GLOBAL BUSINESS ENVIRONMENT AND INTERNATIONAL CHALLENGES

Abhishek Gupta*

Sardar Swaran Singh National Institute of Renewable Energy, Kapurthala (Punjab), India

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Corresponding Author: Abhishek Gupta*
Sardar Swaran Singh National Institute of Renewable Energy, Kapurthala (Punjab), India
iloveindia1909@gmail.com

ABSTRACT

A more comprehensive understanding of an industry can be gained through an analysis of its underlying economic and technical characteristics. A focus on a broad industry may lead to an inaccurate understanding of the market and the nature of competition; it does not tell you who your competitors are and which are the key competing products for your firm. You need to identify your precise market, which can be achieved by conducting a 'market segmentation analysis' and 'strategic group analysis'. A thorough understanding of the industry environment and its likely future should help the strategic decision-maker to develop more appropriate strategies. After reading this research you should be able to understand the significance of the global industry environment for the strategies of multinational firms; apply market segmentation analysis, strategic group analysis, and the Five Forces techniques; understand the importance of industry evolution and the international Product Life Cycle; appreciate differences between forecasting techniques for understanding the future of an industry.

INTRODUCTION

PEST factors are only important if they impact on the industry and the firm. For example, the introduction of a new technology the internet may offer major opportunities for some industries and fewer opportunities for others. The example of Boo.com shows that it is important to understand how changes in the external industry environment affect or do not affect your business. Managers need to understand the industry environment in which they operate, to understand the external opportunities and threats, and to adapt the organization to the industry environment. In order to achieve 'strategic fit', the firm needs to understand the structure of its industry, no matter whether you are a domestic or a multinational firm. Above all, managers need to understand their customers' preferences, lifestyles, shopping habits, etc. The firm must also understand competition in the industry who your competitors are, how much they charge for their products, and how easily new competitors can enter the market. Finally, managers need to understand the suppliers how to form business relationships with them, or how suppliers deliver their goods. Together, customers, competitors, and suppliers are the main elements of the industry environment.

UNDERSTANDING & ADAPTING TO INDUSTRY ENVIRONMENT

A focus on a broad industry may lead to an inaccurate understanding of the market and the nature of competition; it does not tell you who your competitors are and which are the key competing products for your firm. You need to identify your precise market, which can be achieved by conducting a 'market segmentation analysis' and 'strategic group analysis'. When identifying the market, the firm should above all identify the customers who buy the firm's product or service. 'Market segmentation analysis' aims to identify similarities and differences between groups of people who buy and use your goods and services. An added difficulty in global business strategy is that your competitors and customers may differ between countries. So, as part of a market segmentation analysis, a multinational firm may try to identify its main competition by listing all of its main product categories and all of its main geographical markets. Market segmentation analysis focuses on understanding customers. But it is not always the perceptions of customers that define the market. Sometimes markets may be defined by the long history of the industry or by the requirements of technology used to manufacture goods. The Japanese steel industry is an example of an industry divided into two strategic groups. A strategic group is defined as 'a group of firms within the same industry making similar decisions in key areas'. Strategic group analysis aims to identify firms with similar strategies or competing on similar bases. Such an analysis helps to understand who your main competitors are and what strategies your main competitors are likely to pursue. It has been suggested that strategic groups differ in profitability. Strategic group analysis can therefore help us to understand the nature of competition and profitability within an industry sub-group; this gives managers better information about where to invest or what type of strategic action to expect from competitors.
There are no easy prescriptions as to how to identify a strategic group within an industry. A key problem is that the boundaries between strategic groups can be blurred sometimes a multinational firm can be unique and may not easily fit into any strategic group. Mobility barriers are not always very tight, while the external business environment may change (e.g. technology change). The objective criteria cannot always tell us what constitutes a strategic group. Therefore, the most important determinants of strategic groups are perceptions by the senior managers in the industry. Research shows that managers like to partition the external business environment in order to cope with the demands of an uncertain globalizing world where you cannot follow developments in every conceivable market. Therefore managers create mental pictures of where the boundaries of strategic groups lie, and these imagined boundaries are often shared with managers of other firms in the same strategic group. One problem with creating and using mental pictures of strategic groups is that this may lead to ‘strategic myopia’, a human tendency to reject unfamiliar or negative information. This threat is especially present when industries become more international, while the managers’ mental picture of the boundaries of their industry remains rooted in national strategic groups.

