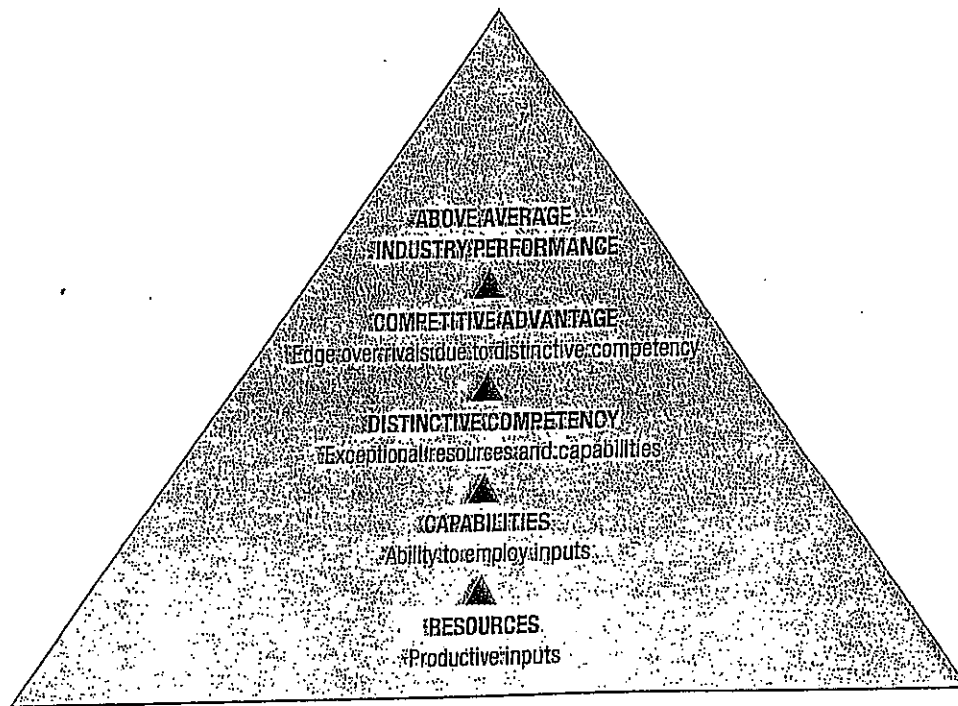


## Resources, Capabilities, and Competitive Advantage



## Tangible and Intangible Resources

TANGIBLE RESOURCES	
Financial resources	Cash
	Short and long-term investments
Physical resources	Plant, equipment
	Land, buildings
	Distribution facilities
	Mines (deposits), materials in stock
Human resources	Years of education and experience
	Employee strength
	Technical personnel as a percentage of total personnel
Organizational resources	Formal structure, procedures, planning and control mechanisms, coordination mechanisms
INTANGIBLE RESOURCES	
Technological resources	Patents
Intellectual resources	Technical knowledge, skills, and stored information
Organizational culture	Positive work climate, employee loyalty
Reputation	Brand name, goodwill, company image
Network resources	Strategic alliances, linkages, and partnerships

Strategic capability is the resources and competences of an organisation needed for it to survive and prosper

Tangible resources are the physical assets of an organisation such as plant, labour and finance  
Intangible resources are non-physical assets such as information, reputation and knowledge

Competences are the skills and abilities by which resources are deployed effectively through an organisation's activities and processes

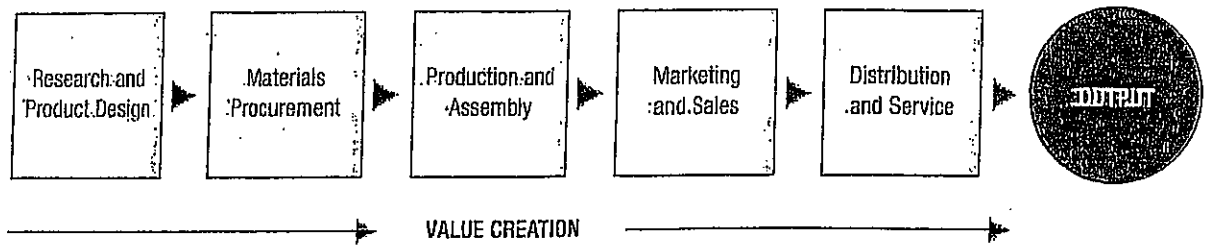
## Strategic capabilities and competitive advantage

	Resources	Competences
Threshold capabilities	Threshold resources <ul style="list-style-type: none"> <li>• Tangible</li> <li>• Intangible</li> </ul>	Threshold competences
Capabilities for competitive advantage	Unique resources <ul style="list-style-type: none"> <li>• Tangible</li> <li>• Intangible</li> </ul>	Core competences

## Strategic capability: the terminology

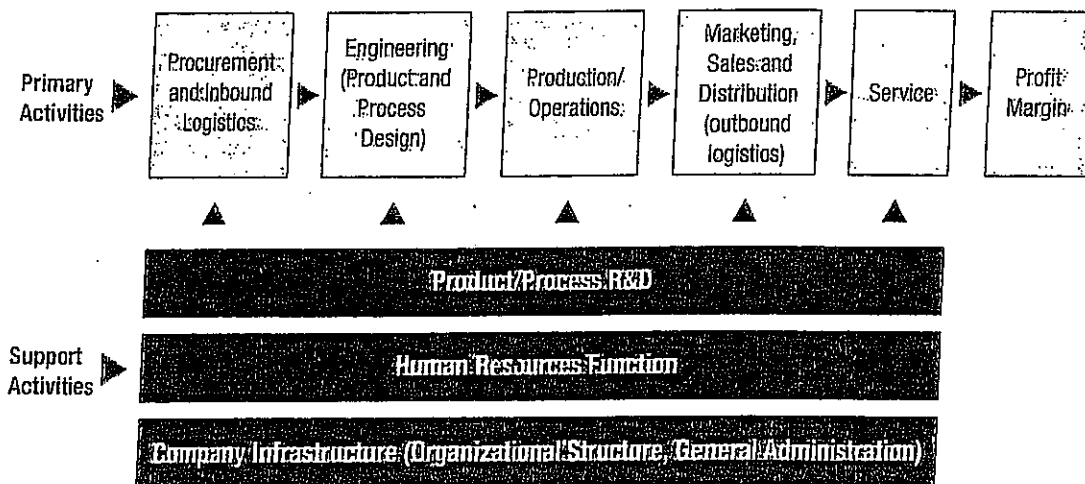
Term	Definition	Example (athletics)
Strategic capability	The ability to perform at the level required to survive and prosper. It is underpinned by the resources and competences of the organisation	Equipment and athletic ability suited to a chosen event
Threshold resources	The resources needed to meet customers' minimum requirements and therefore to continue to exist	A healthy body (for individuals) Medical facilities and practitioners Training venues and equipment Food supplements
Threshold competences	Activities and processes needed to meet customers' minimum requirements and therefore to continue to exist	Individual training regimes Physiotherapy/injury management Diet planning
Unique resources	Resources that underpin competitive advantage and are difficult for competitors to imitate or obtain	Exceptional heart and lungs Height or weight World-class coach
Core competences	Activities that underpin competitive advantage and are difficult for competitors to imitate or obtain	A combination of dedication, tenacity, time to train, demanding levels of competition and a will to win

## Value Chain

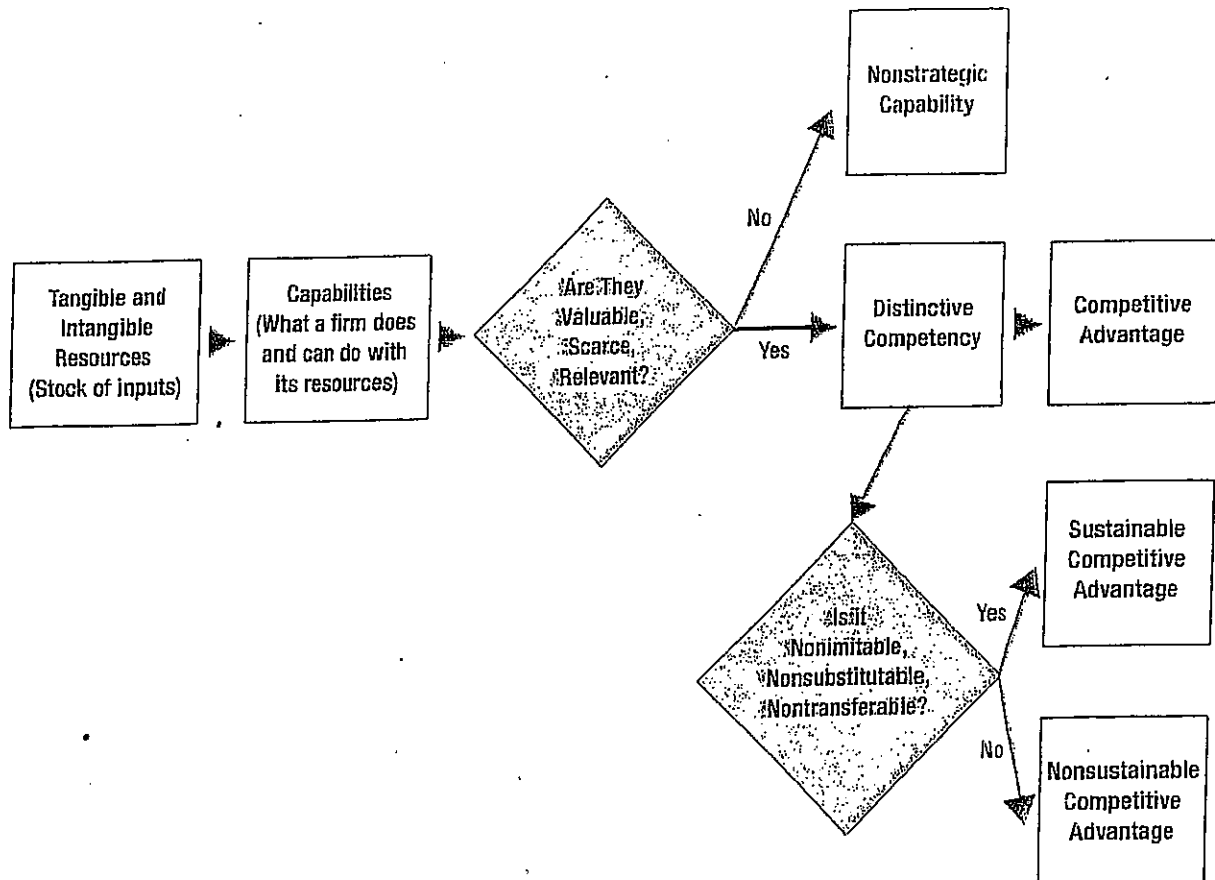


Source: From *Strategic Management: Concepts and Cases*, 13th Edition by J. Thompson and J. Strickland, p. 130. Copyright © 2003. Reprinted by permission of The McGraw-Hill Companies.

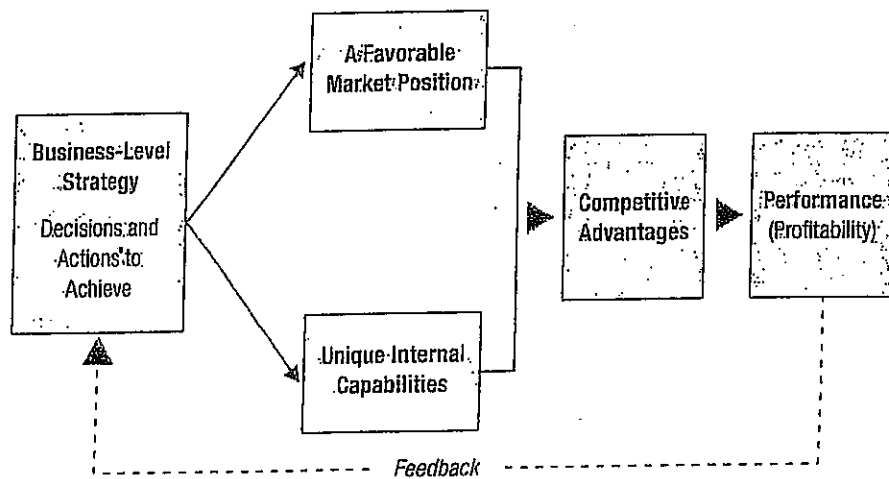
## Primary and Support Activities



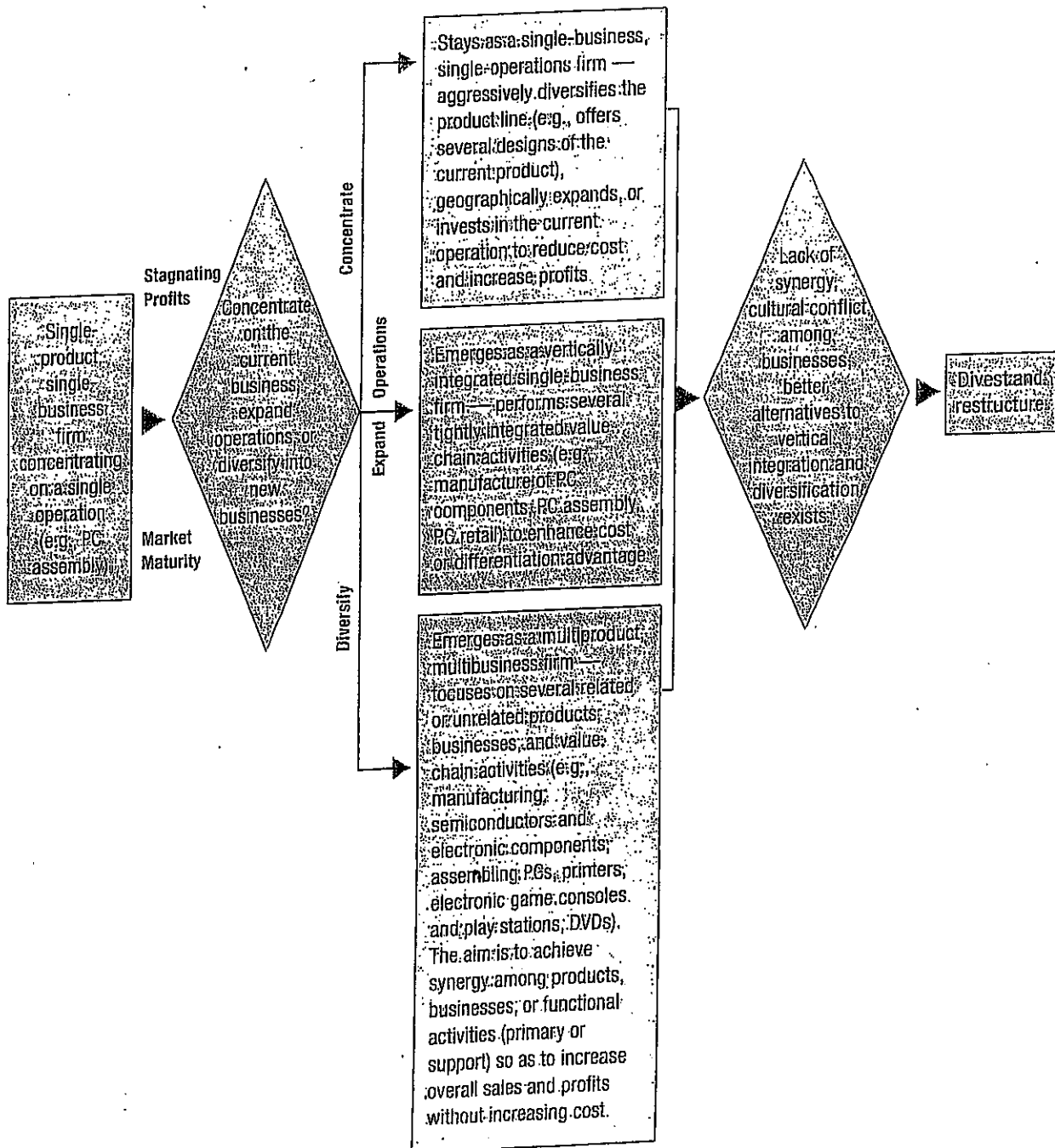
# Path Leading to Competitive Advantage: Resource-Based View



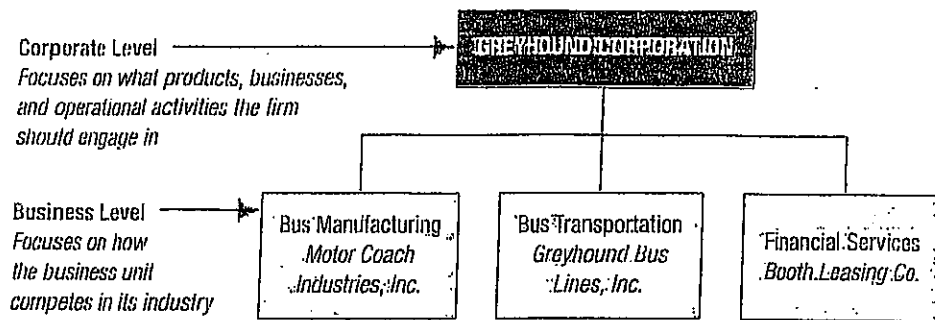
## How Business-Level Strategy Influences Performance



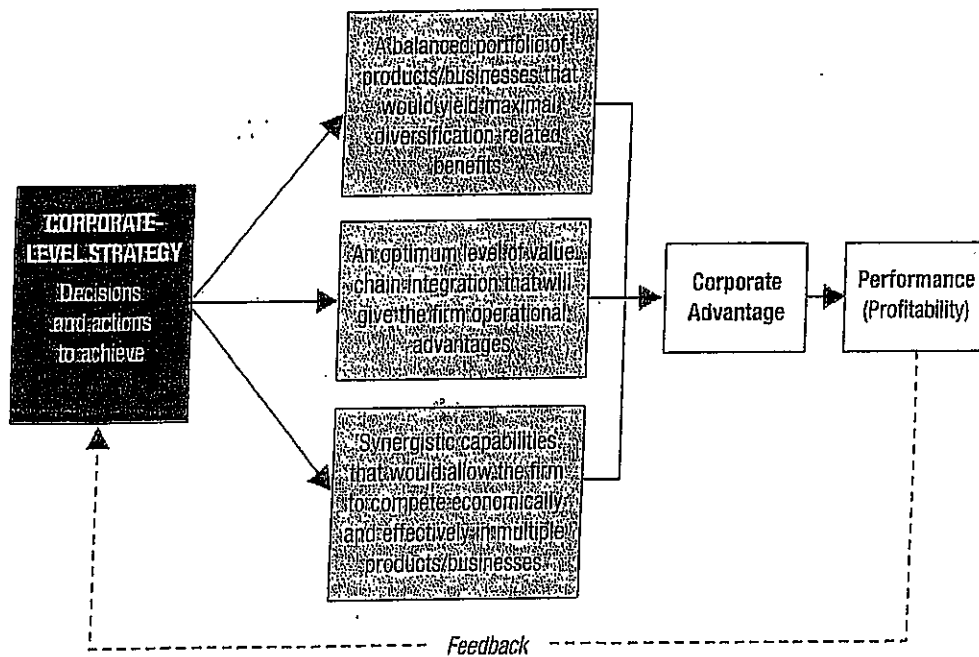
## How Corporate-Level Strategy Evolves for a Firm



## Greyhound Corporation in 1963



## How Corporate-Level Strategy Influences Performance

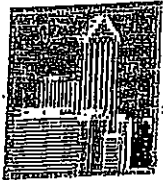




**THE DIFFERENCE BETWEEN TRADITIONAL COST ACCOUNTING AND ACTIVITY-BASED COST ACCOUNTING: A PURCHASING DEPARTMENT EXAMPLE**

Traditional Cost Accounting Categories in Purchasing Department Budget		Cost of Performing Specific Purchasing Department Activities Using Activity-Based Cost Accounting	
Wages and salaries	\$340,000	Evaluate supplier capabilities	\$100,300
Employee benefits	95,000	Process purchase orders	82,100
Supplies	21,500	Collaborate with suppliers on just-in-time deliveries	140,200
Travel	12,400	Share data with suppliers	59,550
Depreciation	19,000	Check quality of items purchased	94,100
Other fixed charges (office space, utilities)	112,000	Check incoming deliveries against purchase orders	48,450
Miscellaneous operating expenses	40,250	Resolve disputes	15,250
		Conduct internal administration	100,200
	\$640,150		\$640,150

Source: Adapted from information in Terence P. Paré, "A New Tool for Managing Costs," *Fortune*, June 14, 1993, pp. 124-29.



## Value Chain Costs for Companies in the Business of Recording and Distributing Music-CDs

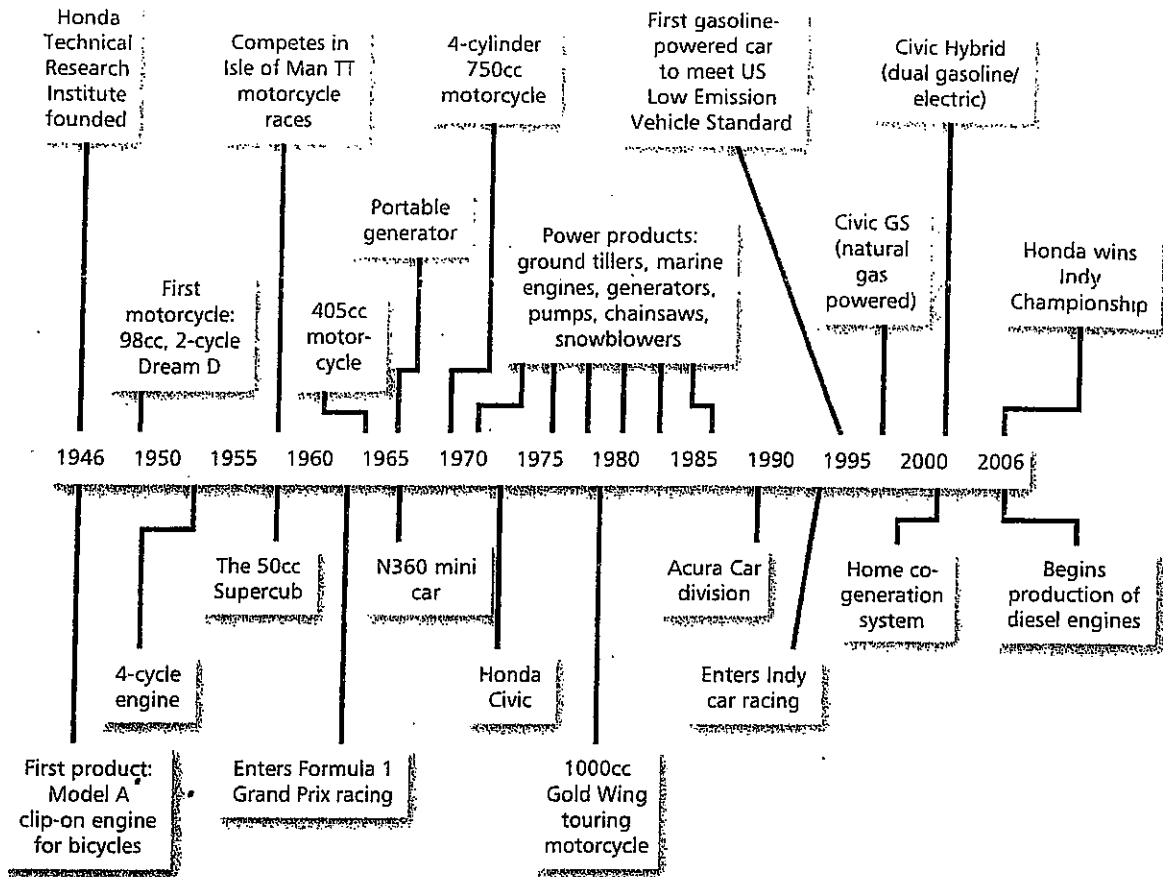
The table below presents the representative costs and markups associated with producing and distributing a music CD retailing for \$15.

