Chapter 2 – The external environment: Opportunities, threats, industry competition and competitor analysis

TRUE/FALSE

1. External environmental conditions create both resources and opportunities for firms that have major implications for their strategic actions.

   ANS: F PTS: 1 DIF: Moderate REF: Introduction

2. Demographic, economic, political/legal, sociocultural, technological, global and environmental changes are the seven elements comprising the industry environment

   ANS: T PTS: 1 DIF: Hard REF: The general, industry and competitor environments

3. Analysis of the general environment is focused on the past; analysis of the industry environment is focused on the factors and conditions influencing a firm's profitability within its industry; and analysis of competitors is focused on predicting the dynamics of competitors' product choices, advertising and intentions.

   ANS: F PTS: 1 DIF: Easy REF: The general, industry and competitor environments

4. When scanning, a firm often deals with ambiguous, incomplete and unconnected data and information.

   ANS: T PTS: 1 DIF: Moderate REF: Scanning

5. When forecasting, analysts must observe environmental changes to determine if an important trend is beginning to emerge.

   ANS: F PTS: 1 DIF: Hard REF: Forecasting

6. The objective of assessing the external environment is to determine the effects of changes in competitor actions and strategy.

   ANS: F PTS: 1 DIF: Moderate REF: Assessing

7. A population's size, age structure, geographic distribution, ethic mix and income distribution are some of the elements of concern in the demographic segment of the general environment.

   ANS: T PTS: 1 DIF: Hard REF: The demographic segment

8. Because the health of a nation's economy affects the performance of individual firms and industries, companies study the economic environment to identify changes, trends and their strategic implications.

   ANS: T PTS: 1 DIF: Moderate REF: The economic segment

9. The political/legal segment is the arena in which organisations and interest groups compete for attention, resources and a voice in overseeing the body of laws and regulations guiding interactions among nations.

   ANS: T PTS: 1 DIF: Easy REF: The political/legal segment

10. The technological segment represents the impact of new products, processes and materials, but it does not include the institutions and activities involved with creating knowledge.

ANS: F PTS: 1 DIF: Moderate REF: The technological segment

11. In transferring jobs offshore, a firm has to balance efficiency and human rights.

ANS: F PTS: 1 DIF: Moderate REF: The global segment

12. The five forces model is an industry-level analytical model.

ANS: T PTS: 1 DIF: Moderate REF: Industry environment analysis

13. The five forces model recognises that both suppliers and customers can become a firm's competitors.

ANS: T PTS: 1 DIF: Moderate REF: Industry environment analysis

14. Switching costs, access to distribution channels, economies of scale, large numbers of competing firms and slow industry growth are some of the entry barriers that may affect the threat of new entrants to an industry.

ANS: F PTS: 1 DIF: Hard REF: Barriers to entry

15. Suppliers are powerful when substitutes are available, the selling industry is relatively consolidated and switching costs are low.

ANS: F PTS: 1 DIF: Hard REF: Bargaining power of suppliers

16. Typically, slow industry growth increases rivalry within an industry.

ANS: T PTS: 1 DIF: Moderate REF: Intensity of rivalry among competitors

17. High exit barriers can cause a company to remain in an industry even though the returns on its invested capital are low or negative.

ANS: T PTS: 1 DIF: Easy REF: High exit barriers

18. An attractive industry is one that is characterised by high entry barriers, suppliers and buyers with strong bargaining power, low threats from substitute products and low rivalry among firms.

ANS: F PTS: 1 DIF: Hard REF: Interpreting industry analyses

19. There is less competition between firms within a strategic group than between a member of a strategic group and companies outside that strategic group.

ANS: F PTS: 1 DIF: Moderate REF: Strategic groups

20. Competitor intelligence is the process of gathering data and information that can help a firm understand its competitors' intentions and the strategic implications resulting from them.

