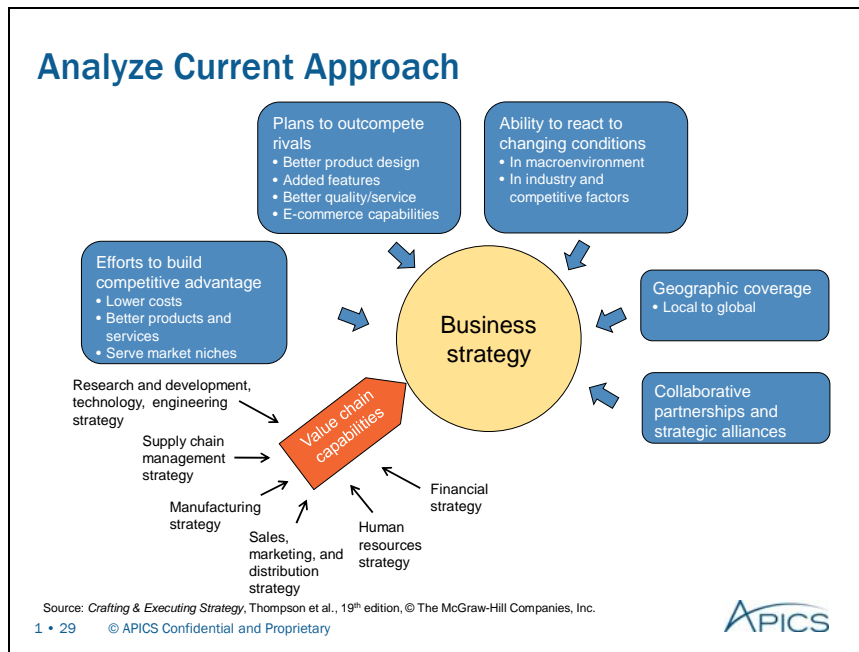
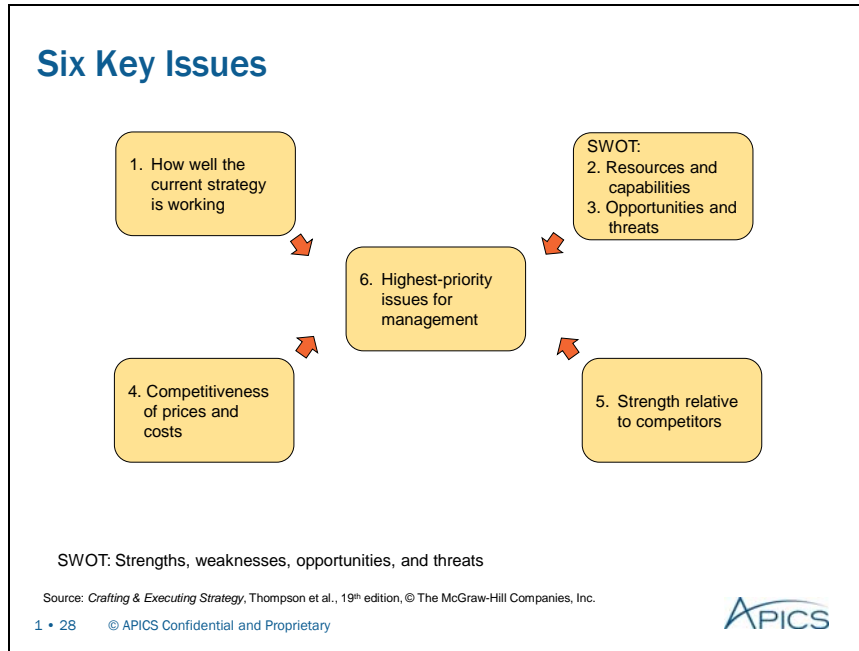


# Strategic Planning: The Internal Environment

Reference: Thompson et al., *Crafting & Executing Strategy*, 19<sup>th</sup> ed., chap. 4.



## **Strategic Planning: The Internal Environment**

The purpose of this section is to familiarize you with key activities, concepts, and issues involved in assessing the internal environment.

Assessment of the internal environment is based on the six issues shown in Visual 1-28. These issues often are addressed concurrently. Because information from the internal environment analysis also is used in the external environment analysis, these analyses can be concurrent or overlapping.

