



Module 2

Assessing External Environment

2.1. STRATEGIC AUDIT OF A CORPORATION/ STRATEGIC AUDIT

2.1.1. Introduction

Different methods are used in order to evaluate the performance of a given strategy. Strategic audit is one of them. In this method, all the management levels and functional areas concerned to the formulation and implementation of the strategy are evaluated. Strategic management process(s) as well as the whole corporate performance is evaluated in accordance with the corporate strategy. A strategic audit is conducted in case a shortfall or a below average performance is observed in an organisation. This strategic audit is conducted with the help of audit firms or internal auditors of the firm can also do the job.

The overall performance of the organisation in accordance with the concurring corporate strategy is audited by the auditors so as to identify issues linked (directly or indirectly) to its poor performance. An audit report (containing audit findings) is prepared by the audit firm or by the team of auditors, once the audit is successfully completed it is put forward to the management of the organisation with the recommended solutions. So in order to improve its performance, the organisation will then strive to imply the recommendations of the audit report.

1) Current Situation

- i) Assessing performance of the organisation as per its objectives, net market share, return on investment, earnings per share, profitability ratio, etc.
- ii) Comparing this performance with similar organisations, strong competitors or the whole industry.
- iii) Determining existing schemes, strategies, objectives and mission and their unambiguousness. Also determining the reliability of schemes, strategies and objectives with each other and with internal as well as external business environment.
- iv) Identifying the short-term and long-term issues confronting the organisation.

2) Record of Performance: Performance record (including financial performance and level of profitability) of the organisation is determined.

3) Corporate and Top Management

- i) Determining the Board of Directors' configuration, i.e., number of part-timers, full-timers, insiders or outsiders.
- ii) Profiling the personality of the top management.
- iii) Determining whether the organisation has developed a suitable approach in order to formulate and implement the corporate strategy.
- iv) The nature of top management and Board of Directors' relationship.

strategy. Strategic audit thus facilitates the top management in identifying organisational weaknesses before they become more serious.

- 4) **Influences the Behaviour:** Strategic audit has an impact on the functioning of various organisational events and it makes sure that they comply with the plans. It acts like a 'steering' which regulates the direction of the organisation and its divisions and controls the same in adverse conditions. It intends to provide a combination of both long-term and short-term plans between the organisation and its external environment.
- 5) **Helps in Achieving Stability and Continuity:** Strategic audit is a very important tool in modern organisations. Along with satisfying the purpose of steadiness and stability, it also helps in organisational adaptation and modifications. It maintains the organisational stability by repeatedly appraising the organisational policies and procedures. Required modifications in the organisational strategies and policies are determined by analysing external environment as well as studying the current strategies of the organisation.
- 6) **Effective Use of Scarce and Valuable Resources:** The management of an organisation gets the required aid by strategic audit in making productive utilisation of valuable resources (which are inadequately available to the organisation). Strategic audit also helps in accomplishing pre-determined objectives with minimum cost and few unpleasant outcomes by maintaining least variability in the development of the resources.
- 7) **Helps in Addressing Governance Problems:** It compels the managers to determine if they are focused towards generating long-term shareholders' value and if they improve their business payments through maximising the short-term performance of the business. Thus, strategic audit helps in addressing governance issues.

2.2. EXTERNAL ASSESSMENT/AUDIT

2.2.1. Introduction

The identification & evaluation of those trends & events that are beyond the control of an organization is called external strategic management audit or external audit, e.g. population shift to sunbelt, increased foreign competition, information technology & computer revolution etc. The external audit points out the important opportunities & threats that comes in front of the organization and therefore

the management of the organization should develop proper strategies to avail those opportunities and to reduce or avoid the effects of threats.

There are numerous factors that affect the organisation and its operations. These factors can influence the organisation in both positive as well as negative ways. Identifying the issues and challenges existing in the external environment is extremely important for an organisation. In order to identify the factors in external environment, an appraisal process of the industry's environment is necessary. Environmental appraisal facilitates the managers with the ability to study the competitive structure and competitive position of the organisation along with the position of its competitors.

By analysing and appraising the external environment, the existing opportunities and threats can be identified. It is the responsibility of the managers to avoid the threats and to reap the benefits from the opportunities in the market. Environmental appraisal also helps the managers in analysing the effects of globalisation on the level of competition within a particular industry. It is well-known that business environment never remains stable rather keeps on changing rapidly. As the businesses grows and expands, the changes in external environment compels the organisations to make efficient strategies to deal with the contingency situations.

Environmental appraisal also allows an organisation to study the steps taken by competitors in the market. By appraising the external environment the companies can improve their internal capabilities and strengths for adapting to the changes in the external environment.

According to Abell, "Environmental appraisal is the identification, measurement, and assessment of environmental impacts".

2.2.2. Nature of External Audit

- 1) The main objective of external audit is to highlight a number of external opportunities that can be availed by the organization along with the threats that need to be avoided by the organization.
- 2) In fact the external strategic management audit does not take into account all the possible factors that affect the business organization but rather only important factors are focused that need proper actions.
- 3) The organization may shows offensive or defensive behaviour through developing strategies that can get benefit from the external opportunities while reducing the effects of external threats.

2.2.3. Process of Performing an External Audit/Procedure of External Analysis

The process of environmental appraisal includes the following steps:

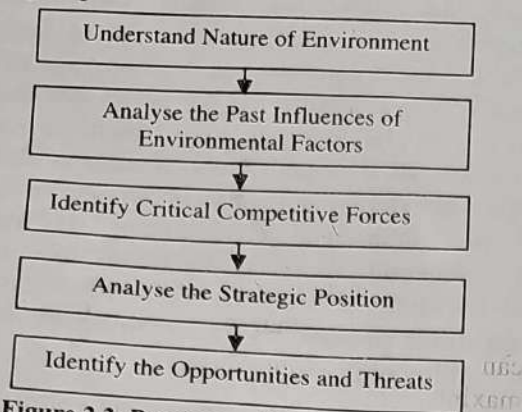


Figure 2.2: Procedure of External Analysis

- 1) **Understand Nature of Environment:** Before starting the environmental appraisal, the strategists must understand the nature, i.e., the volatility of external environment. The volatility here implies to the changes in the environment. To understand the nature of environment, the strategic leaders need to answer following questions:
 - i) Is the environment stable or dynamic?
 - ii) In which ways does the environment change?
 - iii) Are the changes identifiable?
 Answering these questions would help in deciding the future course of actions.
- 2) **Analyse the Past Influences of Environmental Factors:** Once, the nature of external environment is identified, the next step is to identify the factors that have influenced the performance of organisation in the past. Analysing these factors will help in planning and formulating strategies to handle future scenarios.
- 3) **Identify Critical Competitive Forces:** The next step is to identify the key competitive forces existing within the industry with the help of structural analysis. This step helps to analyse the organisation's current position, the bargaining power of buyers and suppliers, the new entrants in the industry, and the existing competitors of the organisation.
- 4) **Analyse the Strategic Position:** In this step, the managers analyse the strategic position of the organisation in relation to its competitors in terms of resources, customers, etc. To identify and analyse the strategic position of an organisation, following ways should be adopted:
 - i) Growth/share analysis;
 - ii) Attractiveness analysis;
 - iii) Strategic group analysis;

- iv) Study of market segments and market power; and
- v) Competitor analysis.

- 5) **Identify the Opportunities and Threats:** Identify the opportunities and threats prevailing in the environment. Formulate efficient strategies to reap the benefits from the opportunities so that the threats can be neutralised. The selection of strategy and effective utilisation of selected resources in an effective manner is crucial for this stage.

2.2.4. Key External Forces/Factors Affecting External Analysis

Various factors affecting the process of environmental appraisal are as follows:

- 1) **Customer Environment:** Different factors that are necessary to analyse customer environment are as follows:
 - i) Tracing the feedbacks of customers,
 - ii) Needs and requirements of customers,
 - iii) Assessment of return rates, and
 - iv) Need of quality improvement and maintenance.
 - v) Assessing the level of competition from present and possible substitutes on the basis of consumer feedback.
- 2) **Competitive Environment:** Following factors should be analysed in the competitive environment:
 - i) Market segments,
 - ii) Competitor analysis,
 - iii) Past researches and developments,
 - iv) Arrival of new competitors,
 - v) Patterns of market shares, and
 - vi) Threat of new entrants and substitutes.
- 3) **Industry Environment:** Monitoring and analysing the industry environment includes:
 - i) Different strategies adopted by the industry,
 - ii) Industry structure,
 - iii) Changes in product or service offerings,
 - iv) Modifications in government regulations,
 - v) Sources of finance in the industry, and
 - vi) Past trends of the market.
- 4) **Macro Environment:** Scrutinising the macro environment requires analysing following factors:
 - i) Socio-economic factors,
 - ii) Political factors,
 - iii) Technological factors, and
 - iv) Demographic factors.

2.2.5. Levels of External Analysis

By analysing the external environment of a business the marketers are able to identify and highlight the opportunities from the threats and strengths from the weaknesses. The factors which are not dependent on the organisation and their existence is not based on

the activities of the organisation are called as external factors. While strengths and weaknesses are internal, opportunities and threats are external and are not in control of the organisation. Opportunities are those situations that the organisations can use to their advantage. While threats are those negative situations that if not tackled promptly can harm the well-being of the organisation. Analysing the external environment requires analysing following areas:

- 1) **Environmental Scanning:** In environmental scanning the broad environmental factors are analysed and studied. These factors are not a part of the organisation's internal environment and hence are uncontrollable in nature. These factors influence the businesses in a significant manner. These factors are a part of the macro environment or the general environment. The common macro environmental factors are economic, political, legal, technological, social, etc.
- 2) **Industry Analysis:** Industry analysis is a tool which is used to assess the degree of competition and complexity within a particular industry. With the help of industry analysis, the marketers study and scrutinise the macro environmental factors that influence a particular industry. Industrial analysis helps the strategic leaders formulate various strategies to neutralise the threats and reap the benefits from the opportunities. Various environmental forces to be studied in the industry analysis are the bargaining power of buyers and suppliers, position of business and competitors, and threats of new entrants as well as the substitutes within the industry.
- 3) **Competitive Analysis:** While appraising the external environment, it is very important to analyse the strengths and weaknesses of the existing and probable competitors. It helps the organisation to formulate the strategies required to survive and succeed in the highly competitive environment. It also outlines the strategies adopted by the competitors. The influence of competition is directly proportional to the degree of concentration in the industry, i.e., if the concentration of the industry is high, the influence of competition is high, and *vice versa*. Competitive analysis helps the organisations in identifying threat and opportunities by providing defensive and offensive strategic moves.

organisations to predict the potential opportunities and threats which in turn helps in strategic planning.