		\$2.40
1. Record company direct production costs	\$0.75	
Artists and repertoire	1.65	
Pressing of CD and packaging		.99
2. Royalties		1.50
3. Record company marketing expenses		1.50
4. Record company overhead		6.39
5. Total record company costs		1.86
6. Record company's operating profit		8.25
7. Record company's selling price to distributor/wholesaler		1.50
8. Average wholesale distributor markup to cover distribution activities and profit margin		9.75
9. Average wholesale price charged to retailer		5.25
10. Average retail markup over wholesale cost		\$15.00
11. Average price to consumer at retail		

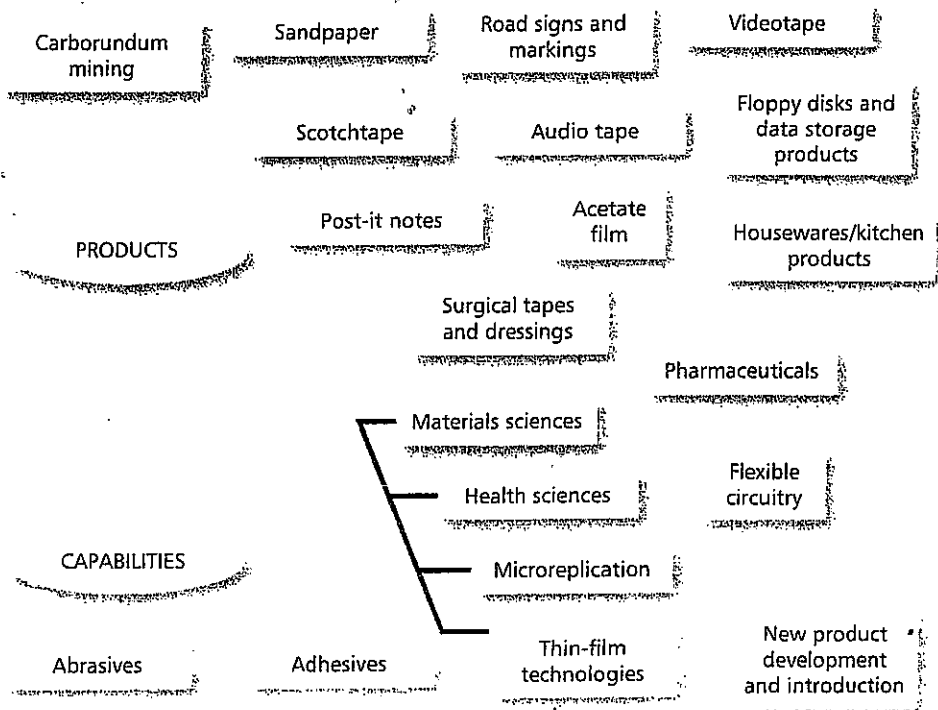
Source: Developed from information in "Fight the Power," a case study prepared by Adrian Aleyne, Babson College, 1999.



## Honda Motor Company: product development milestones

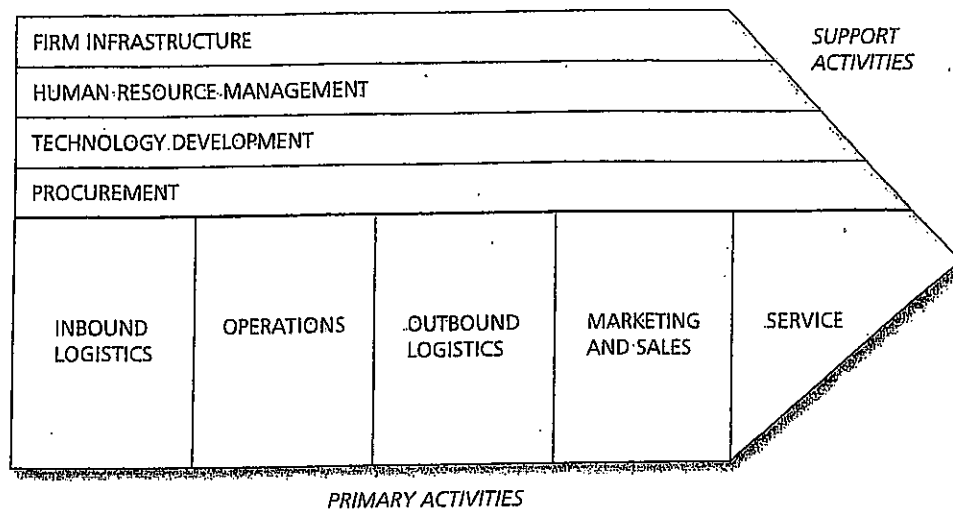


## The evolution of capabilities and products: 3M





### Porter's value chain

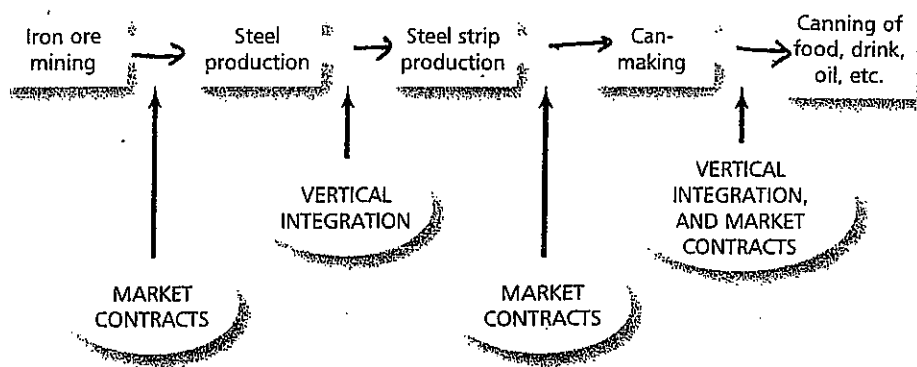


### A functional classification of organizational capabilities

Functional area	Capability	Exemplars
CORPORATE FUNCTIONS	• Financial control	Exxon Mobil, PepsiCo
	• Strategic management of multiple businesses	General Electric, Procter & Gamble
	• Strategic innovation	BP, Google
	• Multidivisional coordination	Unilever, Shell
	• Acquisition management	Cisco, Bank of America
	• International management	Shell, Citigroup
MANAGEMENT INFORMATION	• Comprehensive, integrated MIS network linked to managerial decision making	Wal-Mart, Capital One, Dell Computer
RESEARCH & DEVELOPMENT	• Research	IBM, Merck
	• Innovative new product development	3M, Apple
	• Fast-cycle new product development	Canon, Inditex (Zara)
OPERATIONS	• Efficiency in volume manufacturing	Briggs & Stratton, YKK
	• Continuous improvements in operations	Toyota, Harley-Davidson
	• Flexibility and speed of response	Four Seasons Hotels
PRODUCT DESIGN	• Design capability	Nokia, Apple Computer
MARKETING	• Brand management	P&G, Altria
	• Promoting reputation for quality	Johnson & Johnson
	• Responsiveness to market trends	MTV, L'Oreal
SALES AND DISTRIBUTION	• Effective sales promotion and execution	PepsiCo, Pfizer
	• Efficiency and speed of order processing	L. L. Bean, Dell Computer
	• Speed of distribution	Amazon.com
	• Quality and effectiveness of customer service	Singapore Airlines, Caterpillar



The value chain for steel cans

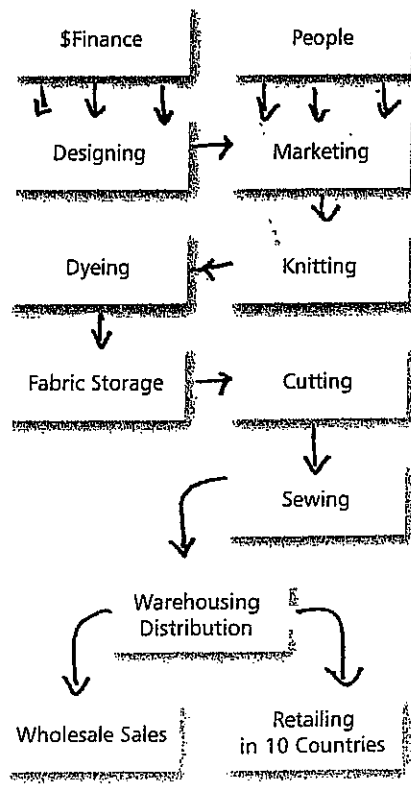


VERTICAL INTEGRATION AND THE SCOPE OF THE FIRM

An American Apparel advertisement

American Apparel<sup>®</sup> Made in Downtown LA  
Vertically Integrated Manufacturing  
[www.americanapparel.net](http://www.americanapparel.net)

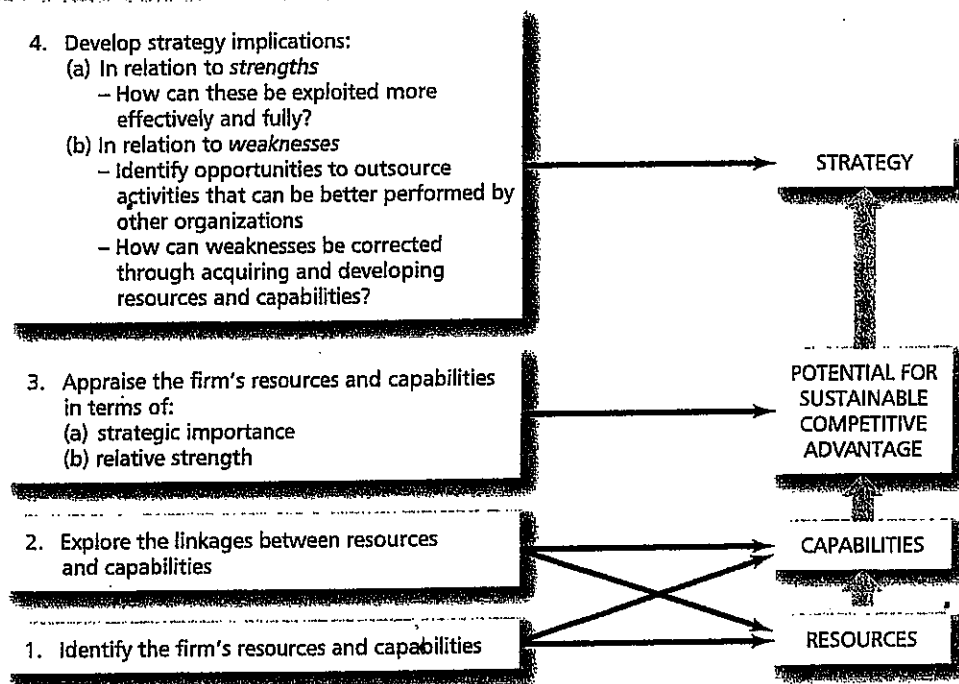
The downtown LA vertically integrated  
Paradigm by American Apparel.  
Now involving 5000 people.





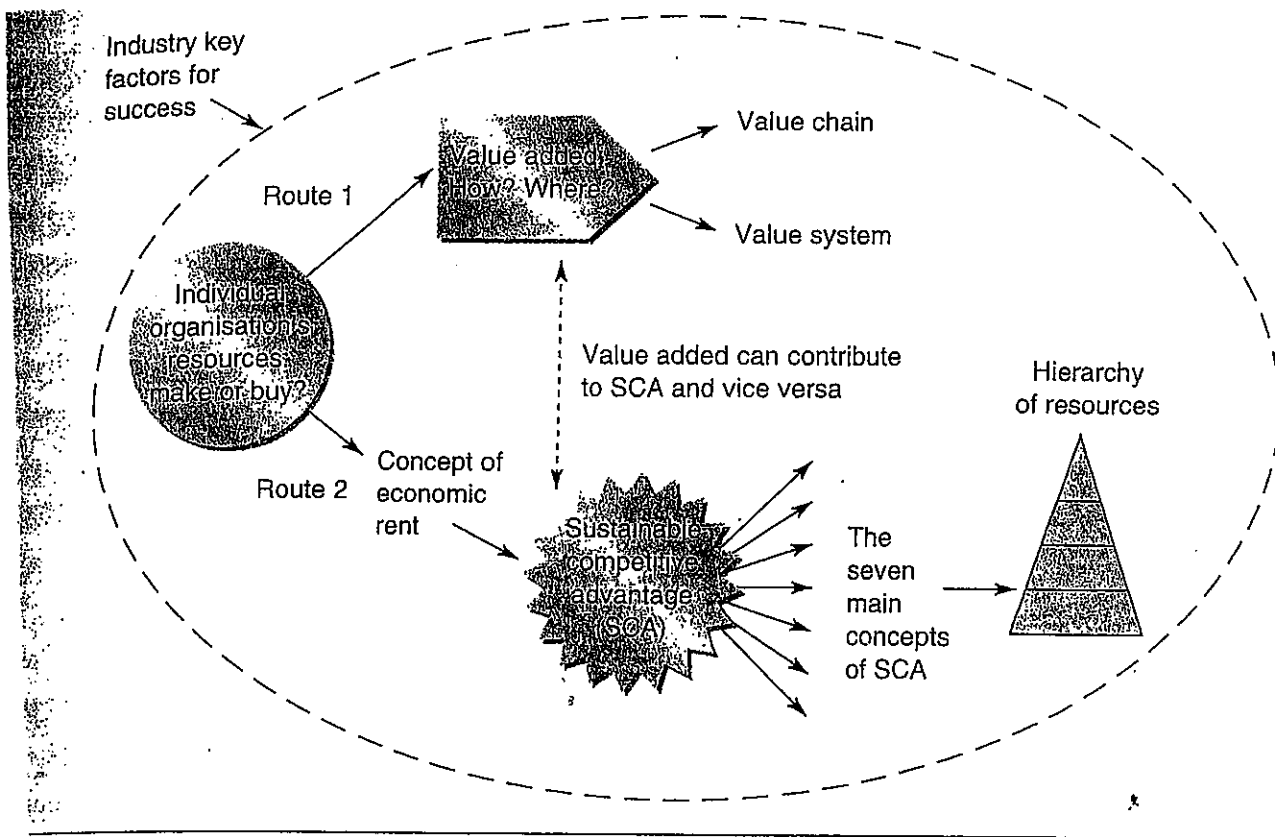


Summary: a framework for analyzing resources and capabilities

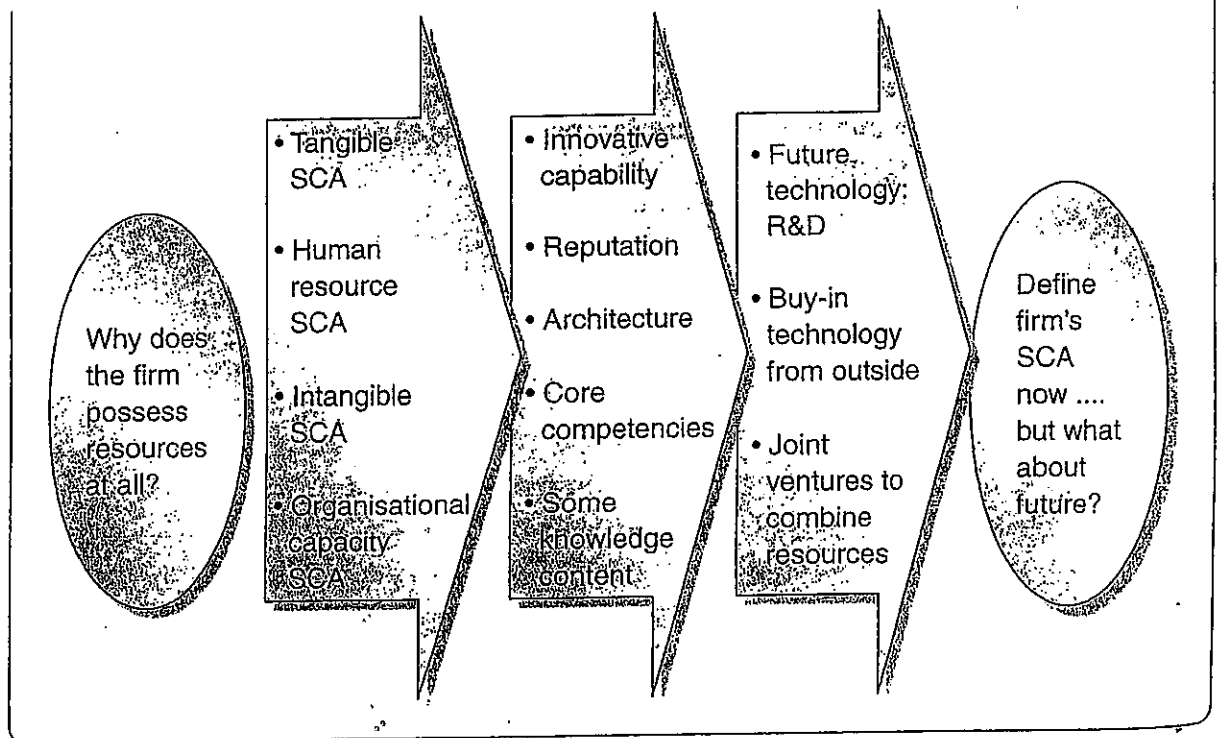




## Analysing resources



## Identifying the resources that deliver SCA



## DELIVERING CUSTOMER VALUE AND SATISFACTION

Customer value and satisfaction are important ingredients in the marketer's formula for success. But what does it take to produce and deliver customer value? To answer this, we will examine the concepts of a *value chain* and a *value delivery system*.

### VALUE CHAIN

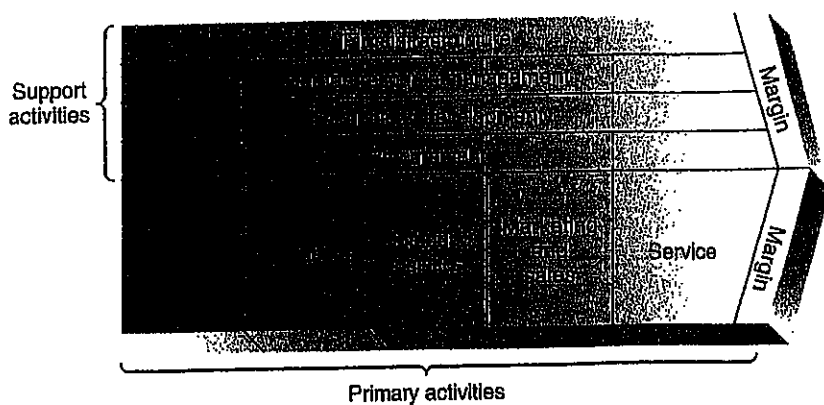
#### *Value chain*

A major tool for identifying ways to create more customer value.

Michael Porter proposed the *value chain* as the major tool for identifying ways to create more customer value (see Figure 18-2).<sup>5</sup> Every firm consists of a collection of activities performed to design, produce, market, deliver, and support the firm's products. The value chain breaks the firm into nine value-creating activities in an effort to understand the behavior of costs in the specific business and the potential sources of competitive differentiation. The nine value-creating activities include five primary activities and four support activities.

The primary activities involve the sequence of bringing materials into the business (inbound logistics), operating on them (operations), sending them

KOTLER, Philip & ARMSTRONG, Gary; Principles of Mktg, 12E, Pearson International Ed, 2008.



**FIGURE 18-2 The generic value chain**  
 Source: Michael E. Porter, *Competitive Advantage* (New York: Free Press, 1985), p. 37.

eral management, planning, finance, accounting, and legal and government affairs borne by all the primary and support activities.

Under the value-chain concept, the firm should examine its costs and performance in each value-creating activity to look for improvements. It also should estimate its competitors' costs and performances as benchmarks. To the extent that the firm can perform certain activities better than its competitors, it can achieve a competitive advantage.

The firm's success depends not only on how well each department performs its work, but also on how well the activities of various departments are coordinated. Too often, individual departments maximize their own interests rather than those of the total company and the customer. For example, a credit department might attempt to reduce bad debts by raising credit standards; meanwhile, salespeople get frustrated and customers must buy elsewhere. A distribution department might decide to save money by shipping goods by rail; meanwhile, the customer waits. In each case, individual departments have erected walls that impede the delivery of quality customer service.

To overcome this problem, companies should place more emphasis on the smooth management of *core business processes*, most of which involve inputs and cooperation from many functional departments. Among other things, these core business processes include the following:

- ◆ *Product development process*: all the activities involved in identifying, researching, and developing new products with speed, high quality, and reasonable cost.
- ◆ *Inventory management process*: all the activities involved in developing and managing the right inventory levels of raw materials, semifinished materials, and finished goods so that adequate supplies are available while avoiding the costs of high overstocks.
- ◆ *Order-to-payment process*: all the activities involved in receiving orders, approving them, shipping the goods on time, and collecting payment.
- ◆ *Customer service process*: all the activities involved in making it easy for customers to reach the right parties within the company to obtain service, answers, and resolutions of problems.

Successful companies develop superior capabilities in managing these and other core processes. In turn, mastering core business processes gives these companies a substantial competitive edge.<sup>6</sup> For example, one of Wal-Mart's great strengths is its superiority in handling the inventory management and order flow process. As individual Wal-Mart stores sell their goods, sales information flows not only to Wal-Mart's headquarters but to Wal-Mart's suppliers, who ship replacement goods to Wal-Mart stores almost as fast as the products move off the shelf.

### Value-delivery network

The network made up of the company, suppliers, distributors, and ultimately customers who "partner" with each other to improve the performance of the entire system.

tuned system delivers a high standard of what the company calls QSCV—quality, cleanliness, and value. McDonald's is effective only to the extent that it successfully works with its franchisees, suppliers, and others to jointly deliver exceptionally high customer value.

