Chapter 3
The External Assessment

Strategic Management: Concepts & Cases
10th Edition
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PowerPoint Slides by
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Chapter Outline
The Nature of the External Audit
The Industrial Organization (I/O) View
Social, Cultural, Demographic & Environmental Forces

Chapter Outline (cont’d)
Political, Governmental, and Legal Forces
Technological Forces
Competitive Forces

Chapter Outline (cont’d)
Porter’s Five-Forces Model
Sources of External Information
Forecasting Tools & Techniques

Chapter Outline (cont’d)
Global Challenge
The External Factor Evaluation (EFE) Matrix
Competitive Profile Matrix (CPM)

External Assessment
It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change. – Charles Darwin

Nothing focuses the mind better than the constant sight of a competitor who wants to wipe you off the map. – Wayne Calloway, Former CEO, PepsiCo
External Strategic Management Audit

-- Environmental Scanning

-- Industry Analysis

Identify & Evaluate factors beyond the control of a single firm
- Increased foreign competition
- Population shifts
- Information technology

Purpose of External Audit
- Identify
  - Opportunities
  - Threats

Key External Forces
- Economic forces
- Social, cultural, demographic & environmental forces
- Political, governmental & legal forces
- Technological forces
- Competitive forces

Key External Forces & the Organization

Competitors
Suppliers
Distributors
Creditors
Customers
Employees
Communities
Managers
Stockholders
Labor Unions
Special Interest Groups
Products
Services

Opportunities & Threats

Gather competitive intelligence –
- Social
- Cultural
- Demographic
- Environmental
- Economic
- Political, legal governmental
- Technological
External Audit – Sources of Information

- Internet
- Libraries
- Suppliers
- Distributors
- Customers
- Competition

Performing External Audit

-- Key Factors
  - Vary over time
  - Vary by industry

Performing External Audit -- Variables

- Market share
- Breadth of competing products
- World economies
- Foreign affiliates
- Proprietary account advantages

Performing External Audit -- Variables

- Price competitiveness
- Technological advancements
- Interest rates
- Pollution abatement

Industrial Organization (I/O) View

-- Industry factors more important than internal factors
  - Performance determined by industry forces
I/O Perspective Firm Performance

Industry Properties

- Economies of Scale
- Barriers to market entry
- Product differentiation
- Level of competitiveness

Economic Forces

- Availability of credit
- Level of disposable income
- Interest rates
- Inflation rates

Economic Forces

- Money market rates
- Fed Gov’t deficits
- GDP trend
- Consumption patterns

Key Economic Variables

- Unemployment trends
- Worker productivity levels
- Value of the dollar in world markets
- Stock market trends
- Foreign economic conditions

Key Economic Variables

- Import/Export factors
- Demand shifts for goods/services
- Income differences by region/customer
- Price fluctuations
- Exportation of labor and capital

Key Economic Variables

- Monetary policies
- Fiscal policies
- Tax rates
- OPEC policies
- ECC policies
Social, Cultural, Demographic & Environmental Forces

Major Impact –
- Products
- Services
- Markets
- Customers

U.S. Facts
- Aging population
- Less Caucasian
- Widening gap between rich & poor
- 2025 = 18.5% population >65 years
- 2075 = no ethnic or racial majority

Facts
- World population > 6 billion
- U.S. population < 300 million

Population characteristics require global strategies

Global trends
- 2003 – China largest exporter to U.S.
- 2003 Asia receives highest foreign direct investment

Global trends
- China’s labor rates less than Mexico
- China provides more site location incentives than Mexico
Export Trends

- Mexico: exports to U.S. 1.2% growth (2002)

Export Trends

- Mexico: corporate income tax rate 34%
- China: corporate income tax rate 17%

Social, Cultural, Demographic & Environmental Forces

21st Century Trends

- More educated consumers
- Aging population
- Minorities more influential
- Local rather than federal solutions

21st Century Trends (cont’d)

- Fixation with youth decreasing
- Hispanics increase to 15% by 2021
- African American increase to 14% by 2021

Key Social, Cultural, Demographic & Environmental Variables

- Childbearing rates
- Number of special interest groups
- Number of marriages & divorces
- Number of births & deaths
- Immigration & emigration rates

Monitor Key Variables

- Actuarial rates
- Per capita income
- Attitudes toward business
- Avg. disposable income
**Social, Cultural, Demographic & Environmental Forces**

- Consumer behavior
- Ethical concerns
- Attitudes toward saving
- Racial equality

**Variables**

**Political, Government & Legal Forces**

**Government Regulation**

**Key opportunities & threats**
- Antitrust legislation
- Tax rates
- Lobbying efforts
- Patent laws

**Increasing Global Interdependence**

**Political variables impact –**
- Formulation of strategies
- Implementation of strategies
Political, Government & Legal Forces

