

Economic Environment and Business Strategy
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Strategic Management – I

Welcome back, everyone. In today's session, we begin our discussion of strategic management, also known as business policy. Strategic management concerns the long-term direction of an organization, the big-picture decisions and actions that shape its performance over time. Unlike operational management, which focuses on day-to-day operations, strategy addresses where the organization is headed and how it plans to achieve its goals. This process involves scanning the environment, formulating strategies, implementing them, and continuously evaluating and controlling outcomes. We will first examine the basic model of strategic management and then move on to environmental scanning, a critical step that serves as a radar for firms to detect opportunities and threats.

From there, we will explore Porter's Five Forces, a key concept in industry analysis that explains why some industries are more profitable than others and how firms can position themselves strategically within their environment. By the end of this session, you should have a clearer understanding of how external and internal factors shape business performance and how managers can use frameworks like Porter's Five Forces to navigate competition effectively. So, let me begin with the basics of strategic management. Strategic management is the set of decisions and actions managers take to secure an organization's long-term success.

Strategic management is not just about planning but also about scanning the environment, formulating strategies, implementing those strategies, and finally evaluating and controlling outcomes. This cycle ensures that organizations remain competitive and adaptable. This is the main textbook from which I have drawn the inputs and resources for this session and the subsequent sessions. This slide presents the basic model of strategic management. It begins by scanning both the external and internal environments.

Based on this, managers then develop strategies. This is the strategy formulation process, which involves investigation, analysis, and decision-making to provide the company with the criteria for attaining a competitive advantage. These strategies are then implemented through programs, budgets, and procedures. Finally, performance is evaluated and controlled to ensure alignment with organizational objectives. This is the final stage: evaluation and control.

The process is cyclical, with feedback driving improvements. So let me now list four key dimensions of strategic management. The first is environmental scanning, the second is strategic formulation, the third is strategy implementation, and the fourth is evaluation and control. In this session, I will focus on the first key dimension: environmental scanning. In the next session, we will discuss strategy formulation. Therefore, one of the most critical steps is to recognize that environmental scanning is an integral part of strategic management.

Here, managers identify environmental risks and opportunities, and then they use tools such as Porter's industry analysis to understand the competitive forces. Effective scanning helps organizations stay ahead of disruptions and capitalize on emerging trends. This is a more detailed version of the strategic management process. As you can see, the first step is environmental scanning, which is one of the key dimensions of the process. Two key elements.

There are two environments, the external and the internal. Therefore, environmental scanning, as I mentioned, encompasses both the external and internal environments, including, as you can see here, natural resources, the societal environment, and the task environment. These are all external environmental factors that are not under the direct control of firms and the industry. However, the internal environment primarily concerns the firms themselves, encompassing their technical know-how, assets, skill competencies, knowledge, structure, chain of command, culture, beliefs, expectations, values, and other factors. In this session, our primary focus will be on the first core block, but we will also discuss the other three blocks—strategic formulation, strategy implementation, and evaluation and control—later. We will reuse the same frame or figure at that time.

Moving forward, this diagram illustrates the relationships among the various environmental variables. These are different layers of environmental variables. At its core, you can see that this is the internal environment. The internal environment, as I already mentioned, belongs to the firms themselves. So that means they have more control over the internal environment.

It includes the structure, culture, and resources that are available within the firms themselves. And surrounding this, so you can see the next layer, this layer, this layer, this surrounding, this is the task environment. These are the task environments, or most of these are related to the industry to which this firm belongs. Surrounding this, as I mentioned, is the task environment, which includes shareholders, suppliers of raw materials, suppliers of output to the market, competitors, employers, trade associations, communities, creditors, customers, special interest groups, and governments, among others. This is the second layer, which primarily encompasses the task environment.

Finally, the broader environment comes into play, encompassing a wide range of external factors. That includes societal, economic, technological, political, legal, and socio-cultural forces. This all falls within what we can call the broader societal environment. Strategic management requires management to understand all these interconnected layers, identify opportunities, challenges, and threats, and act accordingly. To systematize environmental scanning, managers often use the STEEP framework.

This is the STEEP analysis framework they often use. As you can see, it covers important variables in the societal environment, which are the focus of the STEEP analysis. This includes socio-cultural aspects, such as lifestyle changes, career expectations, and consumer activism, among others. You can go through this one item by item to gain a clear understanding of the socio-cultural aspects. And then we have the technological aspects.

