COMPANY SITUATION ANALYSIS

4

A company situation analysis is essential for evaluating the company resources and capabilities. It prepares the groundwork for matching the company's strategy both to the external market circumstances and its internal resources and competitive capabilities. Insightful situation analysis is a precondition for identifying the strategic issues that management needs to address and for tailoring strategy to company resources and competitive capabilities as well as to industry and competitive conditions.

In the previous unit we have discussed about the industry-specific external factors. In the industry analysis, we did not cover the other external environmental factors such as general economic factors, sociocultural factors, political-legal factors, demographic factors, etc. We have described these general environmental factors in unit two. Lesson 1 of this unit addresses the internal environmental factors of a company. The discussions in this lesson would set the stage for company situation analysis that will be discussed in the other lessons of this unit.

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Lesson-1: Analysis of the Internal Environment of a Company

Learning Objectives:

After studying this lesson you should be able to:

- Identify the areas usually covered by internal environmental analysis of a company.
- Develop a framework for internal analysis of an organization.
- Explain who are responsible for conducting internal analysis of organizations.

Introduction

Analysis of the internal environment or microenvironment of an organization is an essential part of situation analysis. The situation of an organization, whether business organization or any other type of organization, is expressed in terms of its internal and external environmental factors. When an analysis is made of both the types of internal and external environment, managers can have a clear idea of the overall situation of the organization. While external environmental factors reside outside of the organization and therefore depict the external situation, the internal environmental factors portray the internal situations of the organization. Internal environmental analysis helps managers identify the internal strengths and weaknesses of an organization in respect of various internal environmental factors. Analysis is made of each factors in different areas of the organization.

Internal environmental analysis helps managers identify the internal strengths and weaknesses of an organization in respect of various internal environmental factors.

Areas Usually Covered by Internal Environmental Analysis

Internal analysis is made of various internal issues of a company. Depending on the nature of the company, the following major issues need to be covered in the analysis: [1]

- Financial position
- Product and service positions
- Product and service quality
- Marketing capability
- Research and development capability
- Organization structure
- Human resources
- Conditions of facilities and equipment
- Past and present objectives and strategies
- And many more

In fact, every area of a company that has substantial impact on the long-term survival of the company should be analyzed to determine the strengths and weaknesses of each area. A framework for internal environmental analysis is shown in Figure 4.1. This framework indicates several sample questions that need to be addressed while making an internal analysis. These are actually important considerations for identification of strengths and weaknesses of an organization.

FRAMEWORK FOR INTERNAL ANALYSIS

Strengths	Weaknesses
A distinctive competence?	No clear vision?
Adequate financial resources?	Poor strategic direction?
Excellent competitive skills?	Obsolete machinery?
Positive image of the company?	Lack of managerial talent?
Access to economies of scale?	Lack of competencies?
Proprietary technology?	Poor track record in strategy implementation?
Cost advantages?	Falling behind in research and development?
Competitive advantages?	Narrow product line?
Product innovation abilities?	Weak market image?
Good leadership and management?	Competitive disadvantages?
Achieved market leadership?	Poor marketing skills?
Well-crafted functional strategies?	Inadequate working capital?

Figure 4.1: A sample framework for internal analysis of a company

Who are Responsible for Conducting Internal Analysis?

Practices differ from organization to organization for performing internal environmental analysis.

The task of assigning the responsibility for performing internal environmental analysis may not be similar in all organizations. Evidence shows that practices differ from organization to organization. Usually the following practices are prevalent in different organizations:

1. **Involvement of the Planning Department:** Some organizations involve the Planning Department for conducting the analysis of internal environment. The staffs in the planning department are expected to be proficient in such analysis. They gather information and then make analysis of the internal situations.

2. **Use of Outside Consultants:** Some organizations use independent consultants for conducting internal analysis. The expert consultants have experience in performing such activities. They can also give impartial view of the situations, which the internal staffs of the planning department or other persons may not give.

3. **Forming of Team:** Some organizations form a team of line managers with relevant experience. Usually such a team performs the analysis in collaboration with the planning staffs who provide technical assistance. The underlying philosophy behind using team approach is that the line mangers will be better able to understand the implications of the analysis and they will be in a better position to guide their strategic planning decisions.

