The External Assessment

Week 03

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Chapter Outline

- The Nature of the External Audit
- The Industrial Organization View
- Social, Cultural, Demographic, and Environmental Forces
- Political, Governmental, and Legal Forces
- Technological Forces
- Competitive Forces
- Porter’s Five-Forces Model
- Forecasting Tools & Techniques
- Global Challenge
- The External Factor Evaluation (EFE) Matrix
- Competitive Profile Matrix (CPM)
"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
- Aging society
- Stock market volatility

Purpose of External Audit

Identify Opportunities & Threats
Relationships between key external forces and organization

Economic forces
- Social, cultural, demographic, and environmental forces
- Political, legal, and governmental forces
- Technological forces
- Competitive forces

Competitors
Suppliers
Distributors
Creditors
Customers
Employees
Communities
Managers
Stockholders
Labor unions
Governments
Trade associations
Special interest groups
Products
Services
Markets
Natural environment

AN ORGANIZATION'S OPPORTUNITIES AND THREATS
Sources of Information

- Internet
- Libraries
- Suppliers
- Distributors
- Salespersons
- Customers
- Competition
External Audit Factors

- Market share
- Breadth of competing products
- World economies
- Foreign affiliates
- Price competitiveness
- Technological advancements
- Interest rates
- Pollution abatement

Criteria
- ✓ Long-term Orientation
- ✓ Measurable
- ✓ Applicable to Competing Firms
- ✓ Hierarchical

Key Factors
- ✓ Vary over time
- ✓ Vary by industry
Industry factors more important than internal factors
Performance determined by industry forces

Industry properties → Firm performance
✓ Economies of Scale
✓ Barriers to Market Entry
✓ Product Differentiation
✓ Level of Competitiveness

“Approximately 20% of a firm’s profitability can be explained by the industry, whereas 36% of the variance in profitability is attributed to the firm’s internal factors”
Economic Forces

Shift to a service economy in the United States
Availability of credit
Level of disposable income
Propensity of people to spend
Interest rates
Inflation rates
Money market rates
Federal government budget deficits
Gross domestic product trend
Consumption patterns
Unemployment trends
Worker productivity levels
Value of the dollar in world markets
Stock market trends
Foreign countries’ economic conditions

Import/export factors
Demand shifts for different categories of goods and services
Income differences by region and consumer groups
Price fluctuations
Export of labor and capital from the United States
Monetary policies
Fiscal policies
Tax rates
European Economic Community (EEC) policies
Organization of Petroleum Exporting Countries (OPEC) policies
Coalitions of Lesser Developed Countries (LDC) policies
Social, Cultural, Demographic, and Environmental Forces

Major Impact

- Products
- Services
- Markets
- Customers

Examples

- More educated consumers
- Religion, ethnic or racial majority
- World population approaching 7 billion
- Gap between rich & poor
- Working parents
- Decimation and degradation of the natural environment
10 CEOs pressuring for caps on greenhouse-gas omissions
Desiring a single national emissions cap
Top 5 buyers of green power:
1. PepsiCo
2. Wells Fargo
3. Whole Foods
5. Johnson & Johnson
Key Variables

✓ Number of marriages/divorces
✓ Number of births & deaths
✓ Use of birth control
✓ Immigration and emigration rates
✓ Social Security programs
✓ Life expectancy rates
✓ Per capita income
✓ Lifestyles
✓ Traffic congestion
✓ Inner-city environments
✓ Average disposable income
✓ Trust in government
✓ Attitudes toward work
✓ Buying habits
✓ Ethical concerns
✓ Attitudes toward saving
✓ Sex roles
✓ Attitudes toward investing
✓ Racial equality
✓ Number of special-interest groups
✓ Number of women and minority workers
✓ Average level of education
✓ Government regulation
✓ Attitudes toward leisure time
✓ Attitudes toward customer service
✓ Recycling & Waste management
✓ Attitudes toward foreign peoples
✓ Energy conservation
✓ Social programs
✓ Social responsibility
✓ level of affluence
✓ Endangered species
Government Regulation

