

Strategic Management

Chapter 3

Analyzing the Macro Environment

outline

- Macro environment
 - Defining scope
- Implications for company sales and revenues
- Gaining competitive advantage by understanding environment
- Understanding the environment
- Looking ahead

Part of analysis

- If you remember the strategy process
 - Set objective
 - **Analyze**
 - Choose strategy
 - Implement (and control)

feedback



What is the business environment

- What does environment mean?
- What is the business environment?
 - All external factors that can impact operation
 - *So many factors exist!*
- Important for businesses to consider
 - *Should a firm consider a major expansion if economic indicators suggest a recession is imminent?*

Macroeconomics

- Useful starting point
- Deals with state of global and national economies
 - Exchange rates, trade flows, relative growth rates
 - GNP, employment rates, interest rates, inflation rates
 - Fiscal and monetary policies

3 reasons for understanding economy

- Distinguish between what's under company control and what's not
 - *If sales go down, did we do something wrong, or is there nothing we could have done?*
- Know of/anticipate changes that will present as opportunities or threats
 - *If interest rates go up, then demand for consumer durables could go down*
- Knowing economy mechanics allows us to interpret predictions
 - *Does person X really know what he's saying when he says that prices will go down*

Implications for sales and revenues

- GNP elasticity
 - Elastic: 1% change in GNP leads to $>1\%$ change in demand
 - 1.5 for hi-fi
 - Inelastic: 1% change in GNP leads to $<1\%$ change in demand
 - 0 for potato

- In the following example, it shows what happens when there is a 4% reduction in GNP
- In reality, the GNP elasticity is 1.5
 - So a 4% reduction results in a $4\% \times 1.5 = 6\%$ reduction in demand
 - Thus the total market size is 94% of original market

- Table 3.1: Revenue and GNP elasticity

■ GNP elasticity	Total market	Market share	Total sales	% change
■				
■ 0.0	1000	15	150	
■ 1.5	940	15	141	-6.0
■ 1.5	940	16	150	0
■				

- Good strategic management
 - Suppose the original sales of $15\% \times 1000 = 150$ needs to be maintained
 - Then solve $150 = s(940)$, so $s = 16\%$
 - *Increase market share by 1% in anticipation of GNP reduction by 4%*

In the example shown in Table 3.1 it was predicted that GNP was expected to fall by 6 (← SHOULD BE 4?) percent. Instead of this, imagine that GNP is expected to grow next year by 5 percent due to expansionist fiscal and monetary policies. What would be the impact be on total sales if market share 1 remained at 15 per cent. 2 increased to 16 per cent. What conclusion would you draw for marketing strategy if the economy were growing?

Environment as a threat to costs

- Not all (input) prices vary uniformly
- Sps a company anticipates 10% increase in demand (due to GNP growth)
 - Increase purchase of inputs by 10%?
- Costs then should go up by 10%
 - But if input prices go up, then cost will go by up by more than 10%
- Cost calculations
 - $C = pq$;
 - $C' = 1.05p \times 1.1q = 1.155 pq = 1.16 C$

Gaining competitive advantage by understanding economy

- How will competitors behave?
 - Are competitors analyzing economy well?
 - Company could have failing market share, in a declining market, with a decreasing competitive price.

Table 3.3: Volatile revenues

Period	Total market	Market share (%)	Price	Total revenue	% change
1	100	20	10	200	
2	95	18	9	154	-23

Price changed 10%, market share 10%, market 5%, revenue changed 23%

Long-term competitive effects

- Managers' attitudes and styles can be influenced by economic conditions
- Managers of mnc's before and now
- UK
- Asia

Macroeconomic Environmental Variables

- Information overload
 - How do you filter?
- Macroeconomics covers
 - The determination of GNP through the interaction of demand and supply in the economy as a whole, and the effect of changes in both demand and supply factors
 - full employment output, actual output, the unemployment rate and the inflation rate
 - the role of expectations
 - money supply and the rate of interest
 - the rate of interest and investment expenditure
 - factors affecting the demand for and supply of imports and exports
 - the determination of the exchange rate and international financial flows

International economy

- Exchange rates
 - Fluctuations have significant implications for predicting the cash flows from foreign countries

For example,
if the company is convinced that a particular currency is undervalued in relation to the domestic currency, a potential strategy is to break into the market now and establish market share in the knowledge that losses will be incurred until a reflation takes place. Or if a company is evaluating a potential investment in a country, the prospect of a reflation of that country's currency could have major implications for the timing of the cash flows necessary to carry out the investment.