FIVE FORCES TECHNIQUES

In order to understand these underlying rules of competition in an industry, Porter proposed a technique called the Five Forces technique. Like PEST analysis, the Five Forces Model can be used to understand the industry environment within one country, one geographical region, or the entire world. But the competitive forces may be very different in countries and regions, so an international manager may be advised to conduct several Five Forces analyses for different countries or regions and then compare the results. It is also very important that the Five Forces are analyzed for a specific market segment or similar market segments, not for an entire industry. It would make little sense for Ford or Volkswagen to analyze the Five Forces for the entire car industry, because the great number of industry factors would be of little use to managers. On the other hand, a car company might find it useful to analyze a specific market, for example, pick-up vans.

BARRIERS TO ENTRY

Barriers to entry are obstacles which potential newcomers would encounter when entering the market. If there are many barriers to entry, it is less likely that the firm will face new competitors. New entrants could lead to lower sales for the firm, they could force the firm to lower prices, or they could force the firm to spend more money on innovation or new distribution channels. As a result, new entrants could mean lower profits for the established firm, so high barriers to entry help to maintain the firm’s profitability. Studies by Bain and Mann have shown that profitability is greater in industries with higher entry barriers. There are several different types of barrier to entry, which are discussed below. Entry into a new industry requires a firm to have resources to invest in, for example, inventories, advertising, and equipment. The capital requirements of entering a new industry vary between industries. However, the barrier of capital requirements can be overcome by new entrants. Research by George Yip has shown that new entrants can overcome entry barriers. Large multinational firms can use resources from established businesses to fund market entry into new business areas. Economies of scale are ‘reductions in the firm’s average costs as a result of an increase in the firm’s output’. Economies of scale may come as a result of the firm’s specialization; the cheaper cost of buying raw materials and other supplies in bulk; savings in marketing costs, as the firm can sell more products without increasing advertising and distribution costs; and savings in production costs, as the firm can use the same equipment to manufacture more products. If there are economies of scale in an industry, new entrants have two choices: either they can enter the market on a small scale and face high unit costs, or they can enter on a large scale and face the risk of not being able to sell their products. Internationalization of markets means that economies of scale increase.

A well-known brand name, perceived higher quality of the firm’s products, or high-quality after-sales service may foster customer loyalty and prevent customers from buying products of a new entrant. When product differentiation is high in a market, new entrants will have to spend large amounts to overcome customer loyalty to established firms. They may need to spend money on advertising in order to increase brand recognition, or on product development in order to improve product quality. Alternatively, new entrants may need to sell their products at a lower price, leading to lower profits. So product differentiation leads to barriers to entry. Internationalization of markets compels new entrants to spend more on additional advertising and other costs in order to gain international awareness of their products. Established firms develop effective ways of distributing their products to customers as time goes on, so access to distribution channels may be restricted for new entrants. Distribution channels may have limited capacity. Distributors may be reluctant to carry a new product or may be prevented from doing so by a long-term contract or an exclusive dealing agreement. Distributors and customers may also be reluctant to switch suppliers, as they develop close relationships with established firms based on trust. When expanding internationally, a new entrant may also find that the distribution channels for the same product vary between different countries. Nonetheless, marketing over the internet may help companies to expand into new countries without having to build up expensive traditional distribution channels.