- 2) **Warns against Threats:** Analysing and studying the environmental factors highlights the existing and potential threats and warn the organisation prior to their occurrence, which help them in developing effective strategies for minimising the effects of threats and to transform them into opportunities.
- 3) **Recognises Environmental Risks:** While analysing the environment the strategists are able to anticipate the risks involved in exploiting the opportunities, so that preventive measurements can be taken for minimising the risks and maximising the benefits.
- 4) **Identifies Opportunities:** With the help of environment appraisal, the organisations can effectively identify the opportunities. This in turn allows the organisation to ensure that the organisational resources are efficiently utilised and predetermined objectives are realised.
- 5) **Provides More Time for Routine Activities:** Analysing environmental factors beforehand provides the managers adequate time for other day-to-day activities, with the help of environmental analysis they can make predictions about the future environmental conditions. This lessens the burden of time as the managers are able to anticipate the future scenarios in advance.
- 6) **Identifies New Growth Avenues:** Appraising the environment closely facilitates the organisation to identify new growth avenues for business. This helps the organisation to succeed and face the competition effectively.
- 7) **Continuous Learning:** Environment appraisal helps the managers to learn from the continuously changing market. It allows the strategists to upgrade their knowledge and improve their skills to stay competitive among the competitors.
- 8) **Builds the Image of Organisation:** Interacting and having a deep insight about the external environment builds the image of an organisation. It reflects the concern of an organisation towards its environment. **For example,** Captive Power Plants (CPP) have been installed by numerous organisations to ensure continuous power supply.
- 9) **Analyses the Competitors:** Environment analysis allows an organisation to study the strategies adopted by the competitors. This helps the strategic leaders to formulate effective strategies to stay competitive in the market.

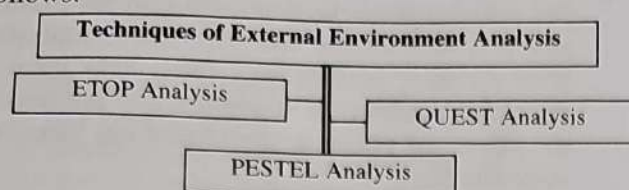
2.2.6. Significance of External Analysis

Environmental appraisal has following benefits:

- 1) **Predicts the Opportunities and Threats:** Environmental appraisal allows the

2.2.7. Methods and Techniques used for External Environment Analysis

Major techniques of environmental scanning are as follows:



2.2.7.1. Preparing an Environmental Threat and Opportunity Profile (ETOP)

Environmental Threats and Opportunities Profile (ETOP) is a technique used to structure the issues of environment. This technique was given by **W.F. Glueck**. The ETOP categorises different environmental issues in various sectors which in turn helps the management to focus their attention towards specific areas. It helps in identifying the potential factors that influence the organisation.

ETOP Preparation

To prepare ETOP of an organisation, the strategists need to classify the environmental factors in specified categories, after which the impacts of those factors can be analysed. This categorisation simplifies the overall analysis process. The **table 2.1** provides an example of an ETOP prepared for TATA DoCoMo Company, which is in the telecommunication industry. Here, upward arrow indicates favourable impact, downward arrow indicates unfavourable impact, and horizontal arrow indicates neutral impact.

Table 2.1: ETOP Preparation

Sector	Analysis	Favourability to TATA DoCoMo	Strategic Implication
1) Economic	Growth of Indian economy along with the expanding population of youth and increasing GDP rates.	(↑)	The company is providing value-added services for youth along with core benefits to the traditional customers (messaging and talk-time services). The focus of the company is on internet facilities.
2) Social	Existing telecommunication facilities are fairly adopted by the society. However, the demand for more enhanced technologies is still there.	(↑)	Customers can be retained and increased with the help of mobile apps, 3G/4G based services, value added services, plug-play devices, and Wi-Fi portability.
3) Political	Allocation of spectrum depends on the government rules and regulations as well as the image of firm.	(↓)	The firm should try to gain more spectrums for providing the support to new subscriptions by providing more payment.
4) Regulatory	Telecom Regulatory Authority of India (TRAI) is establishing its image by making new regulations so that spectrums can be allocated effectively. Formulation of new regulations may lead to hike in tariffs.	(→)	It may become difficult for the company to deal with the increased tariffs. The company may need to increase the prices to cover the tariffs. By providing new and beneficial services, this loss can be covered up.
5) Market	The market has many big players like Bharti Airtel, Vodafone, Idea, Reliance, Aircel, etc., which are doing quite well and have achieved success in this market. But recent trend tells that market is saturated now, and there is a downfall in the rate of net subscriptions.	(↑)	Since, the competition is quite high, hence, there is a chance to earn profit from it. The firm needs to grow its customer base through which rate of subscriptions along with the profits would be increased.

Diagnosing the external environment closely is very essential as it points out the opportunities and threats. While some of the factors create suitable circumstances, other factors impose threats. ETOP facilitates an in-depth analysis of environmental factors that allows the organisations to identify the potential opportunities and threats. This results in more efficient strategic planning. An opportunity can be defined as a favourable situation that provides prospects for a business to grow, expand and make profits as well. **For example**, an untapped market, an unaddressed potential need of customers, new technology, etc.

Constraints are those factors that limit the ability to grow and reduce sales and profit potential. A threat can be defined as an unfavourable situation that restrains the growth and profits of an organisation. **For example**, new entrants, availability of substitutes at low cost, etc.

6) International	To overcome the problem of downfall in subscription rate, the firm can tie-up with the international telecom companies so that better services can be provided.	(↑)	Collaborating with the international firms like NTT DoCoMo & Navteq may provide the leverage of latest technologies. Some of the technologies are SMS, Smart Pilot, Route Finder and push-based E-mail service of Tata DoCoMo, etc.
7) Supplier	Improvement in infrastructure is needed to provide better networking facility and value added services.	(→)	After collaborating with firms like Huawei and ZTE+ enhance the 3G networks and better services, such as 3G network, low cost dongles, Data Cards, etc., DoCoMo is at a good market position.
8) Technology	Latest technologies are being launched every day which enhances the service by allowing customers to use various applications. Technology is an important factor in tempting the customers.	(↑)	The company is the first private firm to launch 3G in the market. It is on its way to launch 4G soon. It has also successfully launched i-Mode, which is a mobile based internet platform.

TATA DoCoMo is in the business of telecommunication in Indian market. As per the ETOP profile, the position of the company is stable and the firm is growing even in intense competition. The company can take the advantage of competition by providing value added services. New government regulations may impose some tariff barriers which may be recovered by launching new and beneficial services. Since, there is fierce competition in the market, hence for the proper allocation of spectrums the firm needs to pay more. Since, there is a lack of infrastructure in the country; hence collaboration would help the firm to spread its coverage. On the other hand, collaborations with international firms may lead to implementation of latest technologies.

The firm is quite ahead by many steps than its rivals in the field of 3G as it was first private firm to introduce it. It is trying to introduce 4G in the market, which would give great market leverage. Hence, it can be seen that ETOP highlights the position of a company in various areas and also shows different environmental factors affecting its operations.

2.2.7.2. QUEST Analysis

The QUEST or "Quick Environmental Scanning Technique" is a technique that facilitates estimation of wide-ranging environmental factors and assesses their influences on the organisation. It tries to scrutinise the environmental forces on the basis of events and trends occurring in the market.

Some of the assumptions made for analysing the environment using this technique are:

- 1) The strategic executives have views about the dynamic environmental forces.
- 2) These views about the environment collectively signify the understanding of the environment by the organisation.

Hence, it can be said that having knowledge about the environmental forces can be useful only when there is a mechanism to interpret and analyse them. In the absence of a specific technique, it is possible that all the future expectations and plans go wasted, as these cannot be shared with the executives. QUEST analysis allows the executives to understand and analyse the different perceptions, interpretations and points of mistakes regarding the environment.

This technique helps the executives in voicing their perceptions and analysing the points at which their individual views differ from each other. Once the points at which the executives disagree are identified, it is possible for the management to negotiate with them so that a consensus can be achieved. The information generated by different views would lead to better decision-making for the achievement of organisational goals. This also allows the organisations to make combined decisions rather than independent and individual ones.

According to Nanus, "QUEST is a future research process designed to permit executives and planners in an organisation to share their views about trends and events in future external environments that have critical implications for the organisation's strategies and policies. It is a systematic, intensive, and relatively inexpensive way to develop a shared understanding of high priority issues and to focus management's attention quickly on strategic areas for which more detailed planning and analysis would be beneficial".

Various tools can be used to perform QUEST, such as questionnaires, stakeholder analysis, Delphi technique, structural analysis, etc.

Process of QUEST

- 1) **Preparation for QUEST:** The first step of QUEST analysis is to make preliminary preparations. These preliminary tasks are as follows:
 - i) Define the environmental issues,
 - ii) Select the members for the analysis (12 to 15),
 - iii) Document the complete information about the past trends of environment relevant for the organisation,
 - iv) Decide the location to carry-out the analysis.
- 2) **Analyse the Environment:** As soon as the preparations have been completed, the environment in which the organisational activities are performed is analysed. This step starts with identifying the vision, mission, and objectives of the organisation. Following the discussions about organisational goals, the past trends and environmental patterns that may influence the operations of the organisation, are discussed. It should be noted that the cross-impact of these forces are also analysed to estimate the capability and strength of the organisation. Strategic leaders should devote considerable time to analyse the environment.
- 3) **Document the Discussions in a Report:** Once, the business environment is analysed, all the outcomes are combined and presented in form of a brief report. This report has two sections, where the first part illustrates about the organisation's strategic content, the second part elaborates about the future possibilities to be faced by the organisation.
- 4) **Discuss the Report:** At last the strategic leaders should discuss the documented report in a meeting, and analyse the alternative courses of actions available to the organisation. These alternative courses of actions should also be evaluated according to the desired future position of the organisation keeping in mind the resources and strengths of the organisation. QUEST does not suggest the strategies to be made; it highlights the issues and challenges to be considered while formulating the strategy.

2.2.7.3. PESTEL/ PEST Analysis

PESTEL analysis or commonly known as PEST analysis is a tool normally used by the organisations to monitor the kind of environment in which they are working or are preparing to start a new business initiative or to introduce a new service or product. PESTEL is an acronym for Political, Economic, Social, Technological, Environmental, and Legal. It provides a binocular vision of the complete business environment from various perspectives that are needed to be traced or assessed while implementing a business plan or idea.

Each feature of PESTEL technique is vital for each and every business or trade. Besides helping in knowing the nature of the market, this technique provides a basic structure which not only specifies what a firm should do, but also helps in determining the future goals of the organisation and the strategies involved in attaining them.

Various factors that are analysed in PESTEL analysis are as follows:

- 1) **Political Factors:** Political factors are the laws, orders, and interventions made by the government in order to regulate the businesses. These regulations influence the operations of business in a significant way.
Government introduces new rules, taxes, and tariffs on the industries which affect the costing strategy. Government set standards as per which the organisations produce goods or services and also controls the type of goods and services to be produced.
- 2) **Economic Factors:** Economic factors are the current and past patterns that exist in the country. These factors encompass the rate of economic growth, inflation, exchange rates, average income, etc., which heavily influence the money circulation and hence regulate the business activities.
- 3) **Social Factors:** Social factors include all those factors that are related to the general public. These factors are closely knitted with the consumption by public, which influences the gross demand of products and services. These factors involve the rate of population growth, literacy rate, employment, public safety, etc.
- 4) **Technological Factors:** Technological factors are one of the prime factors that affect the business operations in the dynamic business environment. These factors involve arrival of new technology in market, automation of business processes, research and development projects, etc.
- 5) **Environmental Factors:** The environmental factors comprise of all the factors that affect or are determined by the surrounding environment. Analysing environmental factors is vital for some sectors especially for tourism, agriculture, farming, etc. Though the business environment is not confined to climate, weather, physical position, global changes in weather, yet it involves all of them.
- 6) **Legal Factors:** These factors are related to the lawful aspects of business. They can be both extrinsic and intrinsic. There are some laws that

are framed by the government of a country. Such laws influence the business environment of the organisation and thus are extrinsic in nature. While some policies are framed by the organisation to safeguard its interest and for ensuring its smooth functioning.

