

7.10: Summary

Key Terms

Barriers to Entry

Industry factors (such as high start-up costs) that can prevent new firms from successfully launching new operations in that industry.

Buyer Power

In the relationship between a firm and its customers, buyers with high power can negotiate product price or features, while buyers with low power cannot.

Capabilities

A firm's skill at coordinating and leveraging resources to create value.

Competition

Business actions a firm undertakes to attract customers to its products and away from competitors' products.

Competitive Advantage

When a firm successfully attracts more customers, earns more profit, or returns more value to its shareholders than rival firms do.

Competitive Environment

Factors and situations both inside the firm and outside the firm that have the potential to impact its operations and success.

Cost-leadership Strategy

A generic business-level strategy in which a firm tightly controls costs throughout its value chain activities in order to offer customers low-priced goods and services at a profit.

Demographics

Part of PESTEL that includes facts about the income, education, age, and ethnic and racial composition of a population.

Differentiation Strategy

A generic business-level strategy in which firms add value to their products and services in order to attract customers who are willing to pay a higher price.

Economic Factors

PESTEL category that includes facts (such as unemployment rates, interest rates, and commodity prices) about the state of the local, national, or global economy.

Environmental Factors

PESTEL category that examines a firm's external situation with respect to the natural environment, including pollution, natural resource availability and preservation, and alternative energy.

Environmental Scanning

The systematic and intentional analysis of a firm's internal state and its external environment.

External Environment

The aspects of the world at large and of a firm's industry that can impact its operations

External Factors

Things in the world or industry environments that may impact a firm's operations or success, such as the economy, government actions, or supplier power. Strategic decisions can be made in response to these things but normally cannot directly influence or change them.

Focus Strategy

A generic business-level competitive strategy that firms use in combination with either a cost-leadership or differentiation strategy in order to target a smaller demographic or geographic market with specialized products or services.

Generic Business-Level Strategies

Basic methods of organizing firm value chain activities to compete in a product market that can be used by any sized firm in any industry

Industry

A group of firms all offering products or services in a single category, for example restaurants or athletic equipment.

Industry Rivalry

One of Porter's Five Forces; refers to the intensity of competition between firms in an industry.

Internal Environment

Innermost layer of a firm's competitive environment, including members of the firm itself (such as employees and managers), investors in the firm, and the resources and capabilities of a firm.

Internal Factors

Characteristics of a firm itself, such as resources and capabilities, that the firm can use to successfully compete against its rivals.

Legal Factors

In PESTEL, the laws impacting business, such as those governing contracts and intellectual property rights and illegal activities, such as online piracy.

Macro Environment

The outermost layer of elements in a firm's external environment that can impact a business but are generally beyond the firm's direct control, such as the economy and political activity.

Micro Environment

The middle layer of elements in a firm's external environment, primarily concerned with a firm's industry situation.

New Entrants

One of Porter's Five Forces, the threat of new entrants assesses the potential that a new firm will start operations in an industry.

Opportunity

A situation that a firm has the resources and capabilities to take advantage of.

PESTEL

A strategic analysis tool that examines several distinct categories in the macro environment: **p**olitical, **e**conomic, **s**ociocultural, **t**echnological, **e**nvironmental, and **l**egal.

Political Factors

PESTEL factor that identifies political activities in the macro environment that may be relevant to a firm's operations.

Porter's Five Forces

Evaluates the interconnected relationships between various actors in an industry, including competing firms, their suppliers, and their customers, by examining five forces: industry rivalry, threat of new entrants, threat of substitutes, supplier power, and buyer power.

Primary Activities

Firm activities on the value chain that are directly responsible for creating, selling, or servicing a product or service, such as manufacturing and marketing.

Resources

Things a firm has, such as cash and skilled employees, that it can use to create products or services.

Sociocultural Factors

PESTEL category that identifies trends, facts, and changes in society's composition, tastes, and behaviors, including demographics.

Strategic Analysis

Process that firms use to study and understand their competitive environment.

Strategic Group

Businesses offering similar products or services and following the same generic competitive strategy.

Strategic Positioning

Firm's decisions on how to organize its actions and operate to effectively serve customers and compete against rivals.

Strategy

Process of planning and implementing actions that will lead to success in competition.

