Appendix–Preparing a Strategic Analysis

Strategic management is an iterative, ongoing process designed to position a firm for competitive advantage in its ever-changing environment. To manage an organization strategically, a manager must understand and appreciate the desires of key organizational stakeholders, the industry environment, and the firm's position relative to its stakeholders and industry. This knowledge allows a manager to set goals and direct the organization's resources in a way that corrects weaknesses, overcomes threats, takes advantage of strengths and opportunities, and, ultimately, satisfies stakeholders.

With case analysis, you can practice some of the techniques of strategic management. Case analysis, to some extent, mirrors the processes managers use to make real strategic decisions. The authors of cases have attempted to capture as much information as possible. They typically conducted extensive interviews with managers and employees and gathered information from public sources such as annual reports and business magazines. Many cases include a detailed description of the industry and competitors as well as an extensive profile of one organization. You can supplement this information through your own library research if your instructor thinks this is appropriate.

Case analysis typically begins with a brief introduction of the company. The introduction, which sets the stage for the rest of the case, should include a brief description of the defining characteristics of the firm, including some of its outstanding qualities, past successes, failures, and products or services. The industries in which the firm is involved are also identified.

The next section of a case analysis can be either an environmental analysis or an internal analysis. Opportunities are defined as conditions in the broad and task *environments* that allow a firm to take advantage of *organizational* strengths, overcome *organizational* weaknesses, or neutralize *environmental* threats. Consequently, both environmental and organizational analyses are required before all of the organization's opportunities can be identified. We have chosen to treat environmental analysis first because it establishes the context in which firm strategies and resources can be understood. However, reversing the order of analysis would not be incorrect and is even preferred by some strategic management scholars.

Environmental analysis is an examination of the external environment, including external stakeholders, the competition, and the broad environment. Systematic external analysis will help you draw conclusions about the potential for growth and profit in the industry and determine keys to survival and success in the industry.

An organizational analysis, which follows the external analysis, is designed to evaluate the organization's strategic direction, business model, business- and corporate-level strategies, resources, capabilities, and relationships with internal and external stakeholders, and then determine the strengths, weaknesses, vulnerabilities, and sources of competitive advantage exhibited by the firm. These determinations must be made against a background of knowledge about the external environment so that the full range of opportunities and threats can also be identified.

STRUCTURING AN ENVIRONMENTAL ANALYSIS

An analysis of the external environment includes an industry analysis and an examination of key external stakeholders and the broad environment. Findings are then summarized, with an emphasis on identifying industry growth and profit potential and the keys to survival and success in the industry. Some organizations are involved in more than one industry. Consequently, a separate industry analysis is done for each of the industries in which a firm is involved.

Industry Analysis

Environmental analysis should begin with an industry analysis. The first step in industry analysis is to provide a basic description of the industry and the competitive forces that dominate it:

1. What is the product or service? What function does it serve? What are the channels of distribution?
2. What is the industry size in units and dollars? How fast is it growing? Are products differentiated? Are there high exit barriers? Are there high fixed costs? (These are some of the forces that determine the strength of competition among existing competitors.)
3. Who are the major competitors? What are their market shares? In other words, is the industry consolidated or fragmented?
4. Who are the major customers of the industry? Are they powerful? What gives them power?
5. Who are the major suppliers to the industry? Are they powerful? What gives them power?
6. Do significant entry barriers exist? What are they? Are they effective in protecting existing competitors, thus enhancing profits?
7. Are there any close substitutes for industry products and services? Do they provide pressure on prices charged in this industry?
8. What are the basic strategies of competitors? How successful are they?
9. To what extent is the industry global? Are there any apparent advantages to being involved in more than one nation?
10. Is the industry regulated? What influence do regulations have on industry competitiveness?