More companies today are partnering with the other members of the supply chain to improve the performance of the customer value-delivery network. For example, Toyota knows the importance of building close relationships with its suppliers. In fact, it includes the phrase "achieve supplier satisfaction" in its mission statement.

Achieving satisfying supplier relationships has been a cornerstone of Toyota's long-term success. U.S. competitors often alienate their suppliers through self-serving, heavy-handed dealings. "The [U.S. automakers] set annual cost-reduction targets for the parts they buy," says one supplier. "To realize those targets, they'll do anything. They've unleashed a reign of terror, and it gets worse every year." Says another supplier, "[Ford] seems to send its people to 'hate school' so that they learn how to hate suppliers." By contrast, in survey after survey, auto suppliers rate Toyota as their preferred customer. Rather than bullying suppliers, Toyota partners with them to help them to meet its very high expectations. It learns about their business needs, provides joint improvement activities, helps train their employees, gives daily performance feedback, and actively seeks out supplier concerns. Says one delighted supplier, "Toyota helped us dramatically improve our production system. We improved by making one component, and as we improved, [Toyota] rewarded us with more components. Toyota is our best customer."

■ Toyota partners with its suppliers and helps them meet its very high expectations. Creating satisfied suppliers helps Toyota produce lower-cost, higher-quality cars, which in turn results in more satisfied customers.

Such high supplier satisfaction means that Toyota can rely on suppliers to help it improve its own quality, reduce costs, and develop new products quickly. For example, when Toyota recently launched a program to reduce prices by 30 percent on parts that it would buy for its next generation of cars, suppliers didn't complain. Instead, they pitched in, trusting that Toyota would help them achieve the target reductions, in turn making them more competitive and profitable in the future. Creating satisfied suppliers helps Toyota to produce lower-cost, higher-quality cars, which in turn results in more satisfied customers.<sup>14</sup>

Increasingly in today's marketplace, competition no longer takes place between individual competitors. Rather, it takes place between the entire value-delivery networks of these competitors. Thus, Toyota's performance against Ford depends on the performance of Toyota's overall value-delivery network versus Ford's. Even if Toyota makes the best car in the marketplace, it might lose in the marketplace if Ford's dealer network provides more customer service and sales.

# ■ Planning Marketing: Partnering to Build Customer Relationships

The company's strategic plan establishes what kinds of businesses the company will operate in and its objectives for each. Then, within each business unit, more detailed planning takes place. The major functional departments in each unit—marketing, finance, accounting, purchasing, operations, information systems, human resources, and others—must work together to accomplish strategic objectives.

Marketing plays a key role in the company's strategic planning in several ways. First, marketing provides a guiding *philosophy*—the marketing concept—that suggests that company strategy should revolve around building profitable relationships with important consumer

groups. Second, marketing provides *inputs* to strategic planners by helping to identify attractive market opportunities and by assessing the firm's potential to take advantage of them. Finally, within individual business units, marketing designs *strategies* for reaching the unit's objectives. Once the unit's objectives are set, marketing's task is to help carry them out profitably.

Customer value and satisfaction are important ingredients in the marketer's formula for success. However, as we noted in Chapter 1, marketers alone cannot produce superior value for customers. Although it plays a leading role, marketing can be only a partner in attracting, keeping, and growing customers. In addition to *customer relationship management*, marketers must also practice *partner relationship management*. They must work closely with partners in other company departments to form an effective *value chain* that serves the customer. Moreover, they must partner effectively with other companies in the marketing system to form a competitively superior *value-delivery network*. We now take a closer look at the concepts of a company value chain and value-delivery network.

## Partnering with Other Company Departments

### Value chain

The series of departments that carry out value-creating activities to design, produce, market, deliver, and support a firm's products.

Each company department can be thought of as a link in the company's *value chain*.<sup>11</sup> That is, each department carries out value-creating activities to design, produce, market, deliver, and support the firm's products. The firm's success depends not only on how well each department performs its work but also on how well the activities of various departments are coordinated.

For example, Wal-Mart's goal is to create customer value and satisfaction by providing shoppers with the products they want at the lowest possible prices. Marketers at Wal-Mart play an important role. They learn what customers need and stock the stores' shelves with the

desired products at unbeatable low prices. They prepare advertising and merchandising programs and assist shoppers with customer service. Through these and other activities, Wal-Mart's marketers help deliver value to customers.

However, the marketing department needs help from the company's other departments. Wal-Mart's ability to offer the right products at low prices depends on the purchasing department's skill in developing the needed suppliers and buying from them at low cost. Wal-Mart's information technology department must provide fast and accurate information about which products are selling in each store. And its operations people must provide effective, low-cost merchandise handling.

A company's value chain is only as strong as its weakest link. Success depends on how well each department performs its work of adding customer value and on how well the activities of various departments are coordinated. At Wal-Mart, if purchasing can't wring the lowest prices from suppliers, or if opera-

tions can't distribute merchandise at the lowest costs, then marketing can't deliver on its promise of lowest prices.



■ The value chain: Wal-Mart's ability to offer the right products at low prices depends on the contributions of people in all of the company's departments—marketing, purchasing, information systems, and operations.

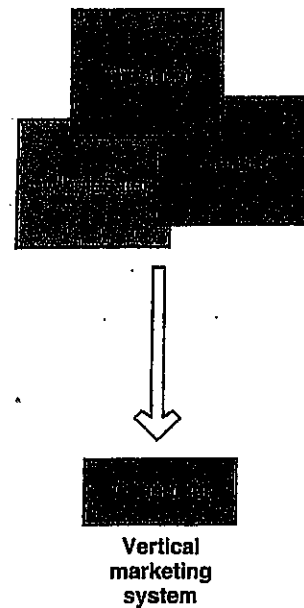
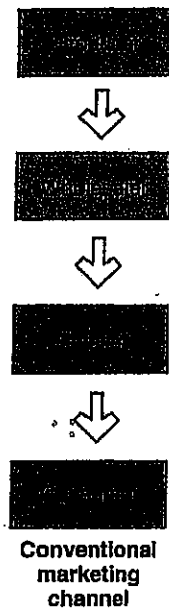


Ideally, then, a company's different functions should work in harmony to produce value for consumers. But, in practice, departmental relations are full of conflicts and misunderstandings. The marketing department takes the consumer's point of view. But when marketing tries to develop customer satisfaction, it can cause other departments to do a poorer job *in their terms*. Marketing department actions can increase purchasing costs, disrupt production schedules, increase inventories, and create budget headaches. Thus, the other departments may resist the marketing department's efforts.

Yet marketers must find ways to get all departments to "think consumer" and to develop a smoothly functioning value chain. Marketing managers need to work closely with managers of other functions to develop a system of functional plans under which the different departments can work together to accomplish the company's overall strategic objectives. The idea is to "maximize the customer experience across the organization and its various customer touch points," says a marketing consultant. Jack Welch, GE's highly regarded former CEO, told his employees: "Companies can't give job security. Only customers can!" He

emphasized that all GE people, regardless of their department, have an impact on customer satisfaction and retention. His message: "If you are not thinking customer, you are not thinking."<sup>12</sup>

Comparison of conventional distribution channel with vertical marketing system



## VALUE DELIVERY SYSTEM

### Customer value delivery system

The system made up of the value chains of the company and its suppliers, distributors, and ultimately customers who work together to deliver value to customers.

In its search for competitive advantage, the firm needs to look beyond its own value chain and into the value chains of its suppliers and distributors, and ultimately, its customers. More companies today are "partnering" with the other members of the supply chain to improve the performance of the customer value delivery system. For example, Campbell Soup operates a qualified supplier program in which it sets high standards for suppliers and chooses only the few who are willing to meet its demanding requirements for quality, on-time delivery, and continuous improvement. Campbell then assigns its own experts to work with suppliers to constantly improve their joint performance.

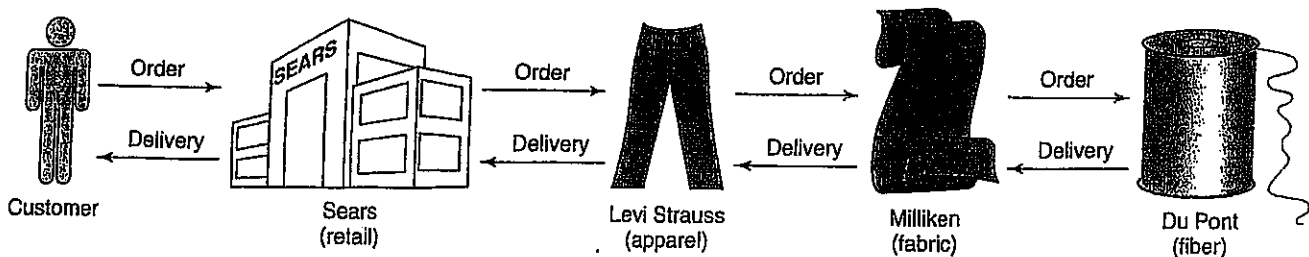
Similarly, Honda has designed a program for working closely with its suppliers to help them reduce their costs and improve quality. For example, when Honda chose Donnelly Corporation to supply all of the mirrors for its U.S.-made cars, it sent engineers swarming over Donnelly's plants, looking for ways to improve its products and operations. This helped Donnelly reduce its costs by 2 percent in the first year. As a result of its improved performance, Donnelly's sales to Honda have grown from \$5 million annually to more than \$60 million in less than 10 years. In turn, Honda has gained an efficient, low-cost supplier of quality components. And as a result of Honda's partnerships with Donnelly and other suppliers, Honda customers benefit from lower cost, higher quality cars.<sup>7</sup>

An excellent value delivery system connects jeans maker Levi Strauss with its suppliers and distributors (see Figure 18-3). One of Levi's major retailers is Sears. Every night, through electronic data interchange (EDI), Levi's learns the sizes and styles of its blue jeans that sold through Sears and other major outlets. Levi's then electronically orders more fabric from the Milliken Company, its fabric supplier. In turn, Milliken relays an order for more fiber to Du Pont, the fiber supplier. In this way, the partners in the supply chain use the most current sales information to manufacture what is selling, rather than to manufacture based on potentially inaccurate sales forecasts. This is known as a *quick response* system, in which goods are pulled by demand, rather than pushed by supply.

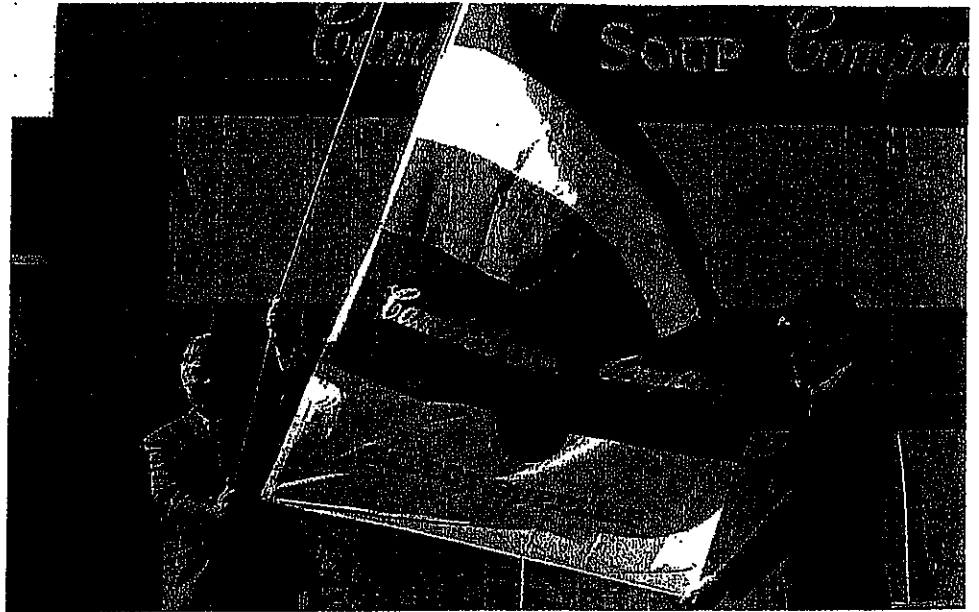
As companies struggle to become more competitive, they are turning, ironically, to greater cooperation. Companies used to view their suppliers and distributors as cost centers, and in some cases, as adversaries. Today, however, they are selecting partners carefully and working out mutually profitable strategies. Increasingly in today's marketplace, competition no longer takes place between individual competitors. Rather, it takes place between the value delivery systems created by these competitors. Thus, if Levi Strauss has built a more potent value delivery system than Wrangler or another competitor, it will win more market share and profit.

Therefore, marketing can no longer be thought of as only a selling department. That view of marketing would give it responsibility only for formulating a promotion-oriented marketing mix, without much say about product features, costs, and other important elements. Under the new view, marketing is responsi-

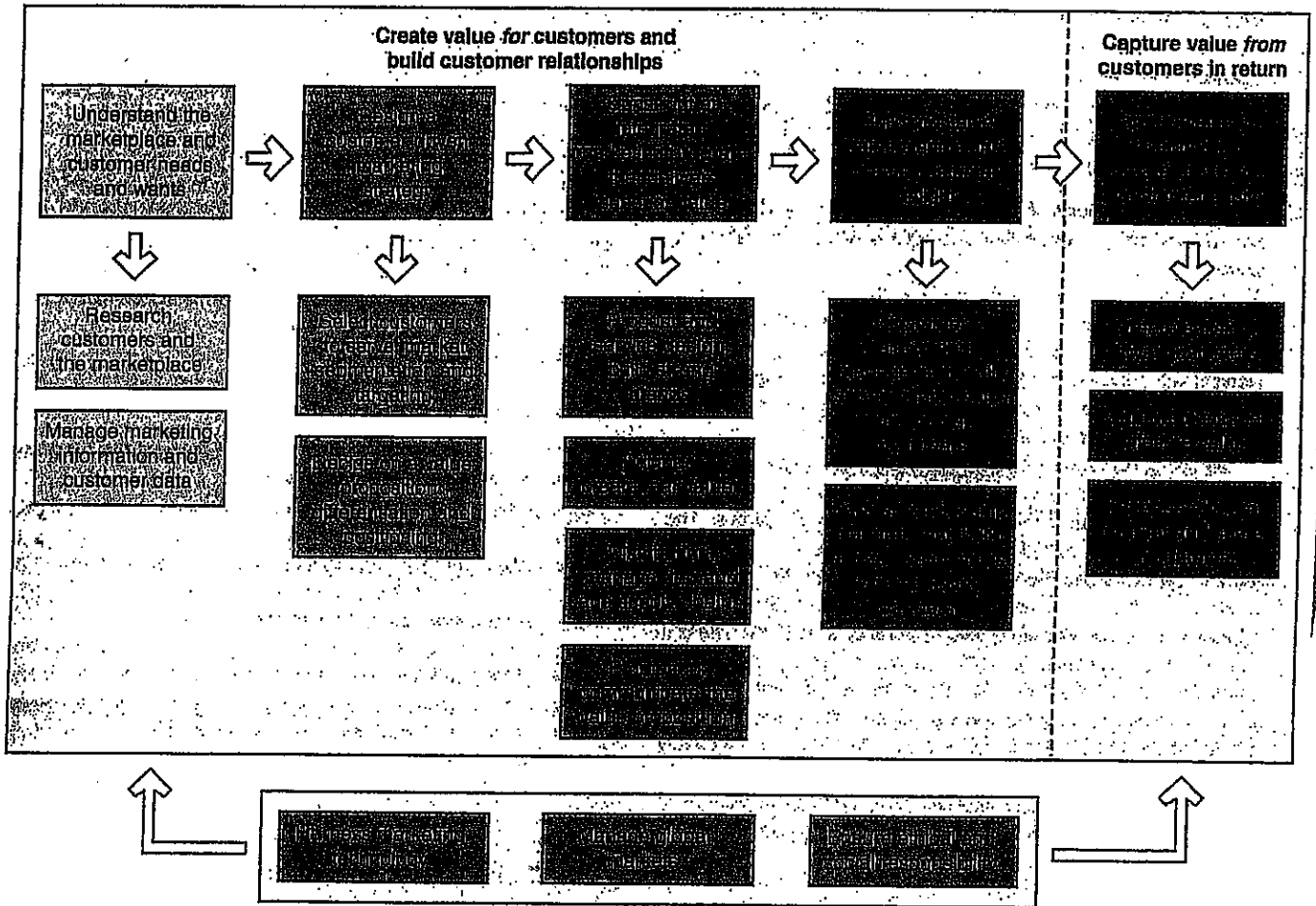
FIGURE 18-3 Levi Strauss's value delivery system



*Customer value delivery system: Campbell operates a qualified supplier program in which it chooses only the few suppliers who can meet its demanding quality requirements. Campbell's experts then work with suppliers to constantly improve their joint performance.*



ble for designing and managing a superior value delivery system to reach target customer segments. Today's marketing managers must think not only about selling today's products but also about how to stimulate the development of improved products, how to work actively with other departments in managing core business processes, and how to build better external partnerships.<sup>8</sup>



An expanded model of the marketing process

## Value Chain Analysis (VCA)

According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors', suppliers', and distributors' value chains.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time.

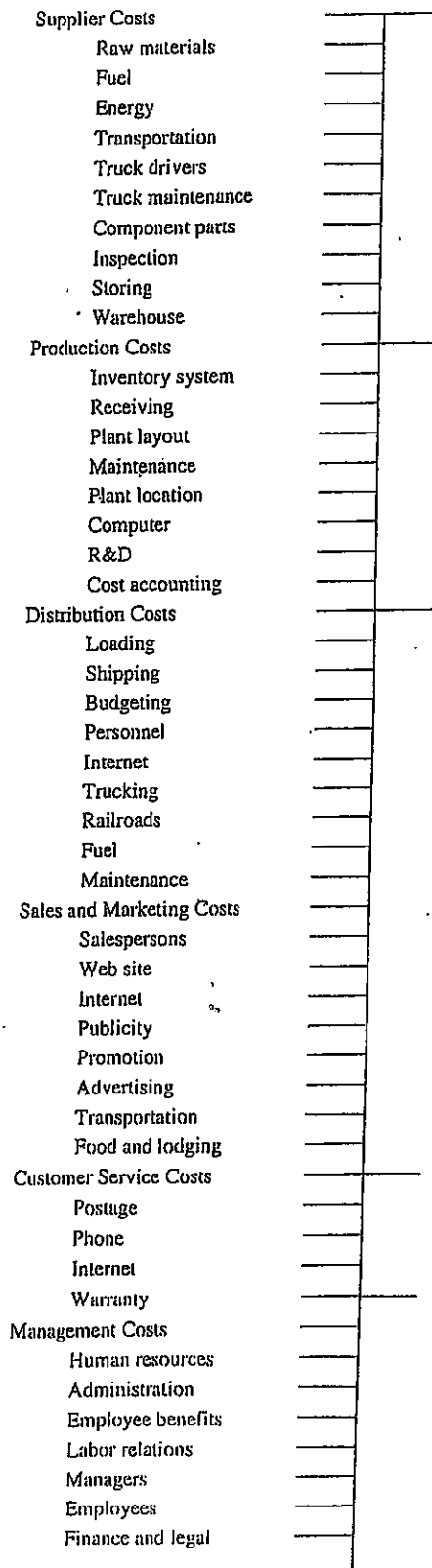
Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders. Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence.

When a major competitor or new market entrant offers products or services at very low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus value chain analysis can be critically important for a firm in monitoring whether its prices and costs are competitive. An example value chain is illustrated in Figure 4-3. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur relative to the value chain of rival firms.

Value chains differ immensely across industries and firms. Whereas a paper products company, such as Stone Container, would include on its value chain timber farming, logging, pulp mills, and papermaking, a computer company such as Hewlett-Packard would

## FIGURE A.1

### An Example Value Chain for a Typical Manufacturing Firm



## Using the Value Chain to Analyze Costs

To analyze costs and make recommendations for building cost advantage, the company or even the business unit is too big a level for us to work at. As we saw in Chapter 5, every business may be viewed as a chain of activities. In most value chains each activity has a distinct cost structure determined by different cost drivers. Analyzing costs requires disaggregating the firm's value chain to identify:

- The relative importance of each activity with respect to total cost.
- The cost drivers for each activity and the comparative efficiency with which the firm performs each activity.
- How costs in one activity influence costs in another.
- Which activities should be undertaken within the firm and which activities should be outsourced.