Think global act local

- Think of world as global market
 - Expand within local market (segments!)
 - Avoiding exchange rate risks
- World is becoming “standardized” by culture imposition
- Regional influences on managers
 - Do we like to take business/investment risks in Bangladesh?
 - What happens when we have a great business idea?
 - Scotland, Singapore

Porter says...

- Impact of national environment on the competitiveness of individual companies determined by
 - Factor conditions: Silicon valley had a large pool of highly skilled manpower
 - Related and supporting industries: are there others to offer power for example?
 - Demand conditions: sophisticated consumers force companies to innovate
 - Strategy structure and rivalry: a country which fosters competition at home potentially breeds a strong core of companies which are capable of competing in the international arena>

Looking ahead

- All decisions are about the future and there are various approaches to assessing what the future might have in store
 - Forecasting
 - PEST
 - Scenario analysis

forecasting

- The whole point behind understanding the economy is to try and predict the future course of events
- Forecasts are never accurate
 - Then why forecast?
 - Because forecasts are valuable
- Forecasts tell you what is likely to happen
 - Helps you to better prepare

Table 3.5: Forecasting UK GNP for a typical year

	GNP % growth
Actual	-2.2
Confederation of British Industry	-0.8
James Capel	-0.4
Morgan Grenfell	0.4
UK Treasury	0.5
National Institute for Economic and Social Research	0.8
London Business School	1.4

No forecaster even came close to predicting what would happen. The difference between the highest of the predictions for GNP growth (+1.4 per cent) and the actual outcome (-2.2 per cent) is not trivial for those companies whose product has a high income elasticity. A company which acted on the basis of the London Business School forecast and increased its output in the expectation of a significant increase in demand would have found itself with substantial unsold inventories by the end of 1991.

- Many forecasting methods
 - Intuitive to quantitative
 - LBS used quantitative method!
- Leading indicator
 - e.g. the number of housing starts
- Think of business cycle
 - Booms and busts
 - Pattern: trend, cycle details, disturbances

What will be the difference in the attitude of a CEO to a major investment if he thinks that the economy is about half way towards the peak of the cycle compared to being at the top and ready to fall back down again?

PEST

- Political
 - Taxation, regulation, intervention
- Economic
- Social
 - Attitudes, fashions, tastes, demographics
- Technological

example

Political

- Recent elections resulted in a new government which is more inclined to stricter regulation and opening up the market.
- The new government is committed to subsidising domestic house insulation.
- There is increasing international political agreement to cut pollution.

Economic

- New gas fields are being opened up with implications for the price of gas.
- There are several indications of a slow down in economic activity which will have a significant effect on industrial demand for energy of all types.
- The price of coal on international markets has started to increase.

Social

- There is a rising public awareness of the need to conserve energy.
- The aversion to nuclear energy is increasing.
- The number of single occupancy households is predicted to increase by 25 per cent over the next two decades.

Technological

- Improved techniques for insulating houses are being developed.
- Studies have shown that alternative energy sources such as wind, water and solar power are now cost effective.

Factor	Issues	Threat
Political	the company is likely to be constrained by the new government, exposed to increased, competition and possibly lower demand than expected	HIGH
Economic	the imminent economic slow down, competition from gas and higher costs of coal	HIGH
Social	trends which are possibly going to find expression through improved insulation and alternative power sources	HIGH
Technological	Research into alternative energy sources starting to pay off	HIGH

Environmental Scanning

- It is important to *continuously monitor* all of the PEST type of variables.
- The reason that many companies are caught unawares is NOT that many events could not be predicted
 - There was simply not enough monitoring
 - Example: IBM didn't monitor rise of PC's
 - GM and BMW didn't see rise of SUV's

- Why don't managers engage in scanning?
 - Distractions not affordable?
 - Away days important...

Scenarios

- Once some projections of futures have been made they can be used as the basis of scenarios
- Scenario is not a forecast
 - Attempt to investigate the implications of possible futures for the company
- Scenarios in page 60 of your textbook
- HW, exercise 3.7 (random calls)