Strategic Analysis Tools

Topic Gateway Series No. 34

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Strategic analysis tools

Definition and concept

Strategic Analysis is:

'… the process of conducting research on the business environment within which an organisation operates and on the organisation itself, in order to formulate strategy.'

BNET Business Dictionary

'… a theoretically informed understanding of the environment in which an organisation is operating, together with an understanding of the organisation's interaction with its environment in order to improve organisational efficiency and effectiveness by increasing the organisation's capacity to deploy and redeploy its resources intelligently.'

Professor Les Worrall, Wolverhampton Business School

Definitions of strategic analysis often differ, but the following attributes are commonly associated with it:

1. Identification and evaluation of data relevant to strategy formulation.
2. Definition of the external and internal environment to be analysed.
3. A range of analytical methods that can be employed in the analysis.

Examples of analytical methods used in strategic analysis include:

- SWOT analysis
- PEST analysis
- Porter's five forces analysis
- four corner's analysis
- value chain analysis
- early warning scans
- war gaming.

An overview of these strategic analysis tools will be provided in this topic gateway.

Context

In the current CIMA syllabus, students will study and may be examined on strategic analysis tools as part of the Management Level Paper 5, Integrated Management. In addition, the tools are commonly used in many organisations for strategic decision making. It is therefore an advantage to develop good strategic analytical skills at an early stage.

Related concepts

Strategic planning; strategic management; business analysis; benchmarking; balanced scorecard; competitor analysis; CIMA Strategic Scorecard™.

Application

Analytical methods and tools are key to ensuring that consistency and an appropriate level of rigour is applied to the analysis.

There are a number of important considerations to be aware of when using analytical tools:

1. The tool must help to answer the question that the organisation has asked.
2. The expected benefit of using the tool needs to be defined and it must be actionable. The more clearly the tool has been defined, the more likely the analysis will be successful.
3. Many tools benefit from input and collaboration with other people, functions or even organisations. There should be sufficient time for collaboration and advance warning given so that people can accommodate the analysis.
4. Proper use of analytical tools may be time consuming. It is important to ensure that key stakeholders, for example, the board, senior directors and company departments are aware of this. Otherwise they may not be able to provide the necessary commitment to complete the analysis.

The aim of the analytical tool is to sharpen the focus of the analysis and to ensure a methodical, balanced approach.

All analytical tools rely on historical, backward looking data to extrapolate future assumptions. It is important to exercise caution when interpreting strategic analysis results. Otherwise the analysis may be unduly influenced by preconceptions or pressures within the organisation which seek to validate a particular strategic assumption.

One of the key skills of a strategic analyst is in understanding which analytical tools or techniques are most appropriate to the objectives of the analysis. Below is an overview of some of the more commonly used strategic analysis tools.

SWOT analysis

A SWOT analysis is a simple but widely used tool that helps in understanding the strengths, weaknesses, opportunities and threats involved in a project or business activity.

It starts by defining the objective of the project or business activity and identifies the internal and external factors that are important to achieving that objective. strengths and weaknesses are usually internal to the organisation, while opportunities and threats are usually external. Often these are plotted on a simple 2x2 matrix.

SWOT analysis diagram

Strengths • What does your organisation do better than others? • What are your unique selling points? • What do you competitors and customers in your market perceive as your strengths? • What is your organisations competitive edge?	**Opportunities** • What political, economic, social-cultural, or technology (PEST) changes are taking place that could be favourable to you? • Where are there currently gaps in the market or unfulfilled demand? • What new innovation could your organisation bring to the market?
Weakness • What do other organisations do better than you? • What elements of your business add little or no value? • What do competitors and customers in your market perceive as your weakness?	**Threats** • What political, economic, social-cultural, or technology (PEST) changes are taking place that could be unfavourable to you? • What restraints to you face? • What is your competition doing that could negatively impact you?

When using SWOT analysis, it should be ensured that:

- Only specific, verifiable statements are used. An example might be 'price is £1.50 per unit lower than competition' rather than 'good value for money'.
- Internal and external factors are prioritised so that time is spent concentrating on the most significant factors. This should include a risk assessment to ensure that high risk or high impact threats and opportunities are clearly identified and are dealt with in priority order.
- Issues identified are retained for later in the strategy formation process.
- The analysis is pitched at the project or business activity level rather than at a total company level, which may be less actionable.
- It is not used in exclusivity. No one tool is likely to be completely comprehensive, so a mixture of option-generating tools should be used.