### **Assess the Current Strategy**

Assessing the current strategy requires examination of a company's competitive approach, supported by the use of quantitative and other performance measures.

### **Analyze the Current Approach**

Visual 1-29 depicts the competitive factors and value chain capabilities that define the competitive approach:

- ◆ Key competitive factors—The analysis of the competitive approach addresses five key competitive factors reflected in current strategy:
  - ◆ efforts to build competitive advantage
  - ◆ plans to outperform rivals
  - ◆ ability to react to changing conditions
  - ◆ geographic coverage
  - ◆ collaborative partnerships and strategic alliances.
- ◆ Value chain capabilities—In addition to competitive factors, the company's value chain capabilities also are critical to its competitive approach. They are responsible for the planning and execution of operations to carry out the business strategy.

## Quantitative and Other Measures

- Sales and market share growth\*
- New customer acquisition rate\*
- Changes in profit margins\*
- Net profit and return on investment (ROI) trends\*
- Innovation and new product and service introduction\*
- Improvement in financial strength and credit rating
- Continuous improvement (inventory turns, unit costs, employee productivity, and so on)
- Strong positive brand association

\*In comparison with competitors

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## Assessing Current Strategy

- helps to determine the overall business strength
- develops data that also are used in external strategy environment analysis
- uses quantitative and other performance measures
- needs to be more intensive if market performance and standing are weak.

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## **Assess the Current Strategy (cont.)**

### ***Quantitative and Other Measures***

It is important to supplement the qualitative analysis of competitive factors with quantitative analysis and other evidence. Visual 1-30 reviews the types of quantitative and other performance indicators useful for evaluating the current strategy.

### ***Summary of Assessing the Current Strategy***

Assessing the current strategy

- ◆ is important in determining the overall strength of the internal environment—the things the company can control
- ◆ develops data that also are used in assessing external environmental factors when creating or modifying the company's business strategy, such as the competitive strength of the company relative to its rivals
- ◆ needs to be based on quantitative and other performance indicators
- ◆ needs to be more intensive if overall market performance and market standing are weak.

## SWOT Analysis

Identify company resource strengths and competitive capabilities

Identify company resource weaknesses and competitive deficiencies

- Structured analysis of a company's strengths, weaknesses, opportunities, and threats (SWOT)
- Basis for crafting a strategy that capitalizes on resource and capability strengths
- Identifies best opportunities and significant threats
- Provides overall assessment of health and sustainability

Identify the company's market opportunities

Identify external threats to the company's future business prospects

Source: *Crafting & Executing Strategy*, Thompson et al., 19<sup>th</sup> edition, © The McGraw-Hill Companies, Inc.

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## SWOT Analysis: Strengths and Weaknesses

- **Strengths**
  - Strategy and operations aligned
  - Excellent financial condition and access to capital
  - Strong brand-name products and services
  - Good supply chain management capabilities
  - Superior product and service quality
  - Scale and learning curve advantages
- **Weaknesses**
  - No clear strategic direction
  - Weak balance sheet, too much debt
  - Undifferentiated, mediocre products
  - Operational and supply chain inefficiencies
  - Product and service quality lags competitors
  - Behind on R&D and technological know-how

Source: *Crafting & Executing Strategy*, Thompson et al., 19<sup>th</sup> edition, © The McGraw-Hill Companies, Inc.

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### **Assess Strengths, Weaknesses, Opportunities, and Threats**

As summarized in the diagram in Visual 1-32, SWOT analysis is a structured approach to analyzing the internal strengths and weaknesses of a company's resources and capabilities, and its external market opportunities and threats.

In the next few pages, we will review the basic steps of SWOT analysis that lead to the following:

- ◆ conclusions about the company's overall business health and sustainability
- ◆ preliminary recommendations for actions to improve its market position and profitability.

### **Strengths and Weaknesses**

Analyzing strengths and weaknesses is similar in concept to preparing a financial balance sheet, except that the balance in this case is between strengths and weaknesses of a company's resources and capabilities.

What are some examples of resources and capabilities?

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Visual 1-33 provides examples of strengths and weaknesses a company might have.

- ◆ In this case, the examples of strengths show a company that appears to be much better than average in competitive advantage.
- ◆ Overall, the examples of weaknesses show a company that is at a great competitive disadvantage.