It has long been recognized that government policy can act as an important or even most important barrier to entry in an industry. In industries such as radio and TV broadcasting a company usually cannot operate without a government license, so the entry of new firms is highly restricted. In knowledge-intensive industries such as pharmaceuticals, established firms are protected by government patents on their products, so that only the innovating firm can use the patent for a period of time. Governments also raise entry barriers more indirectly, for instance, through quality standards or environmental standards. A new environmental law which forces all firms in an industry to install pollution control technology raises the cost of operating in the industry. Large, established firms tend to be in a better position to comply with environmental legislation, and environmental compliance costs therefore raise barriers to entry for newcomers. Potential new entrants may be discouraged from entering...
a market if they expect the established firms to retaliate against them. Retaliation against a new entrant can include, for example, aggressive price-cutting, raising expenditure on advertising, or lobbying the government to erect new entry barriers. A potential new entrant can expect vigorous retaliation when the established firm has a strong position in the market, when the established firm has substantial resources which can be used to retaliate, or when industry growth is slow. In order to deter new entrants, established firms need to pose a credible threat of retaliation; this can be achieved, amongst other means, by maintaining excess capacity which can be used to quickly increase production in the case of new market entry.

**BARGAINING POWER OF BUYERS AND SUPPLIERS**

Every firm must satisfy buyer needs in order to be profitable. Unless buyers are prepared to buy a product or service, the industry cannot survive in the long run. At the same time, buyers push firms to sell products at the lowest possible price, with higher quality and higher levels of service, which reduces firm profitability. The bargaining power of buyers influences the extent to which firms can retain the value created by a product high power of buyers in an industry leads to lower industry profitability, low power of buyers leads to higher industry profitability. The bargaining power of buyers and suppliers are related to each other, so these two forces can be treated together. The power of the buyer depends on the buyer's bargaining position Vis-a-vis the seller/supplier. Buyers and suppliers can include very different groups. Buyers can include, amongst others, consumers, manufacturers buying components or universities buying equipment. Suppliers include not only firms, providing products and services, but also employees, who supply labor. The bargaining power of buyers and suppliers is determined by several factors. Buyer power is high when buyers are concentrated and there are few of them, for instance, when supermarkets buy agricultural products from farmers or when national governments buy defense equipment. Buyer concentration has been shown to be a key reason for lower profits in supplying industries. Conversely, buyer power is low when suppliers are concentrated. High supplier concentration can often be found amongst suppliers of high-technology products; examples include the computer chip maker Intel and the supplier of operating systems Microsoft. When there are many different sources of supply, suppliers may try to increase their bargaining power by forming joint organizations in dealing with the buyers, such as farmers' marketing cooperatives or trade unions.

Buyer power is high when it is easy for the buyer to switch suppliers. In the extreme case, switching costs can be very low and buyer power can be very high. Supplier power is high if buyers would incur high costs in switching to a new type of equipment, breaking existing legal contracts, or retraining their employees. In addition to financial costs, there may also be psychological costs of ending a business relationship or the costs of damaged reputation. The less differentiated the products of the supplier, the more likely it is that the buyer switch suppliers on the basis of price. Supermarkets have much higher buyer power vis-a-vis farmers and manufacturers of unbranded goods than vis-a-vis firms with recognized international brands such as Coca-Cola or Levi’s. If a product accounts for a high proportion of the buyer’s total purchases, the buyer will be more sensitive about the price of the product. Buyers will be more likely to shop around for the best price and will squeeze suppliers, thereby reducing the power of suppliers. In industries where components make up a high proportion of total costs such as cars, electronics and data-processing industries firms occasionally form shared-supply alliances to increase their buyer power and gain economies of scale. In industries where employment costs make up a high proportion of total costs, such as textiles or call centers, American and European firms have been pushed to expand internationally to find cheaper suppliers of labor.

The alternative to finding a buyer or a supplier is to do it yourself, or vertical integration. But a firm does not necessarily need undertake vertical integration; a credible threat may be enough to get greater bargaining power. If a firm can potentially undertake the value-added activities previously provided by a supplier or a buyer (i.e. vertically integrate), it can use the threat of vertical integration to force more profitable business terms on its suppliers and buyers. If the buyer has full information about product demand, market prices, and actual production costs, he/she knows how much the seller can be pushed to offer lower prices. Partial vertical integration can be an effective method of gaining more information about actual production’ costs. The production of own-branded products enables supermarkets to gain information about the cost structures of their suppliers and allows them to negotiate more effectively. The more important the product of the supplier to the quality of the buyer’s own product or service, the less likely it is that the buyer will switch suppliers on the basis of price. The bargaining power of computer manufacturers is low, as the quality of their computers relies heavily on specific products provided by suppliers (Windows operating system, Intel chips, etc.) and the manufacturers cannot switch to other suppliers.