Both these perspectives are given due weightage in the legal analysis, based on which new strategies are planned out. **For example**, before planning out any business endeavour, the consumer laws, safety measures, labour laws are duly contemplated.

2.2.7.4. Ansoff Grid/Matrix

The Ansoff Grid/Matrix is one of the best techniques to identify various growth opportunities which are available to an organisation. In this, two major variables causing an organisation to grow, i.e., growth in market opportunities and growth in product opportunities are combined to form a matrix.

This matrix was developed by Igor Ansoff as a marketing tool and was first published in the article "Strategies for Diversification" in the Harvard Business Review of 1957. It is also called as 'Ansoff Product-Market Growth Matrix'. During the business strategy formulation processes, this matrix proves to be very useful for determining growth opportunities for the organisation. As per this matrix, an organisation attempts to grow by offering new or existing products to the new or existing markets. In this way, it suggests four different options for an organisation to grow.

	Current Products	New Products
Current Markets	Market-Penetration Strategy	Product-Development Strategy
New Markets	Market-Development Strategy	Diversification Strategy

Figure 2.3: Ansoff Grid/Matrix

With the help of this matrix, organisations choose their respective course of action as per their current position in the organisation. The four strategies suggested by this matrix are shown in **figure 2.3**:

- 1) **Market Penetration (Existing Markets, Existing Products):** In this strategy of the matrix, the organisation tries to penetrate a market with its existing portfolio of products. The most viable strategy is by gaining the market

share of the competitors. Other ways of this is by expanding the market and getting non-users to use the product or getting existing users to use more quantities of the product through the impact of advertising and sales promotion. It is the least risky growth strategy for an organisation.

- 2) **Product Development (Existing Markets, New Products):** Another growth strategy for an organisation serving its current market is to develop new products for the existing market. These new products should not be new to the market but to the organisation. **For example**, Pepsi entered into the snack foods segment through Frito Lays. Even though the product category was new for Pepsi but there were other players in this segments like Uncle Chips etc. When an organisation launches new products it is able to attract new customers and this increases the competitiveness of the organisation.
- 3) **Market Development (New Markets, Existing Products):** Another growth strategy for organisations in this matrix is market development. The product can also be launched in newer market segments by making modifications in the product specifications or by appealing to a different class of customers by repositioning. Again the market need not be a new market in terms of origin but a new market of operation for the company. **For example**, Parle Appy Fizz was repositioned targeting a larger number of customer segments whereas initially it was launched for hard professionals.
- 4) **Diversification (New Markets, New Products):** Diversification is also a growth strategy suggested by Ansoff matrix. In this, different new products are launched in different new markets. Mahindra Group is a perfect example of a company which has done diversification as a growth strategy. The various segments in which Mahindra operates are:
 - i) Automotive, ii) Farm equipment,
 - iii) Systech, iv) Financial services,
 - v) IT, vi) Infrastructure
 - vii) Mahindra After-market, viii) Two-wheelers,
 - ix) Mahindra partners division and x) Speciality services.

Thus, it is clear that as the organisation diverts from basic strategy, i.e., existing product in the existing market, different types of risks are faced by it. One can say that market penetration is the least risky growth option whereas diversification is the riskiest one.

2.3. INDUSTRY ANALYSIS

2.3.1. Introduction

A number of environmental factors influence the organisations. It is up to managers to ensure that this influence is harnessed in a positive way, leading to organisational success. For the firm to make profit, it must create value for customers or buyers. Hence, the firm needs to understand its customers. While creating value, the firm has to obtain goods and services from suppliers. So, it must value its suppliers and form enduring business relationships with them. While creating value for its buyers, the firm must closely look at the rivals who are there in the arena competing for the same 'space'. Hence, the firm must understand the competition. Thus, buyers, suppliers and competitors form the substance of a firm's industry environment.

Forces from the industry environment directly affect the firm, and the amount of influence the firm has over its industry is dependent on the dominance of its competitive position. Most strategic management books utilise Michael Porter's Five Forces Model as a framework for analysing the competitive forces within the industry. As so many other models used to make strategic decisions today, the implicit assumption of this model is that the industry is operating within an economy closed to the greater society and ecosystem. From the view of the Five Forces Model, industry analysis is traditionally portrayed in strategic management books from the rather static perspective of "what is" within the industry. This model suggests that strategic managers scan the product market segments in which they compete for opportunities and threats without much regard for context.

Their primary focus is on increasing market share within defined industry boundaries, and the competition is defined as those competitors who directly compete with them in individual product or service categories. Cooperative relationships are typically limited to those with direct suppliers and buyers. Capabilities to create value are viewed as residing in a single firm, and organisational performance is measured primarily in terms of how well the individual firm is managed with respect to its economic sustainability. Thus, within this traditional paradigm of industry analysis, strategic managers engage in adaptive learning within well-defined industry segments.

2.3.2. Competitive Changes during Industry Evolution

With the continuous evolution of an industry, several changes occur in the nature and fundamentals of market

competition. The managers should try to predict changes in the industry caused due to various forces and accordingly formulate suitable strategies. The manager of a firm should give special attention to the industry evolution as the most elementary work of a manager is to predict and utilise the environmental changes, and the literature related to the evolution of industry provides key information about different types of interdependencies, changes in the basis of competitive advantage, and company's strategic choices.

The main focus of industry evolution is upon developing the theory which can be used for explaining the empirical uniformities in the life spans of industries, which are particularly associated with the firm growth and survival, nature of technological innovation, market demand, entry rates, etc. The differences between the firms (i.e., types of firms sustaining and creating innovations) and among the industries (i.e., which traits of the industry has the capability to alter the nature of competition within the industry) are increasingly emphasised by the recent research studies. The industry evolution models are being used by many researchers as theoretical and empirical guidelines in order to analyse various connected issues such as effect of institutional change on industry development, innovation-based competition between incumbents and entrants, and diffusion of knowledge developed by failed companies.

Phases in Industry Evolution

There are number of stages through which an industry has to pass. These stages include initial growth, maturity, and ultimate decline. These stages have different implications for nature of competition. During the industry evolution, there will be some modification in every five main competitive forces. There are mainly five different industry environments which are associated with the different stages during the evolution of the industry:

Stage 1: Embryonic Industry: Embryonic industry is an industry which represents the initial phase of the industry development. At this stage, the rate of growth is low because of three main reasons, viz. buyers' unfamiliarity with the industry's products, poor distribution network and high prices due to the firms' inability to achieve economies of scale. Rather than the brand loyalty or cost economies, having access to vital technological know-how can be seen as the main barrier to entry at this stage. Customer education, perfecting the design of the product, opening up distribution channels, etc., can be seen as the basis of rivalry in embryonic industries.

Stage 2: Growth Industry: Growth industry represents the one which has expanding first-time demand as more new customers are buying the

products. When the familiarity with the product of customer increases, it results in increased sales, which further reduces the products' prices because of economies of scale and development of distribution channels. In the growth stage of the industry evolution, rivalry will be very limited. The revenue and profits of the firm increase due to fast growth in demand and profits, and there will be no impact in the market share of competitors.

Stage 3: Shakeout: When the rate of industrial growth is decelerated due to saturation levels in the demand, it is said that an industrial shakeout has occurred. The market condition where the number of first-time buyers is very less is called a saturated market. There will be an increased competition among the firms when the industry approaches to shakeout stage. The firms will continue to increase its production capabilities with the same rates as it was facing in the growth stage. The future growth rates are predicted on the basis of historical data and different capacity expansion plans are accordingly formulated.

Stage 4: Mature Industry: When the demand of the industry completely saturates, it is termed as mature industry. At this stage, the rate of industrial growth will be almost zero or very low. The addition of new customers due to growth in the population is the only source of any increase in the growth rate. There will be increased barrier to entry and thus new competitors are rare to enter in mature industry. As the industry reaches to the maturity stage, the historical growth rates are not used by the firms. The existing market shares are held back by the firms with the help of price cuts.

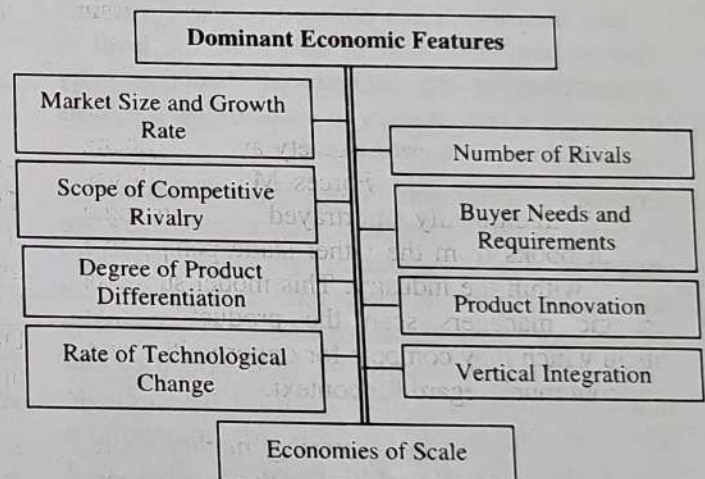
By this stage, most of the industries have consolidated and become oligopolies due to shakeouts. The interdependencies among the firms of the industry will be identified in maturity stage as they tend to avoid any kind of price wars at this stage. These firms try to attain the price leadership with the help of stable demand. Reduction in the competition among the firms is resulted by the net effect of price reduction and thus a greater profitability can be accomplished. Any kind of price war can put serious questions in front of stability of the mature industry. The industry demand can be negatively affected by the general slump in economic activity. When some attempts are made by the firms to encounter the reduced demands, there will be no agreement on the price leadership and thus more competition will result, causing reduction in price and profits.

Stage 5: Decline: Under this stage, the industrial growth rate becomes negative due to various reasons such as international competition within a declining

industry, change in demographics, technological substitution, social changes, etc. Similar to the shakeout stage, the level of competition will be very high due to decline in the demand and increased exit barriers. Rise of excess capacity due to falling demands can be seen as the main issue associated with this stage. For utilising the excess capacity, firms tend to reduce prices thereby creating a price war. Adjustment in the excess capacity will be made by the exit barriers. It will be tougher for the firms to reduce the excess capacity due to increased exit barriers and thus it will result in greater price wars.

2.3.3. Dominant Economic Features

Industries differ from one another in terms of their structure and composition. An industry analysis of a firm thus starts with an analysis of the dominant economic features of the industry. The knowledge of dominant economic features of the industry plays a significant role in evaluating the competitive environment of a company. This analysis also provides a bird's eye view of the industry. Some of these dominant economic features are:



- 1) **Market Size and Growth Rate:** It is essential for a company to have an overview of the industry market size. Market size of an industry is equal to the number of companies in a particular industry. Knowledge of industry growth rate helps in identifying the industry's position in its lifecycle, i.e., early development stage, rapid growth stage, early maturity stage, maturity stage, stagnation stage, decline stage.
- 2) **Number of Rivals:** Before making an entry, a company should identify the rivals in a particular industry. There may be numerous small rivalling companies or a small number of big business houses. **For example,** the petrochemicals industry is dominated by Reliance and a few other larger players. On the other hand, an industry like

FMCG industry has many players – both big and small. It is also important to be aware about the current developments in the industry like mergers and acquisitions, strategic alliances, etc.