## SWOT Analysis: Opportunities and Threats

- Opportunities
  - Growing demand
  - Expansion into new markets and industries
  - New sales channels (internet)
  - Falling trade barriers
  - Alliances to enter new geographic markets
- Threats
  - Sluggish market growth
  - Likely market entry from strong competitors
  - Loss of sales to substitute products and services
  - Strong buyer and supplier bargaining power
  - New restrictive regulatory and trade policies

Source: *Crafting & Executing Strategy*, Thompson et al., 19<sup>th</sup> edition, © The McGraw-Hill Companies, Inc.

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### **Opportunities and Threats**

In contrast to strengths and weaknesses, the analysis of market opportunities and external threats focuses on forces occurring outside the company that the business strategy should address. You will note that many of these factors also are identified and analyzed in the competitive forces analysis (five-forces analysis) of the *external* environment that we reviewed earlier.

What threat factors also are addressed in the competitive forces (five-forces) analysis?

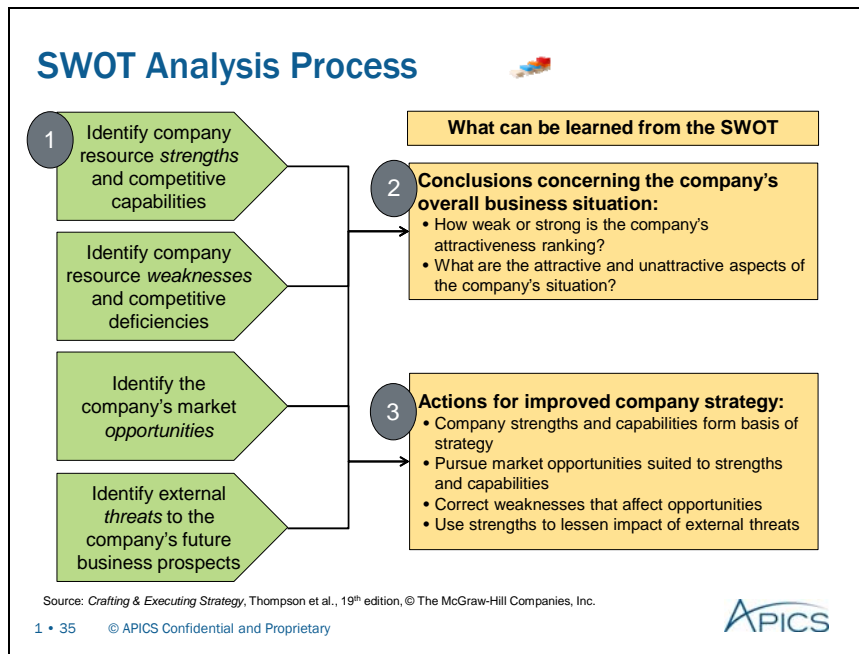
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The inclusion of threat factors in both the five-forces and SWOT analyses is not necessarily redundant.

- ◆ In the external environment analysis, the factors that make up the five forces are addressed as industrywide phenomena to be considered by companies as they decide whether to enter a market, change strategy, or continue to compete.
- ◆ SWOT analysis looks at these factors from an internal environment perspective to determine how they affect the crafting of a company's competitive business strategy.





**Summary of SWOT Analysis**

Visual 1-35 is a brief summary of the three-phase SWOT analysis process.

- ◆ Phase 1 is the identification of
  - ◆ strengths
  - ◆ weaknesses
  - ◆ opportunities
  - ◆ threats.
- ◆ Phase 2 draws *preliminary* findings and conclusions about
  - ◆ the relative strength or weakness of the business
  - ◆ the particularly attractive aspects of the business
  - ◆ aspects that are of concern.
- ◆ Phase 3 translates the findings and conclusions into potential actions for improving strategy and business prospects:
  - ◆ Strengthen competitive capabilities to improve strategic prospects and profitability.
  - ◆ Pursue market opportunities with greatest potential.
  - ◆ Reduce the company's competitive weaknesses and liabilities.
  - ◆ Use strengths to limit the impact of external threats.

Two factors are important in implementing these actions: selectivity and resources. Why are they important, and how are they interrelated?