Strengths

Resources and capabilities of a firm; what it is good at.

Substitutes

One of Porter's Five Forces; products or services outside a firm's industry that can satisfy the same customer needs as industry products or services can.

Supplier Power

One of Porter's Five Forces; describes the balance of power in the relationship between firms in an industry and their suppliers.

Support Activities

Value chain activities that a firm performs to sustain itself; do not directly create a product or service but are necessary to support the firm's existence, such as accounting and human resources.

Switching Costs

Penalty, financial or otherwise, that a consumer bears when giving up the use of a product currently being used to select a competing product or service.

SWOT

Strategic analysis tool used to examine a firm's situation by looking at its strengths, weaknesses, opportunities, and threats

Technological Factors

PESTEL category that includes factors such as the Internet, social media, automation, and other innovations that impact how businesses compete or how they manufacture, market, or sell their goods or services.

Threat

Anything in the competitive environment that would make it harder for a firm to be successful.

Value Chain

Sequence of activities that firms perform to turn inputs (parts or supplies) into outputs (goods or services).

VRIO

analytical tool that evaluates a firm's resources and capabilities to determine whether or not it can support an advantage for the firm in the competitive environment: **v**alue, **r**arity, **i**mitation, and **o**rganization.

Weaknesses

Things that a firm does not have good capabilities to perform or gaps in firm resources.

Summary of Learning Outcomes

7.2 Gaining Advantages by Understanding the Competitive Environment

1. What is strategic analysis, and why do firms need to analyze their competitive environment?

Strategic analysis is a systematic evaluation of a firm's situation, both internally and with respect to what is happening in the outside world. This analysis examines what the firm itself is good or bad at, how rivals in its industry are competing against it for customers, and what factors in the world environment, such as economic indicators or demographic changes, might impact the firm's ability to be successful.

Firms need to conduct this analysis in order to be aware of and prepared for changes in their competitive environment and to maximize their chance of successfully competing against rivals and sustaining their profitability and market share in their industry.

7.3 Using SWOT for Strategic Analysis

2. What is a SWOT analysis, and what can it reveal about a firm?

SWOT is a traditional analytical tool that identifies a firm's strengths, weaknesses, opportunities, and threats (SWOT is an acronym of these four factors). It is useful for conducting a quick look at the internal capabilities (strengths and weaknesses) and external events and situations (opportunities and threats) a firm is facing.

SWOT is not a comprehensive analytical tool, because the four categories for analysis are too broad and will not necessarily identify all of the factors important to a firm's success that a more thorough analysis would.

7.4 A Firm's External Macro Environment: PESTEL

3. What makes up a firm's external macro environment, and what tools do strategists use to understand it?

The external environment of a firm is composed of two primary layers: the macro environment and the microenvironment. The macro environment includes facts and situations that a firm must be aware of but cannot always influence. The macro environment is analyzed using the PESTEL analytical tool that considers a firm's: political aspects, economic indicators, sociocultural trends, demographic facts, technological changes, and environmental and legal aspects.

7.5 A Firm's Micro-Environment: Porter's Five Forces

4. What makes up a firm's external micro-environment, and what tools do strategists use to understand it?

The second layer of a firm's external environment is its micro-environment, which includes the components of a firm's industry, such as competitors, suppliers, and customers. Porter's Five Forces of industry competition (industry rivalry, threat of new entrants, threat of substitutes, supplier power, and buyer power) capture the dynamic relationships between these components.

7.6 The Internal Environment

5. How and why do managers conduct an internal analysis of their firms?

Managers cannot lead their firms to success without understanding what the firm is able to do. An analysis of the firm's resources and capabilities, as well as its gaps, is essential in determining the best path forward for the firm. A good strategy for competitive

advantage capitalizes on a firm's key resources and capabilities, as identified and evaluated using the VRIO (value, rarity, imitation, and organization) analytical tool.

Resources and capabilities that satisfy VRIO criteria are the key things that a firm is best at, and these should be leveraged so the firm can compete against rivals.

7.7 Competition, Strategy, and Competitive Advantage

6. What does it mean to compete with other firms in a business environment, what does it mean when a firm has a competitive advantage over its rivals, and what generic strategies can a firm implement to gain advantage over its rivals?

