**Lecture: Internal and External Environmental Analysis**

SWOT Elements:

S = Strengths (internal to the organization)

W = Weaknesses (internal to the organization)

O = Opportunities (external to the organization)

T = Threats (external to the organization)

Internal to the Organization

What does the organization do poorly?

External to the Organization

Forces within the dimensions of the General Envirornment

Internal to the Organization

What does the organization do well?

External to the Organization

Forces within the dimensions of the General Envirvornment

Strengths and Weaknesses, as their names imply, are **internal** characteristics of an organization - things that your company does well or poorly. Think of your workplace or another organization. Can you name things that the firm does well? These are factors over which managers have complete control, so they are considered Internal Strengths.

**Examples of strengths:**

* Strong brand name or company reputation
* Cost advantages over rivals
* Product innovation capabilities
* Good customer service capabilities

An internal strength can be considered a distinctive competence when the organization and only a few of their competitors possess that internal strength. When the strength is difficult to imitate by the organization's competitors then that distinctive competence creates a sustainable competitive advantage for the organization that possesses the distinctive competence. Therefore, distinctive competencies are of great value to an organization and one that organizations strive to possess and protect.

On the other hand, weaknesses are things that you don’t do well. It is tough to conduct an honest account of weaknesses from inside an organization. Realistic assessment will probably be damaging to one department or another.

**Examples of weaknesses:**

* The organization has outdated product features
* Poor supplier relationships, an understaffed marketing department
* High employee turnover
* Low R&D expenditures compared to industry averages

Opportunities and Threats are **external** environmental forces that have an effect on an organization. They stem from the segments within the General Environment (Political/Legal, Sociocultural, Global, Economic, Technological, and Physical Environment). An opportunity that is occurring in the general environment, if exploited by the organization, will help the organization achieve a competitive advantage over their competitors. On the other hand, a threat that is occurring in the general environment has the potential to impede an organization’s competitive standing within their industry.

**Examples of opportunities:**

* Expanding into new geographic markets (either national or international expansion)
	+ This opportunity would stem from forces from within the economic and global segments
* Falling trade barriers in attractive foreign markets
	+ This opportunity would stem from forces from within the political/legal and global segments
* Advances in technological know-how to create new product lines
	+ This opportunity would stem from a force from within the technological segment
* Changing an existing product or service or creating a new product or service to meet a boarder range of consumer needs
	+ This opportunity would stem from forces from within the sociocultural segment

**Examples of threats:**

* A slowdown in the market growth within the market in which the organization competes within
	+ This threat would stem from a force from within the economic segment
* A shift in the consumers tastes and preferences away from the product or service being offered in the industry
	+ This threat would stem from a force from within the sociocultural segment
* A foreign government creating restrictive trade policies
	+ This threat would stem from forces from within the political-legal and global segments
* A competitor has created a new cheaper, better technological advance that enables them to sell a similar product at a lower cost
	+ This threat would stem from a force from within the technological dimension

After determining their opportunities and threats, firms will apply this information to the ‘Five Forces Model of Competition’ to help firms determine whether or not an industry is attractive. **Remember, that model pertains to an industry as a whole**, however this doesn't mean it’s unrelated to an individual organization. The Five Forces Model of Competition indicates that the forces within the dimensions of the general environment interact to determine the intensity or strength of competition, which ultimately determines the profitability of the industry. Assessing the relative strength of the five competitive forces is important to a firm’s ability to achieve strategic competitiveness and earn above-average returns.

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

Let’s look at these forces individually:

***Threat of New Entrants***

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

The seriousness or extent of the threat of new entrants is affected by two factors: barriers to entry and expected retaliation by firms already in the industry.

* Barriers to entering an industry are present when entry is difficult or when it is too costly and places potential entrants at a competitive disadvantage (relative to firms already competing in the industry). There are seven factors that represent potentially significant entry barriers. They are: economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scale, and government policy.
* Even if a firm concludes that it can successfully overcome all of the entry barriers, it still must take into account or anticipate reactions that might be expected from existing firms. Strong retaliation is likely when existing firms have a heavy investment in fixed assets (especially when there are few alternative uses for those assets) or when industry growth is slow or declining.

***Bargaining Power of Suppliers***

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

* the supplier segment of the industry is dominated by a few large companies and is more concentrated than the industry to which it sells
* satisfactory supplier substitute products are not available to industry firms
* industry firms are not a significant customer group for the supplier group
* suppliers’ goods are critical to buyers’ marketplace success
* effectiveness of suppliers’ products has created high switching costs for buyers
* suppliers represent a credible threat to integrate forward into the buyers’ industry, especially when suppliers have substantial resources and provide highly differentiated products

***Bargaining Power of Buyers***

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

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

***Threat of Substitute Products***

All firms must recognize that they compete against firms producing ***substitute products***, those products that are capable of **satisfying similar customer needs but come from outside the industry** (this **does not** include competitors products within the same industry) and thus have different characteristics. In effect, prices charged for substitute products represent the upper limit on the prices that suppliers can charge for their products. The threat of substitute products is greatest when:

* buyers or customers face few, if any switching costs
* prices of the substitute products are lower
* quality and performance capabilities of substitutes are equal to/greater than those of the industry’s products

***Examples of Traditional and Substitute Products, and Their Usage***

***Traditional product Substitute product*** ***Usage***

Overnight delivery Fax machines/e-mail Document delivery

Sugar NutraSweet Sweetener

Glass Plastic Containers

Coffee Tea Beverages

Paper bags Plastic bags Flexible packaging

***Intensity of Rivalry among Competitors***

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

Because of the interrelated nature of firms’ actions, action taken by one firm generally will result in retaliation by competitors (also known as competitive response). The other competitive forces in the industry will also help to determine the intensity of rivalry within an industry.

After studying the five industry forces, a firm will gain information that will help them to determine an industry’s attractiveness in terms of the potential to earn adequate or superior returns on its invested capital. In general, the stronger the competitive forces, the lower the profit potential for an industry’s firms. A firm will determine an industry as unattractive when the barriers of entry are low, supplier and buyer power are both strong, the threats from product substitutes are high, and there is intense rivalry among competitors. All these factors will make it difficult for firms to achieve strategic competitiveness and earn above-average returns. An attractive industry has the mirror image of these features and offers little potential for favorable performance.

Characteristics of attractive and unattractive industries are summarized below.

***Industry Characteristic Attractive Unattractive***

Threat of New Entry Low High

Bargaining Power of Suppliers Weak Strong

Bargaining Power of Buyers Weak Strong

Threat of Substitute Products Low High

Intensity of Competitive Rivalry Low High