UNIT – 3 ENVIRONMENTAL ANALYSIS

SYLLABUS:

Environmental Analysis: Environmental Scanning – Industry analysis- Porter's Five Forces analysis- Internal Scanning- External factors of analysis – SWOT analysis- Value Chain Analysis Stakeholders Expectations- Scenario Planning

ENVIRONMENTAL ANALYSIS

- Environmental analysis is a strategic tool.
- It is a process to identify all the external and internal elements, which can affect the organization's performance.
- The analysis entails assessing the level of threat or opportunity the factors might present.
- These evaluations are later translated into the decision-making process.
- The analysis helps align strategies with the firm's environment.
- Businesses are greatly influenced by their environment, so they must constantly analyze the trade environment and the market.

PESTEL FRAMEWORK

- There are many strategic analysis tools that a firm can use, but some are more common.
- The most used detailed analysis of the environment is the PESTEL analysis.
- This is a bird's eye view of the business conduct.
- Managers and strategy builders use this analysis to find where their market currently.
- It also helps foresee where the organization will be in the future.
- PESTEL analysis consists of various factors that affect the business environment.
- These factors can affect every industry directly or indirectly.

- **P** Is for "Political.
- **E** Is for "Economic".
- **S** Is for "Social".
- **T** Is for "Technological".
- **E** Is for "Environmental".
- **L** Is for "Legal".

Political Factors

- The political factors take the country's current political situation.
- It also reads the global political condition's effect on the country and business.
- Some of the factors considered for analysis are:
  - Government policies
  - Taxes laws and tariff
  - Stability of government
  - Entry mode regulations

Economic Factors

- Economic factors involve all the determinants of the economy and its state.
- These are factors that can conclude the direction in which the economy might move.
- So, businesses analyze this factor based on the environment.
- It helps to set up strategies in line with changes.

Economic Factors

- Some of the determinants considered for analysis are:
  - The inflation rate
  - The interest rate
  - Disposable income of buyers
  - Credit accessibility
  - Unemployment rates
  - The monetary or fiscal policies
  - The foreign exchange rate

Social Factors

- Countries vary from each other.
- Every country has a distinctive mindset.
- These attitudes have an impact on the businesses.
- The social factors might ultimately affect the sales of products and services.

Social Factors

- Some of the social factors analysed:
  - The cultural implications
  - The gender and connected demographics
  - The social lifestyles
  - The domestic structures
  - Educational levels
  - Distribution of Wealth

Technological Factors

- Technology is advancing continuously.
- The advancement is greatly influencing businesses.
- Performing environmental analysis on these factors will help you stay up to date with the changes.
- Technological factors will help you know how the consumers react to various trends.
- Social media has become a vital part of any business now-a-days.

Technological Factors

- Companies will have to perform this analysis for their benefit. It helps them:
  - New discoveries
  - Rate of technological obsolescence
  - Rate of technological advances
  - Innovative technological platforms

Environment Factors

- The location influences business trades.
- Climatic changes can affect the trade of businesses.
- The consumer reactions to particular offering can also be an issue.
- This most often affects agri-businesses.
- Some environmental factors to be noticed are:
  - Geographical location
  - The climate and weather
  - Waste disposal laws
  - Energy consumption regulation
  - People's attitude towards the environment

Legal Factors

- Legislative changes take place from time to time.
- Many of these changes affect the business environment.
- If a regulatory body sets up a regulation for industries, for example, that law would impact industries and business in that economy.
- So, businesses should also analyze the legal developments in respective environments.
- Some of the legal factors to be aware of:
  - Product regulations
  - Employment regulations
  - Competitive regulations
  - Patent infringements
  - Health and safety regulations

IMPORTANCE OF ENVIRONMENT ANALYSIS

- There are many external factors other than the ones discussed.
- None of these factors are independent.
- They rely on each other.
- It is true that industry factors have an impact on the company performance.
- Environmental analysis is essential to determine what role certain factors play in your business.
- PEST or PESTEL analysis allows businesses to take a look at the external factors.
- Many organizations use these tools to project the growth of their company effectively.
- The analyses provide a good look at factors like revenue, profitability, and corporate success.

STEPS TO CONDUCT ENVIRONMENT ANALYSIS

- ✓ Understand all the environmental factors before moving to the next step.
- ✓ Collect all the relevant information.
- ✓ Identify the opportunities for the organization.
- ✓ Recognize the threats the company faces.
- ✓ The final step is to take action.

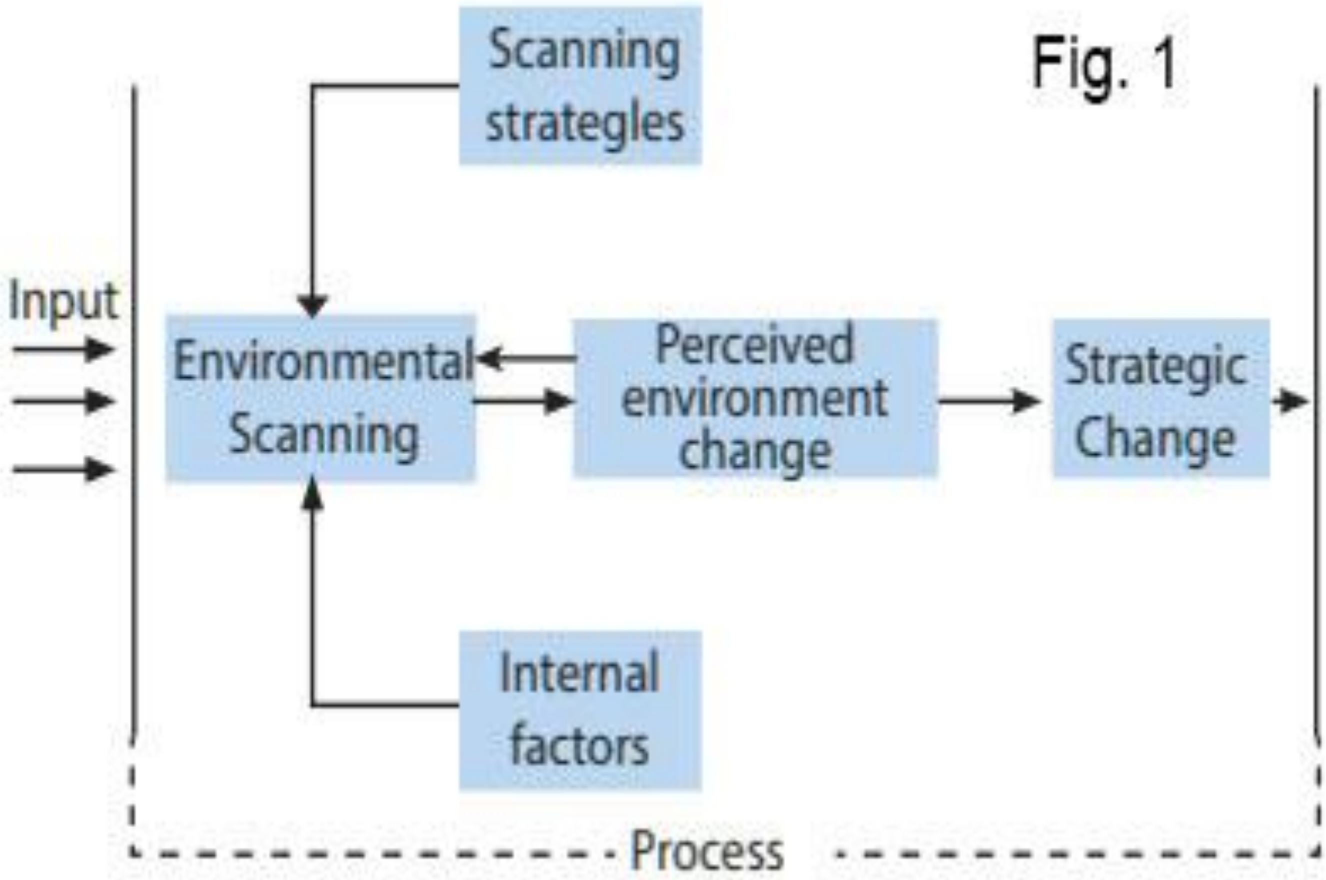
PESTEL ANALYSIS OF FOOD INDUSTRY IN INDIA