ANS: T PTS: 1 DIF: Easy REF: Competitor analysis

MULTIPLE CHOICE

1. The three components of the external environment are:
   A. general, economic and technological environments
   B. general, industry and demographic environments
   C. general, industry and competitor environments
   D. general, competitor and structural environments

   ANS: C PTS: 1 DIF: Easy REF: The general, industry and competitor environments

2. When analysts develop projections of anticipated outcomes based on monitored changes and trends, they are engaged in what activity?
   A. Scanning
   B. Monitoring
   C. Forecasting
   D. Assessing

   ANS: C PTS: 1 DIF: Moderate REF: External environmental analysis

3. Which of the following is not a major twenty-first-century challenge for governments with respect to demographic segment?
   A. Business opportunities
   B. Immigration
   C. Housing
   D. Retirement age
   E. Pensions

   ANS: C PTS: 1 DIF: Moderate REF: Population size

4. The economic environment refers to:
   A. the economic outlook of the world provided by the World Bank
   B. how new environmental regulations will affect the economy
   C. how the environmental movement and the world economy interact
   D. the nature and direction of the economy in which a firm competes

   ANS: D PTS: 1 DIF: Moderate REF: The economic segment

5. The political/legal segment of an environment represents the:
   A. political preferences of different ethnic groups in society
   B. technological values of different political entities in society
   C. ways in which firms and other organisations try to influence government and how government influences them
   D. study of business and organisational attitudes towards government

   ANS: C PTS: 1 DIF: Moderate REF: The political/legal segment

6. The sociocultural segment of an environmental analysis is concerned with:
   A. how technology impacts society
   B. the political condition of the societies in which a firm does business
   C. the economic condition of society
   D. social attitudes and cultural values within a society

   ANS: D PTS: 1 DIF: Moderate REF: The sociocultural segment

7. The technological segment in environmental analysis includes:
   A. institutions and activities involved in creating new knowledge and translating that knowledge into new outputs
   B. the determination of when machinery will need to be replaced in a given firm
   C. considering the technology necessary for a firm to gain a competitive advantage
   D. ensuring a firm's technology will allow that firm to dominate a given market

   ANS: A PTS: 1 DIF: Moderate REF: The technological segment

8. An executive's ability to verify potential substitutes for technologies that are in current use is a result of analysing the ________ segment of the general environment.
   A. economic
   B. political/legal
   C. technological
   D. global

   ANS: C PTS: 1 DIF: Easy REF: The technological segment

9. Compared to the general environment, the industry environment has:
   A. a more subtle effect in creating a barrier to the hiring of new employees
   B. a less direct effect on a firm's strategic competitiveness and its returns
   C. a more direct effect on a firm's strategic competitiveness and its returns
   D. no effect on the firm's strategic competitiveness and its returns

   ANS: C PTS: 1 DIF: Moderate REF: Industry environment analysis

10. The likelihood that firms will enter an industry is a function which pair of factors?
    A. Barriers to entry and the number of incumbents
    B. Fragmentation of competition and diversity of customers
    C. Retaliation expected from incumbents and barriers to entry
    D. Diversity of customers and retaliation expected from incumbents

    ANS: C PTS: 1 DIF: Hard REF: Threat of new entrants

11. Which of the following is *not* a barrier to entry into an industry?
    A. Market knowledge
    B. Product differentiation
    C. Capital requirements
    D. Economies of scale

    ANS: A PTS: 1 DIF: Moderate REF: Barriers to entry

12. The term *economies of scale* refers to the fact that as the:
    A. quantity of product produced in a given period increases, the cost of manufacturing each unit increases
    B. quantity of product produced in a given period increases, the cost of manufacturing each unit remains constant
    C. quantity of product produced in a given period increases, the cost of manufacturing each unit decreases
    D. physical size of the product gets larger, the costs of production become lower

    ANS: C PTS: 1 DIF: Hard REF: Economies of scale

13. The term *product differentiation* refers to the:
    A. ability of product buyers to negotiate a lower price
    B. response of incumbent firms to new entrants
    C. customers' belief that an existing product is unique
    D. fact that as more of a product is produced, it becomes cheaper per unit

    ANS: C PTS: 1 DIF: Moderate REF: Product differentiation

14. Switching costs are the:
    A. one-time costs customers incur when buying from a different supplier
    B. producer's costs of exchanging equipment in a facility when new technologies emerge
    C. costs of changing the firm's strategic group
    D. one-time costs suppliers incur when selling to a different customer