Review Questions

1. What are the areas usually covered by internal environmental analysis? Explain them briefly.
2. Prepare a framework for internal analysis of an organization.
3. Who are responsible for conducting internal analysis of organizations? Which one do you prefer and why?

Application Discussion Questions

1. Talk to the manager of a bank, ask him/her to give you information regarding various resources of the bank and then prepare a list of the financial, human, and physical resources of the bank.
2. From the knowledge that you have gained from the study of internal environmental analysis, you could understand that company image is a very important internal environmental factor. Explain your view about the importance of company image on the basis of your study of a company like the producer of MUM or paper tissue of Bashundhara.

NOTES

1. Lloyd L. Byars, Leslie W. Rue and Shaker A. Zahra, *Strategic management* (Chicago: IRWIN, 1996), p. 89.

Lesson-2: Analytical Techniques of Situation Analysis-I

Learning Objectives:

After studying this lesson, you should be able to:

- Understand what the situation analysis of an organization encompasses.
- Make a list of the techniques for analyzing company situations.
- Understand the meaning of SWOT analysis.
- Define value chain of a company and explain how value chain analysis technique can be used for company situation analysis.

Introduction

Situation analysis encompasses all the factors in the external environment and internal environment of an organization. This is because the situation of an organization is reflected in its external as well as internal conditions. Different organizations use different techniques for the analysis of their situations. Our experience shows that organizations in general use several techniques for analyzing their internal and external situations. [1]

- SWOT Analysis
- Value Chain Analysis
- Strategic Cost Analysis
- Competitive Strength Assessment

The following discussion about the techniques of situation analysis would provide you a working knowledge regarding the pros and cons of the techniques.

SWOT Analysis

SWOT stands for strengths, weaknesses, opportunities and threats.

SWOT stands for strengths, weaknesses, opportunities and threats. *Strength* is something that a company is good at doing. Anything can be strength if it gives the company enhanced competitiveness. A strength can take the form of a skill/expertise, valuable physical assets, valuable human assets, valuable intangible assets, fruitful alliances, etc.[2] *Weakness* is something a company lacks or does poorly or a condition that puts the company at a disadvantage. A company's internal weaknesses can relate to (a) deficiencies in competitively important skills; (b) a lack of competitively important physical, organizational or intangible assets, or (c) weak/missing competitive capabilities in key areas. An *opportunity* is something that a company may grab for growth and profitability. It is a favorable condition in a company's external environment. Opportunities offer important avenues for profitable growth and indicate potential for competitive advantage. A *threat* is something a company may be exposed to in the external environment that may cause suffering in growth or profitability. It is an unfavorable trend in the external environment. Certain factors in a company's external environment may pose threats to its profitability and competitive well-being. Threats can stem from (a) emergence of cheaper/better technologies; (b) introduction of new or imported products by the competitors; (c) entry of low-cost foreign competitors; (d) new government regulations that are more burdensome to a company than its competitors; (e) vulnerability to a rise in interest rates bank loans; (e) adverse changes in foreign exchange rates; (f) political upheaval, and the like.

SWOT analysis is a useful tool for analyzing an organization's overall situation. This approach attempts to balance the internal strengths and weaknesses of the organization with the external opportunities and threats. It provides a good overview of whether a company's condition is healthy or unhealthy. It reveals the company's actual situation regarding resources, capabilities, external opportunities and external threats. It helps to draw conclusions about (a) how strategy can be matched to both its resources and market opportunities; and (b) how weaknesses can be corrected and threats can be guarded against.

SWOT approach attempts to balance the internal strengths and weaknesses of the organization with the external opportunities and threats.

Details of SWOT framework are described in Lesson-3 of this unit.

Value Chain Analysis

A company's value chain identifies the primary activities that create value for customers and the related support activities. Value chain analysis identifies the separate activities and business process that are performed from the designing of a product to supporting it.

Value chain analysis is viewed as a means of evaluating a firm's strengths and weaknesses (SW). It assumes that a firm's basic economic purpose is to create value. The strategy-making lesson of value chain analysis is that increased company competitiveness hinges on managerial efforts to concentrate company resources and talent on those skills and activities where the company can gain dominating expertise to serve its target customers.