- Political Factors:
  - FDI & growth
  - Wide regulations
  - EXIM Policy
  - Harmonised System for tariff rates
- Economic Factors:
  - Growing Disposable Incomes
  - Increasing Labor Costs
  - GDP
  - Inflation
  - Fiscal Policy

- Social Factors:
  - Health consciousness
  - Dietary Regulations
- Technological Factors:
  - Growth of e-commerce & digital economy
  - Automation
- Environmental Factors:
  - Organic farming
- Legal Factors:
  - Food Safety & Standards Authority of India (FSSAI)
  - Bureau of Indian Standards (BIS) & Indian Standards Institute (ISI)
  - Custom Clearance Procedure
  - International Organisation for Standardisation (ISO)
  - Agmark
  - Food Safety & Standards (Packing & labelling) Regulation

ENVIRONMENTAL SCANNING

- Every organization has an internal and external environment.
- In order for the organization to be successful, it is important that it scans its environment regularly to assess its developments and understand factors that can contribute to its success.
- Environmental scanning is a process used by organizations to monitor their external and internal environments.


Scanning
strategles
Input
Environmental
Scanning
Perceived
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Strategic
Change
Internal
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Process
Fig. 1

COMPONENTS OF A BUSINESS ENVIRONMENT

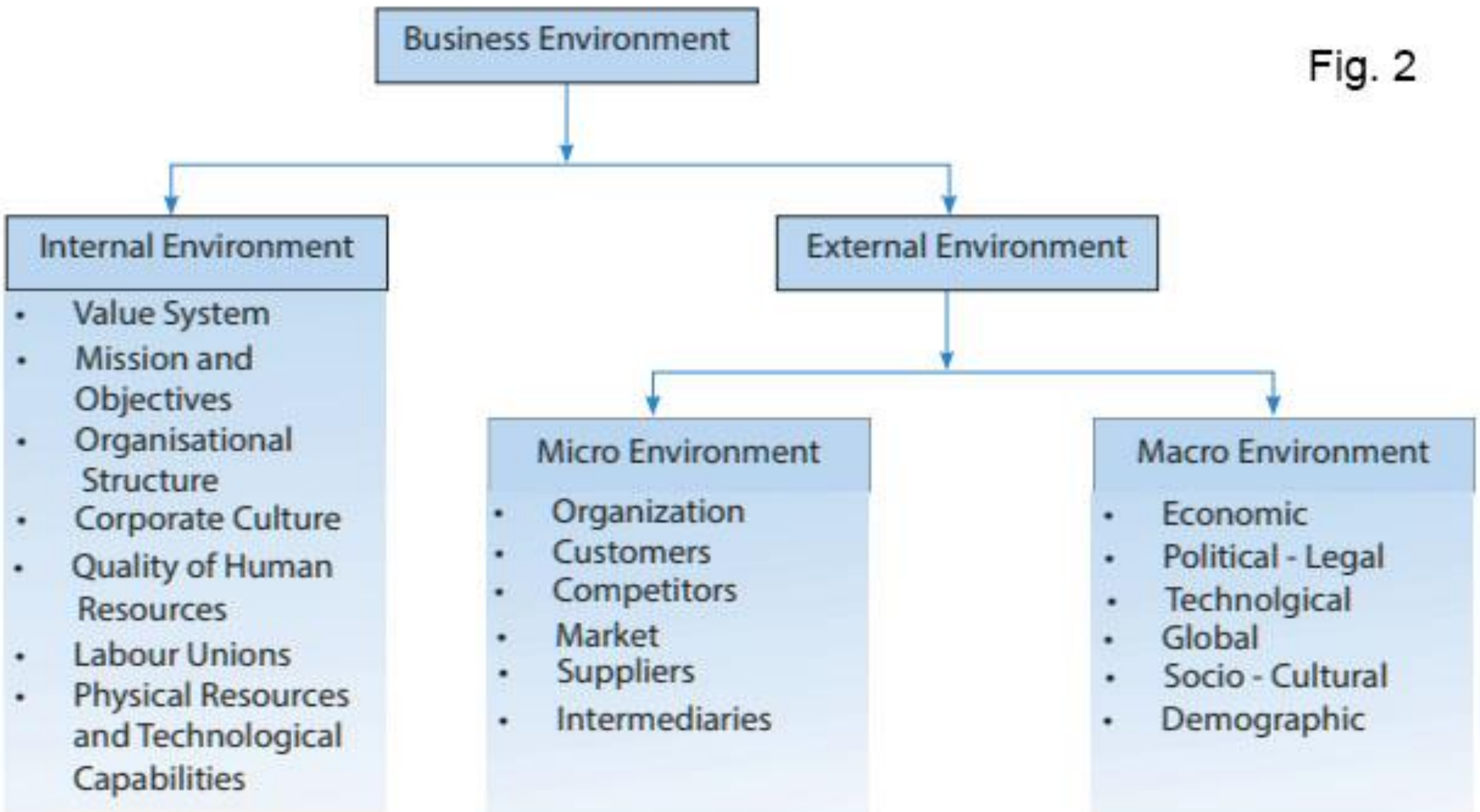


Fig. 2

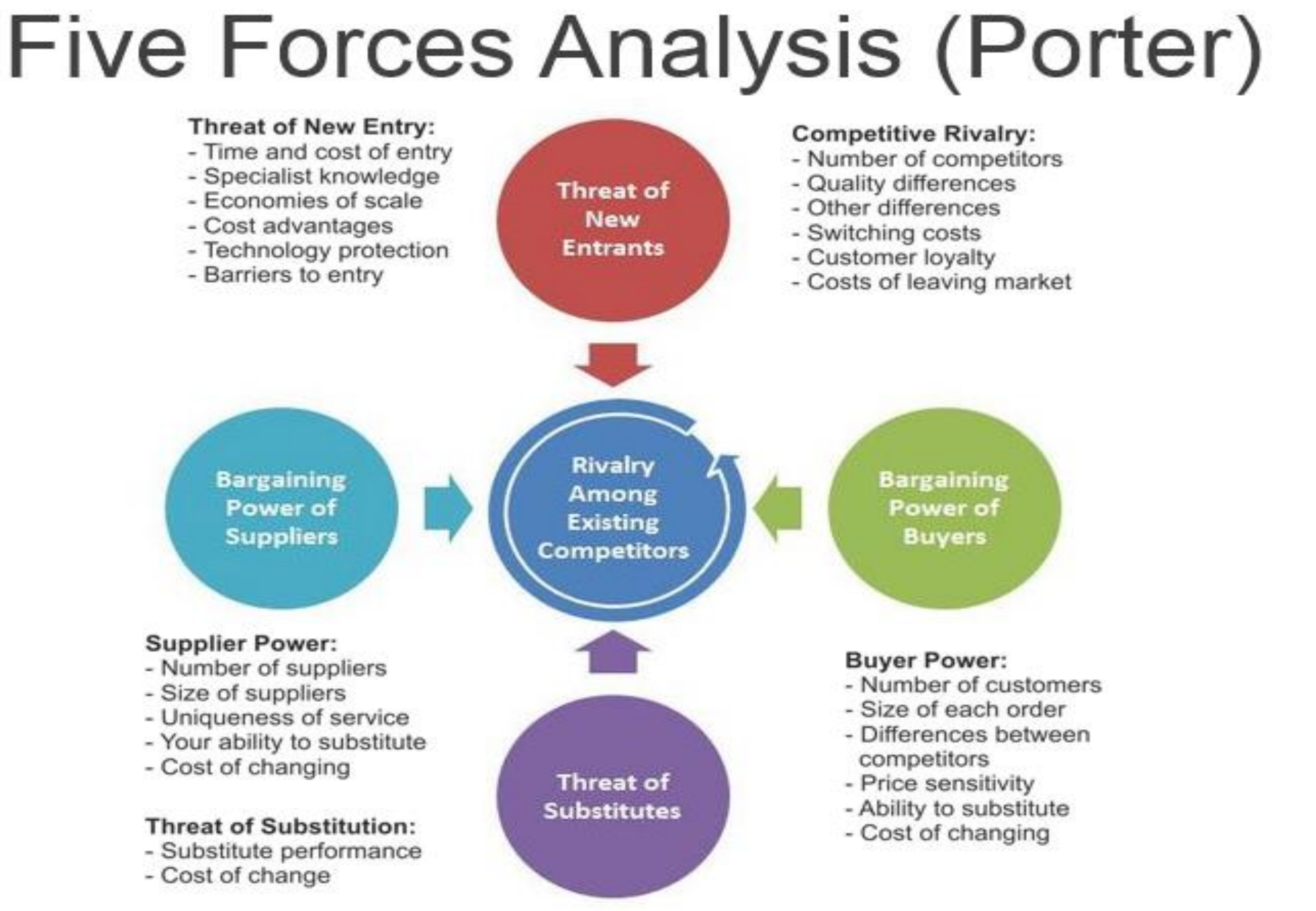
Industry analysis

- Industry analysis is a tool that facilitates a company's understanding of its position relative to other companies that produce similar products or services.
- Understanding the forces at work in the overall industry is an important component of effective strategic planning.
- Industry analysis enables small business owners to identify the threats and opportunities facing their businesses, and to focus their resources on developing unique capabilities that could lead to a competitive advantage

Porter's five forces model

- "**Porter's five forces model** is an analysis tool that uses five forces to determine the profitability of an industry and shape a firm's competitive strategy"
- "It is a framework that classifies and analyzes the most important forces affecting the intensity of competition in an industry and its profitability level."

Porter's Five Forces Model



PORTER'S FIVE FORCES MODEL

- Originally developed by Harvard Business School's **Michael E. Porter** in 1979, the five forces model looks at five specific factors that help determine whether or not a business can be profitable, based on other businesses in the industry.
- Understanding the competitive forces, and their underlying causes, reveals the roots of an industry's current profitability while providing a framework for anticipating and influencing competition (and profitability) over time," Porter wrote in a Harvard Business Review article.

