customers can exercise considerable bargaining leverage. According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

- Identify key aspects or elements of each competitive force that impact the firm.
- Evaluate how strong and important each element is for the firm.
- Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

The Five-Forces Model of Competition



Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

Free-flowing information on the Internet is driving down prices and inflation worldwide. The Internet, coupled with the common currency in Europe, enables consumers to make price comparisons easily across countries. Just for a moment, consider the implications for car dealers who used to know everything about a new car's pricing, while you, the consumer, knew very little. You could bargain, but being in the dark, you rarely could win. Now you can shop online in a few hours at every dealership within 500 miles to find the best price and terms. So you, the consumer, can win. This is true in many, if not most, business-to-consumer and business-to-business sales transactions today.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity and/or inventory; when the products being sold are commodities (not easily differentiated such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table 3-11 summarizes conditions that cause high rivalry among competing firms.

Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry's products
5. Falling product/service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry where producers of lawn mowers, rotary tillers, leaf blowers, and edgers such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton who specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers. 13

Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

- If they can inexpensively switch to competing brands or substitutes
- If they are particularly important to the seller
- If sellers are struggling in the face of falling consumer demand
- If they are informed about sellers' products, prices, and costs
- If they have discretion in whether and when they purchase the product 14

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

There are many excellent Web sites for gathering strategic information, but six that the author uses routinely are listed here:

- http://marketwatch.multexinvestor.com
- http://moneycentral.msn.com
- http://finance.yahoo.com
- www.clearstation.com
- https://us.etrade.com/e/t/invest/marketswww.hoovers.com

Most college libraries subscribe to Standard & Poor's (S&P's) Industry Surveys. These documents are exceptionally up-to-date and give valuable information about many different industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

- Current Environment
- Industry Trends
- How the Industry Operates
- Key Industry Ratios and Statistics
- How to Analyze a Company
- Glossary of Industry Terms
- Additional Industry Information
- References
- Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Many publications and sources on the Internet forecast external variables. Several published examples include Industry Week's "Trends and Forecasts," BusinessWeek's "Investment Outlook," and Standard & Poor's Industry Survey. The reputation and continued success of these publications depend partly on accurate forecasts, so published sources of information can offer excellent projections. An especially good Web site for industry forecasts is finance.yahoo.com. Just insert a firm's stock symbol and go from there.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results." 16 Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must always be made.

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.