An Approach to Strategic Situation Analysis: Using Models as Analytical Tools

Dr. Rodney Blackwell, Assistant Professor, Troy University, USA
Dr. Dianne Eppler, Associate Professor, Troy University, USA

ABSTRACT

Building competitive advantage begins with a thorough strategic situation analysis that includes understanding both the external and internal business environments. Using established business models as investigative tools and linking them together to enhance their analytical value is proposed in this paper as a method of progressing from strategic situation analysis to competitive advantage. Moreover, internal analyses that result in the identification of distinctive competencies and external investigations that uncover industry key success factors give strategists the means to develop strategies that may achieve competitive advantage.

Keywords: competitive advantage, fit theory, strategic analysis.

INTRODUCTION

The Necessity of Using Analytical Models in Strategic Situation Analysis

An underlying assumption of this paper is the necessity of using established business models as analytical tools when conducting a firm’s strategic situation analysis. Models require analysts to examine more thoroughly the multitude of factors surrounding the complexities of comprehensive internal and external analyses (Grant, 2008). When recognizable business and strategic management models are not used to examine macro-environmental, industry, and firm information then analysts lean towards only considering the most superficial evidence available. Not utilizing analytical tools may result is decisions with excessive reliance on hunches and precedent. Strategic decisions must be based on both a thorough analysis and the integration of various internal and external considerations. Methods used for strategic situation analyses may include a variety of business fields from economics and finance to leadership and marketing, and more. Fortunately, there are numerous well-known business models for firm and industry analysis. An exhaustive macro-environmental analysis could include any number of inquiries into fields of study that fall outside of the normal practice of business. Indeed, the macro-environmental issues may involve an understanding of changes in demographics, cultural differences, engineering and information technology, political and legal issues, international relations, threats of civil unrest, and even climate change. Consequently, the complexity of a strategic analysis is simplified by using structured business models and models from other academic disciplines as analytical tools to both rationalize the process and improve the results. Business models may be used as analytical tools throughout the entire process of conducting strategic analyses. Analysts of internal factors have all the models from the various business disciplines available for use as functional tools. Industry analysts are able to utilize strategic management models and concepts, such as Porter’s Five Forces Model of Competition, Driving Forces, Dominant Economic Factors, and others, to determine the critical industry key success factors. Macro-
environmental analysts must make decisions concerning what external issues have the most direct influence on the industry and hence, the individual strategies of industry competitors.

ANALYSIS OF EXTERNAL FACTORS

Strategic situation analysis requires the use of business models or analytical tools to rationalize the complexities of the interactions between the internal organization, external industry, and the macro-environment (Grant, 2008). The macro-environment is made up of all the relevant factors and influences outside of the immediate industry and competitive environment, and is beyond the control of the organization, at least in the short run. These factors may be economic, social, technological, regulatory, population demographics, and others. The macro environment influences the industry and competitive environment and hence, the firm.

Industry Analytical Tools

The part of the external environment most influential to strategic choice is a firm’s competitive industry or industries. The model most often used to assess the forces that are molding competition in an industry is the Five Forces Model of Competition (Porter, 1991). Strategists use this model as an analytical tool to unravel the complexities of industry competition by examining suppliers, buyers, product substitutes, rivalry among firms that make up the current industry, and the threat of new entrants into the industry (Hitt, Ireland, and Hoskisson, 2009). Each of the five factors should be assessed as to how strongly or weakly the competitive force influences the nature of competition in that particular industry. Industries have unique combinations of forces and their importance will change over time. For example, competition in the mortgage banking industry is strongly influenced by threats of new entrants, while other industries may be more strongly influenced by rivalry or buyer power. Once the analysts have assessed the power of each force to shape competition, then the forces should be ranked from the strongest to the weakest. The stronger forces are the industry factors require greater attention when the tool is used to help determine industry key success factors and choices of strategic alternatives.

The Driving Forces model is another indispensable concept used to understand the dynamics of an industry. Driving forces are the factors causing change in industry structure and competition. Macro-environmental factors such as changes in demographics, economic conditions, and technology are the most common causes of industry evolution (Thompson, et al, 2012). The forces driving change in individual industries also differ from one industry to the next. For example, the mortgage banking industry is driven by changes in interest rates, housing prices, and changes in banking regulations, while the information technology industry is influenced by the speed and diffusion of innovation.

There are other strategic management models that can be used to assess the attractiveness and overall conditions within an industry The Dominant Economic Features model is a comprehensive analytical tool often used to describe the structure of an industry. Exact details of this model are beyond the scope of this paper, but industry structural issues such as the number of competitors, scope of rivalry, buyer needs and expectations, product differentiation and innovation, learning curves, and levels of vertical integration make up many of the features used in this analytical tool. In addition, strategic group mapping is an analytical approach to understanding how competitors within an industry have chosen to compete and which firms are involved in head-to-head competition with firms pursuing similar strategies and business models. Value Chain analysis leads to both an understanding and support of line functions and their importance to the industry, while industry Product Life Cycles analysis give strategists as useful tool for planning marketing strategies.
Industry Key Success Factors

External strategic situation analysis will certainly offer strategists a greater understanding of the structure and competitive nature of an industry. Further examination of the macro-environment will equip decision makers with a broad overview of issues that will influence a firm’s strategy and performance now and in the near future. However, the goals of an external analysis should emphasize identifying industry key success factors. This emphasis is due to the critical importance of identifying industry key success factors when developing strategies aimed at achieving competitive advantage.