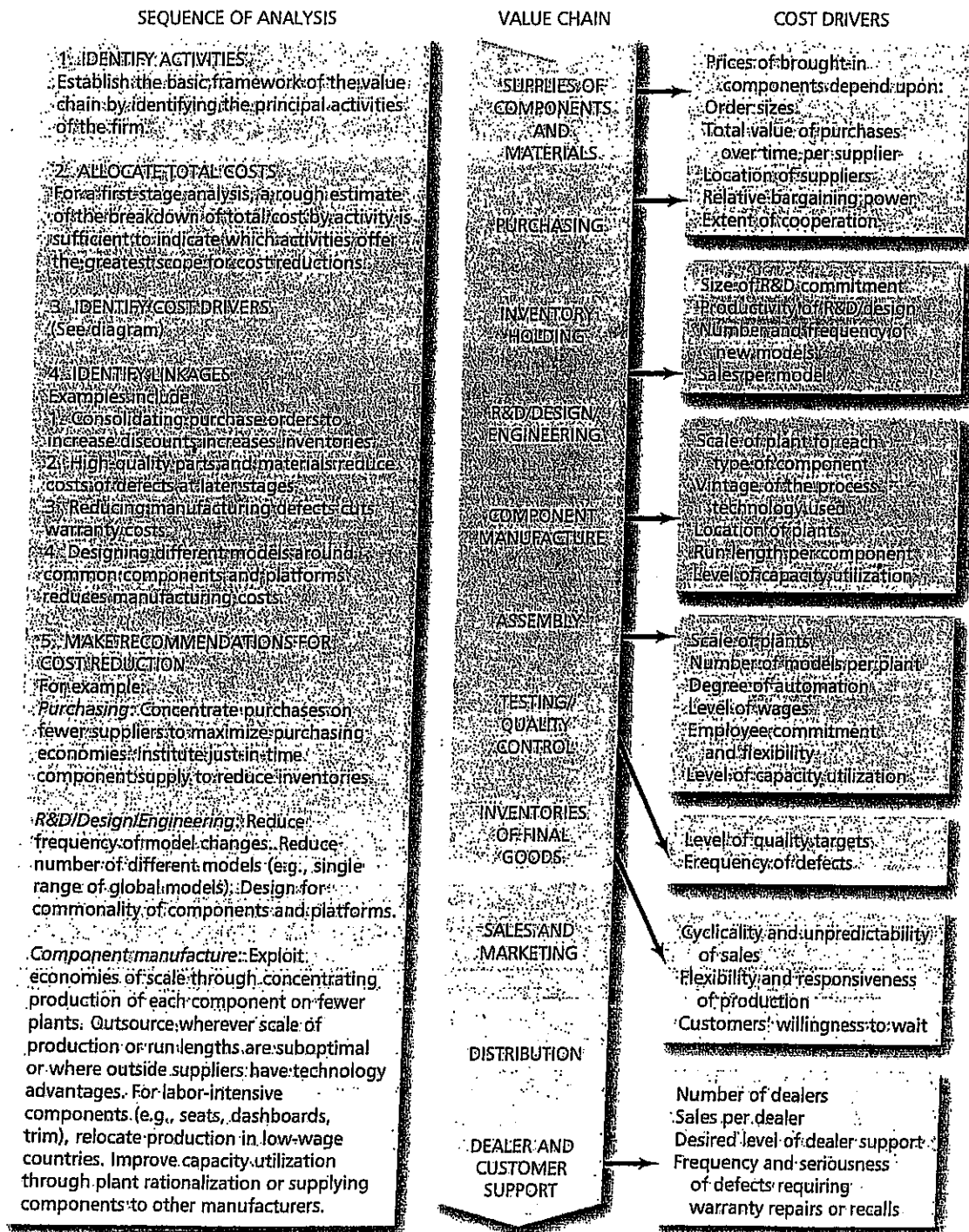
### *The Principal Stages of Value Chain Analysis*

A value chain analysis of a firm's cost position comprises the following stages:

- 1 *Disaggregate the firm into separate activities.* Determining the appropriate value chain activities is a matter of judgment. It requires understanding the chain of processes involved in the transformation of inputs into output and its delivery to the customer. Very often, the firm's own divisional and departmental structure is a useful guide. Key considerations are:
  - the separateness of one activity from another;
  - the importance of an activity;
  - the dissimilarity of activities in terms of cost drivers;
  - the extent to which there are differences in the way competitors perform the particular activity.
- 2 *Establish the relative importance of different activities in the total cost of the product.* Our analysis needs to focus on the activities that are the major sources of cost. In disaggregating costs, Michael Porter suggests the detailed assignment of operating costs and assets to each value activity. Though the adoption of activity-based costing has made such cost data more available, detailed cost allocation can be a major exercise.<sup>19</sup> Even without such detailed cost data, it is usually possible to identify the critical activities, establish which activities are performed relatively efficiently or inefficiently, identify cost drivers, and offer recommendations.
- 3 *Compare costs by activity.* To establish which activities the firm performs relatively efficiently and which it does not, benchmark unit costs for each activity against those of competitors.
- 4 *Identify cost drivers.* For each activity, what factors determine the level of cost relative to other firms? For some activities, cost drivers are evident simply from the nature of the activity and the composition of costs. For capital-intensive activities such as the operation of a body press in an auto plant, the principal factors are likely to be capital equipment costs, weekly production volume, and downtime between changes of dies. For labor-intensive assembly activities, critical issues are wage rates, speed of work, and defect rates.
- 5 *Identify linkages.* The costs of one activity may be determined, in part, by the way in which other activities are performed. Xerox discovered that its high service costs relative to competitors reflected the complexity of design of its copiers, which required 30 different interrelated adjustments.
- 6 *Identify opportunities for reducing costs.* By identifying areas of comparative inefficiency and the cost drivers for each, opportunities for cost reduction become evident. For example:
  - If scale economies are a key cost driver, can volume be increased? One feature of Caterpillar's cost-reduction strategy was to broaden its model range and begin selling diesel engines to other vehicle manufacturers in order to expand its sales base.
  - Where wage costs are the issue, can wages be reduced either directly or by relocating production?
  - If a certain activity cannot be performed efficiently within the firm, can it be outsourced?

Figure 11.7 shows how the application of the value chain to automobile manufacture can yield suggestions for possible cost reductions.

Using the value chain in cost analysis: an automobile manufacturer





## Bringing It All Together: The Value Chain in Differentiation Analysis

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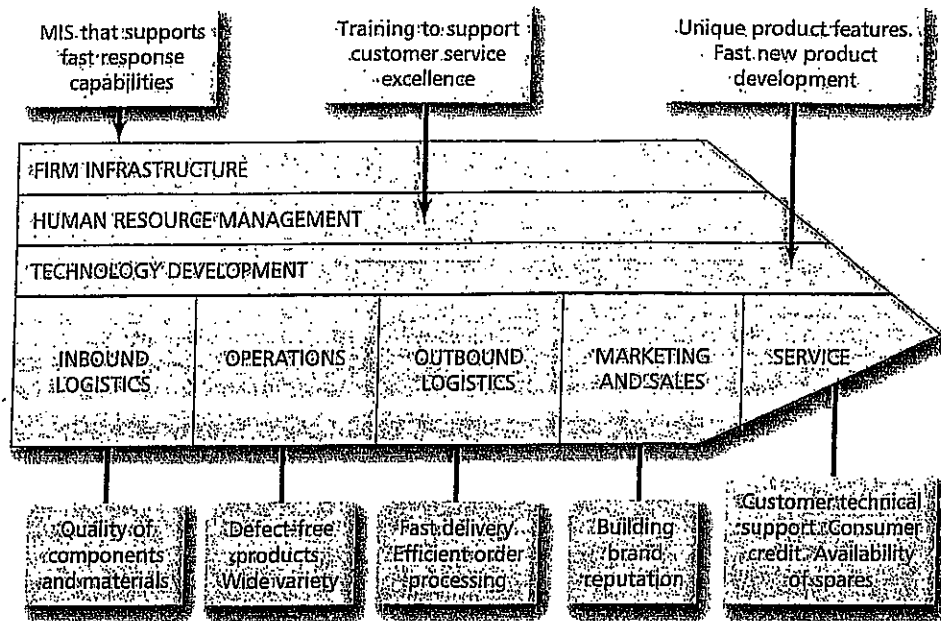
There is little point in identifying the product attributes that customers value most if the firm is incapable of supplying those attributes. Similarly, there is little purpose in identifying a firm's ability to supply certain elements of uniqueness if these are not valued by customers. The key to successful differentiation is matching the firm's capacity for creating differentiation to the attributes that customers value most. For this purpose, the value chain provides a particularly useful framework. Let's begin with the case of a producer good, i.e., one that is supplied by one firm to another.

### *Value Chain Analysis of Producer Goods*

Using the value chain to identify opportunities for differentiation advantage involves four principal stages:

- 1 *Construct a value chain for the firm and the customer.* It may be useful to consider not just the immediate customer, but also firms further downstream in the value chain. If the firm supplies different types of customers – for example, a steel company may supply steel strip to automobile manufacturers and white goods producers – draw separate value chains for each of the main categories of customer.
- 2 *Identify the drivers of uniqueness in each activity.* Assess the firm's potential for differentiating its product by examining each activity in the firm's value chain and identifying the variables and actions through which the firm can achieve uniqueness in relation to competitors' offerings. Figure 9.5 identifies sources of differentiation within Porter's generic value chain.
- 3 *Select the most promising differentiation variables for the firm.* Among the numerous drivers of uniqueness that we can identify within the firm, which one should be selected as the primary basis for the firm's differentiation strategy? On the supply side, there are three important considerations.
  - First, we must establish where the firm has greater potential for differentiating from, or can differentiate at lower cost than, rivals. This requires some analysis of the firm's internal strengths in terms of resources and capabilities.

Using the value chain to identify differentiation potential on the supply side



- Second, to identify the most promising aspects of differentiation, we also need to identify linkages among activities, since some differentiation variables may involve interaction among several activities. Thus, product reliability is likely to be the outcome of several linked activities: monitoring purchases of inputs from suppliers, the skill and motivation of production workers, and quality control and product testing.
  - Third, the ease with which different types of uniqueness can be sustained must be considered. The more differentiation is based on resources specific to the firm or skills that involve the complex coordination of a large number of individuals, the more difficult it will be for a competitor to imitate the particular source of differentiation. Thus, offering business-class passengers wider seats and more legroom is an easily imitated source of differentiation. Achieving high levels of punctuality represents a more sustainable source of differentiation.
- 4 *Locate linkages between the value chain of the firm and that of the buyer.*
- The objective of differentiation is to yield a price premium for the firm. This requires that the firm's differentiation creates value for the customer. Creating value for customers requires either that the firm lowers customers' costs, or that customers' own product differentiation is facilitated. Thus, by reorganizing its product distribution around quick response technologies, Procter & Gamble has radically reduced distribution time and increased delivery reliability. This permits retailers to reduce costs of inventory while simultaneously increasing their reliability to shoppers through lowering the risk of stockouts. To identify the means by which a firm can create value for its customers it must locate the linkages between differentiation of its own activities and cost reduction and differentiation within the customer's activities. Analysis of these linkages can also evaluate the potential profitability of differentiation. The value differentiation created for the customer represents the maximum price premium the customer will pay. If the provision of just-in-time delivery by a component supplier costs an additional \$1,000 a month but saves an automobile company \$6,000 a month in reduced inventory, warehousing, and handling costs, then it should be possible for the component manufacturer to obtain a price premium that easily exceeds the costs of the differentiation.

## STRATEGY CAPSTONE 9-3

### Analyzing Differentiation Opportunities for a Manufacturer of Metal Containers

The metal container industry is a highly competitive, low-growth, low-profit industry. Cans lack much potential for differentiation and buyers (especially beverage and food canning companies) are very powerful. Clearly, cost efficiency is essential, but are there also opportunities for differentiation advantage? A value chain analysis can help a metal can manufacturer identify profitable opportunities for differentiation.

**STAGE 1:** Construct a value chain for firm and customers. The principal activities of the can manufacturer and its customers are shown in the diagram below.

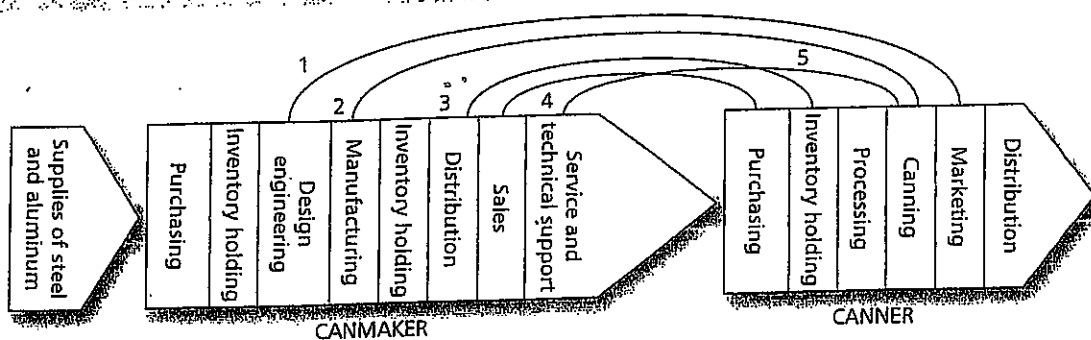
**STAGE 2:** Identify the drivers of uniqueness. For each of the canmaking activities it is possible to suggest several possible differentiation variables. Examples are shown on the diagram.

**STAGE 3:** Select key variables. To select the most promising differentiation

variables, the company's internal strengths must be considered. If the firm has strong technical capabilities, then it might design and manufacture products to meet difficult technical and design specifications, and provide sophisticated technical services to customers. If its logistics capabilities are strong, it might offer fast and reliable delivery, possibly extended to electronic data interchange with customers.

**STAGE 4:** Identify linkages. To determine differentiation likely to create value for the customer, identify linkages between the canmaker's potential for differentiation and the potential for reducing cost or enhancing differentiation within the customer's value chain. The diagram identifies five such linkages.

Identifying differentiation opportunities through linking the value chains of the firm and its customers: can manufacture



1. Distinctive can designs support canners' own marketing activities.
2. High manufacturing tolerances minimize breakdowns on customers' canning lines.
3. Frequent, punctual deliveries enable canners to minimize inventories.
4. Efficient order processing system reduces canners' ordering costs.
5. Speedy, competent technical support increases capacity utilization of canning lines.



## Putting Resource and Capability Analysis to Work: A Practical Guide

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We have covered the principal concepts and frameworks for analyzing resources and capabilities. How do we put this analysis into practice? Let me offer a simple, step-by-step approach to how a company can appraise its resources and capabilities and then use the appraisal to guide strategy formulation.

### *Step 1 Identify the Key Resources and Capabilities*

To draw up a list of the firm's resources and capabilities, we can begin from outside or inside the firm. From an external focus, we begin with key success factors (see Chapter 3). What factors determine why some firms in an industry are more successful than others and on what resources and capabilities are these success factors based? Suppose we are evaluating the resources and capabilities of Volkswagen AG, the German-based automobile manufacturer. We can start with key success factors in the world automobile industry: low-cost production, attractively designed new models embodying the latest technologies, and the financial strength to weather the cyclical-ity and heavy investment requirements of the industry. What capabilities and resources do these key success factors imply? They would include manufacturing capabilities, new product development capability, effective supply chain management, global distribution, brand strength, scale-efficient plants with up-to-date capital equipment, a strong balance sheet, and so on. To organize and categorize these various resources and capabilities, it is helpful to switch to the inside of VW and look at the company's value chain, identifying the sequence of activities from new product development to purchasing, to supply chain management, to component manufacture, assembly, and right the way through to dealership support and after-sales service. We can then look at the resources that underpin the capabilities at each stage of the value chain. Table 5.4 lists VW's principal resources and capabilities.

### *Step 2 Appraising Resources and Capabilities*

Resources and capabilities need to be appraised against two key criteria. First is their *importance*: which resources and capabilities are most important in conferring sustainable competitive advantage? Second, where are our strengths and weaknesses as compared with competitors?

**Assessing Importance** The temptation in assessing which resources and capabilities are most important is to concentrate on customer choice criteria. What we must bear in mind, however, is that our ultimate objective is not to attract customers, but to make superior profit through establishing a sustainable competitive advantage. For this purpose we need to look beyond customer choice to the underlying strategic characteristics of resources and capabilities. To do this we need to look at the set of appraisal criteria outlined in the previous section on "Appraising Resources and Capabilities." In the case of VW, many resources and capabilities are essential to compete in the business, but several of them are not scarce (for example, total quality management capability and technologically advanced assembly plants have become widely diffused within the industry), while others (such as IT capability and design capability) are outsourced to external providers – either way, they are "needed to play" but not "needed to win." On the other hand, resources such as brand strength and a global distribution network, and capabilities such as fast-cycle new product development and global logistics capability, cannot be easily acquired or internally developed – they are critical to establishing and sustaining advantage.

**Assessing Relative Strengths** Objectively appraising the comparative strengths and weaknesses of a company's resources and capabilities relative to competitors is difficult. In assessing their own competencies, organizations frequently fall victim to past glories, hopes for the future, and their own wishful thinking. The tendency toward hubris among companies – and their senior managers – means that business success often sows the seeds of its own destruction.<sup>31</sup> Among the failed industrial companies in America and Europe are many whose former success blinded them to their stagnating capabilities and declining competitiveness: examples include the cutlery producers of Sheffield, England and the integrated steel giants of the United States.

To identify and appraise a company's capabilities, managers must look both inside and outside. Internal discussion can be valuable in sharing insights and evidence and building consensus regarding the organization's resource and capability profile. The evidence of history can be particularly revealing in reviewing instances where the company has performed well and those where it has performed poorly: do any patterns appear?

Finally, to move the analysis from the subjective to the objective level, *benchmarking* is a powerful tool for quantitative assessment of performance relative to that of competitors. Benchmarking is "the process of identifying, understanding, and adapting outstanding practices from organizations anywhere in the world to help your organization improve its performance."<sup>32</sup> Benchmarking offers a systematic framework and methodology for identifying particular functions and processes and then for comparing their performance with other companies. Strategy Capsule 5.4 offers some examples. As McKinsey & Co. has shown, performance difference between top-performing and average-performing companies in most activities tends to be wide.<sup>33</sup>

Ultimately, appraising resources and capabilities is not about data, it's about insight and understanding. Every organization has some activity where it excels or has the potential to excel. For Federal Express, it is a system that guarantees next-day delivery anywhere within the United States. For BMW it is the ability to integrate world-class engineering with design excellence and highly effective marketing. For McDonald's, it is the ability to supply millions of hamburgers from thousands of outlets throughout the world, with remarkable uniformity of quality, customer service, and hygiene. For General Electric, it is a system of corporate management that reconciles coordination, innovation, flexibility, and financial discipline in one of the world's largest and most diversified corporations. All these companies are examples of highly successful enterprises. One reason why they are successful is that they have recognized what they can do well and have based their strategies on their strengths. For poor-performing companies, the problem is not necessarily an absence of distinctive capabilities, but a failure to recognize what they are and to deploy them effectively.

## Examining the Value-Creating Potential of Support Activities

### Procurement

Activities completed to purchase the inputs needed to produce a firm's products. Purchased inputs include items fully consumed during the manufacture of products (e.g., raw materials and supplies, as well as fixed assets—machinery, laboratory equipment, office equipment, and buildings).

### Technological Development

Activities completed to improve a firm's product and the processes used to manufacture it. Technological development takes many forms, such as process equipment, basic research and product design, and servicing procedures.

### Human Resource Management

Activities involved with recruiting, hiring, training, developing, and compensating all personnel.

### Firm Infrastructure

Firm infrastructure includes activities such as general management, planning, finance, accounting, legal support, and governmental relations that are required to support the work of the entire value chain. Through its infrastructure, the firm strives to effectively and consistently identify external opportunities and threats, identify resources and capabilities, and support core competencies.

Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.

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## Examining the Value-Creating Potential of Primary Activities

### Inbound Logistics

Activities, such as materials handling, warehousing, and inventory control, used to receive, store, and disseminate inputs to a product.

### Operations

Activities necessary to convert the inputs provided by inbound logistics into final product form. Machining, packaging, assembly, and equipment maintenance are examples of operations activities.

### Outbound Logistics

Activities involved with collecting, storing, and physically distributing the final product to customers. Examples of these activities include finished-goods warehousing, materials handling, and order processing.

### Marketing and Sales

Activities completed to provide means through which customers can purchase products and to induce them to do so. To effectively market and sell products, firms develop advertising and promotional campaigns, select appropriate distribution channels, and select, develop, and support their sales force.

### Service

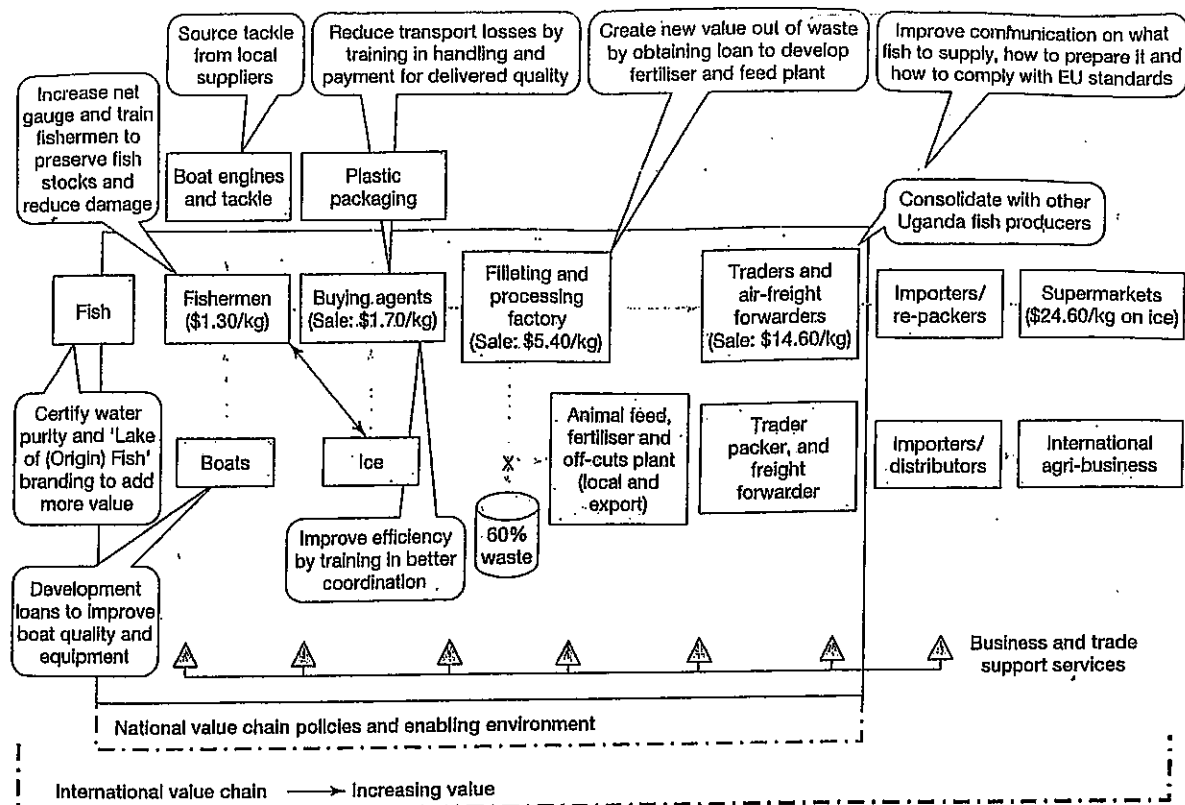
Activities designed to enhance or maintain a product's value. Firms engage in a range of service-related activities, including installation, repair, training, and adjustment.

Each activity should be examined relative to competitors' abilities. Accordingly, firms rate each activity as superior, equivalent, or inferior.

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Source: Ian Sayers, Senior Adviser for the Private Sector, Division of Trade Support Services, International Trade Centre, Geneva. E-mail: [sayers@intracen.org](mailto:sayers@intracen.org).

## A value chain for Ugandan chilled fish fillet exports

*Even small enterprises can be part of an international value chain. Analysing it can provide strategic benefits.*

A fish factory in Uganda barely made any profit. Fish were caught from small motorboats owned by poor fishermen from local villages. Just before they set out they would collect ice and plastic fish boxes from the agents who bought the catch on their return. The boxes were imported, along with tackle and boat parts. All supplies had to be paid for in cash in advance by the agents. Sometimes ice and supplies were not available in time. Fish landed with insufficient ice achieved half of the price of iced fish, and sometimes could not be sold to the agents at all. The fish factory had always processed the fillets in the same way – disposing of the waste back into the lake. Once a week, some foreign traders would come and buy the better fillets; they didn't say who they sold them to, and sometimes they didn't buy very much.