Value chain analysis is viewed as a means of evaluating a firm's strengths and weaknesses (SW).

Value chain analysis is a powerful managerial tool for identifying which activities in the chain have competitive advantage potential. Value chain identifies the activities and business processes that have to be performed in designing, producing, marketing, delivering, and supporting a product or service. It identifies the primary activities that create value for customers and the related support activities. Value chains are a tool for thinking strategically about the relationships among activities performed inside and outside the firm. The chain of value-creating activities starts with raw materials supply and continues on through manufacturing, assembly, wholesale distribution, and retailing to the ultimate end users of the product or service. A company's value chain shows the linked set of activities and functions it performs internally. The chain includes a profit margin because a markup over the cost of performing (the firm's) value-creating activities is customarily part of the price borne by buyers. The value chain of a manufacturing company is presented in Figure 4.2. Figure 4.3 depicts a value chain for a watch manufacturing company.

Value chain analysis identifies the primary activities that create value for customers and the related support activities.

Primary Activities

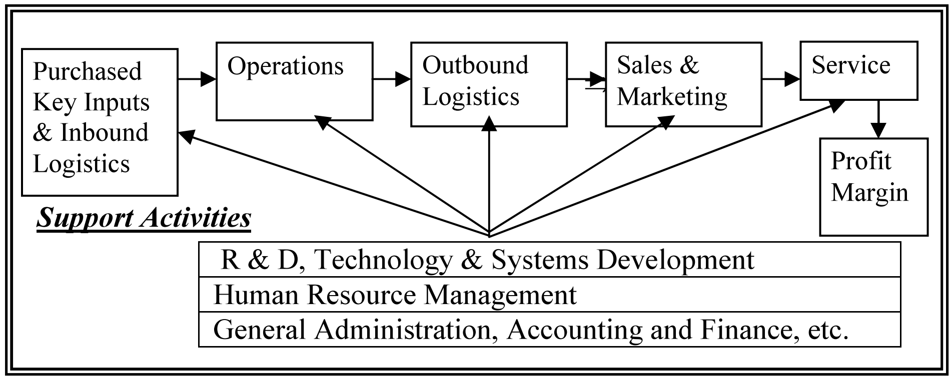

Figure 4.2: A simplified value chain of a manufacturing company

Value Chain of a watch manufacturing factory

Raw Materials Supply
↓
Production of parts & components
↓
Manufacturing & assembly
↓
Wholesale Distribution
↓
Retailing to consumer
↓
Profit Margins
↓

Figure 4.3: Value chain of a watch company

The most important application of Value Chain Analysis is to expose how a particular company's cost position compares with the cost positions of its rivals. What are needed are competitor-versus-competitor estimates for supplying a product /service to a well-defined customer group or market segment.

A company's cost competitiveness depress not only on the costs of internally performed activities (own value chain) but also on cost in the value chains of its supplies and forward channel allies. A company's relative cost position and overall competitiveness is linked with the entire *industry value chain* system.

Review Questions

1. What do you mean by situation analysis of an organization?
2. Make a list of the techniques for analyzing company situations.
3. What is meant by SWOT analysis?
4. Define value chain of a company and explain how value chain analysis technique can be used for company situation analysis.

Application Discussion Questions

1. Browse the web site of a company operating its business in Bangladesh. Note down the relevant information that you would be able to use for SWOT analysis. Now, prepare a SWOT framework and use your information for the identification of the company's strengths, weaknesses, opportunities and threats.

NOTES

1. These techniques have been suggested by Thompson and Strickland, op.cit., chapter 4.
2. The meaning and interpretation of strength, weakness, opportunity and threat have been borrowed from Thompson and Strickland, op.cit., chapter 4.

Lesson-3: Analytical Techniques of Situation Analysis-II

Learning Objectives:

After studying this lesson, you should be able to:

- Use the Strategic Cost Analysis as a technique for company situation analysis.
- Understand the use of Competitive Strength Assessment for the analysis of the situation of a company.

Introduction

In the previous lesson you have learnt about the two techniques of situation analysis such as SWOT analysis and value chain analysis. The other two techniques, although not very popular in the business firms, are discussed in this lesson. These are strategic cost analysis and competitive strengths assessment.