Increasing Global Interdependence

- Strategists in a global economy --
  - Forecast political climates
  - Legalistic skills
  - Diverse world cultures

Political, Government & Legal Forces

Globalization of Industry

- Worldwide trend toward similar consumption patterns
- Global buyers and sellers
- E-commerce
- Technology for instant currency transfers

Key Political, Governmental, & Legal Variables

- Regulation/deregulation
- Tax law changes
- Special tariffs
- PAC's
- Voter participation rates

Key Political, Governmental, & Legal Variables (cont’d)

- Number of patents
- Changes in patent laws
- Environmental protection laws
- Equal employment legislation
- Government subsidies

Key Political, Governmental, & Legal Variables (cont’d)

- Anti-trust enforcement
- Global relationships
- Import/export regulations
- Political conditions
- Location and severity of terrorist activity

Technological Forces

- Major Impact –
  - Internet
  - Communications
  - Semiconductors
Technological Forces

Significance of IT
- Chief Information Officer (CIO)
- Chief Technology Officer (CTO)

Technology-based issues
Essential for nearly every strategic decision

Competitive Forces

Collection & evaluation of data on competitors is essential for successful strategy formulation

Competition on virtually all industries can be described as intense.

Identifying Rival Firms

Strengths
- Weaknesses
- Capabilities
- Opportunities
- Threats
- Objectives
- Strategies

Key Questions Concerning Competitors

- Their strengths
- Their weaknesses
- Their objectives and strategies
- Their responses to external variables
- Their vulnerability to our alternative strategies
Key Questions Concerning Competitors (cont’d)

- Our vulnerability to strategic counterattack
- Our product/service positioning
- Entry and exit of firms in the industry
- Key factors for our current position in industry
- Sales/profit rankings of competitors over time

Key Questions Concerning Competitors (cont’d)

- Nature of supplier & distributor relationships
- The threat of substitute products/services
- Should we keep our strategies secret from employees and stakeholders?

Competitive Forces

Sources of Corporate Information

- Moody’s Manuals
- Standard Corporation Descriptions
- Value Line Investment Surveys
- Dun’s Business Rankings
- Standard & Poor’s Industry Surveys
- Industry Week
- Forbes, Fortune, Business Week

Competitive Forces

7 Characteristics of most Competitive U.S. Firms:

1. Market share matters
2. Understand what business you are in
3. Broke or not, fix it
4. Innovate or evaporate

Competitive Forces

7 Characteristics of most Competitive U.S. Firms:

5. Acquisition is essential to growth
6. People make a difference
7. No substitute for quality

The Five-Forces Model of Competition
The Five-Forces Model

Rivalry Among Competing Firms
- Most powerful of the five forces
- Focus on competitive advantage of strategies

Potential Entry of New Competitors
- Barriers to entry are important
- Quality, pricing, and marketing can overcome barriers

Potential Development of Substitute Products
- Pressures increase when consumer's switching costs decrease
- Firm's plans for increased capacity & market penetration

Bargaining Power of Suppliers
- Large number of suppliers & few substitutes affects intensity of competition
- Backward integration can gain control or ownership of suppliers

Bargaining Power of Consumers
- Customers concentrated or buy in volume affects intensity of competition
- Consumer power is higher where products are standard or undifferentiated

The Global Challenge
- Faced by U.S. Firms --
  • Gain & maintain exports to other nations
  • Defend domestic markets against imported goods
The Global Challenge

Multinational Corporations (MNC’s)

Simultaneously globally competitive & nationally responsive

Globalization

Worldwide integration of:
- Strategy formulation
- Strategy implementation
- Strategy evaluation

Globalization of Industries

- Similar consumption patterns
- Global buyers and sellers
- E-commerce
- Instant transmission of money & information

Industry Analysis: The External Factor Evaluation (EFE) Matrix

<table>
<thead>
<tr>
<th>Key External Factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Wtd Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opportunities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Global PC market expected to grow 20% in 2004</td>
<td>0.10</td>
<td>3</td>
<td>0.30</td>
</tr>
<tr>
<td>2. Cost of PC component parts expected to decrease 10% - 2004</td>
<td>0.10</td>
<td>3</td>
<td>0.30</td>
</tr>
<tr>
<td>3. Internet use growing rapidly</td>
<td>0.05</td>
<td>2</td>
<td>0.10</td>
</tr>
<tr>
<td>4. China entered WTO; lowered taxes for importing PC’s</td>
<td>0.10</td>
<td>1</td>
<td>0.10</td>
</tr>
<tr>
<td>5. The average income for PC worker has declined from $40K/yr to $30K/yr</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
</tr>
</tbody>
</table>

Key External Factors

Opportunities (cont’d)