PEST analysis

PEST analysis is a scan of the external macro-environment in which an organisation exists. It is a useful tool for understanding the political, economic, socio-cultural and technological environment that an organisation operates in. It can be used for evaluating market growth or decline, and as such the position, potential and direction for a business.

Political factors. These include government regulations such as employment laws, environmental regulations and tax policy. Other political factors are trade restrictions and political stability.

Economic factors. These affect the cost of capital and purchasing power of an organisation. Economic factors include economic growth, interest rates, inflation and currency exchange rates.

Social factors. These impact on the consumer's need and the potential market size for an organisation's goods and services. Social factors include population growth, age demographics and attitudes towards health.

Technological factors. These influence barriers to entry, make or buy decisions and investment in innovation, such as automation, investment incentives and the rate of technological change.

PEST factors can be classified as opportunities or threats in a SWOT analysis. It is often useful to complete a PEST analysis before completing a SWOT analysis.

It is also worth noting that the four paradigms of PEST vary in significance depending on the type of business. For example, social factors are more obviously relevant to consumer businesses or a B2B business near the consumer end of the supply chain. Conversely, political factors are more obviously relevant to a defence contractor or aerospace manufacturer.

Porter’s five forces

Porter's five forces of competitive position analysis was developed in 1979 by Michael E. Porter of Harvard Business School as a simple framework for assessing and evaluating the competitive strength and position of a business organisation.

This theory is based on the concept that there are five forces which determine the competitive intensity and attractiveness of a market. Porter’s five forces helps to identify where power lies in a business situation. This is useful both in understanding the strength of an organisation’s current competitive position, and the strength of a position that an organisation may look to move into.

Strategic analysts often use Porter’s five forces to understand whether new products or services are potentially profitable. By understanding where power lies, the theory can also be used to identify areas of strength, to improve weaknesses and to avoid mistakes.

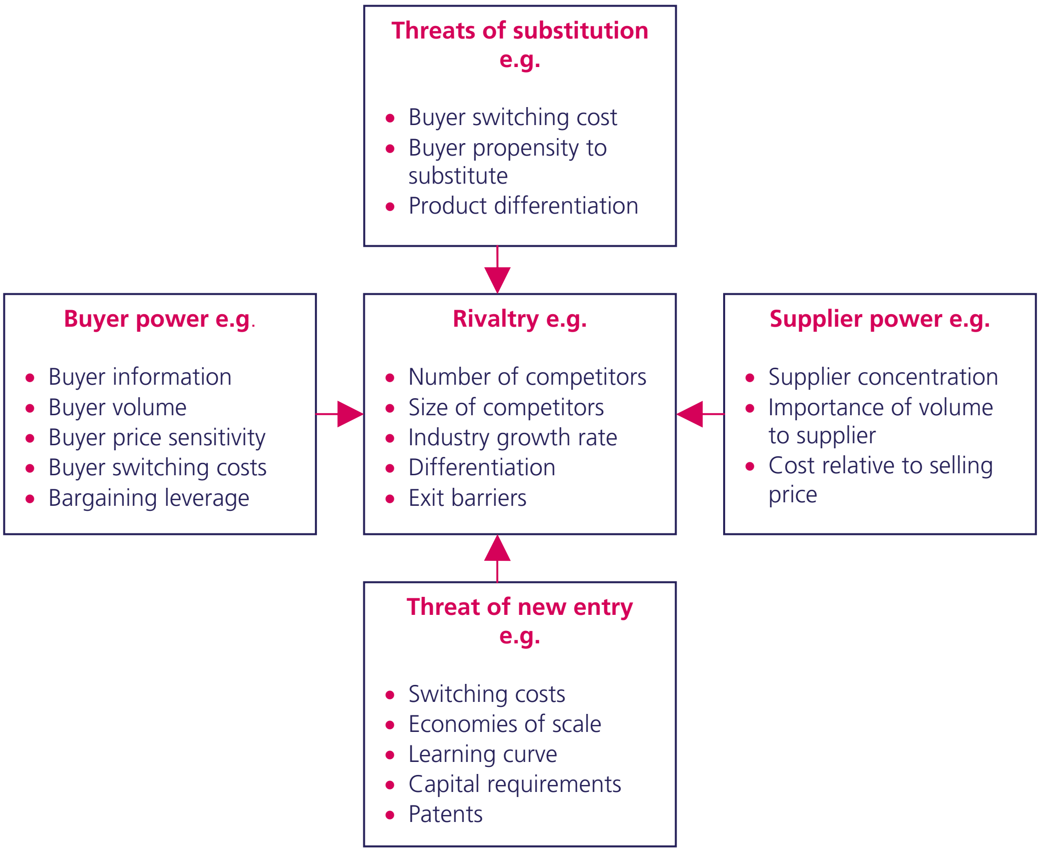
The five forces are:

1. **Supplier power**. An assessment of how easy it is for suppliers to drive up prices. This is driven by:
   - the number of suppliers of each essential input
   - the uniqueness of their product or service
   - the relative size and strength of the supplier
   - the cost of switching from one supplier to another.
2. **Buyer power.** An assessment of how easy it is for buyers to drive prices down. This is driven by:
   - the number of buyers in the market
   - the importance of each individual buyer to the organisation
   - the cost to the buyer of switching from one supplier to another.

If a business has just a few powerful buyers, they are often able to dictate terms.

3. **Competitive rivalry**. The key driver is the number and capability of competitors in the market. Many competitors, offering undifferentiated products and services, will reduce market attractiveness.
4. **Threat of substitution.** Where close substitute products exist in a market, it increases the likelihood of customers switching to alternatives in response to price increases. This reduces both the power of suppliers and the attractiveness of the market.
5. **Threat of new entry.** Profitable markets attract new entrants, which erodes profitability. Unless incumbents have strong and durable barriers to entry, for example, patents, economies of scale, capital requirements or government policies, then profitability will decline to a competitive rate.

Porter's five forces diagram



Based on Michael Porter's five forces of competitive position model
www.businessballs.com/portersfiveforcesofcompetition.htm
[Accessed 12 February 2008]

Four corner’s analysis

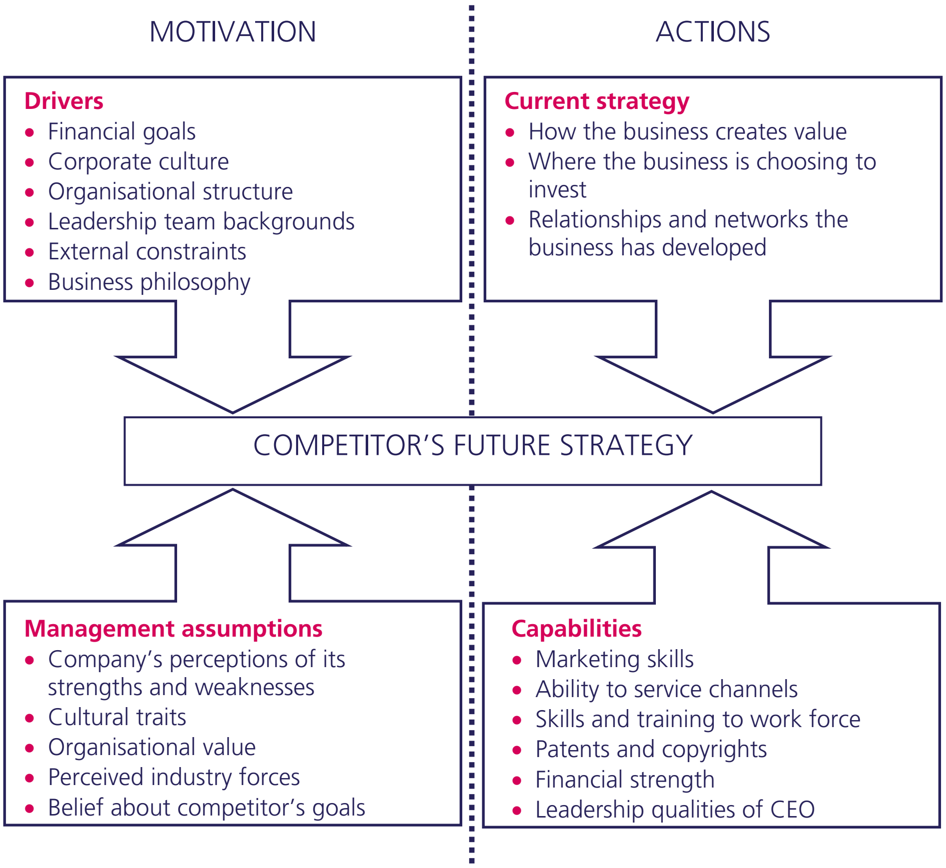
Developed by Michael Porter, the four corner’s analysis is a useful tool for analysing competitors. It emphasises that the objective of competitive analysis should always be on generating insights into the future.