Porter's Five Forces Model

- **<u>Competitive rivalry</u>**. This force examines how intense the competition currently is in the marketplace, which is determined by the number of existing competitors and what each is capable of doing.
- Rivalry competition is high when there are just a few businesses equally selling a product or service, when the industry is growing and when consumers can easily switch to a competitors offering for little cost.
- When rivalry competition is high, advertising and price wars can ensue, which can hurt a business's bottom line.

Porter's Five Forces Model

- **Bargaining power of suppliers**. This force analyzes how much power a business's supplier has and how much control it has over the potential to raise its prices, which, in turn, would lower a business's profitability.
- In addition, it looks at the number of suppliers available: The fewer there are, the more power they have. Businesses are in a better position when there are a multitude of suppliers.
- Sources of supplier power also include the switching costs of firms in the industry, the presence of available substitutes, and the supply purchase cost relative to substitutes.

Porter's Five Forces Model

- **Bargaining power of customers**. This force looks at the power of the consumer to affect pricing and quality.
- Consumers have power when there aren't many of them, but lots of sellers, as well as when it is easy to switch from one business's products or services to another.
- Buying power is low when consumers purchase products in small amounts and the seller's product is very different from any of its competitors.

Porter's Five Forces Model

- **Threat of new entrants**. This force examines how easy or difficult it is for competitors to join the marketplace in the industry being examined.
- The easier it is for a competitor to join the marketplace, the greater the risk of a business's market share being depleted.
- Barriers to entry include absolute **cost advantages, access to inputs, economies of scale and well-recognized brands.**

Porter's Five Forces Model

- **<u>Threat of substitute products or services</u>**. This force studies how easy it is for consumers to switch from a business's product or service to that of a competitor.
- It looks at how many competitors there are, how their prices and quality compare to the business being examined and how much of a profit those competitors are earning, which would determine if they have the ability to lower their costs even more.
- The threat of substitutes are informed by switching costs, both immediate and long-term, as well as a buyer's inclination to change.