- 3) **Scope of Competitive Rivalry:** It is important for the firm to know about the extent or scope of competition in its industry. **For example**, if product diversification is identified as a future industry trend then a new company in the industry should also a plan for future diversification.
- 4) **Buyer Requirements and Needs:** It is very important for a company to know about the needs and requirements of its customers. It also requires to keep a track of the changing patterns of buyer's needs so that it is able acquire new customers and retain the existing ones. It can do this by doing systematic research on buyer behaviour and other market trends.
- 5) **Degree of Product Differentiation:** The degree of differentiation in the industry will define the kind of pricing premium that a firm can charge its customers. In case the level of differentiation is low then the prices charged by the firms will also be low. This will in turn raise the level of competition in the industry. It becomes very difficult for new players to compete on the basis of price due to low profit levels.
- 6) **Product Innovation:** Product innovation is also an important dominant feature. There are industries where companies are characterised by short span of product life cycles and high product innovation levels. Research and Development is a very important function in these industries and industry participants should always try to create new and innovative products for maintaining their market position. **For example**, there is a very high rate of innovation in the smartphone industry. The typical lifecycle of a smartphone phone is very short as the buyers are on the lookout for new features all the time.
- 7) **Rate of Technological Change:** Industries that are dependent on the rapid diffusion of new technologies are characterised by a high investment in R&D on new technologies. When a company enters an industry where the rate of change of technology is high it must direct its efforts in staying at par with the latest technological changes in the industry. Companies which don't adjust to the rapid change of technology lose their market share, **e.g.,** Nokia.
- 8) **Vertical Integration:** It is necessary to analyse the level of integration of the companies. Analysis of an industry is largely affected by the horizontal and

vertical in integration levels as both the level have their respective advantages and disadvantages. Apart from the integration activities competitive advantages and competencies of the rivals firms should also be analysed.

- 9) **Economies of Scale:** Companies also need to analyse and keep abreast of economies of scale in the industry may bring the cost down. They need to analyse the scale of operations of their competitors and see if larger scale of economies brings about reduction in their cost structures. High economy scales lead to low production costs and high profit returns.

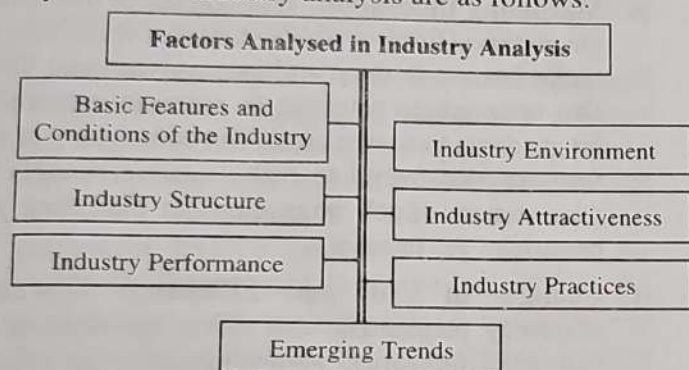
2.3.4. Industry Life Cycle Stages

- 1) **Emerging Stage (Emerging Industry):** An industry which is in its beginning or early stages of development is known as an emerging industry. Some examples of emerging industries could be wireless communication industry during the 1980s, biotechnology and PCs during the 1970s, online retail industry during the early 1990s, etc. Industries grow at a slow rate at this stage. There are several factors that contribute to such slow growth, viz., rising prices, poor distribution channels and unawareness of the buyers regarding the product of the industry.
- 2) **Growing Stage (Growing Industry):** The industry is said to enter the growth stage as soon as the demand for its product rises. The first-time demand for the product increases with the entry of more new customers in the market. At this stage, the distribution channels get better, prices of the products get reduced, familiarity of the buyers regarding the product increases and economies of scale and experience are achieved. All these factors help the industry to enter into the growth stage.
- 3) **Mature Stage (Mature Industry):** This stage is characterised by low or negligible growth, market saturation and replacement demand. Population explosion (entry of new customers in the market) or rise in the replacement demand is the main reason of growth at this stage. There is also a fall in the threats of entry from probable competitors and rise in the barriers to entry. The rate of growth is slowed down therefore, the mere holding of market share can no longer help in maintaining the rate of growth that the firm used to enjoy earlier.
- 4) **Declining Stage (Declining Industry):** Declining stage is the last stage of the industry life cycle. This stage is characterised by a negative growth. Several factors, viz.,

international competition, substitution in technology (more preference to air travel), changes in social dimensions (people becoming more conscious towards health affecting the sales of tobacco) and demographical (decreasing rate of child births affecting the child products' market) contribute to the negative rate of growth. An increase in competition amongst the well-known firms can be seen at this stage. This is the result of rapid decline and increasing barriers to exit. There is also a rise in capacity which is the result of decreased demand in this stage.

2.3.5. Factors Analysed in Industry Analysis

Some of the major factors that are needed to be analysed in the industry analysis are as follows:



- 1) **Basic Features and Conditions of the Industry:** The most basic task is to analyse the general features and condition of the industry. The basic feature of an industry involves the size of industry, the products and services offered by the companies, variants of the products and services, past performances of the industry, current industry position, future expectation, etc.
- 2) **Industry Environment:** Another factor that must be studied in the industry analysis is the environment of the industry. Environment of industry can be classified according to **Michel Porter** as – fragmented, emerging, matured, declining and global industries.
- 3) **Industry Structure:** In order to analyse the industry in a better way, the structure of that particular industry should be understood. Every industry has a specific market size, certain number of companies and each company has its own market share. The firms in an industry compete with each other to capture the market. These characteristics determine the severity of competition in the industry, the extent of profitability and attractiveness of the industry.
- 4) **Industry Attractiveness:** Industry attractiveness is determined by factors like industry potential,

industry growth, the profitability, future trends for the industry, the entry and exit barriers in the industry, etc. All these play a vital role in developing the attractiveness of an industry.

- 5) **Industry Performance:** The determinants of an industry's performance are its annual production, profitability per year, technological advancements, etc.
- 6) **Industry Practices:** The practices of an industry can be defined as the products or services in which the companies deal in, the type of markets they share, the business practices they carry-out, such as pricing, promotion, selling, research and development, etc. All these factors affect the overall industry in significant ways.
- 7) **Emerging Trends:** The trends that are going to define the industry in future also impact the business practices indirectly. Some of the important factors like product life cycle, industry life cycle, changes in needs and preferences of the consumers, changes in laws, possibilities of new entrants, innovation, changes in technology, etc., are some variables that have a significant impact on the industry.

2.3.6. Competitive/Driving Forces

Driving forces help us to understand the state of the industry and also the various factors which are important for doing well in that industry. The operant forces in any industry are very dynamic in nature and the changes taking place in the industry are influenced by these forces. The forces which are most dominant are called the dominant or driving forces.

Common Driving Forces

Many factors can be called driving forces. Some of these factors are particular to an industry, whereas there are some which are common to all the industries. These are as follows:

- 1) **Changing Industry Growth Rate:** Changes in the growth rate of an industry can be a major driving force. It causes distortions in the demand and supply patterns and can lead to of excessive / reduced supply. This in turn influences the entry of new firms or the exit of prevailing ones from the industry. The competitiveness among the firms also gets affected.
- 2) **Growing Buyer Preferences for Differentiated Products instead of Commodity Product:** Buyer preferences can shift and they may start demanding more variety and differentiation. In this situation companies can charge a premium and make customised products which incorporate novel features, options, accessories, distinctiveness, etc. Dell is an example of a company which has made use of this in the computer hardware industry.

- 3) **Product Innovation:** There is continuous competition prevailing in the market place to be the first to launch a product or to make enhancements in the existing product specification. Any industry which is prone to such innovations in products sees a steady inflow of new customers, sustained industry growth and various companies differentiate either broad or narrow in product offerings. In such industries, the companies which practise innovation get an advantage over companies which stick to established lines and do not invest in new product development.
- 4) **E-Commerce and Internet Opportunities:** The Internet is creating a revolution in the landscape of all industries and is throwing up all types of challenges and opportunities in the B2B and B2C space. This transformation is very dynamic as the Internet itself is getting transformed with new technologies and products which are appearing from time to time. The impact of the internet can be seen in all kinds of industries.
- 5) **Changes in Consumer and Producer:** There can also be changes in the way the consumer uses the product or any other offerings. This forces the companies in the industry to make suitable adjustments to the product and service offerings so that they can meet customer expectations in a better way. The changes can be in the way the product is made available or in the number of varieties that are being offered to the customer. There can also be changes in the promotion and advertisement policy of the company.
- 6) **Manufacturing Process Innovation and Technological Changes:** Changes can also occur in the industry because of advancements in technology. This allows the companies to offer better and superior products at cheaper cost than earlier. An **example** of this can be the development of Voice over Internet Protocol (VoIP) which has led to the proliferation of low cost telephony services. Because of this technology, customers are moving away from the traditional landline products. Technology can also entail substantial enhancement in capital equipment, production scale, efficiency of plants, logistics, and distribution channels, experience curve, etc.
- 7) **Rate of Industry Globalisation:** There are many reasons as to why the companies are going international these days. Companies are engaged in devising long term strategies which allow them to get a dominant share of global markets. There is an increased focus on what the global customer wants and this has become an aspect of product design. This has not just resulted in reduced trade barriers between nations but has also improved the profits of the firms. The growth of global organisations like Walmart and Apple bears testimony to this.
- 8) **Entry or Exit of Major Firms:** The entry of foreign firms also changes the existing ways of doing business in local markets. Established companies can enter on their own or get into a joint venture or acquire a local partner. This brings in new technology, skills and management thought in the local markets. This also increases the level of prevalent competition. The entry and exit of firms often changes the rules of the game in many industries. Companies have to adapt to new conditions or get forced out by dominant and more innovative organisations.
- 9) **Marketing Innovation:** With the aid of marketing innovations, firms are able to attract their buyers, create interest in them and increase demand. They also offer greater varieties to the customer which brings down their unit costs. The competitors of the firm are also forced to make suitable changes in their strategy. Such innovations in marketing are because of the Internet.
- 10) **Changes in Cost and Efficiency:** Cost and efficiency parameters also affect the working of industries. Industries' competitiveness can expand or contract as it is based on the efficiency and cost.
For example, the low cost of fax and email has impacted the working of many postal service organisations that were operating at high costs. Similarly newly constructed electricity generating plants have put old coal and gas based plants out of business as these are no longer viable economically.
- 11) **Reductions in Uncertainty and Business Risk:** In the beginning, the level of risk in a new industry is very high. As a result, more risk tolerant entrepreneurs enter the industry. However, once the industry stabilises, more established companies make an entry in these industries. Such established firms tend to invest in the growing industries. This lowers the level of risk in the industry. This reduction in business risk and uncertainty drives the firms in the industry.
- 12) **Regulatory Influences and Government Policy Changes:** The policies and regulations of the Government play a very big role in the dominant practices of an industry. The Government policies affect both the macroeconomic environment as well as specific business sectors. The various actions of the Government can pertain to monetary policy, fiscal policy, the level of subsidies, farm loan waivers, etc. The

monetary policy affects the level of liquidity in the markets through the prevalent interest rates and the availability of credit in the economy. This impacts the cost of capital of firms and also the way they appraise their projects.

- 13) **Technical Know-How Diffusion:** The particular knowledge possessed by a company about a specific manufacturing system or an activity ultimately percolates to other organisations. This diffusion of knowledge can occur through transmission by customers, channel partners, agents, publications in trade and scientific journals, the Internet and also through the migration of workforce and managerial talent from one organisation to another. It can also happen in an organised way when organisations issue licenses to other organisations *in lieu* of royalty or by entering into joint ventures.
- 14) **Changes in Societal Concerns, Lifestyles and Attitudes:** The changes in the tastes, customs and wants of the customers also play a big role in the design and proliferation of new products and services. In today's competitive world, companies have a perpetual eye on what the customer desires and how the attitude of the customer evolves with regards to products and services. Negative attitudes can severely dent the success of the company. Changes in consumer perceptions and attitudes are affected through changes in education levels, changing fashion trends, migration effects, etc.