Strategic Cost Analysis

Strategic cost analysis focuses on a firm's cost position relative to its rivals.

Strategic cost analysis focuses on a firm's cost position relative to its rivals. It involves comparing a company's cost position relative to key competitors, activity by activity, from raw materials purchase to the price paid by ultimate consumers.

A company must be aware to how its costs compare with the costs of rivals. Usually disparities in cost among rival producers stem from differences in –

- prices of raw materials and other inputs
- basic technology
- internal operating costs due to economies of scale, different wage rates and productivity levels, different overhead costs, etc.
- marketing costs, sales, promotion expenses and advertising expenses
- Inbound transportation costs and outbound shipping costs.
- Costs & markups of intermediaries (i.e., distribution costs).

The primary analytical tool of strategic cost analysis is a value chain.

The primary analytical tool of strategic cost analysis is a value chain. It shows values from raw materials supply to the price paid by ultimate customer. The chain goes beyond company's own internal cost structure to cover all the stages in the industry-chain: raw materials supply, manufacturing, wholesale distribution, and retailing.

Value chain/ activity-cost chain reveals a great deal about a firm's cost competitiveness. The total industry value chain or activity-cost chain includes (i) supplier-related activities (such as purchased inputs and inbound logistics), (ii) manufacturing-related activities (such as production and operations, marketing and selling, customer service and outbound logistics, in-house staff support activities, general and administrative activities), and (iii) distribution-related activities (such as distributor/wholesaler and retailer activities). Examining the firm's chain and comparing it to that of the competitors indicate who has how much of a cost advantage/disadvantage and which cost components are responsible. Such information is vital in formulating strategies to create a cost advantage or eliminate a cost disadvantage.

Developing the Data for Strategic Cost Analysis

Once the major elements of the value chain are identified, the next step in strategic cost analysis involves breaking down a firm's departmental cost accounting data into the costs of performing specific activities. A good guideline is to develop separate cost estimates for activities having different economies and for activities representing a significant proportion of cost. Unlike traditional accounting, activity-based costing entails defining expense categories based on the specific activities and then assigning cost to the appropriate activity responsible for creating the cost.

Competitive Strength Assessment

Systematic assessment of a company's competitive position is an essential step in company situation analysis. Competitive Strengths Assessment helps in assessing whether a company's competitive position in the marketplace is strong or weak relative to close competitors. Through Competitive Strengths Assessment, a broad-based assessment is made of a company's competitive position and strength. This step looks at how a company matches competitors on the determinants of competitive success. The competitive strength rankings indicate in which areas a company is strong or weak. As a rule, a company's competitive strategy should be built on its competitive strengths. A company has the best potential for offensive attack in areas where it is strong and competitors are weak.

Competitive strengths assessment helps in assessing whether a company's competitive position in the marketplace is strong or weak relative to close competitors.

Steps in Competitive Strength Assessment

Step-1: Make a list of the industry's key success factors and measures of competitive strengths or weaknesses.

Step-2: Rate the firm and its competitors on each factor. Numerical scales (e.g., from 1 to 5) are widely used. However, ratings of stronger (+), weaker (-), and about equal (=) may be appropriate when assigning numerical scores coveys false precision.

Step-3: Sum the individual strength ratings to get an overall measure of competitive strength for each competitor.

Step-4: Draw conclusions about the size and extent of the company's net competitive advantage or disadvantage based on the strength assessment. Also, take specific note of areas where the company's competitive position is strongest and weakest.

Table 4.1 shows an illustration of unweighted competitive strength assessments When the key success factors or competitive strength measures are used as unweighted, it means that each key factor has been given equal importance by the company. According to this approach, whenever a company achieves highest rating on a factor, it implies that the company has competitive edge on that factor. The differences between the overall ratings indicate net competitive advantage of the companies. In the example in Table 4.1, XY & Co. has a score of 61. It implies that this company has a greater net competitive advantage over Rival-4 than over Rival-1.