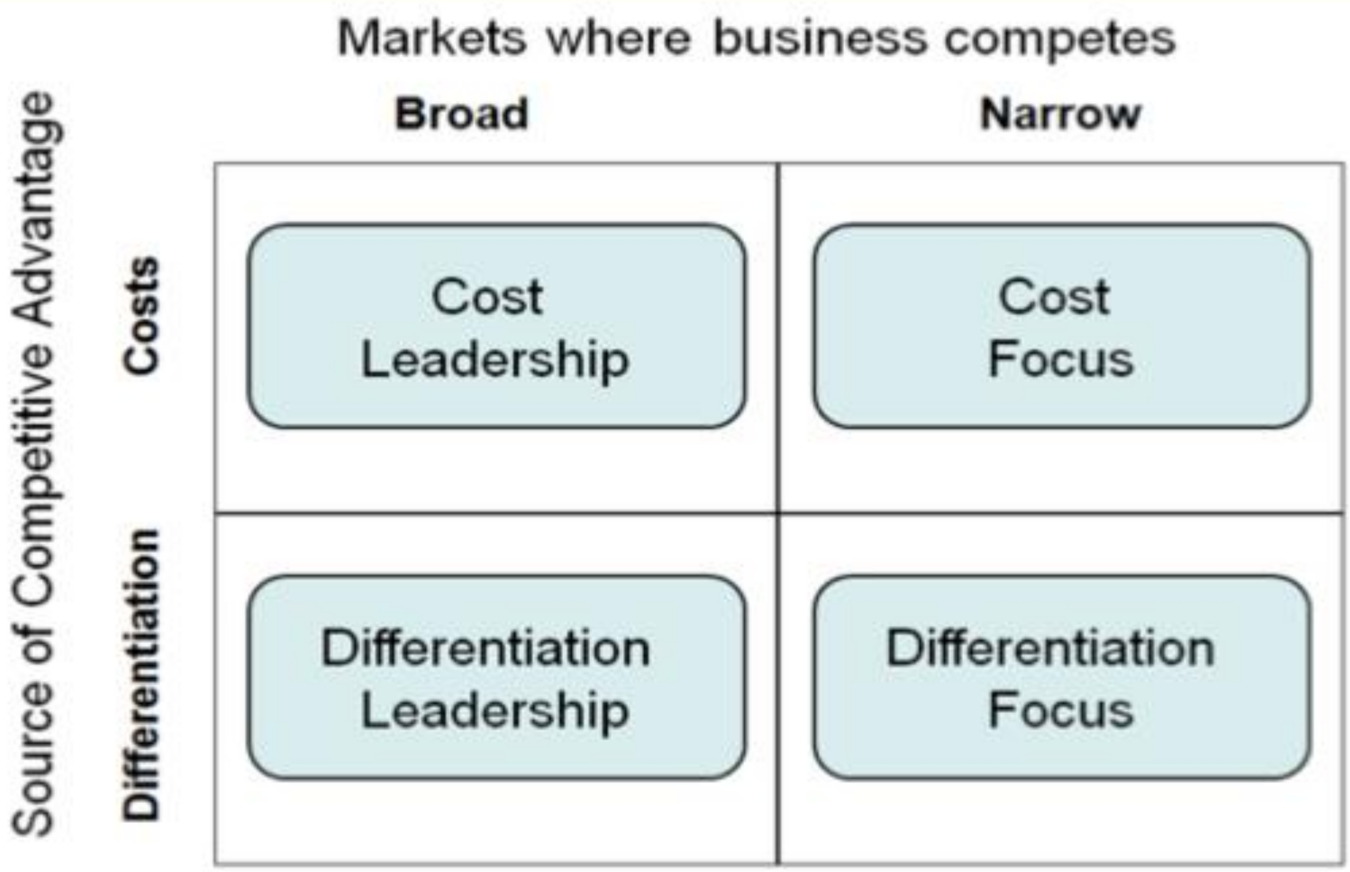
Porter's generic strategies

- Today, companies face their toughest competition ever.
- Companies use their understanding to design market offers to deliver more value than the offers of competitors seeking to win the same customers.
- Companies must also understand their competitors, identify and analyze their strategies to position themselves in such a way as to gain the greatest possible **competitive advantage** against competitors in the marketplace.

Porter's Generic Strategy Framework

- Michael Porter has suggested three general types of positioning strategies to achieve competitive advantage.
- These three generic strategies are defined along two dimensions: strategic scope and strategic strength.
  - *Strategic scope* looks at the size and composition of the market you intend to target.
  - *Strategic strength* is a supply-side dimension and looks at the strength or core competency of the firm.

Porter's Generic Strategies



Cost leadership

- With this strategy, the objective is to become the **lowest-cost producer in the industry**.
- The traditional method to achieve this objective is to produce on a large scale which enables the business to exploit economies of scale.
- This strategy is usually associated with large-scale businesses offering "standard" products with relatively **little differentiation** that are readily acceptable to the majority of customers.
- Occasionally, a low-cost leader will also discount its product to maximise sales, particularly if it has a significant cost advantage over the competition and, in doing so, it can further increase its market share.

- A strategy of cost leadership requires close cooperation between all the functional areas of a business.
- To be the lowest-cost producer, a firm is likely to achieve or use several of the following:
  - High levels of productivity
  - High capacity utilisation
  - Use of bargaining power to negotiate the lowest prices for production inputs
  - Lean production methods (e.g. JIT)
  - Effective use of technology in the production process
- Access to the most effective distribution channels

EXAMPLES

- ***Wal-Mart*** is famous for EDLP, achieved by developing close relationships with its suppliers and vendors to achieve cost savings through large volume purchases and pass these savings to the consumers.
- ***Dell Computers :***achieved market share by keeping low inventories and only building computers to order, procurement advantages from preferential access to raw materials, or backward integration.

- India’s largest steel company **Tata Steel,** the cost leader in the steel manufacturing sector owns raw material assets such as coaland limestone mines through joint ventures or completely, with the assets spread across countries such as Australia, Oman and Mozambique. Tata Steel has largely been able to withstand raw material price fluctuations due to captive iron ore mines.
- **Disadvantage** : Customer loyalty, a reputation for low quality, ends up in price wars, non sustainable

Differentiation leadership

- With differentiation leadership, the business targets much larger markets and aims to achieve **competitive advantage through differentiation across the whole of an industry.**
- This strategy involves selecting one or more criteria used by buyers in a market - and then positioning the business uniquely to meet those criteria.
- This strategy is usually associated with charging a **premium price** for the product - often to reflect the higher production costs and extra value-added features provided for the consumer.
- Differentiation is about charging a premium price that more than covers the additional production costs, and about giving customers clear reasons to prefer the product over other, less differentiated products.

- There are several ways in which this can be achieved, though it is not easy and it requires substantial and sustained marketing investment. The methods include:
- Superior product quality (features, benefits, durability, reliability)
- Branding (strong customer recognition & desire; brand loyalty)
- Industry-wide distribution across all major channels (i.e. the product or brand is an essential item to be stocked by retailers)
- Consistent promotional support – often dominated by advertising, sponsorship etc
- Great examples of a differentiation leadership include global brands like Nike and Mercedes. These brands achieve significant economies of scale, but they do not rely on a cost leadership strategy to compete. Their business and brands are built on persuading customers to become brand loyal and paying a premium for their products.

Cost focus

- Here a business seeks a lower-cost advantage in just one or a small number of market segments.
- The product will be basic - perhaps a similar product to the higher-priced and featured market leader, but acceptable to sufficient consumers. Such products are often called "me-too's".
- Example: All private brands that acts as substitutes for national brands.
- **Southwest Airlines**, famous for its low cost focus follows basically a linear route structure. It only flies one type of airplane and it wants to stay in high-density markets and has been highly efficient.