External Stakeholders and the Broad Environment

A complete environmental analysis also includes an assessment of external stakeholders and the broad environment. The identity and power of competitors, suppliers, and customers was already established during the industry analysis. At this stage of the analysis, other important stakeholders should also be identified and their influence on the industry determined (see Chapter 2). If any of the external stakeholders poses a threat or opportunity, this also should be identified. One of the outcomes of this part of the analysis should be the establishment of priorities for each external stakeholder group, based on the power the group possesses and the extent to which it can facilitate the accomplishment of organizational goals. High-priority stakeholders will receive greater attention during the development of the strategic plan.

The broad environment should also be evaluated. Four of the most important factors are current social forces, global economic forces, global political forces, and technological innovations. Remember that each of these forces is evaluated only as they relate to the industry in question. Forces in the broad environment may also pose threats or provide opportunities.

After describing the industry as it exists now, it is important to capture the underlying dynamics that will create industry change and require new strategic approaches. One useful way to accomplish this is to group factors that influence the industry into two categories: those that create and influence industry demand and those that create and influence industry cost structures and profit potential. The findings from this part of the analysis will help you decide whether the industry is "attractive" (growing and profitable) and worthy of further investment (i.e., time, money, resources). It will also help you identify areas in which the firm may be able to excel in an effort to create a competitive advantage.

Factors that Influence Demand and Cost Structures

There are many industry factors and stakeholder actions that create and influence demand for products and services. Some of the factors are part of the broad environment of the firm, such as the state of the economy. Other factors are part of the task environment, most of which are related to the actions of two key stakeholder groups: customers and competitors. If the underlying factors that create demand are changing, then it is likely that demand patterns will change. For example, demand for washing machines is a function of household formations and replacements. To predict future demand, you would study the numbers of people in the household-forming age bracket, durability of washers, and economic conditions.

Some of the industry factors and stakeholder actions that create and influence demand and growth prospects in an industry include the following:

1. The function(s) served by the product.
2. The stage of the product life cycle (i.e., degree of market penetration already experienced).
3. Economic trends, including income levels and economic cycles (i.e., recession, boom).
4. Demographic trends (part of social trend analysis) such as population and age.
5. Other societal/cultural trends, including fads and commonly held values and beliefs.
6. Political trends, which may include protectionist legislation such as trade barriers.
7. Technological trends, including new applications, new markets, and cost savings that make prices more competitive.
8. Programs developed by firms in the industry, such as new product introductions, new marketing programs, new distribution channels, and new functions served.
9. Strong brand recognition, domestically or worldwide.
10. Pricing actions that stimulate demand.

After analyzing the factors that create and influence demand, you should be able to draw some conclusions about industry growth prospects for the industry and firm. Since you can never be certain about the timetable and ultimate outcome of a trend that, by definition, is changing over time, one technique that may be useful is to develop alternative demand scenarios. For example, if the health of the economy is a major driver of a product's demand, you could consider the upside and downside of an economic recovery using the following type of format: "If the economy recovers within six months, then industry demand for the product could be the highest in five years. If the recovery does not materialize, then demand might linger at last year's levels."

After determining growth prospects for the industry, you will want to determine the cost structure and profit potential of the industry. As with demand, there are various factors and stakeholder actions that create and influence cost/profit structures in an industry. Among these factors are the following:

1. *Stage of the product life cycle.* In the early stages of the life cycle, firms have large investments in product development, distribution channel development, new plant and equipment, and workforce training. In the latter stages, investments are more incremental.
2. *Capital intensity.* Large investments in fixed costs such as plants and equipment make firms very sensitive to fluctuations in demand—high levels of capacity utilization are needed to cover or "spread" fixed costs. Industries that have a lower relative fixed cost investment but higher variable costs are able to control their costs more readily in turbulent demand periods.
3. *Economies of scale.* Larger-sized facilities can achieve lower costs per unit than smaller facilities in some instances because of lower per-foot construction costs, more efficient use of equipment, and more efficient use of indirect labor and management. If a facility is so large that additional equipment and management are needed, economies of scale may be lost.
4. *Experience effects.* With repetition and an environment that encourages and rewards learning, employees can become more productive over time.