The model can be used to:

- develop a profile of the likely strategy changes a competitor might make and how successful they may be
- determine each competitor’s probable response to the range of feasible strategic moves other competitors might make
- determine each competitor’s probable reaction to the range of industry shifts and environmental changes that may occur.

The ‘four corners’ refers to four diagnostic components that are essential to competitor analysis: future goals; current strategy; assumptions; and capabilities.

A summary of Porter's four corner's analysis



Many organisations carry out basic SWOT analysis and have an appreciation for their competitor's strategies. However, motivational factors are often overlooked and yet are generally the key drivers of competitive behaviour.

Understanding the following four components can help predict how a competitor may respond to a given situation.

Motivation – drivers. Analysing a competitor's goals assists in understanding whether they are satisfied with their current performance and market position. This helps predict how they might react to external forces and how likely it is that they will change strategy.

Motivation – management assumptions. The perceptions and assumptions that a competitor has about itself, the industry and other companies will influence its strategic decisions. Analysing these assumptions can help identify the competitor's biases and blind spots.

Actions – strategy. A company's strategy determines how a competitor competes in the market. However, there can be a difference between 'intended strategy' (the strategy as stated in annual reports, interviews and public statements) and the 'realised strategy' (the strategy that the company is following in practice, as evidenced by acquisitions, capital expenditure and new product development).

Where the current strategy is yielding satisfactory results, it is reasonable to assume that an organisation will continue to compete in the same way as it currently does.

Actions – capabilities. The drivers, assumptions and strategy of an organisation will determine the nature, likelihood and timing of a competitor's actions. However, an organisation's capabilities will determine its ability to initiate or respond to external forces.

Value chain analysis

Before making a strategic decision, it is important to understand how activities within the organisation create value for customers. One way to do this is to conduct a value chain analysis.

Value chain analysis is based on the principle that organisations exist to create value for their customers. In the analysis, the organisation's activities are divided into separate sets of activities that add value. The organisation can more effectively evaluate its internal capabilities by identifying and examining each of these activities. Each value adding activity is considered to be a source of competitive advantage.

The three steps for conducting a value chain analysis are:

1. **Separate the organisation's operations into primary and support activities.**
   Primary activities are those that physically create a product, as well as market the product, deliver the product to the customer and provide after-sales support. Support activities are those that facilitate the primary activities.

2. **Allocate cost to each activity.**
   Activity cost information provides managers with valuable insight into the internal capabilities of an organisation.

3. **Identify the activities that are critical to customer's satisfaction and market success.**
   There are three important considerations in evaluating the role of each activity in the value chain.

   - Company mission. This influences the choice of activities an organisation undertakes.

   - Industry type. The nature of the industry influences the relative importance of activities.

   - Value system. This includes the value chains of an organisation's upstream and downstream partners in providing products to end customers.

Value chain analysis is a comprehensive technique for analysing an organisation's source of competitive advantage.

Early warning systems

The purpose of strategic early warning systems is to detect or predict strategically important events as early as possible. They are often used to identify the first scene of attack from a competitor or to assess the likelihood of a given scenario becoming reality.

The seven key components of an early warning system are:

1. **Market definition.** A clear definition of the scope of the arena to be scrutinised. For example, is the arena a particular geographical region, brand or market?

2. **Open systems.** An ability to capture a wide range of information on relevant competitors.

3. **Filtering.** Information that has been collected on the arena needs to be filtered according to significance. Expert interpretation is required in order to identify particular events that signify strategic moves or shifts.

4. **Predictive intelligence**. Using knowledge of the forces driving a competitor to predict which direction they are likely to take. One technique is to build likely scenarios and actively seek the signals that confirm the scenario. The predictions need to be assessed for their probability of occurring and potential impact.

5. **Communicating intelligence.** Ensuring that the right people in an organisation receive regular briefing on key signals.

6. **Contingency planning**. Events that have a high potential impact or probability of occurring may merit contingency plans, for example, a change of strategy or mitigating actions.