- Antitrust legislation
- Tax rates
- Lobbying efforts
- Patent laws

Increasing Global Interdependence

Political variables impact
- Formulation of strategies
- Implementation of strategies

Strategists in a global economy
- Forecast political climates
- Legalistic skills
- Diverse world cultures
Key Political, Governmental, and Legal Variables

✓ Regulation/deregulation
✓ Tax law changes
✓ Special tariffs
✓ Voter participation rates
✓ Number of patents
✓ Changes in patent laws
✓ Environmental protection laws
✓ Equal employment legislation
✓ Government subsidies
✓ Anti-trust enforcement
✓ Global relationships
✓ Import/export regulations
✓ Political conditions
✓ Location and severity of terrorist activity
Technological Forces

Major Impact

- Internet
- Communications
- Semiconductors

Significance of IT

- Chief Information Officer (CIO)
- Chief Technology Officer (CTO)

Technology-based issues

Essential for nearly every strategic decision
Collection & evaluation of data on competitors is essential for successful strategy formulation.

**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
✓ 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
✓ Nature of supplier & distributor relationships
✓ The threat of substitute products/services
✓ Should we keep our strategies secret from employees and stakeholders?
7 Characteristics of Competitive Firms:

1. Market share matters
2. Understand what business you are in
3. Broke or not, fix it
4. Innovate or evaporate
5. Acquisition is essential to growth
6. People make a difference
7. No substitute for quality

Steps to Determine if an Acceptable Profit Can Be Earned

1. Identify key aspects or elements of each competitive force
2. Evaluate how strong and important each element is for the firm
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry
The Five-Forces Model of Competition

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

Barriers to entry are important
- Quality, pricing, and marketing can overcome barriers

Pressures increase when consumers’ switching costs decrease
- Firm’s plans for increased capacity & market penetration

Most powerful of the five forces
- Focus on competitive advantage of strategies

Customers concentrated or buying in volume affects intensity of competition
- Consumer power is higher where products are standard or undifferentiated

Potential Entrants

Bargaining power of suppliers

Threat of new entrants

Suppliers

Industry Competitors

Rivalry among Existing firms

Buyers

Bargaining power of Buyers

Substitutes

Threat of substitute products or services
Conditions Where Consumers Gain Bargaining Power

- If they can inexpensively switch
- If they are particularly important
- 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
Forecasts are educated assumptions about future trends and events

- Quantitative techniques – most appropriate when historical data is available and there is a constant relationship
- Qualitative techniques
The Global Challenge

- Gain & maintain exports to other nations
- Defend domestic markets against imported goods

Facts:
- China’s auto exports doubled in 2006
- China produces more cars than Germany and is the world’s third largest automobile producer
- Changfeng Group first Chinese automaker in the Detroit Auto Show
Multinational Corporations (MNCs)

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: Competitive Profile Matrix (CPM)

**Summarize & Evaluate**

<table>
<thead>
<tr>
<th>Economic</th>
<th>Demographic</th>
<th>Governmental</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social</td>
<td>Environmental</td>
<td>Technological</td>
</tr>
<tr>
<td>Cultural</td>
<td>Political</td>
<td>Competitive</td>
</tr>
</tbody>
</table>

**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

Note:
Understanding the factors used in the EFE Matrix is more important than the actual weights and ratings assigned.
<table>
<thead>
<tr>
<th>Key External Factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Weighted Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Rowan County is growing 8% annually in population</td>
<td>0.05</td>
<td>3</td>
<td>0.15</td>
</tr>
<tr>
<td>2. TDB University is expanding 6% annually</td>
<td>0.08</td>
<td>4</td>
<td>0.32</td>
</tr>
<tr>
<td>3. Major competitor across town recently ceased operations</td>
<td>0.08</td>
<td>3</td>
<td>0.24</td>
</tr>
<tr>
<td>4. Demand for going to cinema growing 10% annually</td>
<td>0.07</td>
<td>2</td>
<td>0.14</td>
</tr>
<tr>
<td>5. Two new neighborhoods being developed within 3 miles</td>
<td>0.09</td>
<td>1</td>
<td>0.09</td>
</tr>
<tr>
<td>6. Disposable income among citizens grew 5% in prior year</td>
<td>0.06</td>
<td>3</td>
<td>0.18</td>
</tr>
<tr>
<td>7. Unemployment rate in county declined to 3.1%</td>
<td>0.03</td>
<td>2</td>
<td>0.06</td>
</tr>
</tbody>
</table>
## EFE Matrix Example