Competition is the battle for customers. Firms compete against rivals offering similar products and services and try to attract customers by making sure their product or service is a little better or less expensive than those of their competitors. The firm that is most successful in this battle, measured in terms of profitability or in terms of market share, has a competitive advantage.

Generic competitive strategies are the basic templates for organizing firm activities to achieve competitive advantage in an industry. A firm will perform value chain activities, such as marketing and research and development, in order to support the overall competitive strategy it has chosen.

Following a generic cost-leadership strategy requires that a firm try to save money throughout the value chain so that it can offer customers low-priced goods and services. In contrast, differentiators add value to their products and services while performing value chain activities so that they can charge premium prices to consumers.

A third generic competitive strategy, focus, is chosen in combination with one of the other two strategies by firms that decide to target smaller geographic or demographic customer groups.

7.8 Strategic Positioning

7. What elements go into determining a firm's strategic position?

A firm develops a strategic position in response to the factors present in its competitive environment. Strategic analysis is essential in identifying and understanding the factors that a strategic position must address. The choice of strategic position factors in a firm's key resources and capabilities when choosing a generic competitive strategy, product or service to be offered, target market, and geographic reach to compete successfully against rivals in an industry. To be successful in allowing a firm to achieve a competitive advantage in its industry, a firm's strategic position should be different from its competitors' positions in the same industry and should be hard for competitors to copy so that the firm's competitive advantage lasts.

? Chapter Review Questions

1. Why do managers use strategic analysis?
2. What information does a SWOT analysis provide managers? What information might it miss?
3. Describe a firm's macro environment and how managers use PESTEL to understand it.
4. What is a firm's micro-environment, and why is it important?
5. What is an industry, and how do Porter's Five Forces help a manager trying to understand a firm's industry environment?
6. What are firm resources and capabilities, and what information does VRIO provide about them?
7. When does a firm have a competitive advantage over its rivals?
8. What are generic competitive strategies, and how are they implemented in a firm's value chain activities?
9. What do strategic group members have in common with each other? What impact do firms outside a strategic group have on those in that group?
10. How does strategic analysis help a firm develop its own strategic position? Why should that position be unique?

Management Skills Application Exercises

1. (Analytical Skills) Assume that you have been hired by a local small-business consulting firm. You have been asked by your boss to review a proposal from a client who is considering opening a new Pilates and yoga studio in a trendy part of town. Because you know SWOT analysis, you have been asked to group the following attributes about the proposed business into a SWOT analysis:

- a. The proposed location is on the same street corner as the main subway line station and three blocks from a ferry terminal that commuters use go to work.

- b. The proposed location has a vestibule and a new HVAC system.
 - c. The street that the location is situated on has many small shops, restaurants, and bars and is a popular gathering place.
 - d. There are many historic structures that are in need of updates, but some owners are reluctant to invest in these aging structures.
 - e. The area has become gentrified over the past decade, and there is more disposable income than in the past.
 - f. In addition to the young professionals, a large number of 55 and over retirees who are now empty nesters have been moving into the neighborhood.
 - g. With the young professionals and empty nesters, this area has one of the lowest birth rates in the nation.
 - h. The two-year lease is affordable for the business plan, but there is no guarantee of renewal after the term.
 - i. There is a rumor of a spin studio opening two blocks away.
 - j. The building has been updated with ramps and restrooms to accommodate disabled patrons.
 - k. The local paper has interviewed the client and will be running a “Pilates Craze” feature in the upcoming weekend newspaper.
2. (Interpersonal Skills) Your instructor may assign you to a small group, and you will receive either a “Team A” or “Team B” assignment. Team A groups will need to meet for 15 minutes in a face-to-face setting, while Team B members will meet electronically either by setting up a meeting via Skype or using text messaging on their cell phones. Team A members will need to set up a time and location for their meeting, while Team B members will need to share their contact information with a team leader. Your instructor will assign a company to discuss and report on. Team A will discuss a firm’s internal environment, while team B will discuss the firm’s external environment. In class, each team will report its conclusions about its assignment and report on the benefits and challenges that meeting in person or electronically posed.
3. (Communication) Set up an interview with a manager at a local business who is involved in the strategic planning process at her company. Ask her what type of planning she is involved in (strategic, operational). Discover if she involves the employees who report to her in the planning process and how planning is tied to goal setting. Write a report on your findings. The interview should take no more than 15 minutes.