7. **A cyclical process**. The process of scrutinising information for new warning signals should never stop. While the emphasis is on emerging threats and opportunities, the process should be flexible enough to tackle unexpected shorter term developments too.

War gaming

War games are a useful technique for identifying competitive vulnerabilities and misguided internal assumptions about competitors' strategies.

Simulations of competitive scenarios are used to explore the implications of changes in strategy in a 'no risk' environment. They also encourage new ways of thinking about the competitive context. War games are often particularly useful for organisations facing critical strategic decisions.

A typical business war game has the following characteristics:

- an off-site venue
- senior managers representing a cross-functional mix of participants
- two to three full days' duration
- four or more teams of between four to eight people each. Each team represents either the sponsoring company or one of its competitors
- preparation time in which each team receives a dossier describing the company they are representing, and its strengths and weaknesses

It also has the following characteristics.

- A structure where games comprise several ‘moves’ or decision rounds. Each move consists of a fixed, predetermined amount of time ranging from a couple of months to several years. During each move, teams make and carry out strategic decisions. After each move, teams assess their positions relative to other teams.
- A ‘control team’ of facilitators who serve as the board of directors. They ensure that strategic plans are acceptable and legal. They also facilitate the debrief, in which participants review the merit of each strategy.

Case studies

The Amway case study on *The Times* 100 website shows how Amway was able to move its business forward by choosing an appropriate marketing strategy. It demonstrates the connection between Amway's own strategies and the defining matrix of strategies developed by Ansoff in 'Strategies for Diversification' published by Harvard Business Review in 1957. **www.thetimes100.co.uk** [Accessed 12 February 2008]

The Coursework4you.co.uk website provides a number of case studies which examine strategic analysis models describing PEST analysis, Porter's five forces, value chain analysis, SWOT analysis and Boston Consulting Group (BCG) matrix techniques. The validity of the analytical models is evaluated by applying them to companies such as Diageo, Lastminute.com, Marks and Spencer, Ryanair and Wal-Mart. **www.coursework4you.co.uk/sprtbus53.htm**
[Accessed 12 February 2008]

The Corporate Strategy Board provides a number of case studies on the use of strategic analysis tools in companies such as IBM, Procter and Gamble and Shell. The website is available to registered users only.
www.csb.executiveboard.com/Public/Default.aspx
[Accessed 12 February 2008]

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Books

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Porter, M.E. (2004). *Competitive strategy: techniques for analyzing industries and competitors.* New York; London: Free Press

Porter, M.E. (1998). *Competitive advantage: creating and sustaining superior performance.* New York; London: Free Press

Worrell, L. (1998). *Strategic analysis: a scientific art.* Wolverhampton: Wolverhampton Business School

Further Information

Websites

The following websites provide a wide range of materials on the topic of strategic analysis tools.

Businessballs.com
Businessballs.com is a free ethical learning and development resource for people and organisations. It includes a number of free resources on strategic analysis, including free materials, exercises, tools and templates.
www.businessballs.com/pestanalysisfreetemplate.htm
[Accessed 12 February 2008]

Corporate Strategy Board
Subscription website offering information, case studies and tools on strategic analysis. **www.csb.executiveboard.com/Public/Default.aspx**
[Accessed 12 February 2008]

Institute for Strategy and Competitiveness (ISC)
Based at Harvard Business School, the ICS is led by Michael Porter and looks at competition and its implications for company strategy, competitiveness and solutions to social problems. **www.isc.hbs.edu** [Accessed 13 February 2008]

Mind Tools
Provides extensive high quality web content, including articles on strategic analysis topics, which are freely available online. **www.mindtools.com**
[Accessed 13 February 2008]

QuickMBA
An online knowledge resource for business administration. Topics are presented as frameworks and summaries on the various subjects of business administration, including strategic analysis. **www.quickmba.com/strategy**
[Accessed 13 February 2008]

Society of Competitive Intelligence Professionals (SCIP)
SCIP is a global organisation for those involved in the practice of collecting competitive intelligence. The society produces conferences, 'Webinars,' an online archive of articles related to the field and a quarterly journal. **www.scip.org**
[Accessed 13 February 2008]

Strategy + Business
Online magazine published by the global management and technology consulting firm, Booz Allen Hamilton. S + B draws on a combination of journalists, academics, consultants and corporate strategists to contribute articles. **www.strategy-business.com**
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