5. *The power of customers, suppliers, competitive rivalry, substitutes, and entry barriers.* Powerful customers, suppliers, competitive rivalry, substitutes, or low entry barriers can erode profit potential. The forces, which are part of Porter's Five Forces Model, were discussed in detail in Chapter 2.
6. *The influence of other stakeholders.* These may include powerful foreign governments, joint venture partners, powerful unions, strong creditors, and so on.
7. *Technological changes that provide opportunities to reduce costs.* Technological innovations can allow a firm to invest in new equipment, new products, and new processes or to alter the balance of investments between fixed and variable costs.

After systematically profiling the factors and stakeholder actions that influence cost structures and profits, you should be able to draw conclusions about industry profit potential. After the basic environmental analysis is complete, the next step is to perform a more detailed examination of the major strategic issues facing the industry.

Strategic Issues Facing the Industry

A thorough environmental analysis provides the information needed to identify factors and forces that are important to the industry in which your organization is involved and, therefore, your organization. These factors and forces may be categorized as follows:

1. *Driving forces in the industry,* which are trends that are so significant that they are creating fundamental industry change, such as the opening up of Eastern Europe or networked computer communications. Of course, each industry will have its own unique set of driving forces.
2. *Threats,* defined as noteworthy trends or changes that threaten growth prospects, profit potential, and traditional ways of doing business.
3. *Opportunities,* which are important trends, changes, or ideas that provide new opportunities for growth or profits.
4. *Requirements for survival,* identified as resources and capabilities that all firms must possess to survive in the industry. An example in the pharmaceutical industry is "product purity." These factors do not command a premium price. They are necessary, but not sufficient to be successful.
5. *Key success factors,* which are factors firms typically should possess if they desire to be successful in the industry. An example in the pharmaceutical industry is the ability to create products with new therapeutic qualities. This ability may lead to high performance.

Having completed an analysis of the external environment, you are ready to conduct a more specific analysis of the internal organization.

STRUCTURING AN ORGANIZATIONAL ANALYSIS

Understanding industry trends, growth prospects, cost structures, profit potential, and key strategic issues can help you critique an organization's strategies and evaluate its strengths and weaknesses. For example, what might qualify as strength in one industry may be an ordinary characteristic or a weakness in another industry. A good organizational analysis should begin with a general evaluation of the internal organization.

Evaluation of the Internal Environment

The following questions are useful in assessing the internal organization:

1. What is the company's strategic direction, including its mission, vision, purpose, and values? If formal documents exist that contain these items, share them.
2. How has the strategic direction changed over time? In what way? Has the evolution been consistent with the organization's capabilities and planned strategies?

3. Who are the principal internal stakeholders? In particular, who are the key managers and what are their backgrounds? What are their strengths and weaknesses? Are they authoritarian or participative in their management style? Is this appropriate for the situation? What seems to drive their actions?
4. Who owns the organization? Is it a publicly traded company with a board of directors? If there is a board and you know who is on it, is the composition of the board appropriate? Is there an individual or group with a controlling interest? Is there evidence of agency problems? How active are the owners and what do they value?
5. What are the operating characteristics of the company, including its size in sales, assets, and employees, its age, and its geographical locations (including international operations)?
6. Are employees highly trained? If a union is present, how are relations with the union?
7. How would you describe the organization's culture? Is it a high-performing culture? Is it supportive of the firm's strategies?

Most instructors also require a financial analysis to identify financial strengths and weaknesses, evaluate performance, and identify financial resources available for strategy implementation. A financial analysis should include a comparison of ratios and financial figures with major competitors or the industry in which the organization competes (cross-sectional) as well as an analysis of trends in these ratios over several years (longitudinal). Some commonly used financial ratios are specified in Chapter 3.