2.3.7. Porter's Five Forces Model

For analysing an industry efficiently, it is essential to consider various competitive forces and how they interact with each other to create pressure on one another. These factors decide the nature of competition in the industry. The study of these competitive forces is necessary because without scrutinising them, an industry cannot be analysed thoroughly.

Michael Porter developed a model which explains that the industry of a firm is affected by five forces. The strategic business manager can use Porter's model to analyse an industry on these five forces and then judge the strengths and weaknesses of his firm based on his industry analysis.

The industry analysis will basically enable the manager to review how strong each force is in a particular industry. This model thus helps the firm to gain an edge over its rivals in the industry. An industry can be very loosely defined as a group of firms who are all producing similar products and

services – so that the customer can substitute one for the other. This five forces model is a widely used technique for analysing the industry. It also illustrates the nature and level of competition existing in the industry along with the forces that shape a business and its functions. An industry consists of number of firms that produce and sell similar products or services to the consumers.

Therefore the five force model is quite significant in understanding the complex and diverse characteristics of the competition in different industry areas. The competition faced by a firm is actually much broader as it includes both current and potential competitors. A company can face negative consequences by emergence of new technologies and new competitors as well as the existing competitors.

Before analysing the nature and scope of competition in an industry, it makes sense to define its boundaries. This helps in the following ways:

- 1) **Define Arena:** It helps in defining the arena (or playing field) of the firm.
- 2) **Focus on the Competitors:** Setting the industry boundaries helps the firm to get an idea of its competitors and the firms that are manufacturing substitute products.
- 3) **Identify Key Factors for Success:** This helps in allocating and deploying the key success factors in the industry.

2.3.7.1. Components of Porter's Five Forces Model

The five forces of the Michael Porter Model are as follows:

- 1) **Rivalry inside Industry:** According to perfect competition model, no firm can enjoy super normal profits, and in the long run the competition drives the excess profits to zero. In the real market, the competition is not perfect and the firms are not just the entities interested in charging money from the consumers, they actually attempt to seek a competitive advantage over their rivals. The level of rivalry in an industry is of great importance to economists and strategic analysts. One such ratio which gives an idea of the prevalent state of competition in an industry is the concentration ratio (CR). A high industry concentration ratio means that a very few firms command a very high market share in that industry. **For example,** the petrochemical industry in India is dominated by Reliance Industries and has a very high concentration ratio. If the concentration ratio is low, then the industry is considered to be a disciplined one.

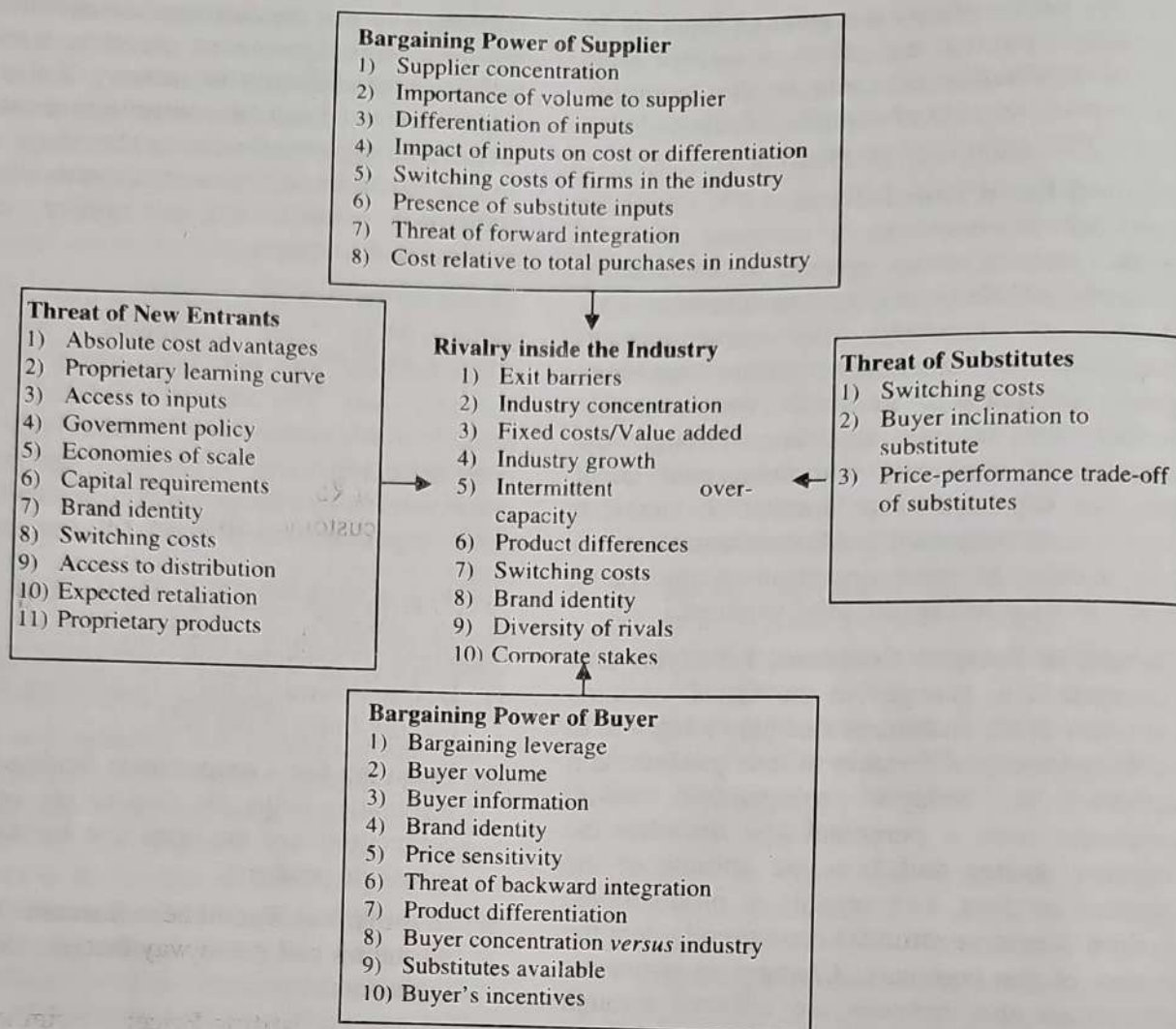


Figure 2.4: Components of Porter's Five Forces Model

This discipline might be a result of a code of conduct or mutual amenability among the firms. This discipline results from the history of competition in the industry, the presence of a great leading firm, an informal or tactical understanding between the players to avoid breaking the rules. However even in a disciplined industry a rebel firm can cause havoc with its business activities.

Following features of the industry can influence the intensity of rivalry:

- Number of Players:** As the number of players increase in an industry, the intensity of competition also rises. The reason behind this competitive landscape is that greater numbers of firms compete for the same customers and resources. The situation gets more intense when the firms with similar market share try to become the market leader.
- Slow Market Growth:** When the market growth is slow then the companies have to increase the intensity of the competition to garner market share. In such cases a company

grows only at the expense of some other company. On the other hand, when the growth rate is more e.g., the initial days of the telecom industry in India, companies can grow by simply being a part of the growing market.

- High Fixed Costs:** The competition intensity also increases with the increase in fixed cost. When the maximum portion of total cost is fixed costs, then firms try to produce more in quantity to achieve the low unit cost. This leads for the firms to compete with other firms in the market, which in turn increases competition. A good example of this is the automobile industry in India
- High Storage Costs or Highly Perishable Products:** If the products manufactured by the industry are perishable or difficult to store then firms will be under pressure to sell their stock rapidly so that the wastage is low. This increases rivalry in the industry.
- Low Switching Cost:** When the cost for switching the products is low, then customers

feel free to switch from one to the other. This increases the competition as every company tries to grab maximum number of customers. **For example**, in the telecom industry, with the introduction of number portability the customers can switch from one mobile operator to another without having to change their numbers. This has increased the competition levels in the telecom sector.

- vi) **Low Levels of Product Differentiation:** If the products in the industry are not differentiated then there is very high rivalry because all products seem alike to the customers and companies have to try harder to gain high market share.
 - vii) **Market Share:** When a company is losing its market share or trying to gain a market share, then the competition is high as the companies struggle with each other to survive and expand their share of the market.
 - viii) **High Exit Barriers:** Exit barriers prevent a company from leaving an industry even if it is suffering from losses. These barriers impose a high cost on the companies if they want to exit from the industry.
 - ix) **Diverse Competitors:** If the competitor firms are different from each other in various aspects such as business orientation, culture, background, etc., then it becomes difficult to anticipate the competitor strategies. The rivalry in this condition can be intense and unstable.
 - x) **Market Saturation:** When the market is growing, then it attracts many firms to enter in the industry and produce the products. This leads to increase in the production. The market reaches a point where it is crowded with the competing firms and the supply is more than the demand. Therefore, the market gets saturated and large number of rival firms trying to target few customers increase the level of competition in the market.
- 2) **Threat of Substitutes:** The substitutes can be defined as the products of other industries that have the ability to satisfy similar needs. **For example**, coffee can be a substitute for tea, as it can also be used as a caffeine drink in the morning.

When the price of a substitute product changes the demand of a related product also gets affected. When the number of substitute products increases, the competition also increases as the customers have more alternatives to select from. This forces the companies to raise or lower down

the prices. Therefore, it can be concluded that the competition created by the substitute firms is price competition. The presence of a number of substitutes impacts the ability of the company to increase the price of its products as increasing the price will make the substitutes more attractive for the target market. Since, the substitute products serve the same or similar purposes; therefore a close substitute may act as a negative competitive force in the market. Hence, the industries which have no close substitutes are more attractive for various firms as they can charge higher prices when required. **For example**, when Coca-Cola came out with a pricing of ₹5 for its 200ml bottles it was able to acquire customers from substitute products like – coconut water, mango and fresh juice etc.

Some of the conditions in which the power of substitutes is high are as follows:

- i) **Low Switching Cost:** When there is slight or no switching cost paid by the customers, they become free to select another similar product substitute. If all the factors remain constant, such as differentiation, brand loyalty, brand image, etc., then it becomes relatively easy for the customers to go for a similar product. The firms must try to design their product in a way that the switching cost is high.
- ii) **Low Substitute Price:** If a similar product is relatively cheaper, then it increases the risk of the consumers to go for the attractive substitute. It also puts a limit on the level of price charged by the companies. If the companies charge prices more than this limit, they may lose their customers.
- iii) **High Quality of Substitute:** If the substitute product has high quality than the company's product, then the customers will prefer to select the substitute product.
- iv) **Better Performance of Substitute Products:** If the performance of substitute products is better than any other product, then it is more likely that the customers will select the substitute one.
- v) **Availability of Substitutes:** The availability of substitutes also affects the market share of an organisation. If there are few substitutes, then it will hardly affect the business, while high number of substitutes can have major impact on the market share. Potential substitute firms can be recognised by creative thinking and considering other non-traditional rival firms.