Differentiation focus

- In the differentiation focus strategy, a business aims to differentiate within **just one or a small number of target market segments.**
- The special customer needs of the segment mean that there are opportunities to provide products that are clearly different from competitors who may be targeting a broader group of customers.
- The important issue for any business adopting this strategy is to ensure that customers really do have different needs and wants - in other words that there is a valid basis for differentiation - and that existing competitor products are not meeting those needs and wants.

- Differentiation focus is the classic niche marketing strategy.
- Many small businesses are able to establish themselves in a niche market segment using this strategy, achieving higher prices than un-differentiated products through specialist expertise or other ways to add value for customers.
- Examples on Product differentiation- Harpic, Hit

STUCK IN THE MIDDLE

- A company’s failure to make a choice between cost leadership and differentiation essentially implies that the company is stuck in the middle.
- There is no competitive advantage for a company that is stuck in the middle and the result is often poor financial performance .
- However, companies like Toyota and Benetton have adopted more than one generic strategy. Both these companies used the generic strategies of differentiation and low cost simultaneously, which led to the success of the companies.

Criticisms of Porter's Generic Strategy Framework

- A business can employ a hybrid strategy without being struck in the middle. Nissan, for instance.
- Cost leadership does not sell products itself.
- Differentiation can be used to increase sales volume rather than charging a premium price.
- Price can sometimes be used to differentiate.
- The competence based strategy framework supersede the generic strategy framework.

Despite these criticisms, porter's model can constitute the basis of a useful framework for categorizing and understanding sources of competitive advantage.

Internal Analysis

- It is the only way to identify the Organisation's strengths and weaknesses
- Its needed for making good strategic decisions.
- It identifies and evaluates resources, capabilities and core competencies.
- Looks at the Organisation's

  -Current vision

  -Mission

  -strategic objectives

  -strategies

Dynamics of Internal Environment

- Organisational Resources
- Organisational Behaviour
- Strengths and Weaknesses
- Synergy effects
- Competencies
- Organisational capabilities
- Strategic Advantage

Resources

- 1. Tangible resources- Relatively easy to identify and include physical and financial assets to create value for the customers

  -Financial Resources, Ex: Firm's capacity to raise equity, Firm's borrowing capacity

  -Physical resources. Ex: Modern Plant and facilities, state-of-the art Machineries etc.,

Tangible resources

- Technological resources –Ex:Trade secrets, innovative production process etc.,
- Organisational resources –Ex: Effective strategic planning process, excellent evaluation and control systems.

Intangible resources

- Difficult for the competitors (and the firm itself)to account for or imitate typical practices that have evolved over time like,

  -Innovation and creativity – Ex: in Technical and scientific skills

  - Reputation or goodwill

  -Human-Ex: Experience and capabilities, Trust, Managerial Skills etc.,

Organisational Capabilities

- Competencies or skills that a firm employs to transform inputs into outputs, and capability to combine tangible and intangible resources to attain desired end

  Ex: -Outstanding customer service

  -Excellent product development capabilities

  -Ability to hire, train and retain human capital etc.,

Core competencies

- To be a core competency it must be

  -Rare

  -inimitable

  -valuable

  -No substitutable

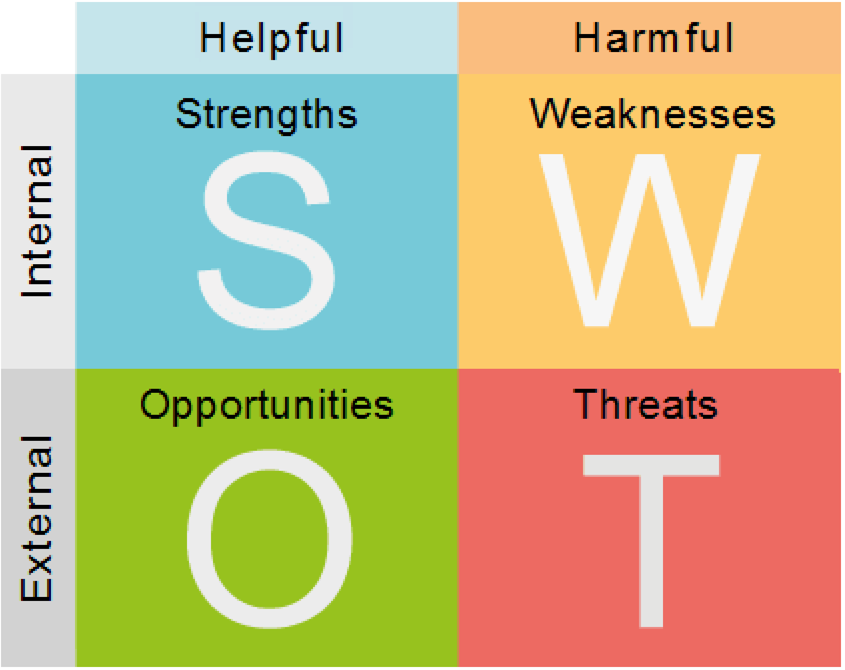
SWOT Analysis

- **Swot analysis** – an analysis of an organization's strengths and weaknesses alongside the opportunities and threats present in the external environment."
- "**Swot analysis** involves the collection and portrayal of information about internal and external factors which have, or may have, an impact on business."

SWOT Analysis

- **S**trengths: factors that give an edge for the company over its competitors.
- **W**eaknesses: factors that can be harmful if used against the firm by its competitors.
- **O**pportunities: favorable situations which can bring a competitive advantage.
- **T**hreats: unfavorable situations which can negatively affect the business.

SWOT MATRIX



Helpful
Harmful
Internal
External
Strengths
S
Weaknesses
W
Opportunities
O
Threats
T

Benefits of SWOT analysis

Swot tool has 5 key benefits:

- Simple to do and practical to use;
- Clear to understand;
- Focuses on the key internal and external factors affecting the company;
- Helps to identify future goals;
- Initiates further analysis.

Limitations

- Many managers and academics heavily criticize or don't even recognize it as a serious tool.
- According to many, it is a 'low-grade' analysis. Here are the main flaws identified by a research:
- Excessive lists of strengths, weaknesses, opportunities and threats;
- No prioritization of factors;
- Factors are described too broadly;
- Factors are often opinions not facts;
- No recognized method to distinguish between strengths and weaknesses, opportunities and threats.

Where to look for them?

Some strengths or weaknesses can be recognized instantly without deeper studying of the organization. But usually the process is harder and managers have to look into the firm's:

- Resources: land, equipment, knowledge, brand equity, intellectual property, etc.
- Core competencies
- Capabilities
- Functional areas: management, operations, marketing, finances, human resources and R&D
- Organizational culture
- Value chain activities

STAKEHOLDERS EXPECTATIONS

- Primary stakeholders: they are directly related to the firm and include

  -customers

  -employees

  -suppliers

  -shareholders

  -creditors

Stakeholders expectations

- **Secondary stakeholders**: Those who have only indirect stake in the corporation but are also affected by the corporations' activities and include:

  -non-governmental organisations (NGO)

  -local communities

  -trade associations

  -competitors and

  -governments.