**THREAT OF SUBSTITUTES**

A substitute product is a good or service which is regarded by buyers as interchangeable. For instance, if a significant rise in the price of beer would prompt consumers to switch to wine, wine would be regarded as a substitute for beer. If there are no readily available substitutes for a product, buyers will be more likely to accept the price for a product. If substitutes are available, buyers will switch to substitutes when the price of the product increases. The existence of substitutes provides a limit on how much the seller can charge for the product; so the threat of substitutes ultimately constrains the profitability of a firm. The development of substitutes is heavily influenced by technological change. The extent to which substitutes can reduce profitability in an industry depends on three factors. First, what is the relative price performance of a substitute? Even if a substitute is cheaper, to what extent can the substitute perform the same function as the other product? Second, how high are the switching costs for the buyer? Third, what is the buyer’s propensity to substitute! These three basic questions will help to assess the threat of a substitute. Substitutes will present a serious threat to the firm’s products if the substitute can perform more or less the same function as the firm’s product, the buyer switching costs are low, and the buyer is willing to substitute.

**Criticisms of the Five Forces Techniques**

Porter’s Five Forces Techniques has come under criticism. It has been said, for example, that the model cannot help firms to cope with the fast-changing business
environment; that it cannot be used for analyzing the position of charitable organizations or government bodies; and that it disregards the importance of human resource management. Two key criticisms relate to the 'static' nature of the model and to the ability of firms to earn profits. The Five Forces Model has been criticized for being too 'static', leading managers to making wrong assumptions about the business environment. Managers are expected to decide on their firm's strategy based on an analysis of the Five Forces, assuming that these normally change slowly. But it has been said that competition is not 'static' but 'dynamic'. Porter assumes that a firm's profitability depends on how attractive the industry is. If competition is intense in an industry, firms will earn low profits no matter how skillful the firm's managers are. But business research has suggested otherwise.

Firm-specific, rather than industry-specific, influences on firm profitability are becoming more important in the global market. But research has suggested that in many industries changes in barriers to entry or changes in seller concentration have been very slow. Therefore, when industry structure changes slowly, the industry's influence on the firm's profitability only changes very slowly. Certainly, there are some highly visible industries where change is very fast but for most industries the industry environment does not change quickly. Brian Arthur has argued that firms usually have the ability to influence industry structure in the early stages of a technological wave. But once a specific product, process, or technology wins over the alternatives, the development of the industry becomes locked into a specific path of development and firms can do little to change the Five Forces. Ultimately, whether you accept the above criticisms of the Five Forces Model depends on your point of view.

INDUSTRY EVOLUTION

The Five Forces and market conditions change over time as a result of industry evolution, which has important consequences for the formulation of strategy. Industry evolution may make an industry more or less attractive as an investment opportunity, and it often forces firms to adjust their strategies. Industry evolution is only important for strategy if it changes the underlying Five Forces. If these are not modified, the firm needs to change only some day-to-day practices, but the strategy can remain the same. The concept of the Product Life Cycle is useful in understanding the course of industry evolution. The basic idea of this cycle is that every product evolves through a cycle of roughly four stages: introduction, growth, maturity, and decline, which correspond to the rate of growth of industry sales. There are few sales in the introduction stage; customers may be reluctant to buy a new product, and sales prices for newly developed products are initially high. Once buyers learn to appreciate the value of a product, sales increase rapidly and prices decline as a result of larger production runs and new competition. After a period of time, the market becomes saturated and rapid growth comes to an end; as demand for a product slows down, firms are under more pressure to fight over the existing customers and rivalry increases. Eventually, demand for a product declines as substitute products emerge. The Product Life Cycle has major implications for international strategies of firms as industry change may force firms to re-locate parts of their business to other countries.