- 3) **Buyer Power:** The bargaining power of buyers also has a very important effect on the manufacturing industry. When there are many producers and there is a single customer in a market, then that situation is termed as a "monopsony". In these markets, the position of buyer is very strong and he sets the price. In reality, only a few monopsony markets exist

The buyer's power or bargaining power of buyers compels the firms to reduce the prices. They may also demand a product or service of higher quality at low price or may demand added value in exchange of their money. The buyers have more power in following conditions:

- i) When the number of buyers is relatively less.
- ii) When buyers purchase in bulk.
- iii) Availability of alternate suppliers who can provide the same product or service at a competitive price.
- iv) When the cost of switching from one producer to the other is quite low.
- v) When the buyers, i.e., wholesaler, retailer, etc., charge low prices from the consumers and are unlikely to pay high prices.
- vi) When the buyers pay the maximum share in the total cost of product. This may lead the organisations to search for cheaper alternatives.
- vii) If the buyer is capable of starting new alliance by integrating backwards with other firms making itself a powerful supplier.

- 4) **Supplier Power:** Since the company needs raw material for producing, therefore the producers have to build relationship with its suppliers. When suppliers have the power in their hands, they can exert influence on the producing firms by selling them raw materials at higher prices. **For example,** Walmart as an organisation thrives on the basis of its relationship with its suppliers.

Bargaining power of the suppliers is their ability to influence the industry either through individual or group interaction with the company. The suppliers have a bargaining power with which they can raise the prices of products or services or force the customers to purchase a low quality product or service. This empowers the position of suppliers in the industry. The suppliers can exercise their bargaining power in the following cases:

- i) **Few Numbers of Suppliers:** The suppliers have higher bargaining power when they are few in numbers and are more dominant than the producing firms.
- ii) **Few or No Alternatives:** If the buyers and producers have few or no alternatives, then

suppliers get an added advantage over the buyers. The buyers would have to purchase the supplies in the price set by the suppliers.

- iii) **Less Important Buyers:** When buyers are not much important for the suppliers then they do not consider them. **For example,** for cement industry, major companies, construction houses have much more value than an ordinary man trying to build his house.
 - iv) **Suppliers Selling Critical Products:** When the suppliers provide critical or crucial products, which are rare to find somewhere else, then they have high bargaining power.
 - v) **Differentiated Supplier Product:** If the suppliers supply differentiated products as compared to other suppliers, then they may have a bargaining power in their hands. This increases the switching costs of the buyer. **For example,** loyalty programmes.
 - vi) **Supplier's Ability to Enter the Buying Industry:** When the suppliers have the ability to enter in the industry by collaborating with other firms through forward integration, then the suppliers have a high bargaining power.
- 5) **Threat of New Entrants:** The market is full of competition. Not only the existing firms pose threat to the business, but the arrival of new entrants is also a challenge. As per the ideal scenario, the market is always open for entry and exits, resulting in comparable profits to all the firms. But, this is not applicable in the real picture market. In reality, all industries have some traits that protect their high profits and help them in warding off potential new entrants by erecting barriers. Various factors that hinder the entry of new firms in the industry are called as "barriers to entry". These barriers prevent the new firms from entering into the industry. This helps in maintaining profit levels for the existing firms. These barriers can either be developed or fully utilised to improve the performance of organisation. These entry barriers can be a source of competitive advantage for the firms.

These barriers to entry can be developed from following sources:

- i) **Government Laws and Regulations:** Government laws and regulations are one of the biggest entry barriers. Although the government tries to keep competition alive in the market, it also supports the existing firms by formulating regulations that encourage market monopolies.

- ii) **Patents as Barriers:** Patents and copyrights also give the owner the right to prevent other players from using a technology or a product. This stops other firms from copying and using those ideas, knowledge, technologies, etc., that give the existing firms a competitive edge.
- iii) **Asset Specificity Inhibits Entry into an Industry:** Many times an industry requires an investment in a particular asset category. More specific the asset, the less is its resale value or it is less deployable. This investment can be in technology or plant and equipment. Hence, asset specificity may act as an entry barrier because the new entrant may not want to invest in the exclusive technology at the risk of failure.

2.3.7.2. Utility of Porter's Five Forces Model

There are three aspects of corporate planning for which Porter's Five Forces Model provides valuable information, which are as follows:

- 1) **Statistical Analysis:** The attractiveness of an industry can be identified by conducting the Five Force analysis. It helps in deciding whether to enter or exit from a particular market or industry. Along with this, it also assists in finding out the profitability level of the business. In addition, an organisation can determine the impact of competitive forces on itself as well as its competitors. As a result, competitors may react differently to changes in competitive forces and this may also affect the entire structure of the industry.
- 2) **Dynamical Analysis:** The Five Force model can forecast the potential attractiveness of the industry in future by applying the PEST analysis. The association of PEST analysis with the model reveals factors influencing the changes to be held in the industry. These factors mainly include economic, political, demographic and technological changes which affect the five competitive forces and also influence the industry structure.
- 3) **Analysis of Options:** The competitive position of organisations can be improved by developing different options. This is only possible, when an organisation has appropriate knowledge about the intensity and power of competitive forces. It may lead to the development of new strategic decisions like new positioning or differentiation for strategic competitive product.

Hence, Porter's Five Forces Model is all about analysing the market structure and competitive situation in a systematic and structured way. This model can be adapted by specific market segments, industries and regions. For this, the first and foremost step is to analyse the scope of market. The concept of

Five Forces Model is based on micro-economics. It involves various economic variables such as supply and demand, market structures like perfect competition, monopoly or oligopoly, relationship between volume of production and cost of production and complementary products and substitutes.

2.3.7.3. Limitations of Porter's Five Forces Model

The several limitations of Porter's Five Forces Model are as follows:

- 1) **Existence of Separate and Identifiable Industry:** This model implies that all industries are separate and identifiable in nature. When a firm associates with other firms to work together, at some point of time, complexities ought to occur. These complexities tend to decrease the ability of a firm to draw accurate conclusions from the model. This happens because the model only states the behaviour of firms in the industry and not their associative role with other firms.
- 2) **Overlooks the Ability of Large Firms:** This model ignores the fact that, there are some large firms which possess the power to implement changes in the industry structure thereby, increasing their profitability level. **For example,** leading airline companies apply substantial safety restrictions in order to create barrier for potential entrants.
- 3) **Disagreement between Theorists:** According to this model, industry factors are considered responsible for deriving firm's profit rather than the resources of the firm. Various theorists and scholars have an enduring debate over identifying the main factor behind the firm's profit. The IO theorists support Porter's model while, resource-based theorist support firm-specific characteristics.
- 4) **Inflexible Industry Structure:** A firm must have numerous industry structures in order to compete in different countries. In international markets, the nature of competition varies among different nations and this may cause various challenges to the firm.
- 5) **Wrongful Market Assumptions:** Economically, the model assumes the market to be a perfect one. But, when an industry is largely controlled then the model provides less meaningful or faulty perceptions.
- 6) **Static Market Structure:** The five forces model rationally adopts a fixed market structure. Therefore, this model is less likely to be appropriate for firms in respect with today's market environment. The constant changes in the

2.4. COMPETITION ANALYSIS

2.4.1. Introduction

In the field of marketing and strategic management, competitor analysis is a process of evaluating the strengths and weaknesses of present and potential competitors. It is considered as a crucial part of the company's marketing plan. By combining all the important sources of competitor analysis into a single framework, an effective profiling of competitors can be done in order to formulate, implement, monitor and adjust the strategy in an efficient manner.

While designing the business strategy, the strategies of company's competitors must be considered by the managers. In case of segmented commodity industries, the strategy of competitors is of less significance compared to the concentrated industries where analysis of competitor's strategy is highly recommended. The two main activities of competitor analysis are as follows:

- 1) Attaining information regarding the main competitors, and
- 2) Utilising that information to forecast the behaviour of competitors.

There are numerous firms competing in a single market. Therefore, the main motive of competitor analysis is to determine and forecast the competitive level and market behaviour of the companies competing in the same marketplace. The recognition of existing and potential competitors is essential for analysing their relative strengths and weaknesses or marketing strategies. If a company is only concentrating on the present competitors' analysis, then it will not be able to trace the capabilities and strategies of future rivals. However, the decision of choosing the right basis for analysing the rivals and the level of competition is a complex one.

In the company's potential market, the suppliers of both kinds, i.e., the ones which are considered as substitutes and the ones which supply related products must be included in the competitor analysis. The identification of competitors is an important activity of managers in scrutinising the level of competition, preparing against the competitors' moves and building counter strategies. At the time of preparing a competitive plan, the company must be clear about its present, potential and indirect competitors. The level of satisfaction that the consumers are deriving from the company's products and services and the other competitive company having similar capabilities also assists in identifying the competitors.

In recent times, competitor analysis has gained advantage on grounds of various reasons such as

increased competition from sophisticated competitors and foreign companies, continuously changing business environment mainly technology-based and short product life cycles. Many companies are implementing a process for identifying competitors, tracking their activities, and assessing their strengths and weaknesses by adopting formalised methods, which is specifically known as 'competitive intelligence'. Competitor analysis results in anticipating the moves of the competitors and also the response of competitors towards the strategies implemented by the company which is conducting the analysis.

2.4.2. Sources of Information for Competition Analysis

The sources of information for competitor analysis can be grouped in three categories:

- 1) **Recorded Data:** The internal and external published information like annual reports and brochures are called recorded data.
- 2) **Observable Data:** This type of data is attained by conducting a comprehensive research using several sources, e.g., competitor's pricing
- 3) **Opportunistic Data:** For this type of data, a detailed planning and organisation is required. The opportunistic data can be attained by having discussions with the suppliers, customers and previous officials of competitors.

Possible sources of competitor's information using Davidson's categorisation are enumerated in below:

Table 2.2

Recorded Data	Observable Data	Opportunistic Data
Annual report and accounts	Pricing/price lists	Meetings with suppliers
Press releases	Advertising campaigns	Trade shows
Newspaper articles	Promotions	Salesforce meetings
Analysts reports	Tenders	Seminars/conferences
Regulatory reports	Patent applications	Recruiting ex-employees
Government reports		Discussion with shared distributors
Presentations/speeches		Social contacts with competitors

Single information holds no value till it is accumulated and organised in a meaningful manner to know the exact situation of the competitor. This analysis also helps to recognise the missing information.

2.4.3. Factors Affecting Competition Analysis

Following factors should be considered for analysing the competition:

- 1) **Competitor's Objectives:** It is very crucial to understand the objectives of the competitors. All

the possible reactions of competitors to different competitive forces can be easily forecasted by knowing their (competitor's) objectives. **For example,** a competitor preferring accomplishment of short-term commercial goals might pay attention to its potential products instead of investing money to respond to a competitive attack. Whereas, another competitor not having any short-term financial goals might respond to a price competition where profit generation is not possible.

- 2) **Competitor's Assumptions:** Another factor useful for analysing competitors' actions is understanding their assumptions. Competitors' potential actions can be easily forecasted with the help of understanding assumptions they have about themselves and their industry. **For example,** on being a new product failed in the past, the competitor may develop an assumption that it (the new product) has no scope in the present market. The crucial part is that these assumptions may not always be exact and provide opportunities to other organisations, which start introducing the similar product in the market. As the established competitors consider these products incompetent, they do not respond to this. **For example,** U.S. motorbike manufacturers' assumption that small bikes are not required in the U.S. market, helped the Honda company to successfully launch small bikes in the U.S. market.
- 3) **Competitor's Current Strategy:** Competitors' current strategy is also useful for analysing them. The strategy of the competitors can be understood with the help of exploring two main aspects, i.e., 'what they say' and 'what they do'. Press releases, top authority statements, analysts' interviews, annual shareholder reports, etc., highlight what the competitors say about their strategy. As it is common that there is a difference between what the competitors say and what they do, analysing what they do is also essential. By analysing the direction of the cashflow of competitors (which may be towards R&D projects, hiring activity, mergers and acquisitions, strategic partnerships, promotional campaigns, capital investments, etc.), their actual strategy can be explored.
- 4) **Competitor's Resources and Capabilities:** Apart from understanding competitors' objectives, assumptions and strategy, identifying their resources and capabilities is also useful for determining their response to a competitive situation. With the help of relevant SWOT

analysis, different functional strengths and weaknesses of the competitors can be highlighted, which determine their capabilities. It is very important to evaluate the rapid response ability of the competitors as the surrounding environment is dynamic in nature. It is possible that some competitors continue their current strategy for longer durations while others quickly adapt the change.

