

Introduction

This video aims to give you a high-level overview of external analysis and help you:

1. Understand the purpose of external analysis and the insights we can gain.
2. Gain exposure to some key tools for external analysis.
3. Learn how these tools work together to generate strategic insight.

The external environment

- The external environment presents threats and opportunities that should be considered in the decision-making process
- Using the example of a fish in a pond, we want to understand:
 - o What is the nature of the competition among the fish?
 - o Do fish cooperate or fight one another viciously?
 - o Is there enough oxygen in the water?
 - o Is there enough food to sustain growth?
 - o Are there climate shifts threatening to change the availability of resources?
 - o Could a drought eliminate the pond altogether?
- Our questions don't explore anything about the fish itself, but its external environment.

Tools for external analysis

Analyzing the competitive environment

- Identify and clearly define the competitive environment of the company.
- Let's use, for example, the auto manufacturing industry. Are we analyzing:
 - o The global auto industry?
 - o The US auto industry?
 - o The EU auto industry?
 - o The economy car segment?
 - o The midsize car segment?
 - o The luxury car segment?
 - o The luxury auto segment in the EU?
- In this scenario, boundaries are important for a meaningful analysis. Let's focus on our competitors at this point.

- Competitive dynamics:
 - What is the nature of the competition? Is it on price or product differentiation?
 - Do the companies cooperate to keep profits high or are they competing aggressively to drive down profits for everyone?
 - Note that we are not analyzing a single company. We're looking at how these various companies inside the circle compete.

Industry Analysis

- Industry analysis requires us to first analyze the nature of competition within the competitive environment (see above).
- Now we can analyze and categorize the other entities and their relationships in the competitive landscape:
 - **Potential Entrants:** companies that could move into the circle and try to compete directly in the competitive environment. The easier it is for new companies to enter your circle, the more difficult it will be for existing companies to capture profits within the circle.
 - **Buyers:** they want lower prices and better products, so they will try to bargain for both. When buyers have a lot of power, they can shift profits from the companies inside our circle to their own pocketbooks.
 - **Suppliers:** they want higher prices and want to provide low cost products. So, like buyers, they try to shift profits from the companies inside the circle into their own pocketbooks.
 - **Substitutes:** they satisfy the job's customers are hiring companies in your circle to do but they're doing it in a different way. The easier it is for your buyers to find appropriate substitutes the harder it will be for existing companies to capture profits within the circle.
 - **Complements:** they provide products or services that when purchased increase demand for the products and services inside your circle. For example, Android apps may increase the demand for Android phones. The more there are attractive complements, the easier it will be for the companies in your circle to capture profits.

- Keep in mind that this analysis is a snapshot and provides insights into the external environment *today*. But things may change in an industry. The next tool will help us take that into account.

PEST analysis

- PEST stands for Political, Economic, Social and Technological analysis.
 - **Political:** i.e. imagine what would happen if a regulation changed made it legal/illegal for some of the companies in our competitive environment to sell products or services.
 - **Economic:** imagine what would happen if an economic crash made it so that a large percentage of the buyers could no longer afford to buy these products and services.
 - **Social:** imagine what would happen if societal preferences shifted such that most consumers felt that the companies in our competitive environment were doing something morally inappropriate, such as negatively impacting the natural environment.
 - **Technological:** imagine what would happen if a new technology made substitute products more attractive.
- Of course, not all trends are concerning. Some can positively impact our competitive environment.
- PEST “draws” another large circle that contains all the organizations in our external environment.
- This circle is what we capture inside the lens of a traditional industry analysis, but the political, economic, social, and our technical trends may change what our snapshot looks like over time.
- At this point, we have a reasonably complete picture of our external environment.

Conclusion

- These tools don't really allow us to say anything about the company itself, just the environment in which it is embedded.
- If we do this analysis well, we know everything we need to know about our external environment today, and we know how our external environment is likely to change soon, given the PEST trends.
- In other words, we can start to ask questions about the fish.