6. Modernization of business firms and government agencies | 0.05   | 2      | 0.10      |
7. U.S. ( & world) economies recovering | 0.05   | 3      | 0.15      |
8. 30% of Chinese population can afford a PC; only 10% of homes have a PC | 0.05   | 1      | 0.05      |

Threats

1. Intense rivalry in industry | 0.10   | 1      | 0.05      |
EFE – Gateway Computers (2003) (cont’d)

Key External Factors

<table>
<thead>
<tr>
<th>Threats (cont’d)</th>
<th>Weight</th>
<th>Rating</th>
<th>Wtd Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Severe price cutting in PC industry</td>
<td>0.10</td>
<td>2</td>
<td>0.20</td>
</tr>
<tr>
<td>3. Different countries have different reg’s and infrastructure for PC’s</td>
<td>0.05</td>
<td>1</td>
<td>0.05</td>
</tr>
<tr>
<td>4. Palm &amp; PDA becoming substitutes</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
</tr>
<tr>
<td>5. Demand exceeds supply of experienced PC workers</td>
<td>0.05</td>
<td>4</td>
<td>0.20</td>
</tr>
<tr>
<td>6. Birth rate in U.S. declining annually</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
</tr>
</tbody>
</table>

EFE – Gateway Computers (2003) (cont’d)

Key External Factors

<table>
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<th>Threats (cont’d)</th>
<th>Weight</th>
<th>Rating</th>
<th>Wtd Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. U.S. consumers and businesses delaying purchase of PC’s</td>
<td>0.05</td>
<td>2</td>
<td>0.10</td>
</tr>
<tr>
<td>8. PC firms diversifying into consumer electronics</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
</tr>
<tr>
<td>Total</td>
<td>1.00</td>
<td>2</td>
<td>2.40</td>
</tr>
</tbody>
</table>

Industry Analysis EFE

Total weighted score of 4.0
- Organization response is outstanding to threats and weaknesses

Total weighted score of 1.0
- Firm’s strategies not capitalizing on opportunities or avoiding threats

Industry Analysis: Competitive Profile Matrix (CPM)

Identifies firm’s major competitors and their strengths & weaknesses in relation to a sample firm’s strategic positions

<table>
<thead>
<tr>
<th>CSF’s</th>
<th>Gateway</th>
<th>Apple</th>
<th>Dell</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wt</td>
<td>Rating</td>
<td>Wtd Score</td>
<td>Rating</td>
</tr>
<tr>
<td>Market share 0.15</td>
<td>3</td>
<td>0.45</td>
<td>2</td>
</tr>
<tr>
<td>Inventory sys 0.08</td>
<td>2</td>
<td>0.16</td>
<td>2</td>
</tr>
<tr>
<td>Fin position 0.10</td>
<td>2</td>
<td>0.20</td>
<td>3</td>
</tr>
<tr>
<td>Prod. Quality 0.08</td>
<td>3</td>
<td>0.24</td>
<td>4</td>
</tr>
<tr>
<td>Cons. Loyalty 0.02</td>
<td>3</td>
<td>0.06</td>
<td>3</td>
</tr>
<tr>
<td>Sales Distr 0.10</td>
<td>3</td>
<td>0.30</td>
<td>2</td>
</tr>
<tr>
<td>Global Exp. 0.15</td>
<td>3</td>
<td>0.45</td>
<td>2</td>
</tr>
<tr>
<td>Org. Structure 0.05</td>
<td>3</td>
<td>0.15</td>
<td>3</td>
</tr>
</tbody>
</table>

Important --
Understanding the factors used in the EFE Matrix is more important than the actual weights and ratings assigned.
### Industry Analysis CPM

**Important --**

Just because one firm receives a 3.2 rating and another receives a 2.8 rating, it does not follow that the first firm is 20 percent better than the second.

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### Key Terms & Concepts

**For Review (Chapter 3)**

**AOL**

**Competitive Analysis**

**, Chief Information Officer (CIO)**

**Competitive Intelligence (CI)**

**, Chief Technology Officer (CTO)**

**Competitive Profile Matrix (CPM)**

**, Competitive Advantage**

**Decruiting**

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**For Review (Chapter 3)**

**Key Terms & Concepts**

**Information Technology (IT)**

**Lifecare Facilities**

**, Internet**

**Porter’s Five-Forces Model**

**, Learning from the Partner**

**Rightsizing**

**, Linear Regression**

**World Wide Web**

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**For Review (Chapter 3)**

**Key Terms & Concepts**

**Director of Competitive Analysis**

**External Factor Evaluation Matrix (EFE)**

**, Downsizing**

**External Forces**

**, Environmental Scanning**

**Industry Analysis**

**, External Audit**

**Industrial Organizational (I/O)**

**, Financial Harmonization**

**Foreign Direct Investment**