Industry key success factors (IKSFs) are defined as competitive factors that affect industry member ability to survive and prosper in the marketplace (Thompson, et al, 2012). It is not easy to determine IKSFs and they vary from industry to industry (Hofer, & Schendel, 1978). Identification depends on the thorough use of analytical tools, as recommended in this paper, but of equal importance is the possession of industry experience by the analysts and the application of common sense by strategists. These managerial skills and experiences cannot be overemphasized (Grant, 2008). For example, innovation and consistent investment in research is a key success factor in the pharmaceutical industry. Examining industry competition and forces driving change are critical to an external analysis as these models may be some of the best tools for identifying IKSFs by analysts.

IKSFs have ceased being emphasized by many industry analysts and strategy theorists for a number of reasons. Some causes of IKSFs losing importance as critical factors in the strategic situation analysis process are difficulty in determining success factors in some industries, trouble with applying them once established, and the absence of generality of these factors across different industries (Ghemawat, 1991). There exists the risk of analyzing industries and macro-environments without uncovering IKSFs with absolute certainty. Also, researchers cope with IKSFs in different ways. It is much easier to concentrate on company strategic responses to IKSFs than to identify them using rigorous analysis of the external environment. While these criticisms have merit, the pursuit of competitive advantage is facilitated by matching organizational unique competencies with IKSFs. This fit between internal competencies and external success factors will be further discussed in the Strategic Fit and Competitive Advantage section of this paper.

ANALYSIS OF INTERNAL FACTORS

Managers are able to guide the development of internal organizational strengths (Weil, 2007). Therefore, any strategic situation analysis will undoubtedly include an internal investigation to uncover firm strengths and weaknesses, determine the nature of a core competency, and discover if specific firms have a distinctive competency.
Many areas of internal investigation may be considered when examining a firm’s strengths and weaknesses. Strengths are sometimes referred to as abilities, competencies, or internal resources. Physical assets, legal contracts, trademarks, human capital, information systems, licenses, business partnerships, manufacturing skills, strategic positioning, and name recognition are only a few internal factors that could be sources of strengths (Hunt, 1997). However, internal strengths must be matched with external opportunities to create effective business-level strategies. Organizational strengths often arise from the functional capabilities that made the organization successful at its inception.

**Functional Analysis**

Marketing, finance, and operations are the most common line functional sources of strengths and weaknesses in organizations. Strengths may also develop from support departments, such as, human resources, public relations, or information systems. Reliable models from the various business disciplines can serve as analytical tools for internal assessments and evaluation of organizational strengths. Using models will help ensure that the functional assessments are exhaustive and rigorous.

For example, evaluating a firm’s target markets, marketing position, and then examining each of the four P’s of marketing (product, price, distribution, and promotion) will offer analysts a strong overview of a firm’s marketing proficiency. Analysts may choose to examine cash flows and ratio analysis to determine a firm’s financial capabilities, while Value Chain analysis could be an effective tool for studying the expanded areas of operations and logistics (Thompson, et al, 2012).

**Organizational Strengths and Weaknesses**

Firms must build appropriate resources and capabilities to serve as the basis of business-level strategy and to create value for stakeholders (Hitt, Ireland, and Hoskisson, 2009). These resources and abilities are easily identified by careful analysis and from the input of experienced managers. Not all strengths of a firm are of equal importance. A firm’s skills and resources in relation to the organization’s external environment determine the importance of the resources to a firm’s success (O’Farrell, Hitchens, & Mofflat, 1993). Certain strengths and unique combinations of strengths that are identified during the analysis will ultimately serve as the basis for strategic decision making. However, determining firm weaknesses is also an important responsibility of strategic analysts.

A weakness may not always be the liability that some less experienced analysts often suggest (Ghemawat, 1991). Indeed, some organizational weaknesses are the result of conscious decisions by managers not to fund these organizational capacities so that the more critical resources can be emphasized. Weaknesses may exist because these functional areas of the firm are less important to the overall success of the firm, and as such, are not critical resources. Some weaker abilities may not have a negative impact on the value or competitiveness of a firm, since these abilities are not where the firm either chooses to compete or the industry structure does not stress the need for these weaker skills. A weakness becomes a concern when it is a critical success factor.