Table 4.1: Illustration of unweighted competitive strength assessments

Key Success Factors/Strength Measure	XY & Co.	Rival 1	Rival 2	Rival 3	Rival 4
Quality/ product performance	8	5	10	1	6
Reputation	8	7	10	1	6
Raw material access/cost	2	10	4	5	1
Technological skills	10	1	7	3	8
Advertising effectiveness	9	4	10	5	1
Marketing	9	4	10	5	1
Financial resource	5	10	7	3	1
Relative cost position	5	10	3	1	4
Ability to compete on price	5	7	10	1	4
Unweighted overall strength rating	**61**	**58**	**71**	**25**	**32**

Note: The illustration is prepared based on Thompson and Strickland, p. 97.
Rating scale 1= very weak; 10= very strong.

Of all the four techniques of company situation analysis, SWOT is most widely used in companies both in our country and other countries. Therefore, in Lesson-3, a detailed discussion about SWOT analysis is devoted to it for helping readers a comprehensive understanding of the relevant issues.

We would like to conclude with a note that a company has the freedom to undertake situation analysis by using the techniques that have been discussed. However, managers should carefully examine each of the techniques to understand the concepts inherent in each technique.

Review Questions

1. What is Strategic Cost Analysis? How can this technique be used for company situation analysis?
2. Discuss the use of Competitive Strength Assessment for the analysis of the situation of a company.

Application Discussion Questions

1. If in your company you are asked to conduct strategic cost analysis, what procedure would you follow? What benefits would your company derive from this analysis?
2. Since the Competitive Strengths Assessment helps in identifying whether your company's competitive position in the marketplace is strong or weak, you can adopt this technique in your company. When you would use this technique, what steps would you follow for the assessment of your company's strengths relative to close competitors?

Lesson-4: SWOT Analysis

Learning Objectives:

After studying this lesson, you should be able to:

- Discuss the importance of SWOT analysis in the organizational context.
- Identify the sources of data for SWOT analysis.
- Discuss the steps that are involved in SWOT analysis.
- Prepare a format for SWOT analysis.

Introduction

In lesson-2, we have discussed the meaning and nature of SWOT analysis in details. We have also highlighted the rationale for SWOT analysis for generation of information regarding the internal and external situations of an organization. This lesson provides an in-depth discussion about SWOT framework as a tool for situation analysis. It mainly examines the importance of SWOT analysis, sources of data for SWOT analysis, steps involved in SWOT analysis, and practical examples of strengths, weaknesses, opportunities and threats.

Importance of SWOT Analysis in an Organization

SWOT analysis is important for a company for the following reasons:

1. It evaluates strengths, weaknesses, opportunities and threats of the company and helps in drawing conclusions about the attractiveness of its situation.
2. It points out the need for strategic action.
3. The strengths identified through SWOT Analysis can be used as the cornerstones of strategy and the basis on which to build competitive advantage.
4. It enables the company to build its strategy around what the company does best on the basis of the strengths and should avoid strategies whose success depends heavily on areas where the company is weak.
5. The results of SWOT analysis are helpful in correcting competitive weaknesses that make the company vulnerable.
6. Based on the opportunities identified through SWOT analysis, mangers can aim their strategies at pursuing opportunities well-suited to the company's capabilities and provide a defense against external threats.

Sources of Data for SWOT Analysis

Thus, the sources of data for SWOT analysis will differ based on the environmental factors.

As has already been said, SWOT is conducted for analyzing the external and internal environmental factors that affect a company's business activities. Thus, the sources of data for SWOT analysis will differ based on the environmental factors. The sources of data for external factors will never be same for different industries. However, there are some common sources which a company may explore: the Internet, trade associations like chambers of commerce and industry, export promotion bureaus, trade fairs and exhibitions, foreign trade missions/consulates, board of investment, concerned ministries, other business units in the same industry, research organizations, consulting firms, market survey firms, independent think tanks like the Center for Policy Dialogue (CPD).

Steps to be Followed in SWOT Analysis

While undertaking SWOT analysis of your company you can follow the following four major steps:

There are four major steps in SWOT Analysis.

1. Identification of opportunities and threats posed by external environment.
2. Identification of opportunities and threats posed by competitors.
3. Identification of the internal strengths and weaknesses of the organization.
4. Assessing the attractiveness of the organization's situations and draw conclusions regarding the need for strategic action.