By mapping the value chain it was clear that there were opportunities for capturing more value along the chain and reducing losses. Together with outside specialists, the fish factory and the fishing

community developed a strategy to improve their capabilities, as indicated in the figure, until they became a flourishing international business, The Lake Victoria Fish Company, with regular air-freight exports around the world. You can see more of their current operations at <http://www.ufpea.co.ug/>, and find out more about the type of analytical process applied at [www.justreturn.ch](http://www.justreturn.ch).

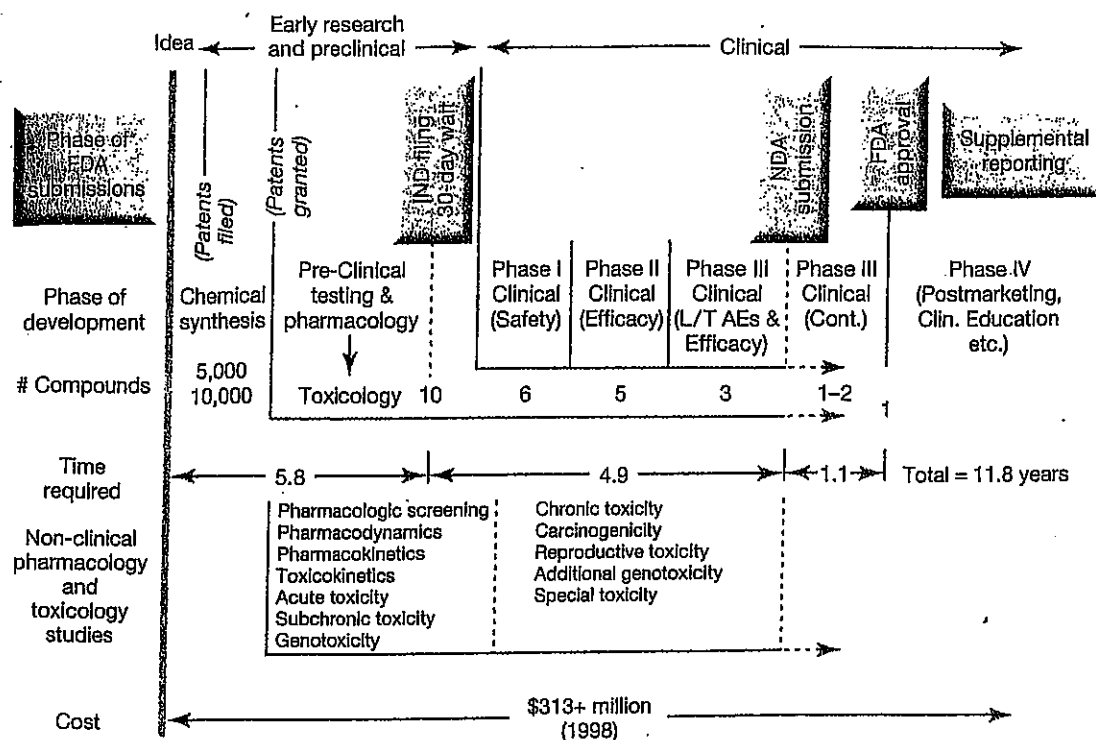
(The approximate costs and prices given represent the situation before improvements were implemented.)

### Questions

- 1 Draw up a value chain for another business in terms of the activities within its component parts.
- 2 Estimate the relative costs and/or assets associated with these activities.
- 3 What are the strategic implications of your analysis?



## Creating new pharmaceuticals



Source: Adapted from Tufts CSDD.

## Leading global pharmaceutical companies, 1997 and 2002

(Top worldwide sales, retail market share and major drug mergers in the late 1990s)

1997		2002			
Company	Total sales (\$bn)*	Company	Total sales (\$bn)*	Share within global retail	Sales growth (2001 to 2002)
Glaxo Wellcome <sup>1</sup> (UK)	11.6	Pfizer <sup>5</sup> (US)	29.5	7.3%	11.4%
Merck (US)	11.4	GlaxoSmithKline <sup>6</sup> (UK)	27.9	7.0%	7.0%
Novartis <sup>2</sup> (CH)	11.0	Merck (US)	20.0	5.0%	6.6%
Bristol-Myers Squibb (US)	9.3	Johnson & Johnson (US)	18.6	4.6%	16.1%
Johnson & Johnson (US)	8.7	AstraZeneca <sup>4</sup> (UK/Swe)	18.1	4.5%	8.6%
American Home Products (US)	8.4	Novartis (CH)	16.6	4.1%	12.8%
Pfizer (US)	8.4	Aventis <sup>3</sup> (Ger/Fra)	14.3	3.6%	10.0%
Roche (CH)	8.0	Bristol-Myers Squibb (US)	14.3	3.6%	-7.4%
SmithKline Beecham (UK)	7.4	Roche (CH)	12.5	3.1%	6.5%
Hoechst (Ger)	7.4	Pharmacia (US) <sup>7</sup>	12.2	3.0%	8.1%

### Notes:

Number	Created	Originating companies	
1	1995	Glaxo (UK)	Wellcome (UK)
2	1996	Sandoz (CH)	Ciba-Geigy (CH)
3	1998	Hoescht (Ger)	Rhône-Poulenc (Fra)
4	1998	Astra (Swe)	Zeneca (UK)
5	2000	Warner-Lambert (US)	Pfizer (US)
6	2000	Glaxo Wellcome (UK)	SmithKline Beecham (UK)
7	2000	Monsanto (US)	Pharmacia (US)

\* \$US1 = approx. €0.83.

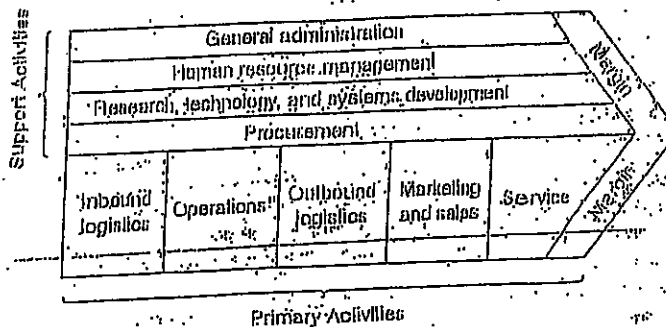
Sources: *The Economist*, 21 November 1998; *Financial Times*, 6 April 2000, and own estimates.



## The Value Chain

Source: Based on Michael Porter, *On Competition*, 1998, Harvard Business School Press.

## The Value Chain



### Primary Activities

- **Inbound Logistics**—Activities, costs, and assets associated with obtaining fuel, energy, raw materials, parts components, merchandise, and consumable items from vendors; receiving, storing, and disseminating inputs from suppliers; inspection, and inventory management.
- **Operations**—Activities, costs, and assets associated with converting inputs into final product form (production, assembly, packaging, equipment maintenance, facilities, operations, quality assurance, environmental protection).
- **Outbound Logistics**—Activities, costs, and assets dealing with physically distributing the product to buyers (finished goods warehousing, order processing, order picking and packing, shipping, delivery vehicle operations).
- **Marketing and Sales**—Activities, costs, and assets related to sales force efforts, advertising and promotion, market research and planning, and dealer/distributor support.
- **Service**—Activities, costs, and assets associated with providing assistance to buyers, such as installation, spare parts delivery, maintenance and repair, technical assistance, buyer inquiries, and complaints.

### Support Activities

- **General Administration**—Activities, costs, and assets relating to general management, accounting and finance, legal and regulatory affairs, safety and security, management information systems, and other "overhead" functions.
- **Human Resources Management**—Activities, costs, and assets associated with the recruitment, hiring, training, development, and compensation of all types of personnel; labor relations activities; development of knowledge-based skills.
- **Research, Technology, and Systems Development**—Activities, costs, and assets relating to product R&D, process R&D, process design improvement, equipment design, computer software development, telecommunications systems, computer-assisted design and engineering, new database capabilities, and development of computerized support systems.
- **Procurement**—Activities, costs, and assets associated with purchasing and providing raw materials, supplies, services, and outsourcing necessary to support the firm and its activities. Sometimes this activity is assigned as part of a firm's inbound logistic purchasing activities.

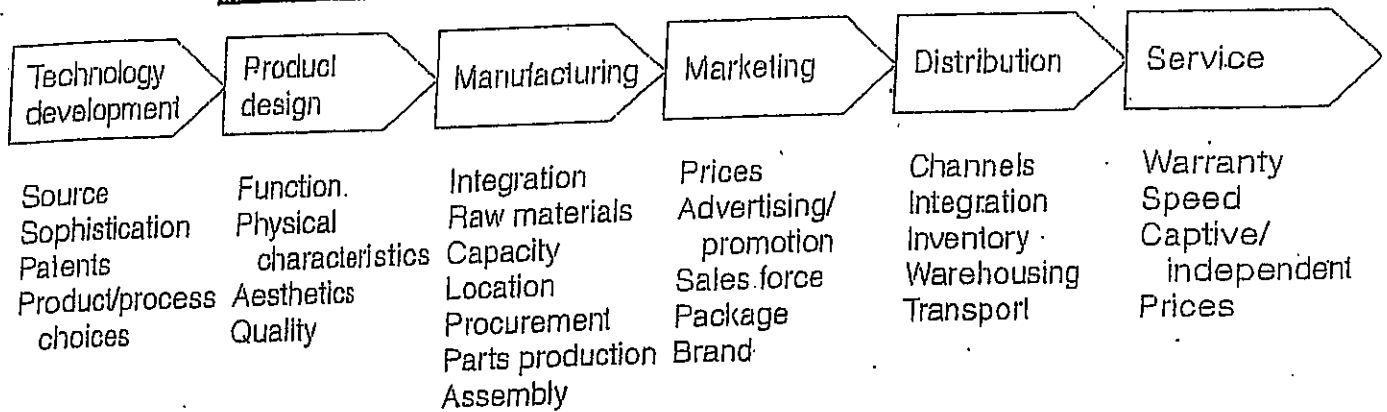
Prof. King  
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VALUE CHAIN  
Analysis

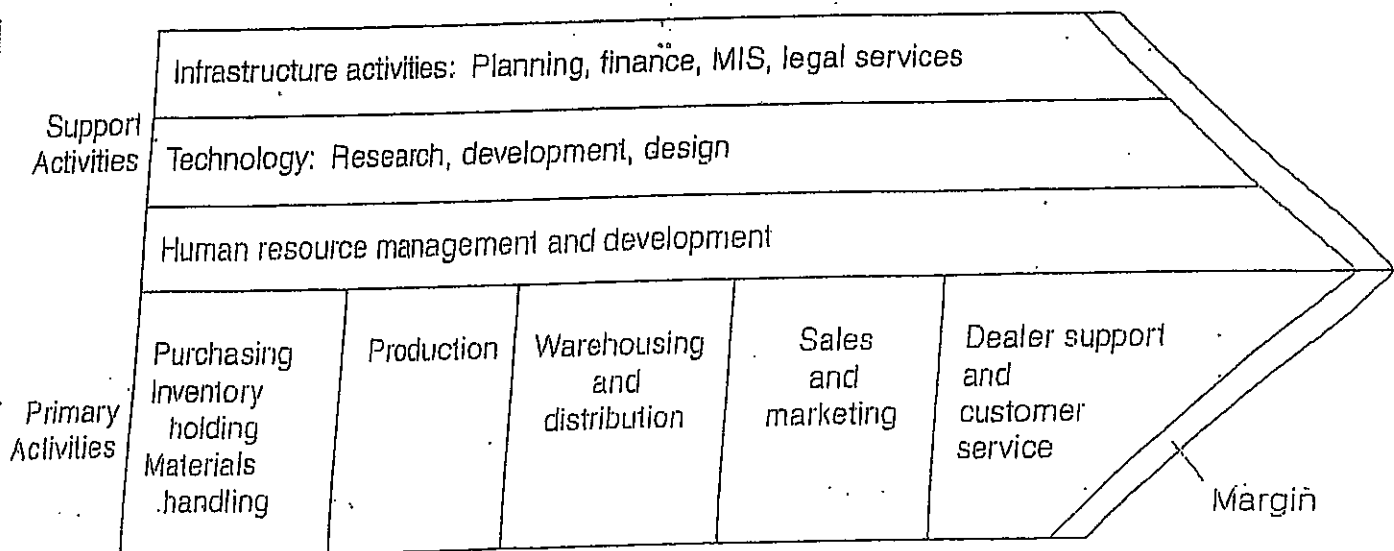
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## Evaluating Firm Strengths and Weaknesses

### The Generic Value Chain Developed by McKinsey & Company



### The Generic Value Chain Developed by Porter

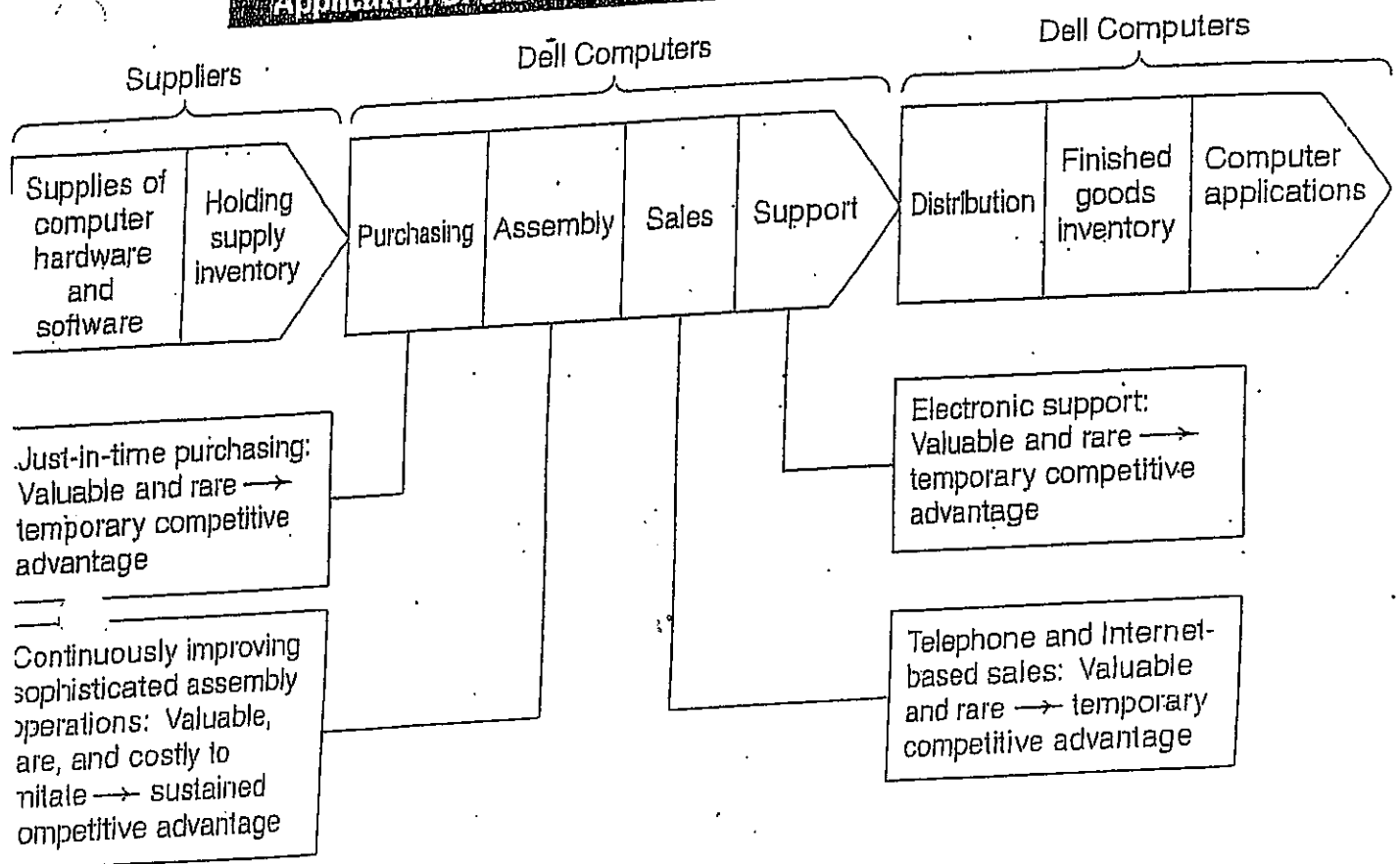


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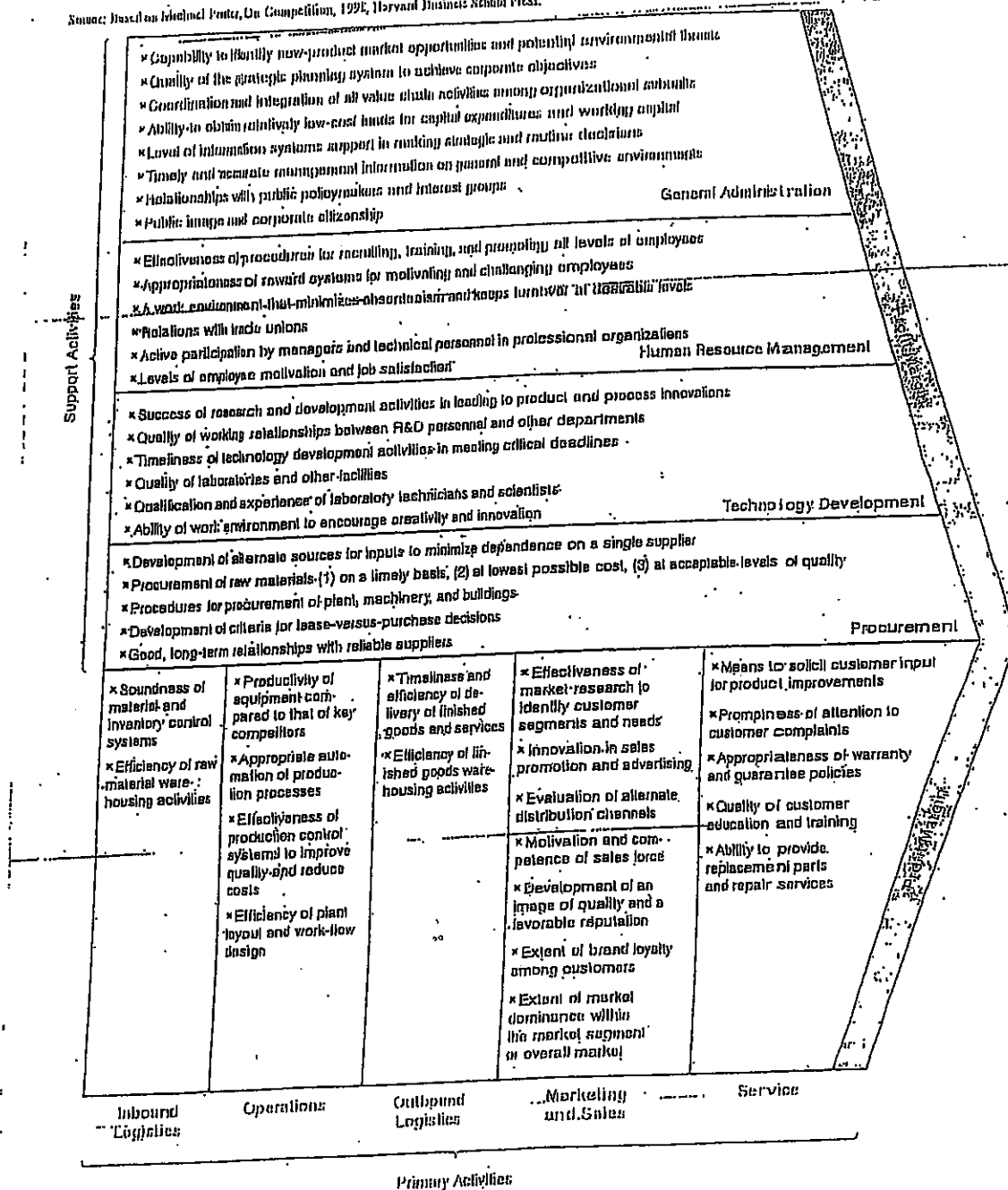
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# An Extended Generic Value Chain for Dell Computers with an Application of the VRIO Framework



## Possible Factors for Assessing Sources of Differentiation in Primary and Support Activities

Source: Michael Porter, *On Competition*, 1991, Harvard Business School Press.



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## Evaluating a Business's Differentiation Opportunities

Source: Based on Michael Porter, *On Competition*, 1998, Harvard Business School Press.

### A. Skills and Resources That Foster Differentiation

Strong marketing abilities.

Product engineering.

Creative talent and flair.

Strong capabilities in basic research.

Corporate reputation for quality or technical leadership.

Long tradition in an industry or unique combination of skills drawn from other businesses.

Strong cooperation from channels.

Strong cooperation from suppliers of major components of the product or service.

### B. Organizational Requirements to Support and Sustain Differentiation Activities

Strong coordination among functions in R&D, product development, and marketing.

Subjective measurement and incentives instead of quantitative measures.

Amenities to attract highly skilled labor, scientists, and creative people.

Tradition of closeness to key customers.

Some personnel skilled in sales and operations—technical and marketing.

### C. Examples of Ways Businesses Achieve Competitive Advantage via Differentiation

Technology Development	Cutting-edge production technology and product features to maintain a "distinct" image and actual product.				
Human Resource Management	Programs to ensure technical competence of sales staff and a marketing orientation of service personnel.				
General Administration	Comprehensive, personalized database to build knowledge of groups of customers and individual buyers to be used in "customizing" how products are sold, serviced, and replaced.				
Procurement	Quality control; presence at key supplier facilities; work with suppliers' new product development activities.				
	Purchase superior quality, well-known components, raising the quality and image of final products.	Careful inspection of products at each step in production to improve product performance and lower defect rate.	JIT coordination with buyers; use of own or captive transportation service to ensure timeliness.	Expensive, informative advertising and promotion to build brand image.	Allowing service personnel considerable discretion to credit customers for repairs.
	Inbound logistics	Operations	Outbound logistics	Marketing and Sales	Service

## Evaluating a Business's Rapid-Response (Speed) Opportunities

### A. Skills and Resources That Foster Speed

Process engineering skills.  
Excellent inbound and outbound logistics.  
Technical people in sales and customer service.  
High levels of automation.  
Corporate reputation for quality or technical leadership.  
Flexible manufacturing capabilities.

Strong downstream partners.  
Strong cooperation from suppliers of major components of the product or service.

### B. Organizational Requirements to Support and Sustain Rapid-Response Activities

Strong coordination among functions in R&D, product development, and marketing.  
Major emphasis on customer satisfaction in incentive programs.  
Strong delegation to operating personnel.  
Tradition of closeness to key customers.  
Some personnel skilled in sales and operations—technical and marketing.  
Empowered customer service personnel.