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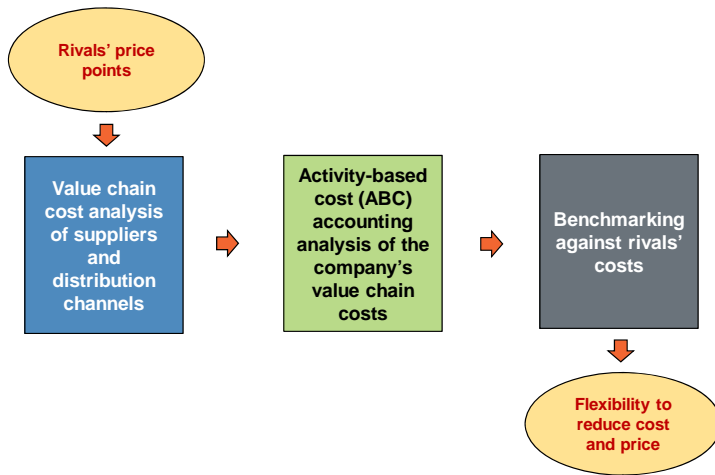
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The SWOT analysis is not the final activity in the internal strategy development process. The remaining activities are

- ◆ determining the company's price and cost competitiveness
- ◆ creating a detailed comparison of the company's competitive strengths and weaknesses relative to its rivals.

## Determining Price Competitiveness



## **Determine Price Competitiveness**

Another critical activity in the internal environment analysis is the review of price and cost competitiveness. The sign of a strong business position is having prices in line with rivals' prices. A rival's product price is usually easy to determine. It is very important to know how your price compares and what can be done to improve your price position.

Tools used to analyze price competitiveness are value chain analysis, activity-based costing, and benchmarking. The following is a high-level summary of the process.

### ***Value Chain Analysis***

Value chain analysis first requires deconstructing the value chain for the product in question by determining the physical flow of the product

- ◆ from its earliest raw material stage through suppliers to the manufacturer
- ◆ through physical transformation by the manufacturer
- ◆ from the manufacturer through distribution channels to the final customer.

Detailed methods for determining the cost structures of suppliers and distribution channels are beyond the scope of this course. The general procedure is to start with the cost of raw materials from different suppliers and the price of the product at different final customer sale points. The next step is to analyze the complexity of these segments of the supply chain, such as the number of transactions that occur within them, to determine the reason for both raw material and final product price differentials among suppliers and distribution channels.

### ***Activity-Based Cost Accounting***

Another step is for the company to use activity-based cost (ABC) accounting to determine the internal value chain or supply chain costs incurred by its own primary activities and support activities.

### ***Benchmarking***

Benchmarking has limitations due to differences in cost-accounting principles used to figure the cost of particular activities. However, there is widespread acceptance and use of reputable third-party benchmarking services. These include consulting organizations and associations whose subscribers and members submit cost data on various activities.

The benchmarking organizations aggregate the data, for example, by converting it into average costs per activity, or publish raw data without attribution to sources. Then they distribute the data to subscribers, who determine their price position relative to rivals.

### ***Summary***

The analysis of price competitiveness requires detailed knowledge of the value chain costs for a product. This enables a company to determine whether and how it can become more cost competitive with its rivals' prices through value chain or supply chain advancements and other improvements. Relative cost position among rivals is a critical factor in rating a company's competitive position, which we will review next.

## Competitive Strength Assessment

- Objectives
  - Determine how each major competitor rates in terms of specific factors.
  - Indicate where a company has a net advantage or disadvantage against main competitors.
  - Indicate where it might be advantageous to strengthen a rating vis-à-vis specific competitors.

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## Rating Criteria

- Quality and product performance
- Reputation and image
- Technological skills
- Dealer network
- Product and service innovation
- Financial resources
- Relative cost position
- Customer service

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**Assess Strength Relative to Competitors**

Ranking the company against its competitors achieves three objectives:

- ◆ It provides details of how *each* competitor rates in terms of specific factors, as shown in the visual.
- ◆ It indicates where a company has a net advantage or disadvantage against main competitors.
- ◆ It indicates where it might be advantageous to strengthen a rating in relation to specific competitors by acquiring more resources or improving capabilities.

**Rating Criteria**

Rating criteria used in assessing competitor strength should be based on the KSFs used in the industry and competitive analysis phases of the external environment analysis. Visual 1-38 shows the KSFs that we will use in the case study at the end of this section. The table below shows the conversion of raw ratings into weighted ratings, or the score, that we'll use in the ranking process.