SWOT ANALYSIS OF TOYOTA

- STRENGTHS:
  - Strong Human Resource
  - Innovative Organizational Culture
  - Strong Brand Image
  - Strong Diversified Portfolio
  - Advanced Technology
  - Global Supply Chain
  - High Production Capability

SWOT ANALYSIS OF TOYOTA

- WEAKNESS:
  - Dependence on Suppliers
  - Not Grabbing Markets
  - Negative Publicity
  - Poor Brand Recognition

SWOT ANALYSIS OF TOYOTA

- OPPORTUNITIES
  - The growth of Developing Nations
  - Green Vehicle Technology
  - Growing Concern for Environmental Pollution

SWOT ANALYSIS OF TOYOTA

- THREATS
  - Number of Competitors
  - High-priced Raw Materials
  - Lower Profits

SWOT ANALYSIS OF BIG BAZAAR

- STRENGTH
  - High brand equity enjoyed by Big Bazaar
  - State of the art infrastructure
  - A vast variety of stuff available under one roof
  - Everyday low prices, which attract customers
  - Maximum percent of footfalls converted in sales
  - Huge investment capacity
  - Biggest value retail chain in India
  - It offers a family shopping experience, where entire family can visit together.
  - Available facilities such as online booking and delivery of goods

SWOT ANALYSIS OF BIG BAZAAR

- WEAKNESS
  - Unable to meet store opening targets on time
  - Falling revenue per sq ft
  - General perception: 'Low price = Low quality'
  - Overcrowded during offers
  - Long lines at billing counters which are time consuming
  - Limited only to value offering low price products. A no of branded products are still missing from Big Bazaar's line of products.

SWOT ANALYSIS OF BIG BAZAAR

- OPPORTUNITIES
  - A lot of scope in Indian organized retail as it stands at approximately 4%.
  - Increasing mall culture in India.
  - More people these days prefer to visit big stores where they can find large variety under one roof

SWOT ANALYSIS OF BIG BAZAAR

- THREATS
  - Competition from other value retail chains such as Shoprite, Reliance (Fresh and trends), Hypercity and D mart.
  - Unorganized retail also appears to be a threat to Big Bazaar's business. A large population still prefers to visit local convenient stores for daily purchases
  - Changing Government policies
  - International players looking to foray India

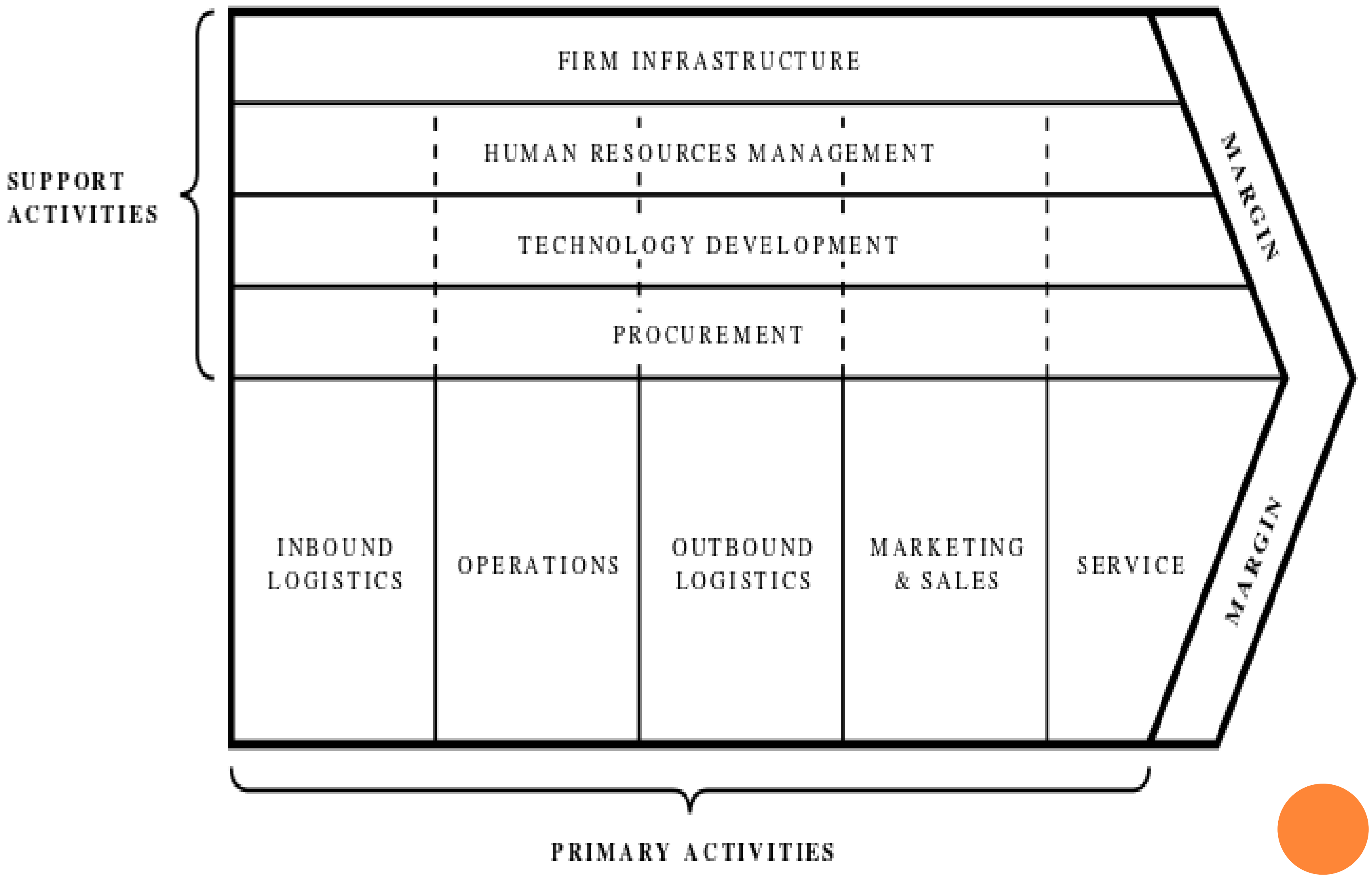
Value Chain Analysis

- A **value chain** is a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market. The concept comes from business management and was first described and popularized by Michael Porter in his 1985 best-seller, *Competitive Advantage: Creating and Sustaining Superior Performance*.