You can see the R&D, investment, and other aspects, including internet availability and telecommunications infrastructure. We also have economic aspects, mainly GDP trends and other key economic variables, which I have already mentioned in previous sessions: interest rates, money supply, inflation, and similar key variables. We also have ecological aspects, including environmental protection laws, climate change, and global warming. All these aspects are covered in the ecological dimension. And then there are the political and legal trends.

This is also part of the environment. You can also see the antitrust regulations and environmental rules. The recent global tariffs and the trade agreements between countries are all part of the steep analysis. So, in this slide, you can see that the task environment focuses on more immediate stakeholders. These are the stakeholders most directly associated with the firms and industries.

And this includes, as you can see, customers, competitors, suppliers, governments, and communities. Analyzing these groups helps managers identify opportunities and threats. So, strategic factors emerging from this analysis directly influence firms' decisions on market entry, pricing, and competitive positioning. So, moving further, competitive advantage arises when organizations can identify and respond to external changes more quickly than their competitors. So, it's just like the early bird.

Those who identify challenges early and respond promptly will survive in the industry, generate more profit, and remain more competitive. Research shows that successful firms are characterized by well-defined systems that integrate planning and review. However, managers' personal biases can create strategic myopia, causing them to ignore unfamiliar information. This is evident in their strategic approach. They often ignore unfamiliar information, even though it is important. In practice, all this information will be very important parameters for decision-making in firms.

This is critical for selectively monitoring the most relevant external factors. Therefore, the firm must focus on the most essential external factors rather than identifying and prioritizing each one. What is more critical for the firm is to focus on those external factors. So, let me also introduce you to some literature related to environmental scanning. The academic research highlights that environmental scanning is an evolving area of study.

Studies show that external factors, particularly competitors' marketing actions, often have a greater impact on business performance than internal strategic choices. This highlights the need for firms to continuously monitor external forces and incorporate them into their strategic decision-making. I am showing you a screenshot of some research papers; I would also suggest providing the citations here. You can review that document to access the full text; please take a moment to do so. So, this is all part of environmental scanning, which is like a radar for business, detecting signals from the external environment.

Research has consistently shown that external factors, particularly competitors' marketing mix elements or strategies, often matter more than a company's internal strategies. Therefore, scholars emphasize the need to fill the research gap in understanding how firms can better utilize scanning to anticipate changes. Overall, based on these findings, I argue that it is essential for firms to understand and identify external forces and environmental factors, as they are beyond the control of the firms and the industry. Therefore, it is essential for firms to thoroughly understand what their competitors are doing, the various environmental factors at play, and how these factors often change. And giving some more input on this.

The environmental scanning system manages the tools used to monitor trends and even weak signals in the environment. By detecting these early, firms can prepare long-term strategies, and ultimately, effective scanning enhances organizational adaptability and performance. Let me now introduce you to Porter's approach to industry analysis. Michael Porter is the expert in this field, and his contributions have been widely acknowledged and used by firms and industries for strategy formulation and implementation.

It mainly has five components. You can see that this is the cornerstone of industry analysis. These components shape competition and profitability. As you can see here, the power of suppliers, the threats of substitutes, rivalry among competitors, the threats of new entrants, and the power of buyers are all evident. Therefore, firms' and industries' profits and competition depend not only on the bargaining power of suppliers and buyers but also on the threat of new entrants, substitutes, and existing rivalry.

When discussing the key aspect of the threat of new entrants, it's important to note that when new firms enter an industry, they increase competition and, as a result, reduce the profit margins of existing firms. However, industries also need to understand the types of entry barriers that are often prevalent, such as high capital requirements, which can make entry difficult. Even with that kind of entry barrier in place, disruptive entry can still occur. For example, in 2016, you may recall, there was the Jio entry. What happened that completely disrupted the market? Jio implemented a predictive pricing strategy, which meant they sold internet and calls at a very low price; that's called predatory pricing.

Such a low price puts a lot of pressure on incumbent firms in the industry, and they are also forced to reduce their prices to retain their existing customers. That often happens, though; even with entry barriers, entry into the telecom market is not easy because it requires a lot of capital investment, and well-established firms are already there. However, Jio made a disruptive entry in 2016. Similarly, the U.S. automobile industry has offered high capital barriers since the 1930s. However, recently, Tesla has entered the highly competitive U.S. automobile industry. The main point I want to highlight here is that there are entry barriers for a new entrant. However, sometimes technology or other factors allow companies with ample resources to advance technologically, which often enables them to overcome those kinds of entry barriers. Moving forward, let me list some of the other potential entry barriers. One is called economies of scale. Economies of scale arise from spreading costs over large volumes.