    ANS: A PTS: 1 DIF: Moderate REF: Switching costs

15. Vigorous retaliation is *not* expected when:
    A. existing firms have major stakes in the industry
    B. an industry is fragmented
    C. industry growth is slow or constrained
    D. existing firms have substantial resources

    ANS: B PTS: 1 DIF: Moderate REF: Expected retaliation

16. Suppliers are powerful when:
    A. satisfactory substitutes are available
    B. they sell a commodity product
    C. they have credible threat of forward integration
    D. they are in a highly fragmented industry

    ANS: C PTS: 1 DIF: Hard REF: Bargaining power of suppliers

17. Under which of the following conditions will a buyer group be relatively weak?
    A. When switching costs are high
    B. When it purchases a large portion of an industry's output
    C. When suppliers sell a commodity product
    D. When it has a credible threat of backward integration

    ANS: A PTS: 1 DIF: Hard REF: Bargaining power of buyers

18. The threat from substitutes is low when:
    A. switching costs are low
    B. the substitute product's price is higher than the industry product's price
    C. the quality of the substitute product is better than the quality of the industry's product
    D. the substitute product stimulates new process innovations within the industry

ANS: B PTS: 1 DIF: Moderate REF: Threat of substitute products

19. When rival firms compete aggressively by trying to attract competitors' customers, this might be an indication of:
A. an industry with low exit barriers
B. increasing economies of scale
C. slow industry growth
D. high bargaining power among buyers

ANS: C PTS: 1 DIF: Hard REF: Intensity of rivalry among competitors

20. Which one of the following factors does *not* affect the intensity of rivalries between firms?
A. A high number of equally balanced competitors
B. Slow industry growth
C. Business policies guiding the markets
D. High fixed costs or high storage costs

ANS: C PTS: 1 DIF: Moderate REF: Intensity of rivalry among competitors

21. Exit barriers to a firm would include:
A. emotional barriers
B. non-specific assets
C. low government restrictions
D. low fixed costs of exit

ANS: A PTS: 1 DIF: Hard REF: High exit barriers

22. An industry with low entry barriers, buyers with strong bargaining positions and intense rivalry among competing firms is called a(n) ________ industry.
A. rivalrous
B. unattractive
C. moderately attractive
D. moderately unattractive

ANS: B PTS: 1 DIF: Hard REF: Interpreting industry analyses

23. Firms within strategic groups:
A. follow dissimilar strategies
B. follow similar strategies across certain dimensions
C. typically engage in more intergroup rivalry than intragroup rivalry
D. exist almost exclusively in the manufacturing sector

ANS: B PTS: 1 DIF: Moderate REF: Strategic groups

24. Which one of the following is *not* a common dimension by which to classify strategic groups?
A. Product quality
B. Technological leadership
C. Customer service
D. Firm size

ANS: D PTS: 1 DIF: Easy REF: Strategic groups

25. The competition within each strategic group is:
    A. typically very low
    B. an unknown factor in the analysis of competitive practices within a firm's strategic group
    C. more intense than that between strategic groups
    D. less intense than that between strategic groups

    ANS: C PTS: 1 DIF: Easy REF: Strategic groups

26. High mobility barriers between strategic groups:
    A. increase the market share of members of a particular strategic group
    B. protect the market share of members of a particular strategic group
    C. reduce the market share of members of a particular strategic group
    D. increase the rivalry between strategic groups

    ANS: B PTS: 1 DIF: Moderate REF: Strategic groups

27. Competitor analysis focuses on:
    A. firms with which a company competes directly
    B. firms that produce products that are substitutes
    C. all firms in the industry
    D. companies that might enter the industry

    ANS: A PTS: 1 DIF: Moderate REF: Competitor analysis

28. Which one of the following is *not* a component of competitor analysis?
    A. Assumptions
    B. Market size
    C. Future objectives
    D. Current strategy

    ANS: B PTS: 1 DIF: Moderate REF: Competitor analysis

ESSAY

1. Identify and describe the three major parts of the external environment.

   ANS:
   The external environment has three major parts. The first is the general environment, which includes elements in the broader society that affect industries and their firms. The second part, the industry environment, involves factors that influence a firm, its competitive actions and responses, and the industry's profit potential, as determined by the threat of entry, suppliers, buyers, product substitutes and the intensity of rivalry among competitors. The competitor environment is the third part of the external environment and comprises each major competitor's future objectives, current strategy, assumptions and capabilities.