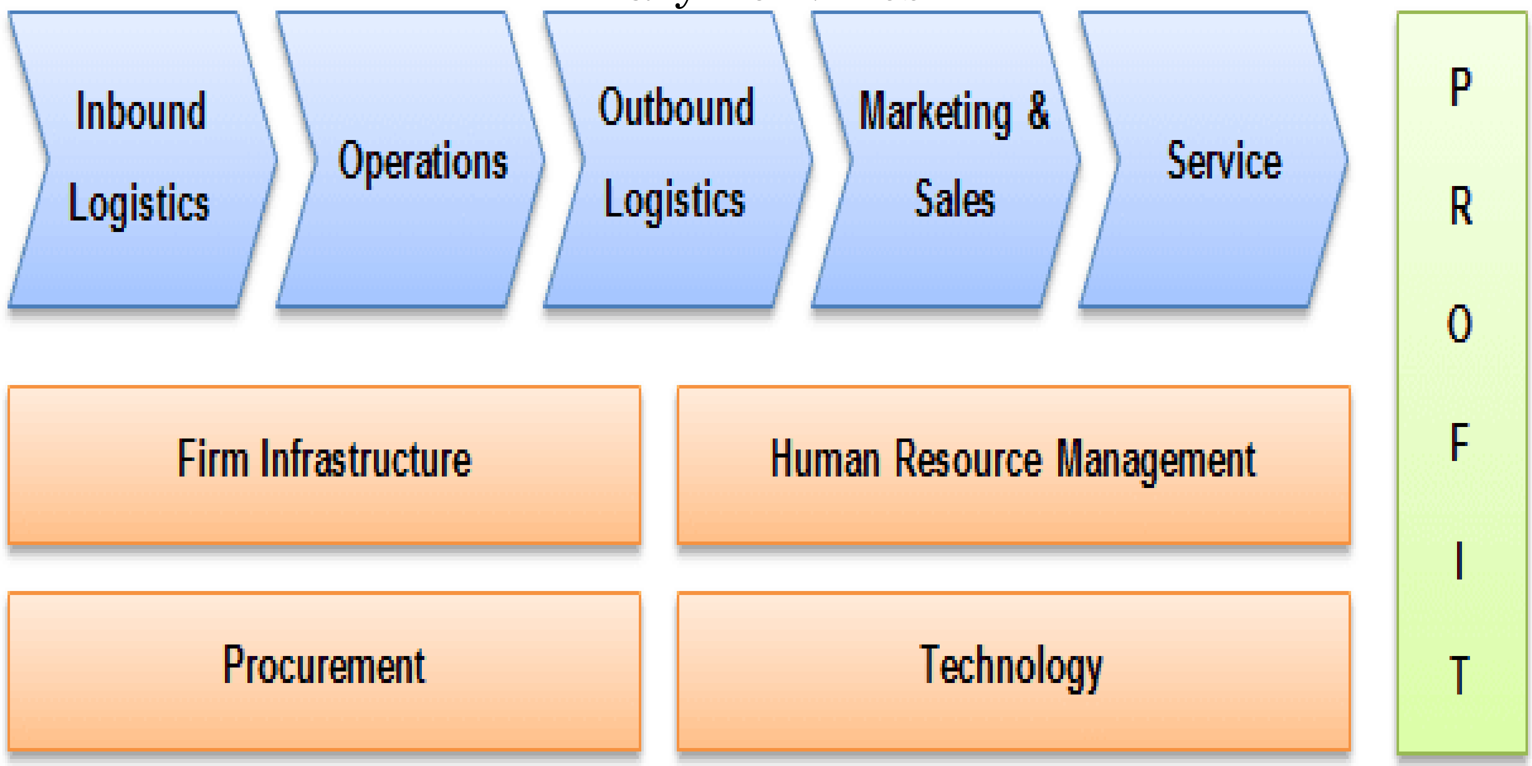
Value Chain Analysis

- **“Value chain analysis** (VCA) is a process where a firm identifies its primary and support activities that add value to its final product and then analyze these activities to reduce costs or increase differentiation.”
- “**Value chain** represents the internal activities a firm engages in when transforming inputs into outputs.”

Value Chain Analysis



Primary Activities



Support Activities

- Although, primary activities add value directly to the production process, they are not necessarily more important than support activities.
- Nowadays, **competitive advantage mainly derives from technological improvements or innovations** in business models or processes. Therefore, such support activities as ‘information systems’, ‘R&D’ or ‘general management’ are usually the most important source of differentiation advantage.
- On the other hand, primary activities are usually the **source of cost advantage**, where costs can be easily identified for each activity and properly managed.

WAL-MART'S VALUE CHAIN

Suppliers → **Wal-Mart Distribution Center** → **Wal-Mart Store** → **Wal-Mart Shopper**

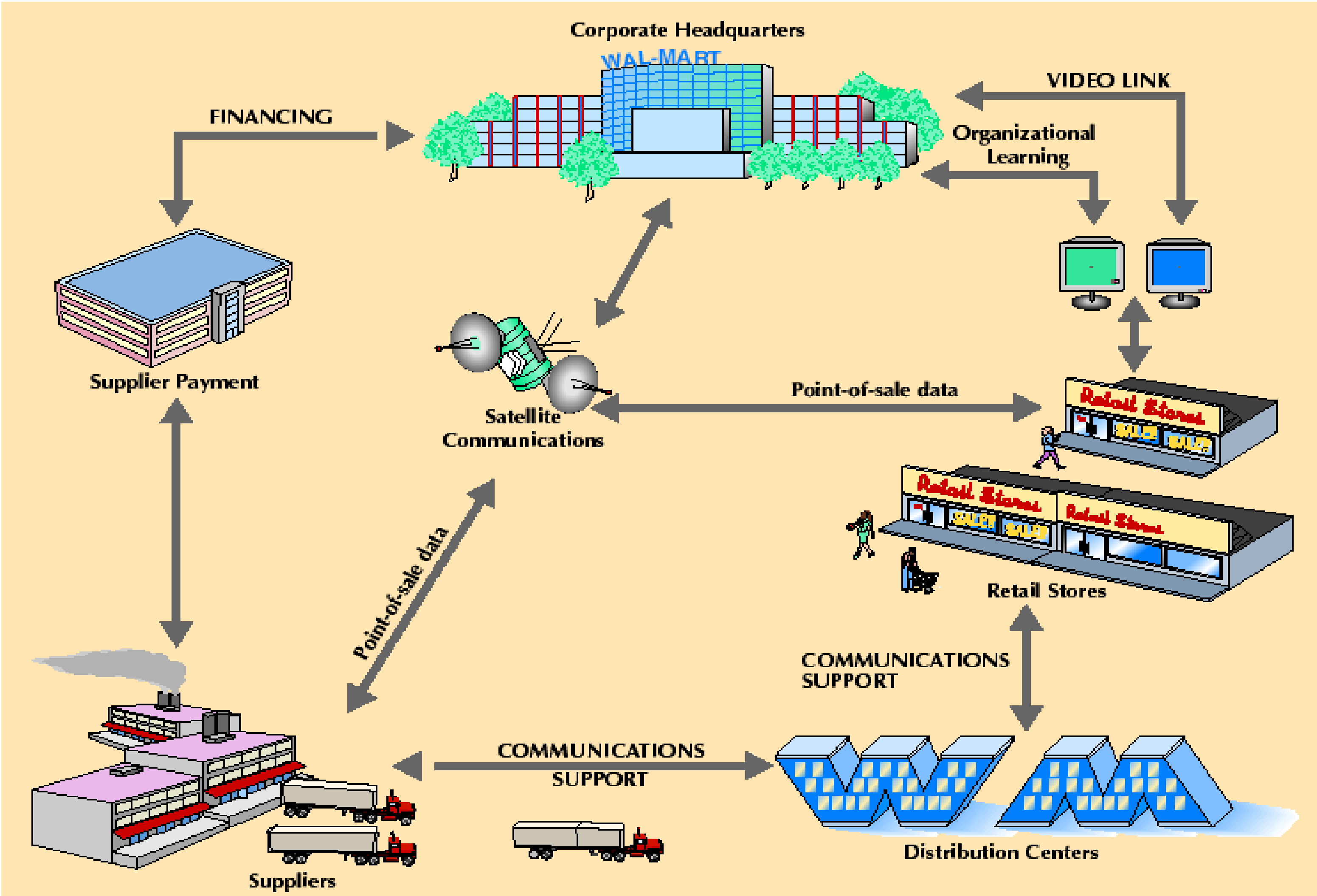
Vendors are Wal-Mart's suppliers. They deliver products to Wal-Mart's distribution center or directly to one of the stores. Wal-Mart is able to bargain for the lowest possible price because of the high volume of sales. Therefore, Wal-Mart passes this savings to its customers.