When analyzed superficially, ratios can be more misleading than informative. For example, in comparing return on assets for two firms in the same industry, the one with the higher ratio could have superior earnings or devalued assets from too little investment. Two firms can differ in return on equity because of different debt–equity financing policies rather than from true performance reasons. When accurately interpreted and considered in the larger organization context, the analysis may also uncover strengths, weaknesses, or symptoms of larger organizational problems.

Identification of Resources and Capabilities

The foregoing analysis of the internal environment provides an excellent starting point for identifying key resources and capabilities. For example, outstanding resources and capabilities may result from (1) superior management, (2) well-trained employees, (3) an excellent board of directors, (4) a high-performance culture, (5) superior financial resources, or (6) the appropriate level and type of international involvement. However, these potential sources of competitive advantage barely scratch the organizational surface.

You should also evaluate the organization's primary value chain activities to identify resources and capabilities. These activities include its (7) supply chain management, (8) internal operations management, (9) distribution and location management, (10) marketing management, and (11) management of post-transaction contacts, as well as the support activities of (12) research and development, (13) consumer research, (14) financial management/accounting, (15) information technology, (16) human resources management, (17) legal support, and (18) strategic planning processes. Chapter 3 provided a description of how to use the value chain.

In addition, an organization may have (19) an excellent reputation, (20) a strong brand name, (21) patents and secrets, or (22) valuable cooperative relationships (i.e., alliances, joint ventures, contracts) with one or more external stakeholders. All of these potential resources and capabilities (and many others) are discussed in this book. They form a starting point that you can use to help identify the potential sources of competitive advantage. Each company will have its own unique list.

Evaluation of Strategies and Business Model

The next step in internal analysis is to describe and critique the organization's past strategies and business model. You will need to describe them in detail, discuss whether they have been successful, and then *evaluate whether they fit with the industry environment and the resources and capabilities of the organization.*

1. What is the company's *pattern* of past strategies (corporate, business, functional, international)? What is its business model—the way the firm creates value for customers, entices them to pay for it, and converts their payments to profit?
2. How successful has the company been in the past with its chosen strategies and business model? How successful is the company now?
3. What explains success or failure? (Use your environmental and organizational analyses to support your answer.)

Many instructors require their students to evaluate the success of an organization on the basis of both qualitative and quantitative (financial) measures. Financial measures were developed during your financial analysis, so you only need to make reference to them here. Some common qualitative measures include product or service quality, productivity, responsiveness to industry change, innovation, reputation, and other measures that indicate key stakeholder satisfaction (i.e., employees, customers, managers, regulatory bodies, society).

Identification of Sources of Competitive Advantage

You are now ready to consolidate your internal and external analyses into lists of strengths and weaknesses, as well as expand and revise your lists of opportunities and threats. In Chapter 1, strengths were defined as firm resources and capabilities that can lead to a competitive advantage. Weaknesses, on the other hand, were described as resources and capabilities that the firm does not possess, resulting in a competitive disadvantage. Consequently, each of the resources and capabilities identified during the organizational analysis should be measured against the factors identified in the environmental analysis. The next paragraph describes how this can be done.

Resources and capabilities become strengths if they have the potential to lead to a competitive advantage. This happens when they are *valuable*, which means that they allow the firm to exploit opportunities and/or neutralize threats arising from the external environment, and they are *unique*, meaning that only a few firms possess the resource or capability. Using these criteria, a list of strengths should be assembled. Strengths become sources of competitive advantage when an organization is *aware of their value* and has *organizational systems in place* to take advantage of this potential. If the strength is also *hard to imitate*, then it can lead to a sustainable competitive advantage; consequently, these types of strengths should be highlighted. Weaknesses also should be listed. These are resources and capabilities the firm does not possess that, according to your environmental analysis, lead to a competitive disadvantage.