   PTS: 1 DIF: Easy REF: The general, industry and competitor environments

2. What are the four components of the external environmental analysis? Describe the purpose of each of these stages.

   ANS:

The four components of the external environmental analysis are scanning, monitoring, forecasting and assessing. Scanning seeks to identify early signals of environmental changes and trends. Monitoring is the process of detecting meaning through ongoing observations of environmental changes and trends. Forecasting involves developing projections of anticipated outcomes based on monitored changes and trends. The final stage is assessing, which involves determining the timing and importance of environmental changes and trends for firms' strategies and their management.

PTS: 1 DIF: Easy REF: External environmental analysis

3. What are some of the sources of information that can be used to analyse the general environment?

ANS:
Several sources can be used to analyse the general environment, including a wide variety of websites and printed materials (e.g. trade publications, newspapers, business publications and the results of academic research and public polls), trade shows and suppliers, customers and employees of public-sector organisations. Google, Bing (the result of an alliance between Yahoo! and Microsoft) and other search engines are now very widely used for this purpose. People in boundary-spanning positions can therefore easily obtain much information. Salespeople, purchasing managers, public relations directors and customer service representatives, each of whom interacts with external constituents, are examples of individuals in boundary-spanning positions. Expatriates in multinational corporations can act as significant boundary spanners as they act in and return from their foreign assignments.

PTS: 1 DIF: Easy REF: External environmental analysis

4. Identify and describe the six segments of general environment analysis.

ANS:
- The demographic segment encompasses items such as population size, age structure, ethnic mix and income distribution.
- The economic segment includes analysis of inflation rates, interest rates, savings rates, budget and trade deficits/surpluses, and gross domestic product.
- The political/legal segment analyses tax laws, labour laws, business philosophies and educational policies.
- The sociocultural segment studies work force diversity, attitudes about work life, product preferences and environmental concerns.
- The technological segment includes studies of product and process innovations, applications of knowledge and R&D expenditures.
- The global segment observes political events, changes in global markets and the development of newly industrialised countries.

PTS: 1 DIF: Hard REF: The general, industry and competitor environments

5. Identify the five competitive forces and explain how they determine industry profit potential.

ANS:
- Threat of new entrants: New entrants increase production capacity in an industry, which results in lower profits for all firms unless demand is increasing. Firms erect barriers to entry to diminish the threat of new entrants.
- Bargaining power of suppliers: Suppliers with a great deal of power can increase prices of inputs. If firms are unable to pass along price increases to customers, then profits diminish.
- Bargaining power of buyers: When buyers have a great deal of power, they attempt to force prices down, increase quality and increase service levels, thus driving profits down.
- Threat of substitutes: Powerful substitutes place an upper limit on prices firms can charge, limiting industry profits.
- Intensity of rivalry: This is often based on product price, which limits profits.

PTS: 1 DIF: Moderate REF: Industry environment analysis

6. What are some of the barriers to entry and how do they affect competition within an industry?

ANS:
The common barriers to entry are economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scale and government policy. New entrants face a dilemma when confronting current competitors' scale economies. Small-scale entry places them at a cost disadvantage. Alternatively, large-scale entry, in which the new entrant manufactures large volumes of a product to gain economies of scale, risks strong competitive retaliation. Typically, new entrants must allocate many resources over time to overcome existing customer loyalties. To combat the perception of uniqueness, new entrants frequently offer products at lower prices. This decision, however, may result in lower profits or even losses.

Competing in a new industry requires a firm to have resources to invest. In addition to physical facilities, capital is needed for inventories, marketing activities and other critical business functions. Even when competing in a new industry is attractive, the capital required for successful market entry may not be available to pursue an apparent market opportunity.

Switching costs are the one-time costs customers incur when they buy from a different supplier. Usually, the more established the relationship between parties, the greater the cost incurred in switching to an alternative offering. Over time, established industry participants typically develop effective means of distributing products. Once a relationship with its distributors has been developed, a firm will nurture it to create switching costs for the distributors. Access to distribution channels is often a strong entry barrier for new entrants, particularly in consumer non-durable goods industries (for example, in grocery stores where shelf space is limited) and in international markets.