### C. Examples of Ways Businesses Achieve Competitive Advantage via Speed

Technology Development	Use of companywide technology sharing activities and autonomous product development teams to speed new product development.				
Human Resource Management	Develop self-managed work teams and decision making at the lowest levels to increase responsiveness.				
General Administration	Highly automated and integrated information processing system. Include major buyers in the "system" on a real-time basis.				
Procurement	Preapproved, online suppliers integrated into production.				
	Working very closely with suppliers to include their choice of warehouse location to minimize delivery time.	Standardize dies, components, and production equipment to allow quick changeover to new or special orders.	JIT delivery plus partnering with express mail services to ensure very rapid delivery.	Use of laptops linked directly to operations to speed the order process and shorten the sales cycle.	Locate service technicians at customer facilities that are geographically close.
	Inbound logistics	Operations	Outbound logistics	Marketing and Sales	Service

## Evaluating a Business's Cost Leadership Opportunities

Source: Based on Michael Porter, *On Competition*, 1998, Harvard Business School Press.

### A. Skills and Resources That Foster Cost Leadership

Sustained capital investment and access to capital.

Process engineering skills.

~~Intense supervision of labor or core technical operations.~~

Products or services designed for ease of manufacture or delivery.

Low-cost distribution system.

### B. Organizational Requirements to Support and Sustain Cost Leadership Activities

Tight cost control.

Frequent, detailed control reports.

Continuous improvement and benchmarking orientation.

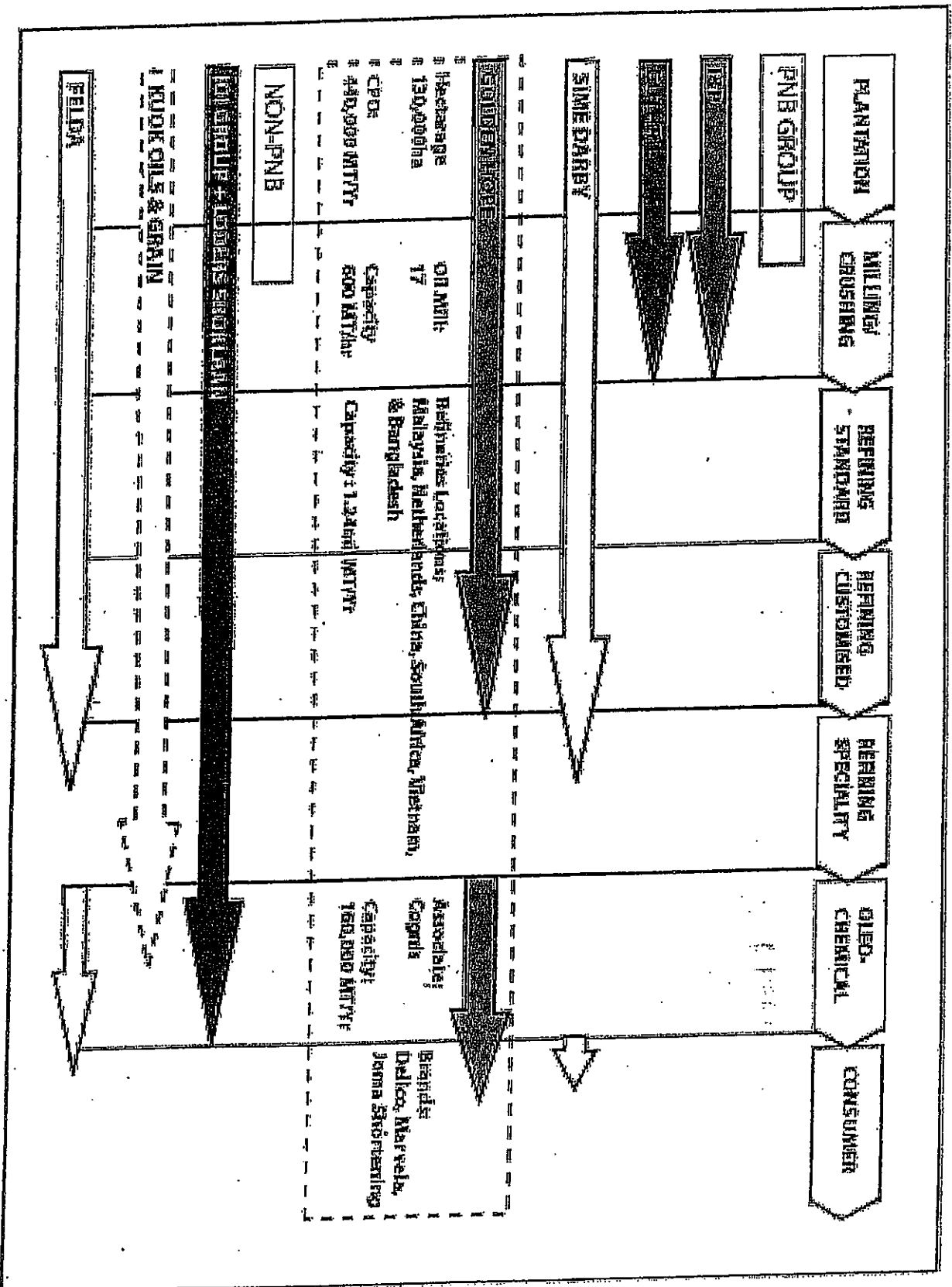
Structured organization and responsibilities.

Incentives based on meeting strict, usually quantitative targets.

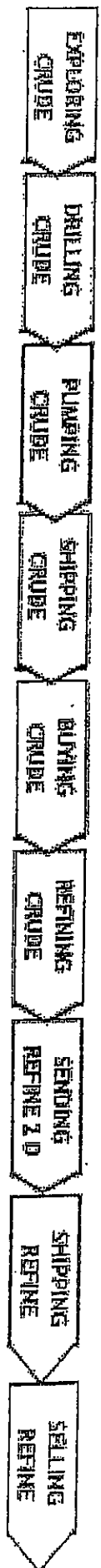
### C. Examples of Ways Businesses Achieve Competitive Advantage via Cost Leadership

Technology Development	Process innovations that lower production costs.		Product redesign to reduce the number of components.	
Human Resource Management	Safety training for all employees reduces absenteeism, downtime, and accidents.			
General Administration	Reduced levels of management cuts corporate overhead.		Computerized, integrated information system reduces errors and administrative costs.	
Procurement	Favorable long-term contracts; captive suppliers or key customer for supplier.			
	Global, online suppliers provide automatic restocking of orders based on our sales.	Economy of scale in plant reduces equipment costs and depreciation.	Computerized routing lowers transportation expense.	Cooperative advertising with distributors creates local cost advantage in buying media space and time.
				Subcontracted service technicians repair product correctly the first time or they bear all costs.
	Inbound logistics	Operations	Outbound logistics	Marketing and Sales
				Service

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# VALUE CHAIN OF ACTIVITIES (SIMPLIFIED) OIL - BASE REFINED PRODUCTS



## Honda's Competitive Advantages

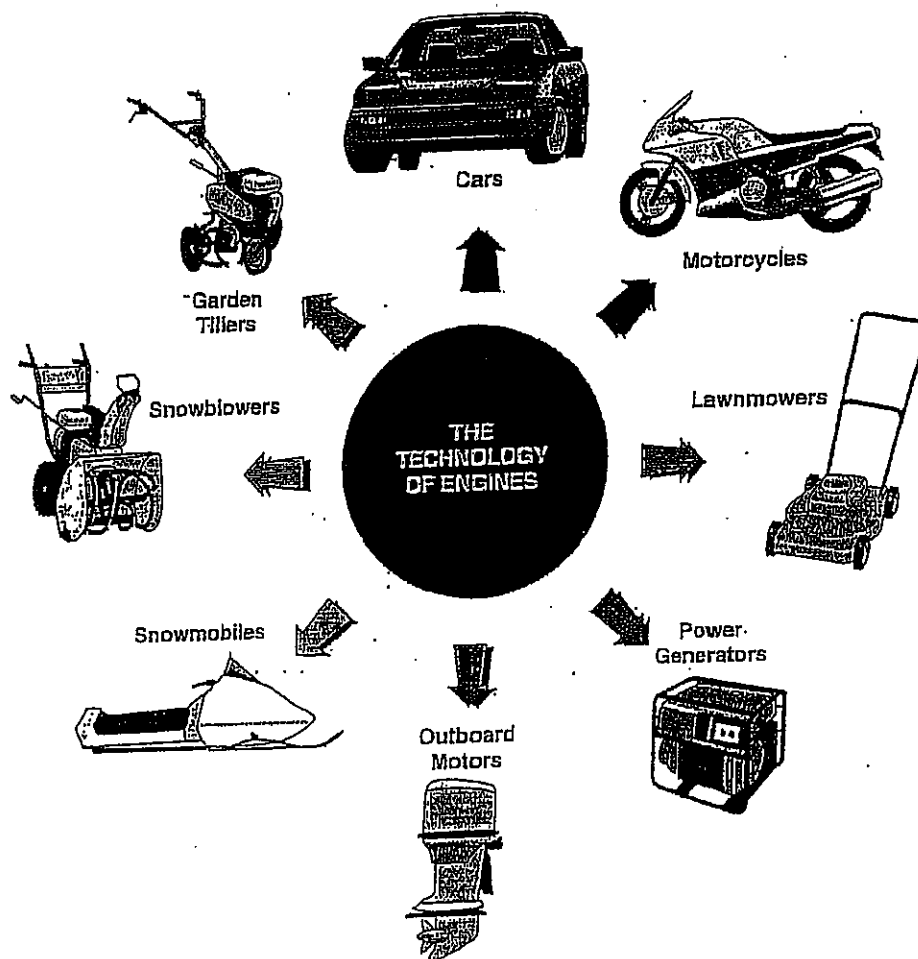
At first blush anyone looking at Honda's lineup of products—cars, motorcycles, lawn mowers, power generators, outboard motors, snowmobiles, snowblowers, and garden tillers—might conclude that Honda has pursued unrelated diversification. But underlying the obvious product diversity is a common core: Honda's expertise in the technology of gasoline engines.

Honda's strategy involves transferring the company's expertise in gasoline engine technology to additional products, exploiting its capabilities in low-cost/high-quality manufacturing, using the widely known and respected Honda brand name on all the products, and promoting several

products in the same ad. One Honda ad teased consumers with the question "How do you put six Hondas in a two-car garage?" and then showed a garage containing a Honda car, a Honda motorcycle, a Honda snowmobile, a Honda lawn mower, a Honda power generator, and a Honda outboard motor.

The relatedness in the value chains for the products in Honda's business lineup produces competitive advantage for Honda in the form of economies of scope, beneficial opportunities to transfer technology and capabilities from one business to another, and economical use of a common brand name.

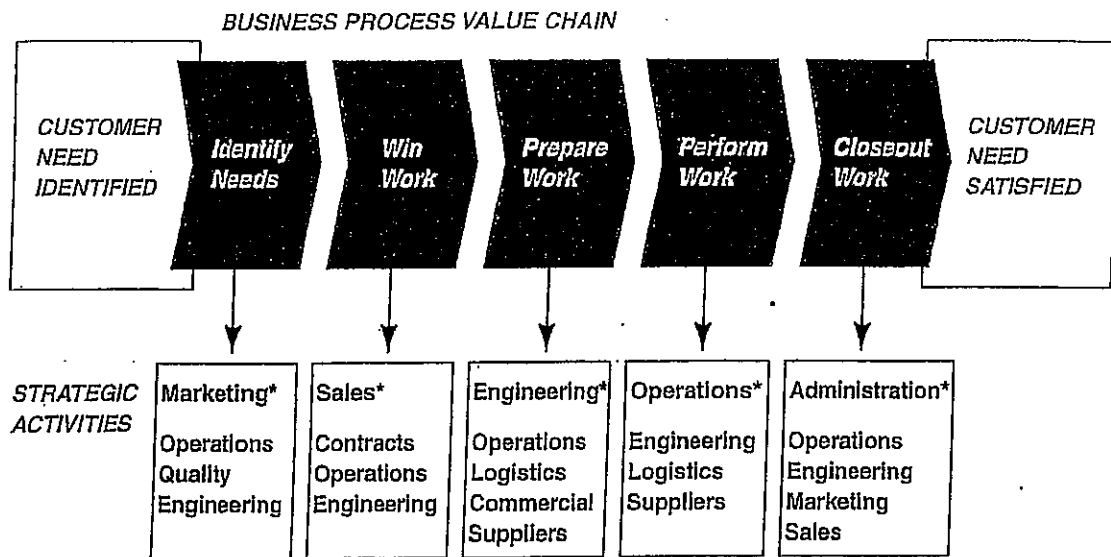
### Honda's Competitive Advantage



Source: Adapted from C. K. Prahalad and Yves L. Doz, *The Multinational Mission* (New York: Free Press, 1987), p. 62.

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10/16



*\*leading strategic activity*

#### Example of Key Success Factors:

- The ability to deliver superior value through products and services. Increase customer penetration.
- The ability to carry out competitive manufacturing and commercial process reviews.
- Attracting superior talent—the ability to attract employees with critical expertise and skills.
- The ability to grow the business through competitive pricing and marketing image.
- The ability to establish long-term relationships with satisfied customers.
- The ability to establish long-term relationships with parties in the distribution channels.
- The ability to implement efficient administrative routines that cut costly red tape procedures to a minimum.
- The ability to create an IT system capable of supporting operations.
- The ability to employ satisfied and competent employees.
- The ability to access and absorb new and critical sources of knowledge and technology.

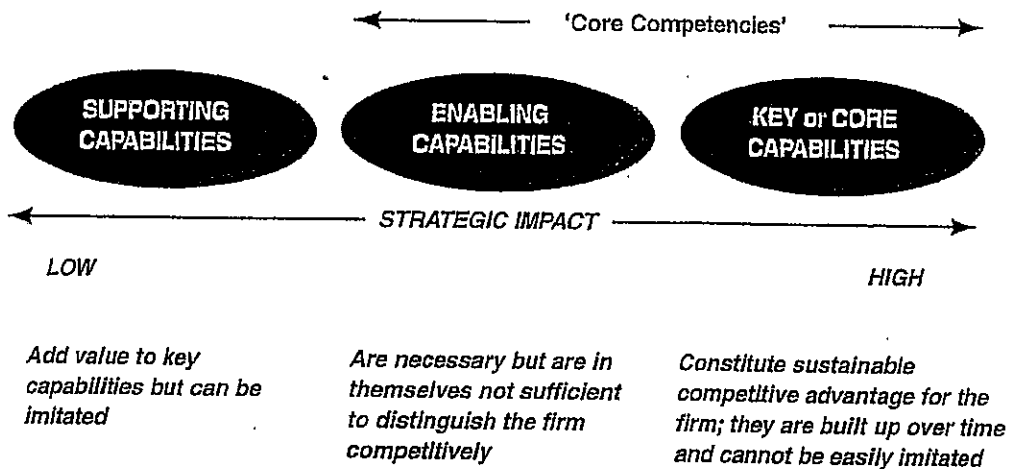
KSFs must be identified within the context of the firm's industry. The environmental analysis method can help firms to zoom in on those KSFs that describe the firm's current, and ultimately, future competitive playing field. The choice of key success factors should reflect a clear understanding of the firm's changing competitive environment.

It is helpful to think about current and future developments in the industry's time frame and scope, stakeholder profile and general trends and uncertainties in the macro environment when selecting key success factors:

1. Time frame and scope:
  - What is the firm's time frame measured against the pace of relevant technological development?
  - What are its competitors' time frames?
  - What is the investment intensity of the industry?
  - Is there a relevant political time? If so what is it?
  - What is the scope of the industry—is it global or domestic?
2. Stakeholder profile:
  - Who are the firm's and the industry's stakeholders?
3. Trends and uncertainties:
  - What are the key economic, political, societal, and technological drivers?
  - What is the potential impact (positive, neutral, negative) of each of these on the firm's and the industry's competitiveness?

The objective of this stage of the methodology is to compile a list of key success factors relevant to the core business process selected.

## Strategic Positioning of the Firm's Capabilities

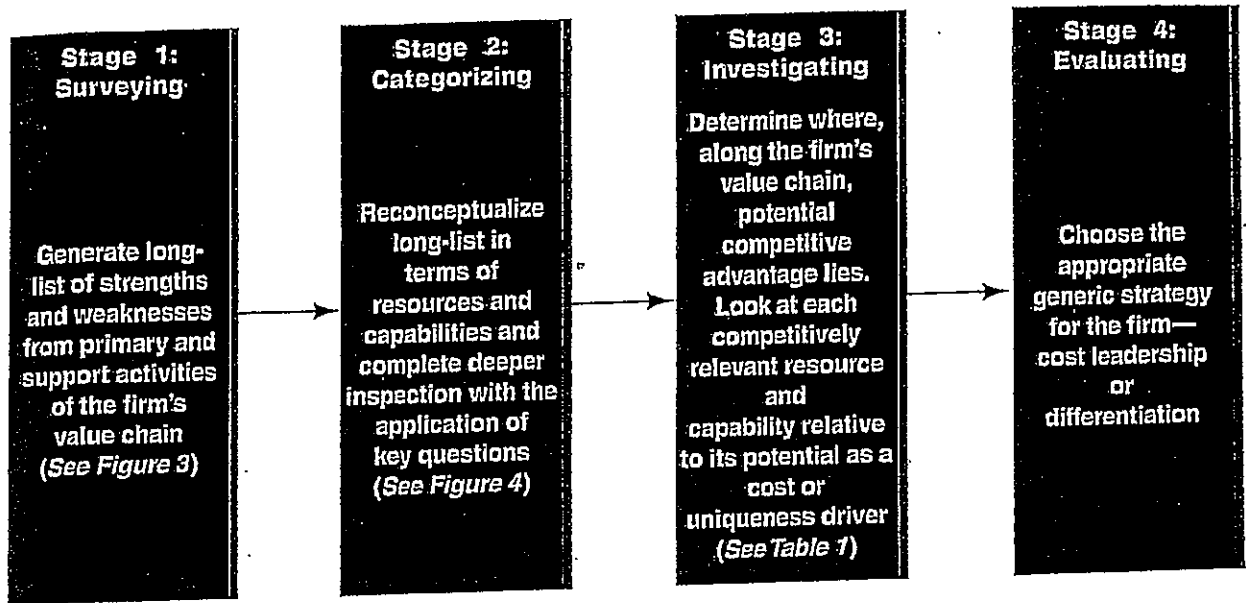


## Classification of Capability According to Competitive Impact

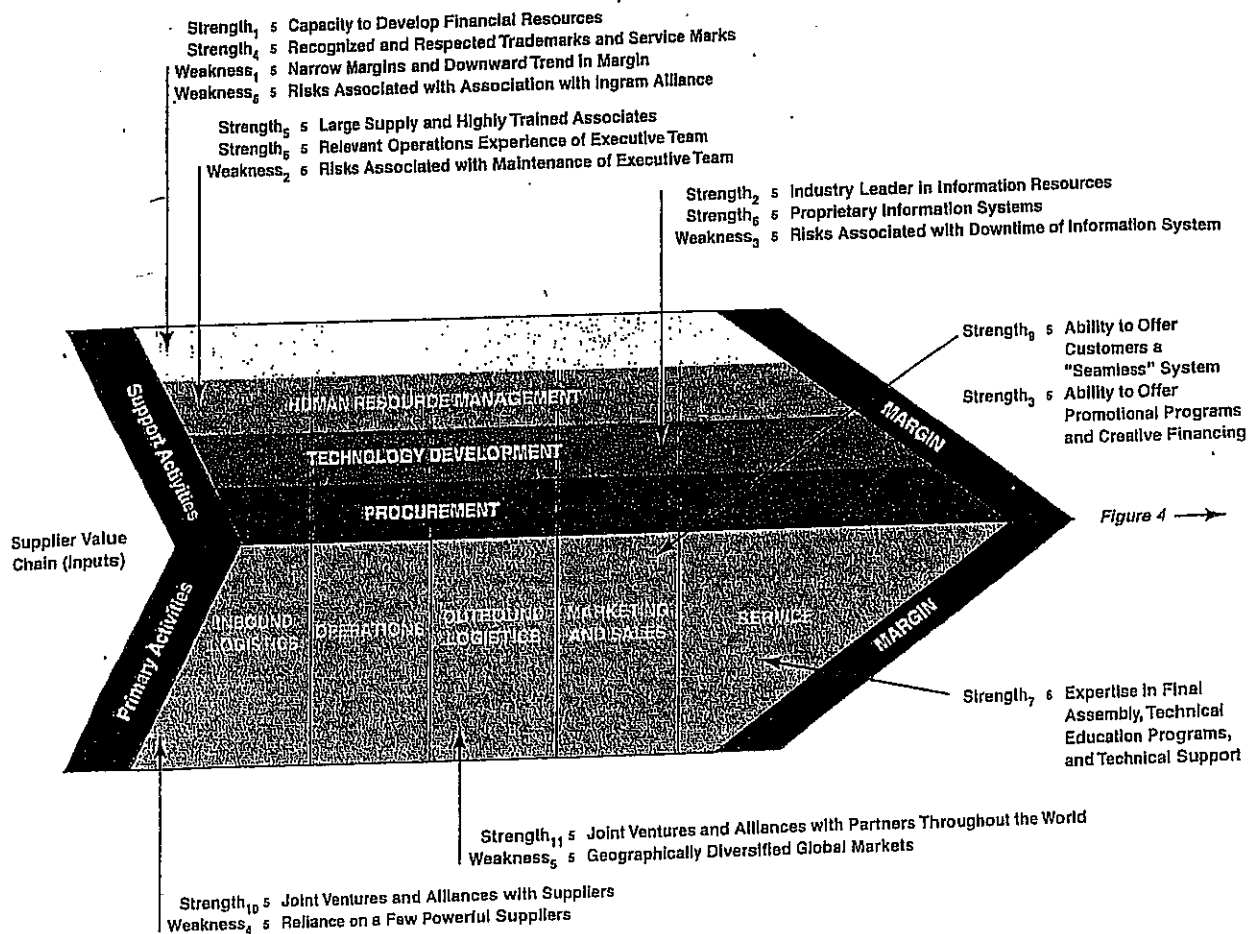
Competitive Classification	Competitive Impact of Capability
1. EMERGING	<ul style="list-style-type: none"> <li>Has not yet demonstrated potential for changing the basis of competition.</li> </ul>
2. PACING	<ul style="list-style-type: none"> <li>Has demonstrated its potential for changing the basis of competition.</li> </ul>
3. KEY or CORE	<ul style="list-style-type: none"> <li>Is embedded in, and enables, products/processes.</li> <li>Has major impact on value-added stream (cost, performance, quality)—and enables proprietary position.</li> </ul>
4. ENABLING or BASE	<ul style="list-style-type: none"> <li>Necessary (enabling) but confers only minor impact on value-added streams; common to all competitors; commodity status (base).</li> </ul>