Opportunities are conditions in the external environment that allow a firm to take advantage of organizational strengths, overcome organizational weaknesses, or neutralize environmental threats. Consequently, now that the organizational analysis is complete, you should reevaluate your list of opportunities to determine whether they really apply to your organization. You also should evaluate threats to make sure they are applicable to your firm. Threats are conditions in the broad and task environments that may stand in the way of organizational competitiveness or the achievement of stakeholder satisfaction.

At this point, you may also want to add to your list of opportunities some of the potential linkages and alliances that the firm could develop with external stakeholders. For example, if your company is strong in production but weak in foreign marketing, you may see an opportunity to enter a new foreign market through a joint venture with a strong marketing company. Another example may involve neutralizing a threat of new government regulation by forming an alliance with competitors to influence the regulating body.

DEVELOPING A STRATEGIC PLAN

Your environmental and organizational analyses helped you to (1) draw conclusions about the growth prospects and profit potential in the industry and any trends that are critical to the firm; (2) evaluate the past strategies and strategic direction of the firm; and (3) develop a list of strengths, weaknesses, opportunities, and threats. The next step is to make recommendations concerning the strategies the firm may want to pursue in the future.

Strategic Direction and Major Strategies

You should probably begin your strategic recommendations by focusing on the strategic direction and major strategies of the firm. Are strategies and the overall business model taking advantage of industry opportunities? If you determined earlier that the business strategy is not as successful as it should be, what adjustments should be made? Could the company have more success by focusing on one segment of the market? Or if the company were pursuing a focus strategy, would broadening the target market be appropriate? If the company were pursuing cost leadership, would a differentiation strategy work better? If differentiation does not seem to be working very well, would a cost leadership strategy be better? Or, would a best cost strategy be the most appropriate?

Finally, you should examine the corporate strategy (concentration, vertical integration, related or unrelated diversification). Is your corporate strategy still appropriate, given your environmental analysis? Is your dominant industry stagnant? Is it overregulated? Is competition hurting profitability? Should you consider investing in other industries? If so, what are their defining characteristics? What core competencies and capabilities could be applied elsewhere? What opportunities could be explored that relate to the corporate strategy?

It is possible that you may want to leave the strategic direction and major strategies alone, especially if the organization has enjoyed recent success. Regardless of whether you altered the direction and strategies, at this point you have now established what you think they should be. The direction and corporate- and business-level strategies provide guidance for fine-tuning an organization's strategies. Each of the recommendations you make from this point on should be consistent with the strategic direction and major strategies and business model of the organization. At this point, it is time to explore strategic opportunities further.

Evaluation of Opportunities and Recommendations

Using the strategic direction and corporate- and business-level strategies as guides, strategic opportunities should be evaluated further. These alternatives were generated during earlier analyses. They include the following:

1. *Opportunities that allow a firm to take advantage of organizational strengths.* These opportunities may involve alternatives such as better promotion of current products and services, new products or services, new applications for existing products and services within existing markets, exploring new domestic or foreign markets, diversifying into areas in which strengths can be applied, or creation of joint ventures with companies with complementary strengths. These are only a few examples.
2. *Opportunities for the firm to overcome organizational weaknesses.* Do any of the organizational weaknesses relate to an area that you described in your industry analysis as essential for survival? Do any of the weaknesses relate to key success factors? Firms can overcome their weaknesses through strategies such as learning from joint venture partners, creating new alliances with organizations that are strong where the organization is weak, or fixing problems internally through

R&D, better controls, efficiency programs, and so on. Again, these are only a few examples.

3. *Opportunities for the firm to neutralize environmental threats.* These often involve creation of strategic alliances to offset the influence of a powerful stakeholder such as a government regulator, a strong union, a powerful competitor, or an influential special interest group. The firm may form an alliance *with* the powerful stakeholder or with other stakeholders in an effort to balance the power. Firms may also form alliances to help cope with threats emerging from the broad environment.