Once the products are delivered to the distribution center, they are sorted and placed on trucks to be delivered to stores. This allows for less than 48 hour deliveries to stores and increased efficiency on trucks with backhauls.

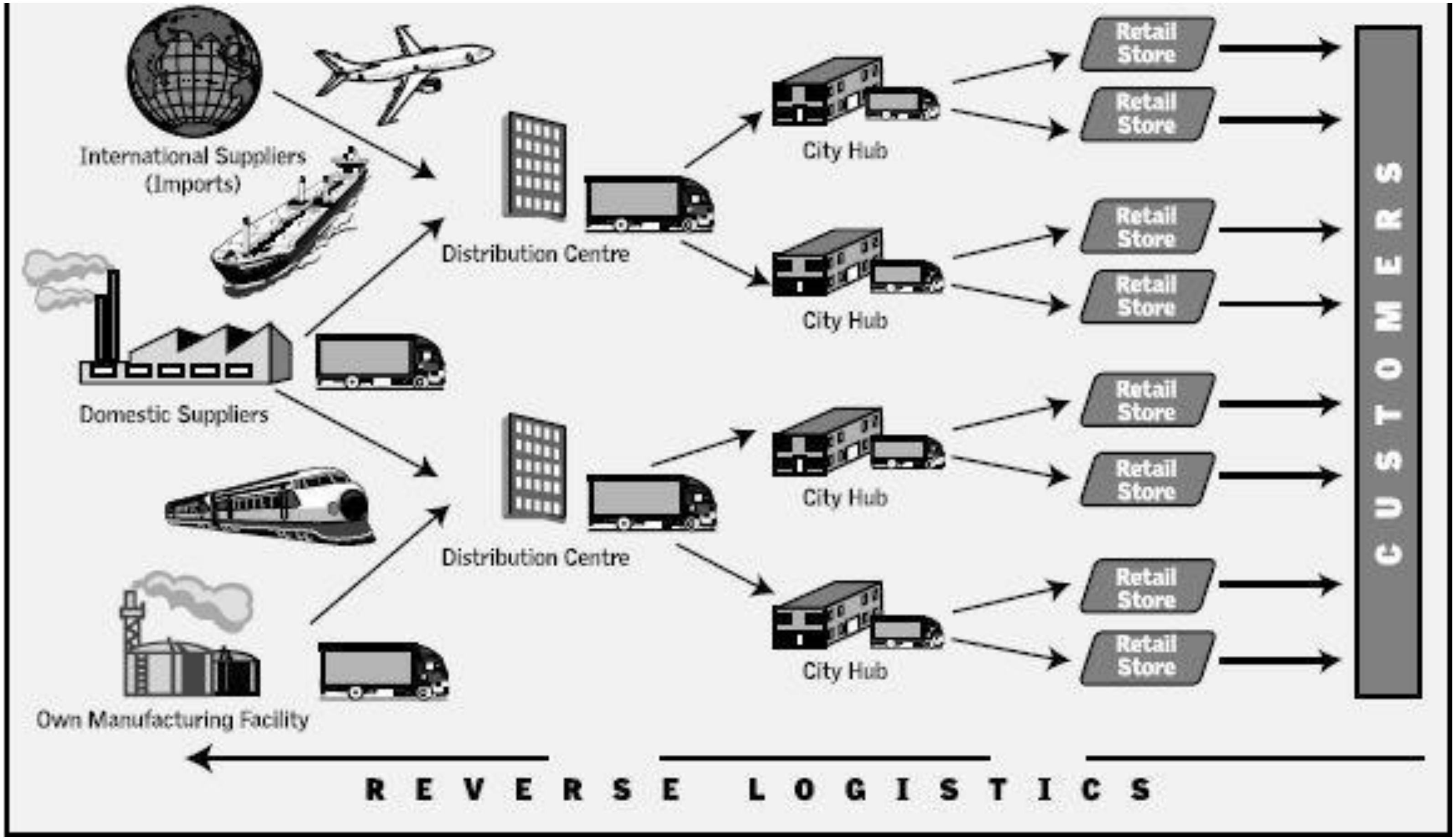
After products are delivered to the stores, they are placed on the appropriate shelf location for customers to view. Store locations are located throughout the country

Customers can purchase products at very low prices and have the ability to return any item.

Wal-Mart Supply Chain



Retail Value Chain



Scenario Planning

- **Scenario planning**, also called **scenario thinking** or **scenario analysis**, is a strategic planning method that some organizations use to make flexible long-term plans. It is in large part an adaptation and generalization of classic methods used by military intelligence.

- The original method was that a group of analysts would generate simulation games for policy makers. The games combine known facts about the future, such as demographics, geography, military, political, industrial information, and mineral reserves

Scenario planning

- Sometimes it's helpful to involve stakeholders in thinking laterally about your shared future: five, 10 or maybe 15 years from now.
- Scenario planning is a tool to help stimulate new thinking and explore uncertainties.
- Instead of focusing on what you know, you invest time on what you don't know.
- Scenario planning is used to help assess uncertainties in your external environment before you begin to open up choices for the future.

Scenario Planning

- Focus of Scenario Planning:

  -Environmental

  -Social

  -Economic

  -Institutional

What is Scenario Planning for:

- Policy Development
- Planning
- Investment decisions

Dynamic Scenarios

- In cases when scenario planning is integrated with a systems thinking approach to scenario development, it is sometimes referred to as DYNAMIC SCENARIOS.
- Scenario planning may involve aspects of systems thinking, specifically the recognition that many factors may combine in complex ways to create sometime surprising futures.

Scenario Planning Process

- Specify the scope of planning and its timeframe.
- For the present situation develop a clear understanding for each of the scenario
- Identify elements that are certain to occur and that will be driving forces.
- Identify the uncertainties in the environment.
- Identify the more important drivers.
- Create scenarios (like creating scenes/stories) using the extreme variables.
- Quantify the impact of each scenario on the firm and formulate appropriate strategies.

Benefits of Scenario Planning

- Managers are forced to break out of their standard world view and overlooking certain uncertainties in the general forecast.
- Decision-makers are better able to recognize scenario in its early stages
- Managers are better able to understand the source of differences between scenarios when they are envisioning different scenarios