2.4.4. Strategy Framework for Analysing Competition

A framework has been introduced by **Michael Porter** for analysing the competitors. Typically, this framework is based on four key aspects of competitors, which are as follows:

- 1) Competitor's objectives,
- 2) Competitor's assumptions,
- 3) Competitor's strategy,
- 4) Competitor's resource and capabilities.

Competitors are influenced by their objectives and assumptions. Strategy and capabilities define competitor's ability of what they can do. All these four elements can be illustrated in the **figure 2.5:**

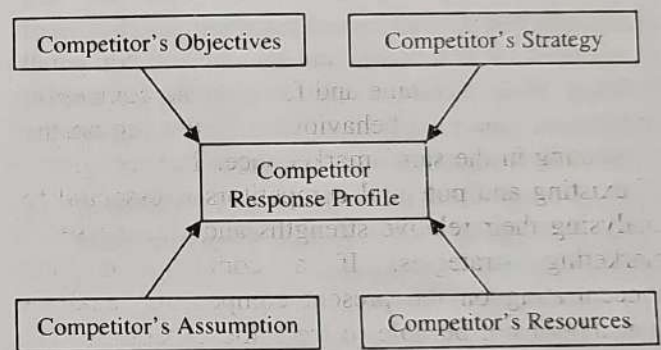


Figure 2.5: Components of Competition Analysis

- 1) **Competitor's Objectives:** A company can anticipate the moves of its competitors in a better way if it is aware of competitor's objectives. These objectives are mainly short-term and long-term. A competitor having short-term objective would not waste its time and money defending against competitive strategies and would rather focus on positioning its products strongly in the market. Whereas, a competitor having long-term objective ignores short-term profit-making and only focuses on price based competition.

The objectives of competitors can also be financial or of other types like market share, growth rate, technology leadership, etc. In addition, these objectives vary at every strategic level, viz., corporate, business unit and functional level. The most relevant functions of the

competitors can be identified by a company through their organisational structure. **For example**, the functions which are reported directly to the higher officials hold much more importance than others. Other factors which indicate the competitors' objectives are management incentives, tolerance for risk, composition of the Board of Directors, legal restrictions, background of the executives and some corporate level objectives. The tendency of the competitor to modify its strategy is indicated by whether it is achieving the objectives or not.

- 2) **Competitor's Assumptions:** The competitor's strategies are based upon the assumptions that their manager has about the industry and the organisation. **For example**, if a new product launched by a firm fails to do well in the market, it is assumed that there is no demand for such product. This type of assumption may be correct and may be wrong. If it is wrong, then this will block the future opportunities of the firm and create new opportunities for other rival firms. A product similar to the previous failed product may be launched by new companies creating a high demand for the product. **For example**, US manufacturers made an assumption on their past experiences that there was no demand for small bikes. Then, Honda decided to enter the US market by launching a small motorbike. Following are the bases for competitor's assumptions:

- i) Beliefs about its competitive position,
- ii) Past experience with a product,
- iii) Regional factors,
- iv) Industry trends, and
- v) Rules of thumb.

Other than the assumptions made by a competitor about a specific market, it can also make assumptions about its competitors in the analysis. Along with this, it may also assess whether the assumption made is right or not.

- 3) **Competitor's Current Strategy:** 'What the competitor says' and 'what it does' are the two main sources of competitor's strategy. Following points highlight 'what the competitor says' about the strategy:

- i) Managerial statements,
- ii) Annual shareholder reports,
- iii) Press releases, and
- iv) Interviews with analysts.

There is sometimes a variation between 'what the competitor says' and 'what it does'. The following points are the activities indicating what the competitor is actually doing:

- i) Hiring activity,

- ii) R&D projects,
- iii) Capital investments,
- iv) Promotional campaigns,
- v) Strategic partnerships, and
- vi) Mergers and acquisitions.

- 4) **Competitor's Resources and Capabilities:** The resources and capabilities of a competitor define its ability to respond against the competitive market environment. For this, it is important for a competitor to have adequate knowledge of its competitor's assumptions, objectives and current strategy. The strengths and weaknesses of a competitor determine its capabilities in different functional areas, SWOT analysis is one such example. A competitor's capabilities are governed by its strengths. In order to increase the competitor's capabilities in specific areas the analysis can be further carried out. The rate at which the competitor is growing depicts its capabilities. Other than this, a financial analysis can also be performed to identify its sustainable growth rate.

Since, the competitive environment is dynamic in nature. The ability of competitor to respond quickly towards the changes must be evaluated. There are firms who adapt and mobilise things quickly whereas, there are some firms which have a slow speed and take years to adapt a particular change. The factors which affect the firm's capabilities to adapt swiftly can be large investments in fixed assets, low cash reserves and an organisational structure.

2.4.5. Steps in Competition Analysis

The firm must carefully examine the various elements of competitor analysis in order to transform its competitive analysis activities into the firm's profitability. Therefore, the firm must consider the following steps involved in competitive analysis:

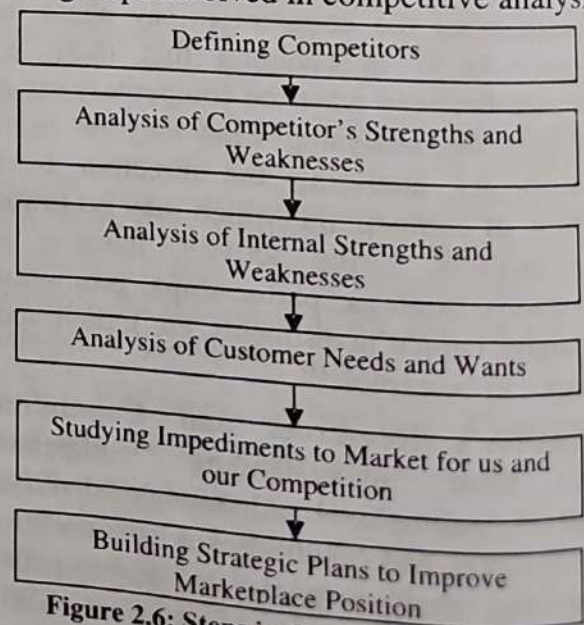


Figure 2.6: Steps in Competition Analysis

1) **Defining Competitors:** The first and foremost step in this process is to define the competitors. It is advised by many business professionals and consultants that companies should examine the competencies of its present and potential competitors. Some companies offer products and services which are less similar, while others may offer the same type of products or services offered by one's own company. Therefore, the companies have to choose whether the competition is an opportunity or a threat (either in present or in future) to the company financially.

2) **Analysis of Competitor's Strengths and Weaknesses:** After defining the company's competitors, the company must identify and analyse their strengths and weaknesses. Here, the main focus of the company is on its competitor's strengths and weaknesses and partially on the products and services offered by them. In reality, all the elements of customer preferences like product's quality, price, distribution, service, etc., are considered as the first half portion of competitive analysis. While, other half of the analysis is to examine the internal strengths and capabilities of its competitors.

In the long run, it is difficult for the company, to compete with its competitors who have substantial financial resources, highly motivated or creative individuals and have several other operational assets.

3) **Analysis of Internal Strengths and Weaknesses:** The next important step in the process is to analyse the internal strengths and weaknesses of the company. The points to be considered by company while analysing its internal strengths and weaknesses are:

- i) Involvement of highly motivated, confident and creative employees.
- ii) Participation of talented marketing and advertising personnel.
- iii) Identification of various companies' processes that provide benefits to the company in the market environment.
- iv) Introduction of updated stock management system.

Once the company's strengths are identified, then it can further be utilised by the company to improve and enhance its market position.

4) **Analysis of Customer Needs and Wants:** In order to be successful in the competitive market, every company should carefully analyse the needs and wants of the customers. Customer's priorities should be considered as the main priority of the

company. Apart from determining the customers' current needs and wants, business firms must also anticipate the future demands of the customers. Moreover, many small organisations along with analysing priorities that is already available in the market, must also focus on new product development and innovation in services to attain success in the competitive market environment.

5) **Studying Impediments to Market for Competition:** The companies that are willing to enter into new markets have to face several challenges. There are some challenges which can be dealt easily, while others may prevent launching of a campaign. Some of the common barriers to enter a new market are as follows:

- i) **High Start-Up Costs:** High costs for start-up is most challenging and formidable for companies, especially small companies.
- ii) **Patents:** This protects the new products and processes from competitors.
- iii) **Market Saturation:** It is more challenging to create a niche in a crowded market than establishing one's existence in the less competitive market.
- iv) **Knowledge:** One of the major barriers to make a successful market entry is knowledge. This may involve lack of expertise in manufacturing, marketing, technical and engineering areas.

6) **Building Strategic Plans to Improve Marketplace Position:** The last step involved in the process for competitor's analysis is building various strategic plans that enhance the small company's position in the market. A well-defined strategic plan must cover all the aspects of business processes or operations like production, pricing, distribution and marketing of various products or services in the competitive market.

2.4.6. Importance of Competition Analysis

In the competitor's analysis, adequate knowledge about competitors is very essential. It is a systematic process of analysing the strengths and weaknesses of competitors in order to find out opportunities and threats for their own organisation. Some of the several benefits of competitor analysis are as follows:

1) **Identifying Competitive Information:** It helps to identify the future plans and strategies of competitors and forecasts possible actions towards various competitive plans. Along with this, it also determines the competitors' reaction towards the activities and plans of the company.

- 2) **Provides Motivation:** Competitor analysis motivates the company to set-up a definite, hostile and proactive standpoint towards several competitive strategies and the entire business environment.
- 3) **Choosing Competitors:** Competitor analysis defines the competitor's capabilities and strategies and ascertains the most appropriate competitor to compete with the company. Moreover, it states the weaknesses and inabilities of competitors.
- 4) **Hidden Opportunities are Revealed:** There are numerous opportunities which are present in the market but remain hidden. Through competitive analysis, companies come across its different functional areas, their visions and outlooks. This encourages the companies to become more competitive.
- 5) **Strategy Development:** The information about the competitors helps the company to formulate their strategy in accordance with the competitor's moves. By using competitive analysis in an appropriate, brief and timely manner, an exceptional communication strategy can be developed. This way, a company can design an effective and competent strategy.
- 6) **Strategy Implementation:** By analysing the competitors, companies can apply its offensive strategy towards capitalising its strengths and exploiting the opportunities available. Likewise, companies can manage its threats and overcome its weaknesses by implementing the company's defensive strategies.
- 7) **Positioning Effectively:** Competitive analysis helps the marketer to determine the benefits which the customers' are receiving; this distinguishes the company from its competitors. These benefits allow the marketer to provide its customers with a unique value proposition by building strong brand image and market position.
- 8) **Product Development:** In this highly competitive environment, companies can attain appropriate knowledge about competitor's products and implement suitable product development strategies for future. Other than this, it also enables the company to surpass competitors in terms of price, functionality or quality.
- 9) **Planning Market Entry:** Through competitive analysis, companies can easily trace competitor's moves and plan their schedule effectively to make a perfect entry in the market. It also defines the timeline for developing a new product and launching it in the market.