Various internal skills and resources of firms may interact and create higher order organizational Strengths. The ability of the firm to utilize both tangible and intangible resources creates capabilities. Hierarchically, when a firm is able to integrate capabilities across functional areas, it can turn capabilities into competencies. Managers usually develop competencies as a response to industry competition (O’Farrell, Hitchens, & Mofflat, 1993). Important competencies are often found in the human abilities and the intellectual skills of the employees (Prahalad, & Hamel, 1990; Thompson, et al, 2012). Core competencies exist when strengths and competencies emerge as the predominant abilities of firms.
Core Competencies

The value-enhancing capacities of core competencies must not be overlooked. Building core competencies is significant to the development of successful and effective strategies (Mooney, 2007). Indeed, a critical step in the path to competitive advantage begins with identification and support of a firm’s core competency. Skills, abilities, and resources are often linked together to create and sustain core competencies. Core competencies of firms do not happen by accident. They are carefully nurtured, developed, and supported by senior management. These core competencies will often emerge as the identity of the firm, such as innovation at 3M Corporation or efficient large scale retailing at Walmart. The best core competencies are not easily imitated by competitors (Prahalad, & Hamel, 1990). However, a core competency is not dependent upon uniqueness among the industry competitors (Thompson, et al, 2012). A core competence that is not easily imitated by competitors becomes a distinctive competency.

Distinctive Competency

Distinctive competency is not a recent concept. The concept was first described by Selznick in 1957 and was the focus of much of the earlier work in strategic development (Peters, 1984). Because of the difficulty of imitating a distinctive competency, this resource can become a powerful strategic tool that often results in a firm’s above average financial performance (Makadok, & Walker, 2000). Porter (1998) states that unique strengths central to an organization’s success are distinctive competencies. Core competencies that are supported and reinforced by other organizational strengths, and are further found to be unique in a competitive industry are distinctive competencies and set firms apart from their rivals.

While a firm’s distinctive competency is the most logical candidate for building and continuing business-level strategies, the constantly changing business environment may require modification or a complete shift in organizational direction. During times of business environmental uncertainty, strategic positions may deteriorate and leading managers to try more innovative strategies (Gurkov, & Settles, 2011). A firm with a long-standing successful strategy may find it difficult to anticipate macro-environmental or industry structural changes that could lead to organizational vulnerabilities (Katz, 2001). The importance of analyzing external factors cannot be overemphasized as a safeguard against the ever present danger of strategic complacency.

![Figure 2: Internal Analysis: Building a Distinctive Competency](image)

STRATEGIC FIT AND COMPETITIVE ADVANTAGE

Developing business-level strategies and building efficient and effective organizational structures that create competitive advantage is often stated as the goal of strategic management (Stoner, 1987). Competitive advantage enables a firm to outperform competitors in an industry. Any organization with a competitive
advantage, relative to other firms in the industry, will have superior performance, including higher profits. Burgelman (1994) asserts the importance of matching business-level distinctive competence with important competitive factors and that the need for this link is even more important in rapidly changing environments. Organizational success has to be connected to business-wide competencies. Distinctive competencies help to create and sustain a competitive advantage (Mooney, 2007).

![Figure 3: Strategic Fit: Aligning Distinctive Competency with IKSF Leads to Competitive Advantage](image)

**IKSF Leads to Competitive Advantage**

Competitive advantage results from a close fit between distinctive competencies and the key success factors found in competitive industries. The fit between distinctive competencies and IKSFs concept underlies the logic of this model building paper.

Unfortunately, the term “competitive advantage” suffers from overuse and misuse by journalists, business executives, and strategists. An often overused term and one that is used incorrectly can result in a loss of meaning. In March of 2008, a Vice-President at Chrysler LLC, the automaker requiring a bailout from the United States government merely nine months later, described their design process as a competitive advantage in the automobile industry (Hammonds, 2008). Clearly, Chrysler did not have a competitive advantage in the 2008 automobile industry or it would not have required a government bailout to remain viable and solvent.

**CONCLUSIONS**

There are a plethora of tools for internal company, external industry, and macro-environmental analyses, therefore, analysts must be guided by the goals of strategic situation analysis. This paper proposes that models should be used as analytical tools to ensure a thorough analysis of the complexities of the constantly changing internal and external environments of business and the creation of successful strategies. The goal of an internal analysis should go beyond merely determining strengths and weakness for use in a SWOT analysis model. Core competencies of a firm, if they exist in the particular firm being investigated, must be determined. Also, identification of the extremely important IKSFs must be determined. Naturally, not all firms have developed strengths and competencies into core competencies or achieved a distinctive competency. Once an internal analysis has ranked strengths and weaknesses, identified any core competencies and a distinctive competency, if it is present, then the analysis has met the essential goals and is complete. The macro-environmental and industry analyses have the goals of uncovering industry threats and opportunities as well as establishing, emphasizing, and explaining industry key success factors. In order to create effective strategies these internal competencies must be matched with external opportunities while minimizing external threats and avoiding weaknesses to
achieve organizational goals. Strategy recommendations are made with the ultimate goal of creating a sustainable competitive advantage.

REFERENCES


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