### Threats

<table>
<thead>
<tr>
<th>Threat</th>
<th>X</th>
<th>Y</th>
<th>X*Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>8. Trend toward healthy eating eroding concession sales</td>
<td>0.12</td>
<td>4</td>
<td>0.48</td>
</tr>
<tr>
<td>9. Demand for online movies and DVDs growing 10% annually</td>
<td>0.06</td>
<td>2</td>
<td>0.12</td>
</tr>
<tr>
<td>10. Commercial property adjacent to cinemas for sale</td>
<td>0.06</td>
<td>3</td>
<td>0.18</td>
</tr>
<tr>
<td>11. TDB University installing an on-campus movie theatre</td>
<td>0.04</td>
<td>3</td>
<td>0.12</td>
</tr>
<tr>
<td>12. County and city property taxes increasing 25% this year</td>
<td>0.08</td>
<td>2</td>
<td>0.16</td>
</tr>
<tr>
<td>13. Local religious groups object to R-rated movies being shown</td>
<td>0.04</td>
<td>3</td>
<td>0.12</td>
</tr>
<tr>
<td>14. Movies rented from local Blockbuster store up 12%</td>
<td>0.08</td>
<td>2</td>
<td>0.16</td>
</tr>
<tr>
<td>15. Movies rented last quarter from Time Warner up 15%</td>
<td>0.06</td>
<td>1</td>
<td>0.06</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1.00</td>
<td>2.58</td>
<td></td>
</tr>
</tbody>
</table>
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>Critical Success Factors</th>
<th>Weight</th>
<th>Rating</th>
<th>Score</th>
<th>Rating</th>
<th>Score</th>
<th>Rating</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>0.20</td>
<td>1</td>
<td>0.20</td>
<td>4</td>
<td>0.80</td>
<td>3</td>
<td>0.60</td>
</tr>
<tr>
<td>Product Quality</td>
<td>0.10</td>
<td>4</td>
<td>0.40</td>
<td>3</td>
<td>0.30</td>
<td>2</td>
<td>0.20</td>
</tr>
<tr>
<td>Price Competitiveness</td>
<td>0.10</td>
<td>3</td>
<td>0.30</td>
<td>2</td>
<td>0.20</td>
<td>4</td>
<td>0.40</td>
</tr>
<tr>
<td>Management</td>
<td>0.10</td>
<td>4</td>
<td>0.40</td>
<td>3</td>
<td>0.20</td>
<td>3</td>
<td>0.30</td>
</tr>
<tr>
<td>Financial Position</td>
<td>0.15</td>
<td>4</td>
<td>0.60</td>
<td>2</td>
<td>0.30</td>
<td>3</td>
<td>0.45</td>
</tr>
<tr>
<td>Customer Loyalty</td>
<td>0.10</td>
<td>4</td>
<td>0.40</td>
<td>3</td>
<td>0.30</td>
<td>2</td>
<td>0.20</td>
</tr>
<tr>
<td>Global Expansion</td>
<td>0.20</td>
<td>4</td>
<td>0.80</td>
<td>1</td>
<td>0.20</td>
<td>2</td>
<td>0.40</td>
</tr>
<tr>
<td>Market Share</td>
<td>0.05</td>
<td>1</td>
<td>0.05</td>
<td>4</td>
<td>0.20</td>
<td>3</td>
<td>0.15</td>
</tr>
<tr>
<td>Total</td>
<td>1.00</td>
<td>3.15</td>
<td>2.50</td>
<td>2.70</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note:
3.2 vs 2.8 rating, it does not follow that the 1st firm is 20 percent better than the 2nd.
Thank you