Managerial Decision Exercises

- 1. Select three different businesses from different industries, such as a hospitality business (hotel, restaurant, fitness center), a manufacturing company, and a not-for-profit business. Perform a SWOT analysis for each business.
- 2. Perform a quick PESTEL analysis of the companies listed below. What is the largest risk for each of the companies? Assume that you had \$100,000 to invest in one of more of these companies. Explain how you would allocate your investment and why you chose this particular allocation.
 - Uber
 - Tesla
 - General Motors
- 3. Technology has the ability to disrupt industries. You are involved in an industry that is undergoing change and disruption by taking this class. The traditional textbook industry is being disrupted by the availability of digital textbooks, and free textbooks such as this one are further impacting traditional textbook publishers. Place the following statements into Porter’s Five Forces model.
 - a. Students have access to the material at a greatly reduced cost.
 - b. Authorship is funded through philanthropic donations rather than royalties paid from textbook sales revenue.
 - c. More students have access to the Internet than ever before.
 - d. Companies, governments, and students invest large sums of money in their education.
 - e. Traditional public educational institutions are adapting their delivery models for online learning.

- f. Private companies such as Apollo (University of Phoenix) are offering lower-cost education options.
- g. Bookstores now offer traditional textbooks as well as used and rental options.
- h. Government legislation is urging faculty to consider lower-cost options.

Critical Thinking Case

Tesla Aims for the Mass Market

Elon Musk co-founded Tesla in 2003 with the vision of making electric cars that could rival, and even replace, traditional gas-engine cars in the consumer marketplace. At the start of the 21st century, the external environment was beginning to show favorable signs for the development of electric cars: people were becoming more concerned about the environment and their carbon footprints, and gas prices were beginning a steep climb that had already spurred the sales of hybrid gas-electric cars such as the Toyota Prius.

The automobile industry was not responding to these environmental trends, instead relying on the fact that trucks such as the Ford F-150 and Chevrolet Silverado were still the two top-selling vehicles in America in 2003. Musk saw a different future for vehicles, and Tesla introduced the all-electric Roadster in 2008. Four years later, the more practical Model S was introduced, and Tesla sales began to climb.

As a new entrant in the automobile industry, though, Tesla faced several challenges. Manufacturing and distribution in this industry are extremely expensive, and Tesla had to develop the capability of efficiently manufacturing large quantities of cars. Tesla also had to establish dealerships for its cars, although it also decided to sell cars online, taking advantage of tech-savvy consumers' comfort with online shopping. Perhaps Tesla's greatest challenge was convincing consumers to trust the new technology of all-electric cars. Range anxiety became an actual term, describing people's fear that their car batteries would run out before they reached their destinations. To combat this, Tesla developed an extensive network of charging stations so consumers could be confident that they could charge their cars conveniently.

Elon Musk has been a master of raising money to fund Tesla's efforts to successfully enter the mainstream automobile manufacturing industry; so far, Tesla's entry has cost billions of dollars. Tesla has also taken advantage of tax incentives to develop its charging stations and to sell its cars, because Tesla customers receive tax credits for the purchase of their cars. Tesla cars are not inexpensive, however, and that has limited their marketability. Most Americans cannot afford the Model S or more recent Model X's high prices (up to and exceeding \$100,000).

In 2017, Tesla launched the Model 3, designed to transform the car industry by being its first mass-market, affordable model. The company started taking "reservations" for the model in 2016, promising that it would arrive with a \$35,000 price tag. By mid-2017, the reservations list had reached half a million customers, creating a new problem for Tesla. How could it possibly manufacture that many cars when production levels for all of 2016 were less than 84,000 cars?



Exhibit 7.13 Tesla 3 The Tesla Model 3. (Credit: Brian Doyle/ flickr/ Attribution 2.0 Generic (CC BY 2.0))

Critical Thinking Questions

1. What PESTEL factors supported Tesla's success? Which factors posed challenges?
2. How has Tesla's strategic position changed since it was founded in 2003?
3. What kind of responses would you expect from Tesla's rivals in the automobile manufacturing industry to the Model 3's popularity?

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