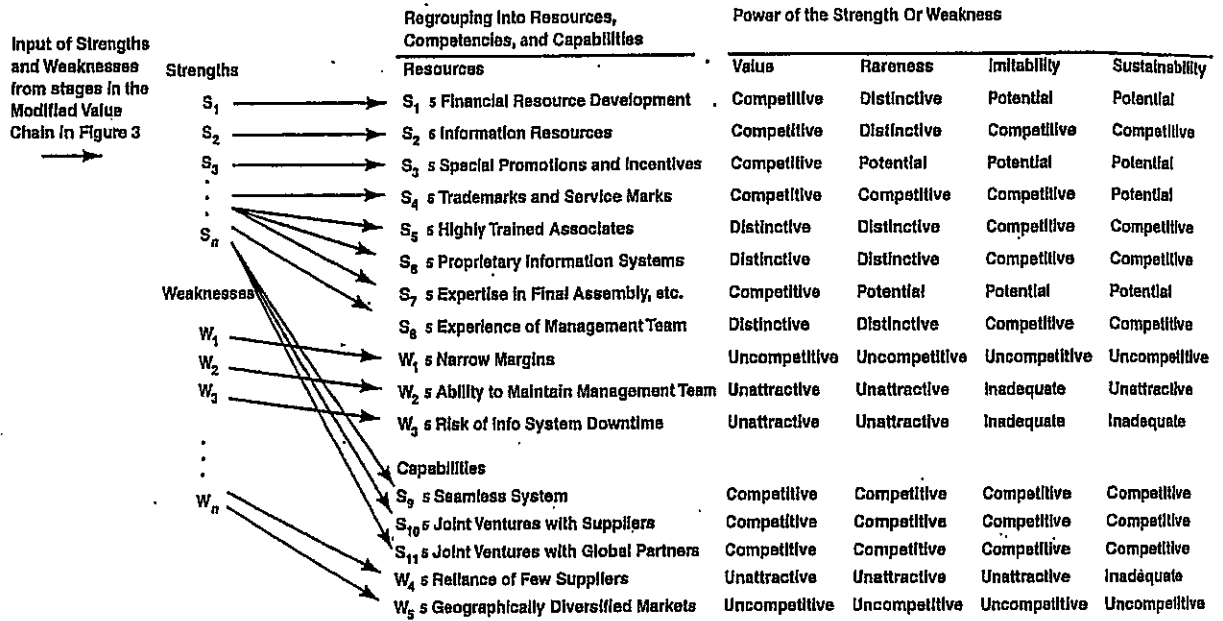
## Internal Environmental Analysis Process



## Strengths and Weaknesses Related to Primary and Support Value Activities in Porter's Modified Value Chain



## Assessment of Internal Factors for Strategic Advantage (ASSIST)



## Strengths and Weaknesses as Potential Sources of Competitive Advantage and Disadvantage

Strength/Weakness	Description	Potential Source of Competitive Advantage/Disadvantage	Location on Modified Value Chain
S <sub>1</sub> Resource	Capacity to rapidly develop financial resources with growth rates of more than 40 percent and almost 30 percent in net sales and net income respectively.	Uniqueness Driver	Organizational Infrastructure
S <sub>2</sub> Resource	Industry leader relative to investments in information resources, warehousing systems, and administrative infrastructure. In the past five years, Ingram has reduced its general and administrative expenses by more than a percent through the use of leading-edge information technologies.	Cost Driver	Organizational Infrastructure
S <sub>3</sub> Resource	Ability to offer special promotions and incentives.	Not Competitively Relevant (See Figure 4)	Organizational Infrastructure
S <sub>4</sub> Resource	Company possesses a number of trademarks and service marks that are visible and respected throughout the world.	Uniqueness Driver	Organizational Infrastructure
S <sub>5</sub> Resource	Highly trained associates that receive training through the company's extensive in-house training system.	Uniqueness Driver	Human Resources
S <sub>6</sub> Resource	Only wholesale distributor of microcomputers with a centralized global information expertise illustrated by its impulse system. On a typical business day, the company's systems handle 12 million on-line transactions, 26,000 orders, and 97,000 shipments.	Uniqueness Driver	Technology Development
S <sub>7</sub> Resource	Expertise in final assembly.	Not Competitively Relevant (See Figure 4)	Operations
S <sub>8</sub> Resource	Top management team with experience in number of industries relevant to company's operations. Members of the team have substantial international experience in software development, telecommunications, transportation, and shipping.	Uniqueness Driver	Human Resources
S <sub>9</sub> Capability	Ability to offer reseller customers a "seamless" supply system of one-stop shopping.	Uniqueness Driver	Marketing and Sales
S <sub>10</sub> Capability	Joint ventures with suppliers that allow many of the effects of vertical integration while avoiding the most significant risks.	Cost Driver	Inbound Logistics
S <sub>11</sub> Capability	Joint ventures and strategic alliances with firms outside the United States leverage company's international management expertise. In addition to the United States, Ingram has almost twenty locations in Europe, three in Canada, seven in Mexico, and three in Asia. More than 100,000 reseller customers are serviced in more than 120 countries worldwide. Over 30 percent of net sales are derived from operations outside the United States.	Uniqueness Driver	Inbound and Outbound Logistics
W <sub>1</sub> Resource	Narrow margins accentuated by downward trend. Gross margin has declined from a little over eight percent to about 6.8 percent over the past three years.	Cost Driver	Organizational Infrastructure
W <sub>2</sub> Resource	Dependent on company's ability to retain and motivate current executive team.	Uniqueness Driver	Organizational Infrastructure
W <sub>3</sub> Resource	Dependence on information system and risk of downtime.	Not Competitively Relevant (See Figure 4)	Technological Development
W <sub>4</sub> Capability	Over reliance on a few suppliers.	Not Competitively Relevant (See Figure 4)	Inbound Logistics
W <sub>5</sub> Capability	Geographical diversity of operations and markets makes effective coordination a challenge even in light of state-of-the-art information system.	Uniqueness Driver	Inbound and Outbound Logistics

## Strategic Implications and Competitive Advantage

Strategic Strength/Weakness	Strategic Implication
<b>Strengths:</b>	
S <sub>1</sub> Resource—Uniqueness Driver—Organizational Infrastructure	Ingram Micro's ability to generate financial resources in an industry characterized by low margins in association with the name recognition it possesses because of its trademarks and service marks provides significant opportunities for further differentiation its services and deeper market penetrations.
S <sub>2</sub> Resource—Cost Driver—Organizational Infrastructure	
S <sub>3</sub> Resource—Uniqueness Driver—Technology Development	
S <sub>4</sub> Resource—Uniqueness Driver—Organizational Infrastructure	Ingram Micro's resources in the areas of state-of-the-art information systems, highly trained sales associates, and experienced management team offer the opportunity for differentiation through the continual introduction of market relevant service innovations, technical assistance, after service sales, and a seamless distribution system.
S <sub>5</sub> Resource—Uniqueness Driver—Human Resources	
S <sub>6</sub> Resource—Uniqueness Driver—Technology Development	
S <sub>7</sub> Resource—Uniqueness Driver—Operations	Ingram Micro's financial resources, managerial expertise, and sales resources in combination with its worldwide network of suppliers and strategic alliances along with the information system that can link them provide an unparalleled opportunity for service differentiation in a highly competitive industry where cost advantage is difficult to achieve.
S <sub>8</sub> Capability—Uniqueness Driver—Marketing and Sales	
S <sub>9</sub> Capability—Cost Driver—Inbound Logistics	
S <sub>10</sub> Capability—Uniqueness Driver—Inbound and Outbound Logistics	
<b>Weaknesses:</b>	
W <sub>1</sub> Resource—Cost Driver—Organizational Infrastructure	Ingram Micro's narrow margins and downward trend in margin underscore the difficulty of obtaining a competitive advantage in the industry through cost leadership. Cost control is essential to survival but cost leadership is not a viable path to competitive advantage for the company.
W <sub>2</sub> Resource—Uniqueness Driver—Organizational Infrastructure	
W <sub>3</sub> Capability—Uniqueness Driver—Inbound and Outbound Logistics	Ingram Micro's need to maintain the management team and focus on coordination of internationally diverse operations are potential issues that could erode the opportunity for competitive advantage through service differentiation.

Opportunities to Build Value or Sharing	Potential Competitive Advantage	Impediments to Achieving Enhanced Value
<p>Market-Related Opportunities:</p> <p>Shared sales force activities or shared sales office, or both:</p>	<p>Lower selling costs.</p> <p>Better market coverage.</p> <p>Stronger technical advice to buyers.</p> <p>Enhanced convenience for buyers (can buy from single source).</p> <p>Improved access to buyers (have more products to sell).</p>	<ul style="list-style-type: none"> <li>• Buyers have different purchasing habits toward the products.</li> <li>• Different salespersons are more effective in representing the product.</li> <li>• Some products get more attention than others.</li> <li>• Buyers prefer to multiple-source rather than single-source their purchases.</li> </ul>
<p>Shared after-sale service and repair work.</p>	<p>Lower servicing costs.</p> <p>Better utilization of service personnel (less idle time).</p> <p>Faster servicing of customer calls.</p>	<ul style="list-style-type: none"> <li>• Different equipment or different labor skills, or both, are needed to handle repairs.</li> <li>• Buyers may do some in-house repairs.</li> </ul>
<p>Shared brand name:</p>	<p>Stronger brand image and company reputation.</p> <p>Increased buyer confidence in the brand.</p>	<ul style="list-style-type: none"> <li>• Company reputation is hurt if quality of one product is lower.</li> </ul>
<p>Shared advertising and promotional activities.</p>	<p>Lower costs.</p> <p>Greater clout in purchasing ads.</p>	<ul style="list-style-type: none"> <li>• Appropriate forms of messages are different.</li> <li>• Appropriate timing of promotions is different.</li> </ul>
<p>Common distribution channels.</p>	<p>Lower distribution costs.</p> <p>Enhanced bargaining power with distributors and retailers to gain shelf space, shelf positioning, stronger push and more dealer attention, and better profit margins.</p>	<ul style="list-style-type: none"> <li>• Dealers resist being dominated by a single supplier and turn to multiple sources and lines.</li> <li>• Heavy use of the shared channel erodes willingness of other channels to carry or push the firm's products.</li> </ul>
<p>Shared order processing.</p>	<p>Lower order processing costs.</p> <p>One-stop shopping for buyer enhances service and, thus, differentiation.</p>	<ul style="list-style-type: none"> <li>• Differences in ordering cycles disrupt order processing economies.</li> </ul>

continued

Opportunities to Build Value or Sharing	Potential Competitive Advantage	Impediments to Achieving Enhanced Value
Operating Opportunities: Joint procurement of purchased inputs.	Lower input costs. Improved input quality. Improved service from suppliers.	<ul style="list-style-type: none"> <li>Input needs are different in terms of quality or other specifications.</li> <li>Inputs are needed at different plant locations, and centralized purchasing is not responsive to separate needs of each plant.</li> </ul>
Shared manufacturing and assembly facilities.	Lower manufacturing/assembly costs. Better capacity utilization, because peak demand for one product correlates with valley demand for other. Bigger scale of operation improves access to better technology and results in better quality.	<ul style="list-style-type: none"> <li>Higher changeover costs in shifting from one product to another.</li> <li>High-cost special tooling or equipment is required to accommodate quality differences or design differences.</li> </ul>
Shared inbound or outbound shipping and materials handling.	Lower freight and handling costs. Better delivery reliability. More frequent deliveries, such that inventory costs are reduced.	<ul style="list-style-type: none"> <li>Input sources or plant locations, or both, are in different geographic areas.</li> <li>Needs for frequency and reliability of inbound/outbound delivery differ among the business units.</li> </ul>
Shared product and process technologies or technology development or both.	Lower product or process design costs, or both, because of shorter design times and transfers of knowledge from area to area. More innovative ability, owing to scale of effort and attraction of better R&D personnel.	<ul style="list-style-type: none"> <li>Technologies are the same, but the applications in different business units are different enough to prevent much sharing of real value.</li> </ul>
Shared administrative support activities.	Lower administrative and operating overhead costs.	<ul style="list-style-type: none"> <li>Support activities are not a large proportion of cost, and sharing has little cost impact (and virtually no differentiation impact).</li> </ul>
Management Opportunities: Shared management know-how, operating skills, and proprietary information.	Efficient transfer of a distinctive competence—can create cost savings or enhance differentiation. More effective management as concerns strategy formulation, strategy implementation, and understanding of key success factors.	<ul style="list-style-type: none"> <li>Actual transfer of know-how is costly or stretches the key skill personnel too thinly, or both.</li> <li>Increased risks that proprietary information will leak out.</li> </ul>

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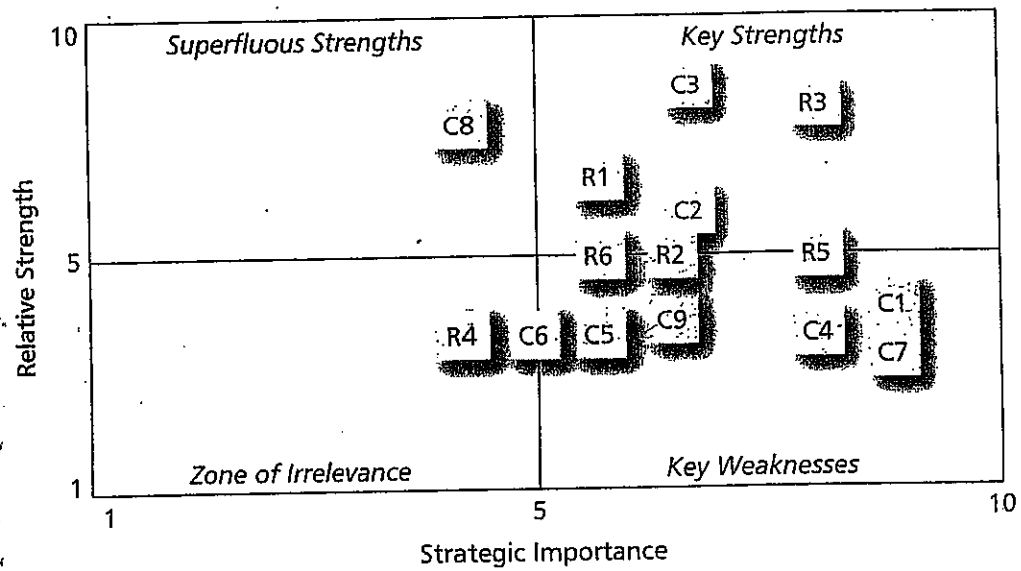
### Appraising VW's resources and capabilities

	Importance <sup>1</sup>	VW's relative strength	Comments
<b>RESOURCES</b>			
R1. Finance	6	6	A— credit rating is above average for the industry, but free cash flow remains negative
R2. Technology	7	5	Despite technical strengths, VW is not a leader in automotive technology
R3. Plant and equipment	8	8	Has invested heavily in upgrading plants
R4. Location	4	4	Plants in key low-cost, growth markets (China, Mexico, Brazil), but German manufacturing base is very high cost
R5. Distribution (dealership network)	8	5	Geographically extensive distribution with special strength in emerging markets. Historically weak position within the US
R6. Brands	6	5	VW, Audi, Bentley, and Bugatti are strong brands, but together with Skoda and Seat, VW's brand portfolio lacks coherence and clear market positioning
<b>CAPABILITIES</b>			
C1. Product development	9	4	Traditionally weak at VW, with few big hits: Beetle (introduced 1938), Golf (1974), Passat (1974), Vanagon (1979). Despite major upgrading, product development still weak compared to industry leaders
C2. Purchasing	7	5	Traditionally weak — strengthened by senior hires from Opel and elsewhere
C3. Engineering	7	9	The core technical strength of VW
C4. Manufacturing	8	4	VW is a high-cost producer with below average quality
C5. Financial management	6	4	Has traditionally lacked a strong financial orientation
C6. R&D	5	4	Despite several technical strengths, VW is not a leader in automotive innovation
C7. Marketing and sales	9	4	Despite traditional weakness in recognizing and meeting customer needs in different national markets, VW has increased its sensitivity to the market, improved brand management, and managed its advertising and promotion with increasing dexterity
C8. Government relations	4	8	Important in emerging markets
C9. Strategic management	7	4	Effective restructuring and cost cutting, but lack of consistency and consensus at top management level

1 Both scales range from 1 to 10 (1 = very low, 10 = very high).

2 VW's resources and capabilities are compared against those of GM, Ford, Toyota, DaimlerChrysler, Nissan, Honda, Fiat, and PSA, where 5 represents parity. The ratings are based on the author's subjective judgment.

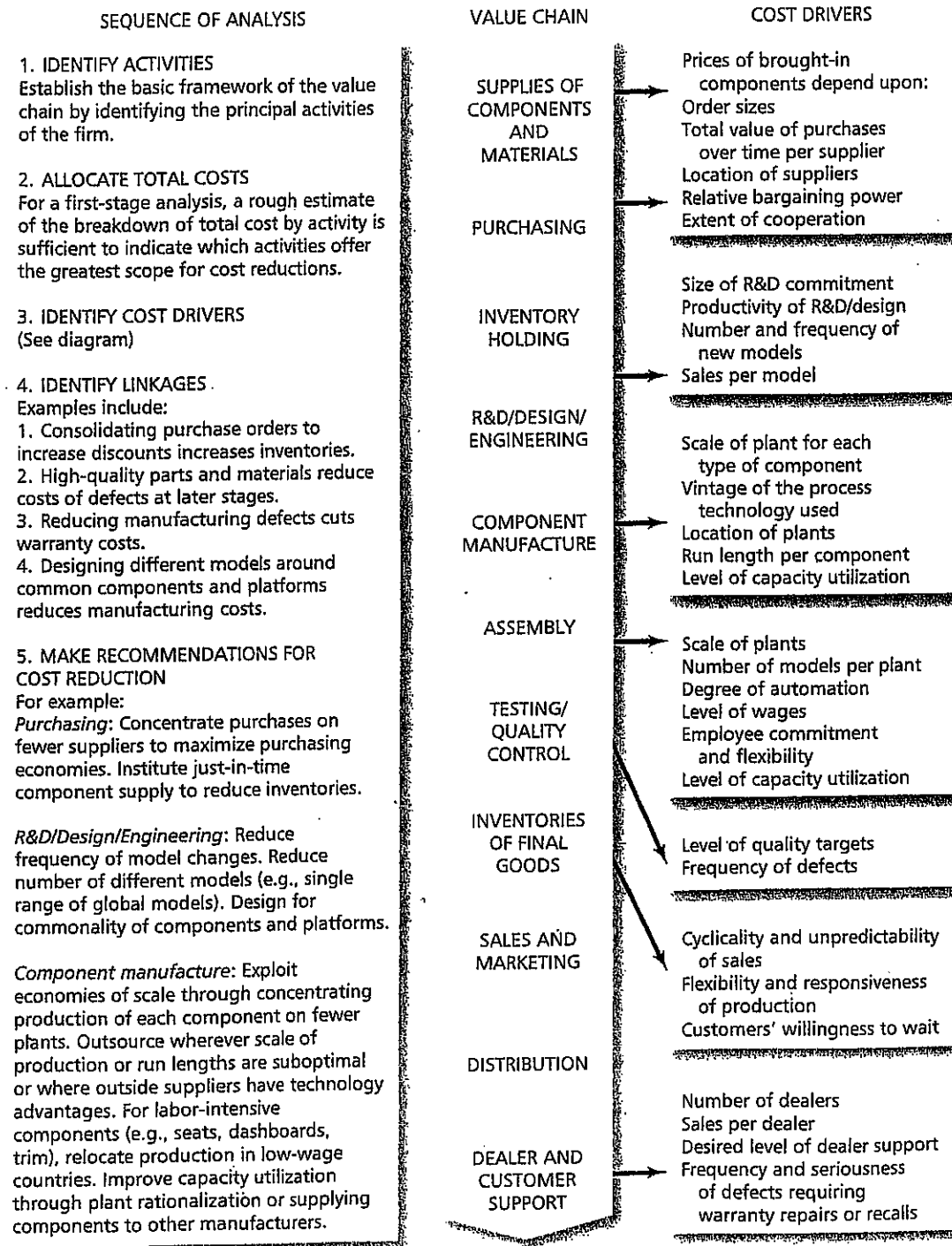
# Appraising VW's resources and capabilities (hypothetical)



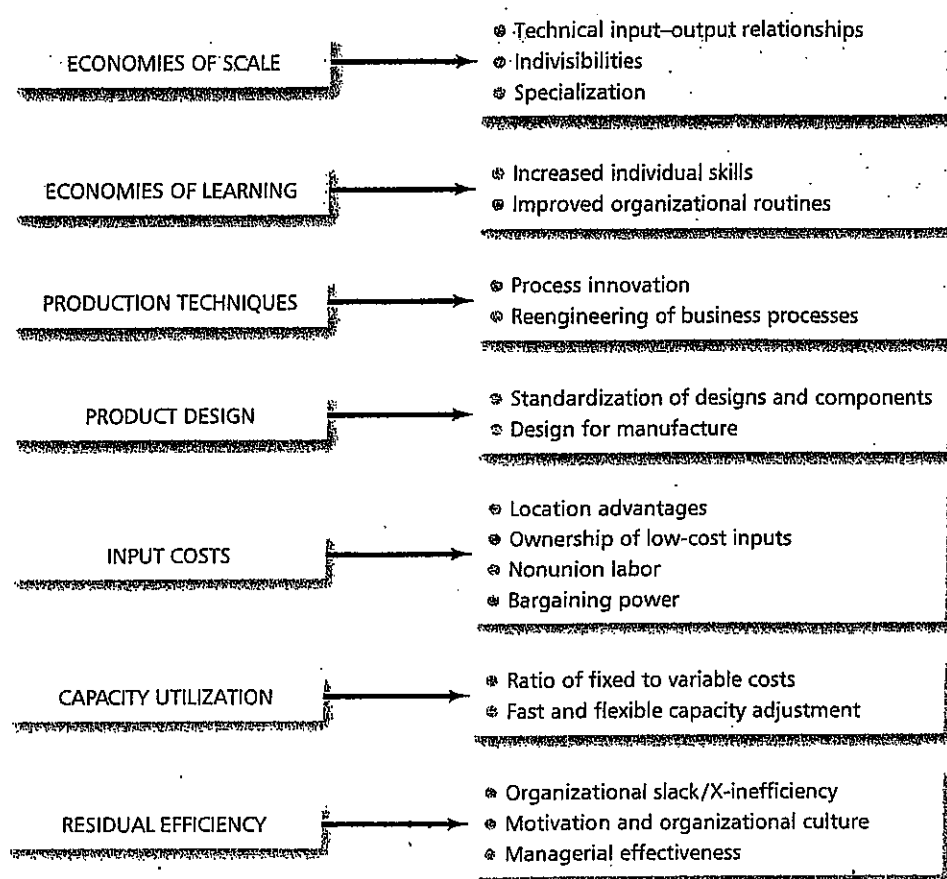
Note: The table is based on the ratings of resources and capabilities in Table 5.4.