Sometimes, established competitors have cost advantages that new entrants cannot duplicate. Proprietary product technology, favourable access to raw materials, desirable locations and government subsidies are examples. Through licensing and permit requirements, federal, state or local government can also control entry into an industry. Also, governments often restrict entry into some industries because of the need to provide quality service or the need to protect jobs.

PTS: 1 DIF: Hard REF: Barriers to entry

7. Describe the conditions in which the bargaining power of suppliers is high and then in which the bargaining power of buyers is high.

ANS:
A supplier group is powerful in the following situations:

- It is dominated by a few large companies and is more concentrated than the industry to which it sells.
- Satisfactory substitute products are not available to industry firms.
- Industry firms are not a significant customer for the supplier group.
- Suppliers' goods are critical to buyers' marketplace success.
- The effectiveness of suppliers' products has created high switching costs for industry firms.
- It poses a credible threat to integrate forward into the buyers' industry – credibility is enhanced when suppliers have substantial resources and provide a highly differentiated product.

Customers (buyer groups) are powerful in the following situations:

- They purchase a large portion of an industry's total output.
- The sales of the product being purchased account for a significant portion of the seller's annual revenues.
- They could switch to another product at little, if any, cost.
- The industry's products are undifferentiated or standardised and the buyers pose a credible

threat if they were to integrate backward into the sellers' industry.

PTS: 1 DIF: Hard REF: Bargaining power of suppliers; Bargaining power of buyers

8. What are high exit barriers and how do they affect competition within an industry?

ANS:
Exit barriers are economic, strategic and emotional factors that cause companies to remain in an industry, even though the profitability of doing so is in question. The following are common sources of exit barriers: specialised assets; fixed costs of exit; strategic interrelationships or mutual dependence of business units; emotional barriers; and legal and social restrictions. The higher the exit barrier, the greater is the likelihood that a firm will engage in very competitive strategic actions.

PTS: 1 DIF: Hard REF: High exit barriers

9. What factors affect the intensity of rivalry among competitors? Briefly explain each of these factors.

ANS:
Six factors are known to affect the intensity of rivalry among competitors in an industry setting. The first, numerous or equally balanced competitors, reflects the fact that rivalry will be greater if many competitors are participating in the industry or if a few competitors exist but they are of equivalent size. Slow industry growth is the second factor. In slow-growth markets, firms battle to increase their market shares by attracting competitors' customers. The third factor is high fixed costs or high storage costs. When fixed costs account for a large part of total costs, companies try to maximise the use of their productive capacity. Doing so allows the firm to spread costs across a larger volume of output. However, when many firms attempt to maximise their production capacity, excess capacity is created on an industry-wide basis. To then reduce inventories, individual companies typically cut the price of their product and offer rebates. These practices intensify competition. Lack of differentiation or low switching costs are the fourth factor. When buyers view products as commodities (i.e. as products with few differentiated features or capabilities), rivalry intensifies. The fifth factor is high strategic stakes. Competitive rivalry is likely to be high when it is important for several of the competitors to perform well in the market. The final factor is high exit barriers. When companies continue competing in an industry even though the returns on their invested capital are low or negative, it is usually a result of high exit barriers, where the costs associated with leaving the industry would result in severe financial costs.

PTS: 1 DIF: Hard REF: Intensity of rivalry among competitors

10. What are strategic groups and what are their strategic implications?

ANS:
A strategic group is a set of firms emphasising similar strategic dimensions to use similar strategies. Strategic groups have several implications. First, because firms within a group offer similar products to the same customers, the competitive rivalry among them can be intense. The more intense the rivalry, the greater the threat to each firm's profitability. Second, the strengths of the five industry forces – the threats posed by new entrants, the power of suppliers, the power of buyers, product substitutes and the intensity of rivalry among competitors – differ across strategic groups. Third, the closer the strategic groups are in terms of their strategies, the greater is the likelihood of rivalry between the groups. Having a thorough understanding of primary competitors helps a firm formulate and implement an appropriate strategy.

PTS: 1 DIF: Moderate REF: Strategic groups