Hence, from the above benefits it is clearly understood that the companies implementing systematic competitor analysis and profiling gain substantial advantage. For having a successful competitive business environment, a comprehensive profiling capability is very essential.

2.5. KEY SUCCESS FACTORS

2.5.1. Concept of Key Success Factors

The term 'Critical/Key Success Factor' was initially used in the context of data and business analysis. Critical Success Factors (CSFs) are the essential attributes required for an organisation to be successful in the marketplace. They can be referred to as the resources, skills and traits that an organisation needs for survival and succeeding in the market.

The critical success factors vary from industry to industry. **For example**, for dairy and processed food industry, variety and efficient distribution are the key success factors, without which the survival of the company would not be possible. On the other hand, for the banking sector, aspects like technology and prompt service are critical success factors. It is essential for an industry to identify its CSFs for achieving desired growth and success. CSFs are a part of the environment in which industry operates and also a part of the internal organisational resources available to that particular industry. It is therefore essential to study the resource allocation and utilisation methods of the particular industry for analysing the external environment of the organisation.

It is important that the internal resources and skills of an industry are analysed before applying the same to the external environment of the firm. The Key Success Factor or KSF is an essential component or element that the organisation should possess for achieving its mission and succeeding in its external environment.

2.5.2. Sources of Key Success Factors

The Critical Success Factors of an organisation are dependent on the current business situations. Different situations give rise to different CSFs. **Rockart** and **Bullen** have prescribed five critical success factors from the point of view of an individual organisation:

- 1) **Industry Characteristics:** The attributes of a particular industry outline its critical success factors. Hence, it can be said that these success factors can be different for different industries. **For example**, if one looks at three different industries – IT, healthcare and education sector,

the CSF for each will differ. Even in IT sector, if one looks at HCL and Infosys – the CSF for both companies will differ because both companies operate in different environments.

- 2) **Current Strategy and Position:** The CSFs for all the organisations in the industry are not the same. An organisation's current position also defines its success factors. CSFs for an organisation can also be defined by its present market position. The major factors that support the current position are the strategy, resources, and capabilities of an organisation. **For example**, in the FMCG market, the CSF for HUL will differ from a firm like Nirma, though both of them are from the same industry. HUL's CSF will focus more on brand building at a national level and leveraging on its international image, whereas Nirma's CSF will focus on low cost and regional presence. Similarly, the CSF for firms in the IT sector – IBM, HCL, Tech Mahindra all will differ because they have different resources and capabilities in their respective segments. Therefore, it is not necessary for every organisation to have the same set of success factors.
- 3) **Environmental Factors:** Some of success factors exist in the external environment as well. Although these environmental variables are beyond the control of the organisation, but the management should consider these factors for developing and improving the critical success factors. **For example**, the trends in an industry, government laws and regulations, current economic scenario and cultural changes can affect the organisation's CSFs. **For example**, firms operate under legal and environmental restrictions in a country which they have to adhere to. Liquor companies have to operate in an environment where excise duties are high and where the product cannot be directly advertised. This is a constraint under which they have to operate in India and this is applicable to all firms in the liquor industry.
- 4) **Temporal Factors:** Temporary factors are the success factors that result due to some specific event. These factors are not generally a part of day-to-day business operations, but are formed due to some sudden temporary change. **For example**, if there is too much or too little stock in an organisation, then inventory can be the critical success factor.

2.5.3. Identification of Key Success Factors

The identification of critical success factors for a firm and linking it to the strategy of the firm was propounded and developed in 1960s by **D. Ronald Daniel** of the **McKinsey & Company**. With the

passage of time, this concept has been refined and many industries have applied the concept. Critical success factors are the key determinants of an organisation that help an organisation to achieve its objectives. These are the factors that ensure success of any organisation by assisting in planning, implementing and reviewing of a strategy. If the organisation frames its strategy without keeping the critical success factors in mind, then it will certainly fail. Many companies have failed because of their lack of vision in identifying the critical success factors which are necessary for the firm.

CSFs are also call by the names like strategic thrust areas and strategic challenges, etc. Nowadays, companies face a common 'predicament' (challenge) while identifying the CSFs. This situation of predicament arises due to the failure in identification of those factors that have a significant impact on the business operations. The companies are generally unsure about the challenging areas that require attention and even when the company is certain that the factors are critical for its success, there is hardly any indication of improvement.

As a result, the company is not able to take advantage of the current and future opportunities and hence loses its competitive edge. The answer to this lies in 'elucidation'. A company should develop a systematic approach for identifying critical success factors. After the CSFs are identified, continuous efforts must be applied in organising and monitoring the progress against each factor.

Process of Identification of Critical Success Factors

Identification of critical success factors requires following steps:

- 1) **Identify the Challenging Factors:** The first step to identify the critical areas is to identify the barriers to the success of firm. These barriers can be related to either internal (company strategy, policies, employees related) or external (economic, political, legal, etc.) environment of the company.
- 2) **Create a Strategic Plan:** Once the challenges are identified by the firm, it can then develop a strategic plan for removing these obstacles. This plan will help to overcome these barriers by anticipating them prior to their occurrence. This plan will help to overcome these barriers and also in foretelling the obstacles that might affect the future performance of the organisation.
- 3) **Segmentation of Customers:** The next step after formulating the strategic plan is to segment the customers. The prime motive for market segmentation is to understand the behaviour of customers. Segmenting the customers refers to

the process of dividing the heterogeneous group of customers into several homogeneous groups based on certain factors such as geography, demography, benefits, etc. By segmenting the customers, the marketers are able to analyse the needs and wants of consumers and identify the points where they lack in their performances.

- 4) **Compare the Performance of Company:** After segmenting the market, the marketers are able to identify the expectation of consumers from different companies and compare the products offered by those companies. This comparison also enables the companies to understand the performance of other brands. In this step, the company can analyse its own performance *vis-a-vis* its competitors across the entire value chain on factors like cost, quality, cycle time, customer satisfaction, etc. This process of benchmarking helps the company to identify few critical areas which can help the company to overtake its competitors.
- 5) **Examine the Competitor's Practices:** The company also needs to understand how its competitors operate, how do they produce the products, what kind of quality standards do they have, what is their production cycle, etc. The company then needs to compare these practises with own methods and identify how they are superior or inferior to the standards of other companies. This will help the company to identify shortcomings in own strategy and to devise means to overcome them so that it can serve the target customers in a better way.
- 6) **Analyse the Impact on Result:** After identifying the critical areas, the management of the organisation should discuss the importance of those factors and analyse their impact. This also helps in identifying the relevant critical success factors. The analysis of impact can help the management to know the barriers that may prevent it from achieving the organisational objectives. This analysis of the results may help in providing in-depth understanding of the success factors.
- 7) **Modifying the Production Strategy if Required:** When analysis of the competitor's strategy is completed for the production of same products, and the related shortcomings are analysed, then the company can modify its own production strategies for competing with the competitors. **For example**, when HUL lost its market-share of Surf to cheaper priced Nirma, it was forced to look at its production methods and innovate. This led to the birth of Wheel which was launched by HUL to counter Nirma in the Indian consumer marketplace.

2.5.4. Implementation of Key Success Factors

Critical success factors can be implemented with the help of the following steps:

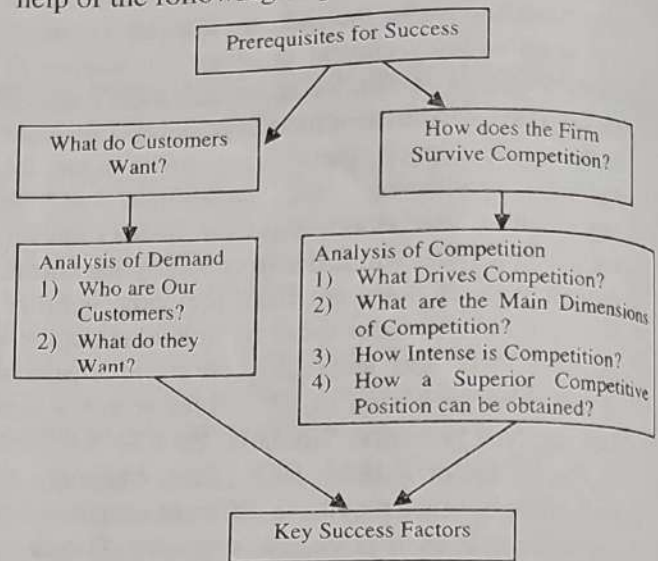


Figure 2.7: Implementation of Critical Success Factors

- 1) **Determine the Needs of Customers:** The first and foremost step in implementing CSFs is to determine the needs and wants of customers. They should regard customers as the very basis of existence of the industry and also the source of profitability. To analyse the customers accurately, the marketers need to identify their customers, analyse their needs, and determine how they choose between various offerings in the marketplace. Once the marketers have a good understanding of the customer, they can proceed to the next implementation step. **For example**, if one analyses the needs of people travelling by flight in India, two needs are highlighted – the need for low costs and the need for timely service. Any company offering airlines services in India has to take this as a starting point if it wants to delight its customers. It will thus have to analyse its entire service model so that it can provide a low cost service to its customers. Indigo is a perfect example of this.
- 2) **Determine the Basis of Competition:** The firm also needs to understand the dynamics of competition in its industry, i.e., how are firms competing in the industry? Is it on the basis of cost, differentiation or value? Marketers need to understand the level of competition and the bases upon which the competition exists and upon which the organisations can survive. **For example**, in the electronics market, customers select on the basis of price, durability, quality.

brand reputation, performance, etc. For a company to survive and succeed in the market, it needs to produce offerings at low cost so that the capital cost is covered.

3) **Identifying Critical Success Factors (CSFs):**
Some of the major types of critical success factors are as follows:

i) **Technology-Oriented Success Factors**

- a) Capability to innovate in the production process,
- b) Expertise in latest technologies,
- c) Expertise in scientific research, and
- d) Capability to innovate new product.

ii) **Manufacturing-Oriented Success Factors**

- a) Manufacturing quality products,
- b) Highly productive labour force,
- c) Setting plant locations incurring low cost,
- d) Ability to manage a wide range of products and customised products,
- e) Ability to produce at low cost,
- f) Designing and engineering of products of low cost,
- g) Efficient utilisation of fixed assets, and
- h) Sufficient supply of skilled manpower,

iii) **Distribution-Oriented Success Factors**

- a) Reduced distribution costs,
- b) Efficient channel network of marketing intermediaries,
- c) Gaining plenty of space on store shelves,
- d) Prompt delivery and
- e) Having retail outlets that are owned by the company.

iv) **Marketing-Oriented Success Factors**

- a) Skilled, available, and trained service employee,
- b) Skills for selling,
- c) Adequate after-sales services,
- d) Eye-catching package of product,
- e) Extensive product line and adequate selection of products,
- f) Trained and skilled salespeople, and
- g) Correct fill-ups of purchase orders.

v) **Skills-Oriented Success Factors**

- a) Proficiency in designing products,
- b) Speedy process of research and production,
- c) Talented employee and salespeople,
- d) Knowledge of technology,
- e) Knowledge about quality, and
- f) Attractive and attention-grabbing advertisements.