

Chapter 2

The Basic Principles of Competitive Strategy: External and Internal Diagnosis

ABSTRACT

Firms operate in a more and more complex, dynamic, less predictable environment. This situation requires following different approaches of strategic positioning and strategic planning and developing new patterns of strategic thinking. There are several strategic models and tools. Most of them have advantages and disadvantages. In spite of these limitations, these models must be examined. The purpose of this chapter is to conduct a strategic analysis (external and internal diagnoses). It familiarizes the reader with the forces that shape competition in a company's external environment and then analyzes internal strategic capabilities for identifying strategic sustainable competitive advantage.

INTRODUCTION

Firms operate in a more and more complex, dynamic, less predictable environment. This situation requires to follow different approaches of strategic positioning and strategic planning and to develop new patterns of strategic thinking. There are several strategic models and tools. Most of them have advantages and disadvantages. But in spite of these limitations, these models are not unless and must be examined.

The purpose of this chapter is therefore to conduct a strategic analysis (external and internal diagnosis). It familiarizes with the forces that shape competition in a company's external environment

and then analyzes internal strategic capabilities for identifying strategic sustainable competitive advantage.

The chapter defines first several key notions such as industry, sector, competitive advantage and critical success factors. The next section describes the forces that shape competition in a company's industry environment, using Porter's five forces model as an overall framework and to a lesser extent PESTEL model. The chapter moves on to explore the concepts of internal resources and competencies that can impact a company's competitive position and performance in the global marketplace. The final section is dedicated to the value chain as it can be conducted at the

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firm level (internal value chain) or at an industry level (industry value chain). It summarizes the basic principles of value chain thinking and value chain analysis (VCA).

The strategic external diagnosis is based on the assumption that if the organization is able to analyze its current environment and assess potential changes, it will be better placed than its competitors to respond to changes. The internal diagnosis is related to the fact that companies could have an impact on their environment thanks to their strategic assets according to the Resources-Based-View (RBV) approach. An organization on its own can affect its external factors.

A GENERAL OVERVIEW OF STRATEGIC TOOLS AND KEY CONCEPTS

The Strategic Approach

This section provides a review of the main tools used in strategic management. We have mentioned in chapter 1 the five steps related to the strategic management process:

- 1- Gather and collect information;
- 2- Establish a strategic diagnosis;
- 3- Make recommendations;
- 4- Implement; and
- 5- Evaluate.

The objective here is to show how a strategic diagnosis (stage 2) could be conducted.

To simplify in the field of strategic management, two complementary approaches enable an explanation of the sustainable competitive advantage of a company, or alternatively its difficulties and its positioning problems in the market. An initial ‘external’ analysis of the environment calling on the use of various models including that of Porter (1980/1998, 1985) (the well-known “five forces” framework determining industry

attractiveness), which stresses the fact that the company must adapt to its environment and find attractive and profitable sectors, i.e. sectors that are characterized by relatively weak competitive pressure (low rivalry, low threat of substitutes, low threat of entry, low buyer power and low supplier power). A second ‘internal’ analysis, based on “resources and competences” (Barney, 1991; Prahalad & Hamel, 1990; Wernerfelt, 1984) insists conversely on the capacity of a company to use and transform its environment. The most competitive company is the one which possesses the most advantageous resources and the competences necessary for the implementation and combination of these resources.

Figure 1 presents these two levels of analysis: external and internal. Both of them are based on several tools that are described in this chapter. We consider that concepts mentioned in bold are particularly relevant for a strategic analysis:

- **At the External Level:** The Five Force (+1) framework, industry value chain.
- **At the Internal Level:** The RBV approach, firm value chain.

The notion of business models is developed in chapter 6.

Key Concepts

Towards a Sustainable Competitive Advantage

Firms compete in international markets. How firms create and sustain competitive advantage? At the heart of positioning is competitive advantage. In the long run, firms succeed relative to their competitors.

There are two basic types of competitive advantage:

- **Lower Cost:** Is the ability of a firm to design, produce, and market a comparable

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