## Using the value chain in cost analysis: an automobile manufacturer



### The drivers of cost advantage



# 8

## **Strengths, weaknesses, opportunities and threats (SWOT) analysis**

*By Tony Jacobs, Jill Shepherd and Gerry Johnson*

### **Editors' introduction**

Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis has become a popular analytical tool used by managers and students. It has the merits of being straightforward to employ. However, there are problems associated with it, not least in its subjectivity and in drawing out any implications from the exercise. In *Exploring Corporate Strategy* the technique is used at the end of Chapter 4 to show how the impact of issues identified in Chapters 3 and 4 can be considered together and in terms of their impact on each other. This is the departure point for this chapter, which goes on to show how SWOT analysis can be used more specifically both for the analysis of strategic issues and the evaluation of strategies. The chapter argues that SWOT analysis should be undertaken more rigorously and provide more direct links to applications, employing scoring mechanisms which, while often subjectively based, require managers to discuss and debate the grounds for such scoring. The chapter uses a worked example from the pharmaceutical industry to show the application of the techniques it develops and, in this respect, can usefully be read in conjunction with the case study on the pharmaceutical industry in *Exploring Corporate Strategy*.

### **8.1 Introduction**

SWOT analysis is a popular tool used by managers as an organisational framework for intuitive information and as a means of summarising and integrating more formal analyses about the external operating environment and an organisation's current resources and capabilities. However, care has to be taken to avoid several potential pitfalls, some of which can also be applied to other frameworks and tools of analysis.

- A SWOT analysis can result in long lists of observations which provide little overall insight or clarity about required action. This chapter suggests ways of avoiding this.
- There are no formal mechanisms to ensure that managers challenge their own frames of reference or their organisation's paradigm; indeed SWOT can be used by managers to 'ride their own hobby-horses'. However, if such a challenge can be achieved, this is where useful analysis rests, and this chapter suggests ways in which this can be done.
- A further danger is that managers might conceive of strengths and weaknesses in terms of the strategy they aim to implement rather than that which currently exists. In this sense it is important that the strengths and weaknesses are considered in terms of current realised strategy rather than just future intended strategy.
- There is also evidence that there is a tendency for managers to see environmental changes as threats rather than opportunities. Such negative perceptions of change may hinder the identification of opportunities. Again this chapter suggests ways of overcoming this.

The purpose of this chapter is to show how SWOT analysis can be used more effectively than is often the case by demonstrating how it can integrate and enhance other frameworks of strategic analysis, and contribute to the evaluation of strategic options.

SWOT stands for strengths, weaknesses, opportunities and threats; the strengths and weaknesses are statements of the internal capabilities of an organisation. A strength, therefore, would be an internal resource which would enable an organisation to deal effectively with its business environment – for example, close and good links with customers. An internal weakness would leave opportunities poorly accounted for, or not addressed at all. For example, a weak distribution system might hinder sales of a popular and fast-moving product.

Opportunities and threats exist outside of the organisation in many different areas; examples might include competitor moves, government legislation, technological advances and changing customer needs. Typically the environmental opportunities and threats presented in a market are the same for all competitors; the issue that will vary will be their ability to capitalise on them.

The aim of SWOT analysis is to match likely external environmental changes with internal capabilities, to test these out and challenge how an organisation can capitalise on new opportunities, or defend itself against future threats. The exercise, therefore, seeks to challenge the robustness of an organisation's current strategy and highlight areas that might need to change in order to sustain or develop its competitive position.

## 8.2 Steps in SWOT analysis

There is no one 'right way' of undertaking SWOT analysis. The approach taken here is to apply the idea of identifying strengths and weaknesses, opportunities and threats to contribute to strategic analysis and strategy evaluation. The chapter uses a worked example from the pharmaceutical industry and shows how the series of steps followed can progressively add insight and value to the manager's thinking about strategic issues.

### 8.2.1 Identification of strengths, weaknesses, opportunities and threats

There is first a need to identify what might be the key external factors which constitute opportunities and threats, and the key capabilities or competences (or lack of them) which constitute strengths and weaknesses. This identification might be done by using some of the analytical techniques suggested in Chapters 3 and 4 of *Exploring Corporate Strategy* (4th edition). It is not the role of this chapter to repeat these techniques, but their relevance and application to the steps which follow can be illustrated with reference to a pharmaceutical company.

#### Opportunities and threats

A pharmaceutical company employing frameworks such as PEST and Five Forces analysis in the late 1990s would be likely to identify a number of key changes in its environment:

- Increasing globalisation of the industry
- Entrance of new technologies such as biotechnology and genetics
- Healthcare rationing as governments find themselves unable to fund increasing costs of healthcare
- A more complex and sophisticated customer base. In the UK, for example, regional health authorities (RHAs) are now customers, as well as general practitioners (GPs). Additionally, GPs are now able to manage their own funds and can retain up to 50 per cent of money saved from their annual budgets
- Threat of new diseases and antibiotic-resistant strains of illnesses.

#### Strengths and weaknesses

Similarly, the resource profile and competences – the strategic capability – of an organisation can be assessed. The internal strengths and weaknesses are related to the available resources, the competence of the organisation in undertaking its activities and the balance of its resources and mix of activities. The tools available for this are detailed

in Chapter 4 of *Exploring Corporate Strategy* (4th edition) and notably in Figure 4.1 of that chapter.

Again, using the pharmaceutical industry as an example, analyses of the current capabilities of Company A, an established player predominantly of the European market, identified the following strengths and weaknesses:

### *Strengths*

- large and effective salesforce targeted at GPs
- leading edge research facilities
- global recognition of Company A's leading product
- good current and historic profit margins.

### *Weaknesses*

- no current competences in biotechnology/genetics
- no imminent product launches
- lack of global coordination of research activities
- over-reliance on leading product.

While SWOT analysis itself will not identify such key factors, it does require that they be identified. In this way it can promote thoughtful analytical questioning and the integration of findings which emerge from this.

### 8.2.2 *Challenging managers' mindsets*

Of course, the labelling of strengths, weaknesses, opportunities and threats can, itself, give rise to problems. For example, typically managers tend to view environmental changes as threats. SWOT can be a useful tool to challenge managers' mindsets in this regard by switching the labelling of environmental influences from threats to opportunities; in a sense, this is just being able to see external change from different angles.

In our example from the pharmaceutical industry, healthcare rationing was labelled as a threat. However, the development of an innovative new drug, perhaps through the use of biotechnology – the advent of which was also labelled as a threat – could create an opportunity if it decreased overall healthcare expense by reducing the number of costly operations performed or the time patients spent in intensive care hospital wards.

Similarly, managers might assume that their organisation's current strengths will remain as strengths as the environment changes; but this is not necessarily so. For example, managers might view their organisation's brand name as a strength. However, if the organisation

is trying to increase sales from outside its traditional customer base, the image conjured up by the brand may be a weakness when viewed from the new market segment.

### 8.3 *A basic SWOT analysis*

Assessing the impact of environmental changes on the strengths and weaknesses of an organisation can help managers to understand the changing environment in such a way that will enable them to identify opportunities, or to recognise threats which are especially important – the key issues. This is how SWOT analysis is used at the end of Chapter 4 in *Exploring Corporate Strategy* (2nd edition). It is used here as a basis of showing how such an approach can be further extended both for analytic and evaluative purposes.

The identified strengths, weaknesses, opportunities and threats are collated into a matrix. A scoring mechanism is also used, as aimed to provide clarity to the analysis and as a means of getting managers to assess:

- the environmental changes that are most critical
- the internal strengths that will remain as strengths or become weaknesses in the changing environment
- the internal element that is most influenced by each external change

In our example of the pharmaceutical industry, it might appear as shown in Table 8.1. The scoring system employed is very straightforward:

- A positive (+) score denotes that a strength that a company possesses would help it take advantage of, or counteract, a problem arising from an environmental change or a weakness that would be offset by the environmental change
- A negative (–) score denotes that a strength would be reduced by the environmental change or a weakness would prevent the organisation from overcoming the problems associated with an environmental change or be accentuated by the change
- A zero (0) score indicates that current strength or weakness would not be affected by an environmental change.

Scoring can be a lengthy process, because any matrix of average size will not only generate a large number of impacts to be considered, but will also highlight differences in opinions between managers.

Using our pharmaceutical company (and Table 8.1) as an example, analysis of the company's existing strengths shows that the majority have remained as strengths and will help the company react to the environmental changes. However, the large salesforce, currently targeted at the GPs, is likely to lose its effectiveness as regional health

Table 8.1 Impact analysis for Company A

Environmental change (opportunities and threats)	Increasing globalisation of industry	Entrance of new technology	Health care rationing	RHAs now customers as well as GPs	New diseases and resistance to antibiotics	+	-
<b>Strengths</b>							
Large and effective GP salesforce	0	+1	+1	-3	0	+2	-3
Leading edge research facilities	+1	+2	-1	0	+2	+5	-1
Global recognition of leading product	+2	+1	+1	+1	0	+5	0
Good profit margins	0	+1	+1	+1	+1	+4	0
<b>Weaknesses</b>							
No current competences in biotechnology or genetics	-1	-3	-1	0	-2	0	-7
No imminent product launches	-2	-2	-1	-1	-1	0	-7
No global coordination of research activities	-2	-2	0	0	-2	0	-6
Over-reliance on leading product	0	-1	-1	0	0	0	-2
<b>Environmental impact scores</b>							
	+3	+5	+3	+2	+3		
	-5	-8	-4	-4	-5		

authorities begin to influence healthcare spending. Fundholding status for GPs will also have the effect of making them more cost conscious and, more importantly, less brand loyal. Thus, what had been a major strength historically can now be seen as less of a strength, even inappropriate, to the changed environment.

Company A's weaknesses have remained as weaknesses. In particular, Table 8.1 suggests that not only is the company's R&D department not 'coming up with the goods' in terms of new products, but the company is not taking advantage of the global brand recognition of their leading product by capitalising on this to generate sales of their other products.

An overall indication of the company's position, given the changes it faces, is shown by the 'environmental impact score' at the foot of the table, in these terms the future does not look very good, with an aggregated negative score against each of the likely environmental changes. This suggests that existing strengths are likely to be offset by existing weaknesses unless action is taken.



### 8.4 Competitor analysis

Assessing the impact of environmental change on a company's strengths and weaknesses can be augmented by analysing how environmental changes might affect its competitors.

This assessment can in practice be difficult, not only because

Table 8.2 *Impact analysis for Company A and major competitors*

	Increasing globalisation of industry	Entrance of new technology	Health care rationing	RHAs now customers as well as GPs	New diseases and resistance to antibiotics	
Company A	-2 No global coordination of research but leading product has global recognition	-3 No current competences in this field	-1 Little experience in USA where rationing is already in place	-2 Salesforce still interfacing only with GPs	-2 Current research directed towards traditional diseases	
Competitor W	-2 No commercial products; currently a research institution	+5 Leading competences and intellectual property	-4 No experience in sales; drugs in development likely to be costly	-4 No experience; would need to be able to justify high prices to practitioners	+5 All research in new therapeutic areas	
Competitor X	+2 Very large American-owned global company	+3 Established network of alliances with biotech companies	+2 Strong health economics department	+3 Experience with purchasing organisations in US	+1 Promising products in development but yet to launch any	+11
Competitor Y	-5 European firm with small percentage of sales outside home market	-3 Poor research facilities with no investment in emerging technologies; no financial ability to redress this	+2 Experience gained through facing tough cost-containment measures in own country	-1 Own market still GP based: no experience with dealing with RHAs or equivalent	+2 Promising drug in co-development with multi-national	-5
Competitor Z	+1 Company has over-the-counter (OTC) line with strong global branding	-2 All current research using traditional technologies	+1 Marketing OTC products - a useful competence	+2 Salesforce work as team, interfacing with decision-making units	+3 Reputation for investing in difficult-to-treat therapeutic areas	+5

the difficulties of obtaining enough information to make reasoned judgements, but also because the boundaries of an industry can be unclear and are not likely to provide any precise delineation of competition especially if, as in the case of the pharmaceutical industry, the industry is becoming increasingly global. However, despite the difficulties, attempting to understand how the competition may be affected by environmental change, and how they might be able to capitalise on their own strengths or be restrained by their weaknesses, can be useful to an organisation in developing and pursuing its own strategy.

In our example of the pharmaceutical industry, analysis of Company A's competitors might appear as shown in Table 8.2. Company A's scores, taken from Table 8.1, have been aggregated to allow a comparison with its competitors.

This analysis suggests that Company A, with an overall impact score of  $-10$ , is in a poor position, when compared to its major competitors, to take advantage of the changing environment. Competitor X is well positioned with positive scores against all the environmental changes and an overall score of  $+11$ . Competitor Z, with its score of  $+5$ , is in a relatively good position but its only negative score ( $-2$ ) is against the environmental change identified as having the greatest impact: the entrance of new technologies. Competitor Y is in a weak position ( $-5$ ), scoring badly in terms of the predicted globalisation of the industry and new technology and Competitor W's overall position is neutral ( $0$ ); its weaknesses prevent it from capitalising on its strengths in biotechnology and new disease research.

## 8.5 Suitability analysis

So far this chapter has shown how SWOT analysis can be used to contribute to *strategic analysis*. However, it can be taken further to help inform the evaluation of strategies by providing a basis for screening options rather like the ranking technique described in Section 8.2.2 of *Exploring Corporate Strategy*. This is now explained and again illustrated with reference to the pharmaceutical company.

The analyses shown in Sections 8.3 and 8.4 above should help managers to generate some strategic options which match organisational capabilities with likely environmental changes; and address competitive strengths and weaknesses. For example, strategies might include moving into new product areas or new markets, vertical integration, company acquisition and so on; these, and other options, are detailed in Chapter 7 of *Exploring Corporate Strategy* (4th edition).

A matrix can be constructed to show the strategic options set against, in this case, *both* environmental changes and strengths and weaknesses. Systematically managers should discuss the likely impact of each environmental change on the alternative strategies, scoring

Table 8.3 Suitability of strategic options for Company A

Strategic options	External changes					Strengths				Weaknesses			
	Increasing globalisation of industry	Entrance of new technology	Health care rationing	RHAs now customers as well as GPs	New diseases and resistance to antibiotics	Large and effective GP sales force	Leading edge research facilities	Global recognition of leading product	Good profit margins	No current competences in biotechnology or genetics	No imminent product launches	No global co-ordination of research activities	Over-reliance on leading product
Strategy A*	+1	+3	+1	0	+1	0	+1	+1	0	+2	-1	-3	+1
Strategy B†	+3	+1	+1	0	+1	0	+1	+2	+1	-1	+1	-3	+1
Strategy C‡	0	+3	+1	0	+2	0	+2	0	+1	-2	+3	-1	+2
Strategy D§	0	-1	+3	+3	-3	0	+1	+1	+2	0	0	0	-1

\* Strategy A: Form alliances with biotechnology companies (to broaden product base)

† Strategy B: Enhance global coordination of research activities

‡ Strategy C: Develop own biotechnology capability

§ Strategy D: Consolidate/improve on past strengths and reduce costs

the positive and negative impacts. By aggregating the scores the organisation will be able to see:

- which strategies will capitalise on environmental changes, build on strengths and overcome weaknesses and which will not;
- which strategy, in relation to others, is therefore likely to offer the best way forward.

In the example of the pharmaceutical industry, Company A might produce the matrix shown in Table 8.3.

Strategy D, one of consolidation around past strengths, may appear attractive, as it requires no great change in terms of strategy or organisational culture. It does go some way towards helping the company address a more cost-conscious environment but does nothing to counter the emergence of new technologies and increasing globalisation of the industry, which is seen to have major impacts. In the short term it appears to be a strategy which could be helpful; in the long term it is unlikely to be especially beneficial.

Strategies A and B give similar overall scores. Alliances would possibly give rapid access to new technologies and new products to help re-supply the company's product pipeline. If managed well, that could boost the company's internal R&D, though they might also lead to a further degradation of internal drug discovery effort. And, if the company cannot manage its own research well, how will it manage a network of global alliances? While this strategy has certain advantages, there also appear to be some problems. Strategy B, the restructuring of research effort, could allow the benefit of economies of scale, investment and intellectual capital to be realised in terms of:

- coordinating access and use of expensive high-tech equipment (e.g. robotics) which must be applied across research areas to be economically viable
- increasing the sharing of knowledge and capital across the research function and between research and other functions
- ensuring that contacts with academia and opinion leaders are better managed across the world.

Moreover, it does appear to address some of the key external changes taking place in the industry. The problem is, of course, that the company has no track record in biotechnology or global coordination of research.

Strategy C could conceivably combine the benefits of A and B. New blood, and therefore new skills and experience, would need to be brought into the company to enhance internal resources. In time the salesforce would be presented with innovative products that might themselves reduce spending on certain diseases. In addition, current strengths would be built on to some extent; though again there is a question mark over the company's past capabilities in this field. However, this appears to be the most attractive strategy.

#### *8.5.1 Weighted suitability analysis*

The susceptibility of each strategy to environmental change can also be tested by questioning the relative importance of each environmental change on the matrix and weighting them accordingly. The aggregate scores from this process may very well change the attractiveness or appropriateness of the alternative strategies. For example, if the managers felt that increasing globalisation was the most significant external change likely to face the industry in the next few years, then, arguably, it would affect at least three of the columns in the suitability analysis. This is reflected in Table 8.4, where the scores for these three columns have been given additional weightings, thus affecting the aggregate scores. There is little effect on the evaluation of strategy D but the effects on strategy A, and to some extent B, are clear. Strategy A and particularly B address the globalisation issue and, arguably, might build on the existing global reputation of the leading product, but the concern is whether the organisation has the experience and capabilities to manage on a global scale.

Of course, in fact, the real benefit of this approach is to facilitate management debate in the evaluation. Managers have to discuss what is most important and what is not; and what the effects could be. In the case of this company it would, for example, be likely to focus discussion on the capacity of the organisation to manage on a global basis. It might also raise questions about reliance on a single strategy. Perhaps the pursuit of both strategies B and C might make sense.

Table 8.4 Suitability of strategic options for Company A – weighted analysis

Strategic options	External changes					Strengths				Weaknesses				Total score
	Increasing globalisation of industry	Entrance of new technology	Health care rationing	RHAs: now customers as well as GPs	New diseases and resistance to antibiotics	Large and effective GP sales force	Leading edge research facilities	Global recognition of leading product	Good profit margins	No current competences in biotechnology or genetics	No imminent product launches	No global co-ordination of research activities	Over-reliance on leading product	
	X3					X2				X3				
Strategy A	+3	+3	+1	0	+1	0	+1	+2	0	+2	-1	-9	+1	+1
Strategy B	+9	+1	+1	0	+1	0	+1	+4	+1	-1	+1	-9	+1	+1
Strategy C	0	+3	+1	0	+2	0	+2	0	+1	-2	+3	-3	+2	+1
Strategy D	0	-1	+3	+3	-3	0	+1	+2	+2	0	0	0	-1	+1

Strategy A: Form alliances with biotechnology companies (to broaden product base)

Strategy B: Enhance global coordination of research activities

Strategy C: Develop own biotechnology capability

Strategy D: Consolidate/improve on past strengths and reduce costs

## 8.6 Sensitivity analysis

In some circumstances environmental change might be relatively predictable. Other environmental changes are more difficult to predict or be confident about and, as suggested in Section 8.3.1 of *Exploring Corporate Strategy*, it can therefore be useful to test and challenge the assumptions underlying an organisation's strategic alternatives through sensitivity testing. The results of this might affect the acceptability of the various strategic options.

In the pharmaceutical industry Company A had placed a good deal of emphasis on the likely development of new technologies giving rise to new treatments, especially through the advent of biotechnology. Other industry observers have suggested that this expectation may be misplaced. Let us assume that it was. This can be tested by removing all the factors specifically concerned. At its most extreme, this might suggest taking two of the strategies (A and C) and at least two of the factors (entrance of new technology and competences in biotechnology management) out of the evaluation. Table 8.5 shows the resulting evaluation.

Here the evaluation of strategies B and D show that there is little to choose between them in terms of scores. It does nevertheless show that, in making their choice, the managers might need to consider very seriously whether the real issue is increasing globalisation (which would suggest the choice of strategy B) or the restructuring and cost-consciousness of the industry (which would suggest strategy D).

The process can of course be repeated for the other environmental changes. For example, Company A identified that the industry in

Table 8.5 Suitability of alternative strategies for Company A

Strategic options	Environmental change											Aggregate scores	
	Increasing globalisation of industry	Health care rationing	RHAs now customers as well as GPs	New diseases and resistance to antibiotics	Large and effective GP sales force	Leading edge research facilities	Global recognition of leading product	Good profit margins	No imminent product launches	No global co-ordination of research activities	Over-reliance on leading product	+	-
Strategy B*	+3	+1	0	+1	0	+1	+2	+1	+1	-3	+1	+11	-3
Strategy D†	0	+3	+3	-3	0	+1	+1	+2	0	0	-1	+10	-4

\* Strategy B: Enhance global coordination of research activities

† Strategy D: Consolidate/improve on past strengths and reduce costs

which it operates was becoming increasingly global: how sensitive are the various strategic options to this? What would the effect be if globalisation did not occur or came about over a much longer timescale than was initially envisaged?

## 8.7 Summary

SWOT analysis is a popular and well-known framework which is best used by managers with an understanding and knowledge of the day-to-day aspects of an organisation. It can be used either as an organising framework for intuitive information or as part of a more formal process of analysis.

This chapter concentrates on the latter – the more formal process of analysis – and challenges readers to use the SWOT framework in a more constructive and effective way than is often the case, by utilising the basic idea of SWOT analysis in conjunction with other approaches to strategic analysis and strategy evaluation introduced and discussed in *Exploring Corporate Strategy* (4th edition). This approach enhances the benefits of the framework, in particular by:

- thinking through when future changes might occur and the resultant opportunity or threat
- challenging managers' mindsets about when an environmental change is an opportunity or a threat
- matching external changes with internal repercussions, and attempting to gauge the size of the internal impact and identify key priorities for strategic attention
- providing a format for thinking about competitive positioning by comparing the impact of changes on the organisation with that on competitors.

# References for Strategic Planning

The following is a list of books I have found useful in thinking about and implementing strategy. They include references I used in developing this book.

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12. [www.theequitykicker.com](http://www.theequitykicker.com)
13. Any other related sites emphasizing your industry base.
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  - c) Establish the network/system: International-National-local.