**Example of Conversion of Strength Ratings into Scores (Partial Table)**

Strength (KSF)	Weight	SMR Co.		Rival A		Rival B		Rival C	
		Strength rating	Weighted score	Strength rating	Weighted score	Strength rating	Weighted score	Strength rating	Weighted score
Quality	.10	8	.80	5	.50	10	1.00	1	.10
Manufacturing capability	.10	2	.20	10	1.00	4	.40	5	.50
-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
Cost position	.30	5	1.5	10	3.0	3	.90	1	.30
Customer service	.15	5	.75	7	1.05	10	1.5	1	.15
Overall rating	N/A	61	5.95	58	7.70	71	6.85	25	2.10
Sum of weights	1.00								

Where does information on each of these ratings, for the company and its competitors, come from?

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## Manage Strategic Issues

- How to reduce high costs
- How to sustain growth as demand softens
- How to defend against well-financed new market entrants
- Whether to leverage a proprietary technology by entering a new industry
- Whether to expand into a new market segment
- Whether to expand into a foreign market

## Manage Strategic Issues

The last and final analytical step draws on the industry and competitive analysis and the evaluations of the company's own competitive strengths and weaknesses. These enable management to determine the relative importance of strategic issues such as those shown in the visual.

Determining the issues means identifying and understanding the scope and significance of the issues, not determining what specific actions to take. This will occur after another strategy development process in which managers choose between *competitive strategy options*, which are referred to by some as *strategic alternatives*. This is the subject of the next section.



## Problem 1.2 Competitive Strength Assessment Case Study



1. In what stage of the product life cycle is this product likely to be, and what are some of the likely characteristics of the product?
2. Who is the strongest competitor in the strategic group, and what are its competitive advantages?
3. Why does Rival B have a higher overall score than SMR Co.? What are its competitive advantages over SMR, and what can SMR do to put competitive pressure on Rival B?
4. Will Rival C be vulnerable if SMR Co. gains a better competitive position over Rival C's customers? If so, what other rival might feel compelled to respond?



**Class Problem 1.2: Competitive Strength Assessment Case Study**

The purpose of this case study is to examine the competitive strengths and weaknesses of SMR Co. and its three main competitors. Refer to the data in the table below and answer the questions on the next participant workbook page.

The left column is the strength. The next column shows the weight (importance on a 0.00–1.00 scale, with 1.00 as the highest) assigned to each of these strengths. Two columns appear under each company heading—the strength rating for the appropriate KSF within that company (rated on a 1–10 scale, with 10 as the highest) and the weighted score, which is the strength rating for that company multiplied by the weight.

Strength (KSF)	Weight	SMR Co.		Rival A		Rival B		Rival C	
		Strength rating	Weighted score	Strength rating	Weighted score	Strength rating	Weighted score	Strength rating	Weighted score
Quality	.10	8	.80	5	.50	10	1.00	1	.10
Reputation	.10	8	.80	7	.70	10	1.00	1	.10
Manufacturing capability	.10	2	.20	10	1.00	4	.40	5	.50
Technological skills	.05	10	.50	1	.05	7	.35	3	.15
Dealer network	.05	9	.45	4	.20	10	.50	5	.25
Product innovation	.05	9	.45	4	.20	10	.50	5	.25
Financial Resources	.10	5	.50	10	1.00	7	.70	3	.30
Cost position	.30	5	1.5	10	3.0	3	.90	1	.30
Customer service capabilities	.15	5	.75	7	1.05	10	1.5	1	.15
Overall rating	N/A	61	5.95	58	7.70	71	6.85	25	2.10
Sum of weights	1.00								





**Class Problem 1.2: Competitive Strength Assessment Case Study (cont.)**

1. Looking at the weights only, in what stage of the life cycle is this product likely to be, and what are some of the likely characteristics of the product?

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2. Who is the strongest competitor in the strategic group, and what are its competitive advantages?

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3. Why does Rival B have a higher overall score than SMR Co.? What are its competitive advantages over SMR, and what can SMR do to put competitive pressure on Rival B?

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4. Will Rival C be vulnerable if SMR Co. gains a better competitive position over Rival C's customers? If so, what other rival might feel compelled to respond?

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