Evaluation of opportunities means much more than simply accepting them on the basis of earlier environmental and organizational analyses. They also should be evaluated based on factors such as the following:

1. *Cost/benefits analysis.* Do the financial benefits of pursuing the opportunity appear to outweigh the financial costs?
2. *Ethical analysis.* Is pursuit of this strategy consistent with the purpose of the organization? Could there be negative effects on the firm's reputation?
3. *Protection of other strengths.* Does pursuit of this opportunity in any way detract from or weaken other strengths? For example, could it damage a brand name? Could it weaken a strong financial position?
4. *Implementation ability.* Will implementation of this strategy be easy or difficult? In other words, does the strategy "fit" the capabilities, structure, systems, processes, and culture of the organization?
5. *Stakeholder analysis.* How will this strategy affect key stakeholders? Which ones are likely to support it? Are they high priority? Which ones are likely to oppose it? Are they high priority? What are the strategic ramifications of their support or opposition?
6. *Future position.* Will the strategy continue to be viable as the industry and the broad environment undergo their expected changes? Will it provide a foundation for survival or competitive success?

The result of this analysis should be a recommendation or recommendations that the organization should pursue. Many evaluation tools can facilitate the evaluation process, such as a pay-off matrix that provides an evaluation of several alternatives based on a standard set of criteria (see Appendix Exhibit 1.1). However, the tools should never act as substitutes for in-depth analysis of the alternatives themselves. In other words, even if a numeric scorekeeping system is used, the numbers should be explained based on detailed strategic analysis.

You may not be required by your instructor to conduct a formal analysis of alternatives based on a standard set of criteria; however, you should still make

A Pay-Off Matrix Approach to Evaluating Opportunities

Appendix Exhibit 1.1

	Criteria			
	Criterion 1	**Criterion 2**	**Criterion 3**	**Total**
Opportunity 1	−2	1	2	1
Opportunity 2	2	1	−1	2
Opportunity 3	1	2	1	4

Source: In this matrix, −2 means that the opportunity is very weak based on the criterion, −1 means weak, 0 means neutral, 1 means strong, and 2 means very strong.

recommendations concerning changes the organization should make to remain or become competitive and satisfy its stakeholders.

Implementation and Control

Recommendations should always be accompanied by an implementation plan and basic controls. The following are major questions that should be addressed during this section of a case analysis. Questions 7 and 8 relate specifically to control.

1. How do the recommendations specifically address concerns that were identified during the analysis?
2. What will be the roles and responsibilities of key internal *and* external stakeholders in carrying out the recommendations and how are they expected to respond? What actions should be taken to smooth out the transition period or avoid stakeholder discontent?
3. Does the organization have the resources (funds, people, skills) to carry out the recommendations? If not, how should the organization proceed in developing or acquiring those resources?
4. Does the organization have the appropriate systems, structures, and processes to carry out the recommendations? If not, how should the organization proceed in creating the appropriate systems, structures, and processes?
5. What is the appropriate time horizon for implementing recommendations? What should the organization and its managers do immediately, in one month, in six months, in a year, and so on?
6. What are the roadblocks the organization could encounter while implementing the recommendations (i.e., financing, skilled labor shortages)? How can the organization overcome these roadblocks?
7. What are the desired outcomes or changes the organization should expect once the recommendations have been implemented? How will the organization know if the recommendations have been successful? In other words, what are the objectives associated with your recommendations?
8. What were some of the major assumptions you made with regard to the external environment? Which of these factors, if different from expected, would require an adjustment to your recommendations?

Following the implementation section, you may want to update your audience (your instructor or other students) concerning actions the firm has taken since the case was written. If you do an update, remember that what the organization did, even if it appears to have been successful, may not have been the optimal solution.

A NOTE TO STUDENTS

The material in this appendix represents the way we teach case analysis. Since there is not a standard method for analyzing cases, your instructor may teach a method of case analysis that differs from our approach. Also, cases can be treated in many different formats, including class discussions (complete with discussion questions to be answered before coming to class), written papers, formal presentations, and class debates. After reading this appendix, check with your instructor for specific instructions and requirements.