We now discuss the details of the steps involved in the SWOT analysis.

Step-1: External Environmental Analysis

- Identify the key political, economic, social-cultural, demographic, natural/ecological and technological forces that are most likely to affect the organization.
- Monitor information on the environmental forces.
- Select the method to be used in forecasting these forces.
- Forecast the trends in these forces.
- Identify the market opportunities on the basis of the forecasts of these forces.
- Identifying the threats to a company's future profitability.

Step-2: Competitive Analysis

- Analyze the industry structure.
- Analyze the nature of competition.
- Identify and analyze individual competitors.
- Identify key strengths and weaknesses of the company as compared to those of competitors.
- Identifying company's market opportunities
- Identify threats and opportunities based on industry competitiveness.

Step-3: Internal Environmental Analysis

- Identify the areas for analysis (such as financial position, product position, etc.)
- Analyze each of the selected areas.
- Identifying company's internal strengths and resource capabilities.

- Identifying company's internal weaknesses and resource deficiencies.
- Evaluate the strengths and weaknesses for their strategy-making implications.

Step-4: Concluding SWOT Analysis

- Assess the attractiveness of organization's situation on the basis of identified strengths, weaknesses, opportunities and threats.
- Draw conclusions regarding the need for strategic action.

Strengths, weaknesses, opportunities and threats point to the need for strategic action. Managers need to – (a) undertake actions to protect/improve the company's strengths, (b) initiate efforts to overcome the weaknesses, (c) pursue market opportunities well-suited to the company's resource capabilities, and (d) take actions to defend against external threats to the company's business.

A format for SWOT analysis with examples from a bank is given below for your better understanding of how to write down statements for strengths, weaknesses, opportunities and threats.

A FORMAT FOR SWOT WITH EXAMPLES
(The examples are given in the context of a banking company)

INTERNAL STRENGTHS	INTERNAL WEAKNESSES
• Our bank has a trained workforce. • Top managers are visionary. • It has adequate physical facilities. • It has sound organization structure showing clear reporting relationships.	• Some of the directors are not professional bankers, and thus they ignorantly create obstacles in effective decision-making. • Ten out of 54 branches are not making profits. • Overhead expenditures are high.
EXTERNAL OPPORTUNITIES	**EXTERNAL THREATS**
• Freedom granted by Bangladesh Bank to charge discriminatory interest rates on various accounts. • People's shift in attitudes toward hire purchase through bank loans and in using credit cards for regular shopping. • Bank's growing prospect in entering into foreign markets.	• Depression in the economy. • Slow growth in industrialization. • Industries are becoming sick in an increasing rate. • Undue pressures from outside for granting loans to financially unviable projects. • Competition among banks in 'snatching away' customers.

What Managers need to do after the SWOT Analysis?

Once the SWOT analysis has been completed, managers have at their disposal adequate information for setting organizational goals/objectives (long-range and short-range). Long-range goals/objectives specify the results desired in the organization's mission. They normally extend beyond current fiscal year. Short-range objectives (one year or less) should follow logically from long-range objectives.

Once the long-range objectives have been set, the stage has now been set for formulating appropriate strategies. The strategies must be formulated keeping in view the realities of the overall environment so that the predetermined objectives can be achieved effectively and efficiently.

By the time, a company's mangers/strategy-makers have been able to understand the situations of the organization in the context of industry and the general external environment as well as the internal conditions of the company. Based on this understanding, they should now be in a position to decide about the competitive strategies that the organization needs for achieving its goals/ objectives. The next unit deals with the formulation of competitive strategies in relation to the objectives.

Review Questions

1. Why is it necessary to undertake SWOT analysis in the business organizations?
2. Why do the sources of data for SWOT analysis differ?
3. What are the common sources of data for SWOT analysis which a company may explore?
4. Discuss the steps that managers need to follow while conducting SWOT analysis in their organizations?
5. After the SWOT analysis has been completed, what do the managers need to do next?

Application Discussion Questions

1. Suppose you are a mid-level manager in a large manufacturing company. As advised by the top management, you have just completed SWOT analysis of your company. Based on the information that you have generated through SWOT analysis, what step would you take next that should logically lead to strategy formulation?