For instance, the car manufacturer is reducing the per-unit cost as production expands. That means that if a firm produces many goods or services, the marginal cost of production declines because it enjoys economies of scale. Due to large-scale production, the unit cost declines. That is one. Therefore, if existing firms are already engaged in large-scale production, it will be difficult for a new firm to enter, as it needs to capture the market after entering.

Suppose they capture only a very small share of the market; that means they can produce only a small volume of goods. Therefore, they won't enjoy economies of scale. When firms produce many goods and services, they gain a cost advantage; however, new firms cannot enjoy this kind of cost advantage. Additionally, there are other factors, including product differentiation. Product differentiation means that strong brands create high entry barriers. For example, in the case of toothpaste, you are likely familiar with well-established firms such as Cibaca, Colgate, and Closeup.

You know that they have built strong brand value, so it will be difficult for any new entrant to establish a presence in this market, as they have already established a high brand value and created product differentiation. For example, with toothpaste, you can see that if you use Colgate or Close-Up, the psychological feeling created by the advertisements has been established. All these products are unique and differ from one

another. Then, there are the capital requirements, which you are aware of, especially when making an entry. Some firms, businesses require large capital requirements, particularly finance firms. For example, if you want to start a bank or an insurance company, you need a large amount of capital.

That is often difficult for new firms. Switching costs are another concern. When consumers move from one product to another, it can be difficult to switch, especially if they have been using Microsoft Office and Excel. If you introduce new software to the market or a new MS Office-type product, people won't switch immediately from what they have been using. Therefore, Windows, MS Office, and similar products make switching difficult because the switching costs are high. In addition, government policy matters because it influences entry through licensing and regulations. Let me provide you with a bit more insight into the economics of scale and a related concept, the economics of scope.

And the economies of scale, which I have already mentioned, refer to the cost advantages of producing a large volume of goods and services. Another related concept is the economic source scope. Economic source scope, on the other hand, comes from producing multiple products together. So just look at the State Bank of India. You know that the State Bank of India is one of the largest commercial banks in the country.

And SBI, because it already has a large infrastructure base and substantial technical and managerial skills, can easily set up an insurance company, pension businesses, and other banking services through the same network. This is called economies of scope. Economies of scope refer to cost savings achieved by producing a variety of products using shared resources. They occur when producing a variety of products reduces costs. Overall, economies of scale and economies of scope both reduce per-unit costs and enhance competitive advantages for firms.

The main point I am presenting here is that existing firms can enjoy economies of scale and economies of scope, which prevent new firms from entering the industry. For new entrants, it takes time to develop economies of scale and economies of scope after entering the business. In addition, rivalry among firms is intense when industries have many competitors and when growth is slow. In such cases, firms often resort to price wars. If products are commodities, such as gasoline, competition is even more cutthroat. When industries have high fixed costs, such as airlines, the fixed costs are substantial. Each airline incurs costs of around a million dollars.

Firms fight fiercely to fill their capacity. Not only do they face exit barriers, such as specialized assets, for example, airlines; just think about airlines. So, if the airlines are making losses, they cannot freely exit because they have already invested in the airlines. The assets cannot be used for any purpose other than their intended use. So, they must

continue in the business. Therefore, it forces companies to continue competing, even when they incur losses, as the assets they have already acquired cannot be used for other purposes.

Similarly, when rivals add diverse strategies, rivalry intensifies in the business. Beyond rivalry and entry barriers, the points we have discussed so far, industries also face risks from substitutes, as well as powerful buyers and suppliers. Thus, stakeholders such as the government and unions add further complexity. Ultimately, companies that collaborate to add value, such as Intel and Microsoft, can significantly impact industry dynamics. To conclude this session, let us connect the dots. We began with environmental scanning, a radar that helps firms detect and respond to external changes.

The research indicates that external factors, particularly competitors' actions, often have a greater impact on business performance than internal strategies alone. We then moved on to Porter's 5 Forces, which provide a structured way to analyze industry competition. The threat of new entrants, the power of buyers, and the power of suppliers shape profitability. Entry barriers, economies of scale and scope, and the intensity of rivalry collectively determine the attractiveness of an industry. Ultimately, we also observed that industry dynamics are influenced by stakeholders, substitutes, and even complementors, such as Intel and Microsoft.

Together, environmental scanning and Porter's framework provide us with powerful tools to understand industries, anticipate challenges, and sustain competitive strategies and advantages. Thank you for watching this session. See you in the next session.