THE FIVE PHASES OF THE INTERNATIONAL PRODUCT LIFE CYCLE

The most new products are first introduced in rich developed countries. This is because, it is argued, firms located in such countries have more capability to innovate than firms in poor developing countries. In addition, people in developed countries have more money to spend on newer products than people in developing countries. The total production of the new product takes place in the country of origin (often the USA) because the speed of adjusting the product to the home market demand is very important for the success of the new product. This stage is characterized by high unit production costs, but these costs are less significant because the demand for innovative products is price inelastic at this phase. The price is inelastic when, with all other factors held constant, the change in the quantity demanded to a change in price is very small or nonexistent. Initially, the new product goes through a slow sales growth and profits are nonexistent because of the heavy expenses in production and marketing. At some point the product become well-known in the home market, and customers from other developed and high-income countries start buying the product. This leads to the second phase. The market for the product widens as demand develops in other high-income countries. The production of the product becomes fairly standard and the widening of the market makes economies of scale possible. As a result, price decreases. This causes the market for the product to widen further, as customers in low and medium income countries are able to afford the new product. As the production of product becomes standard, firms in other developed countries imitate the product and start production in their own countries.

The low price attracts more customers from developing countries. As the demand for the product increases in developing countries, late movers from developed countries begin to export and even produce new product in developing countries. Eventually, the increasing international distribution of the product, and the relatively lower costs of production, will result in developed countries exporting back to the country where the product was originally introduced. At this stage, demand for the product declines in the home market and other developed countries as customers demand new products. The standardization of the production process makes it possible to produce the product in developing countries. Because of the cost advantage developing countries have over developed countries due to cheap labor costs, production moves to developing countries. Finally, the country in which the product was first introduced and produce becomes the importer of the product.

FORECASTING AND CHALLENGE OF INTERNATIONALIZATION

Internationalization of markets is a challenge for corporate forecasting, in that it is difficult to forecast distant markets from central company headquarters. This challenge is greatest when it comes to forecasting uncertain events such as the development of new technologies. Using internet sources or merely interviewing foreign managers may not always allow a firm to pick up 'weak signals' of important future trends. In technology forecasting, the most effective forecasting can be achieved when it is performed by the firm's research centers around
the world, which collect information on the spot. Cheaper
alternatives to establishing research centers include
international 'listening posts' or 'technology scouts'. At the
same time, it is important that central company
headquarters have an overview of different forecasts, and
that international forecasting activities are fed into
strategic decision-making at the company's headquarters.
It makes no sense for a company to have technology scouts
around the world if top management is unable to act on
their forecasts. In order to coordinate forecasting activities
across its worldwide subsidiaries, Bayer formed a central
forecasting group, which resides in the strategic analysis
department.

SUMMARY
This paper has demonstrated that it is important to
understand how changes in the ex-Eternal industry
environment affect or do not affect a firm. The first step is
to identify your precise market, because a focus on a broad
industry may lead to an inaccurate understanding of the
market and the nature of competition. In order to identify
the precise market, firms can conduct a market
segmentation analysis and a strategic group analysis. A
more comprehensive understanding of an industry can be
gained through an analysis of its underlying economic and
technical characteristics. The Five Forces and market
conditions change over time as a result of industry
evolution, so managers need to understand the causes
underlying industry change. The concept of the Product
Life Cycle can help to understand industry evolution. An
extension of the concept, known as the International
Product Life Cycle Model (IPLC), helps to explain why
industry change may force firms to relocate parts of their
business to other countries. The model suggests that
advanced countries are the first to introduce new products;
then the innovating country tends to lose its exports
initially to other developed countries and subsequently to
less-developed countries; eventually the innovating
country may cease producing a specific product. Ultimately,
the strategic decision-maker would like to know what
could happen to his/her industry in the future.
Understanding industry evolution and forecasting future
change is crucial, since the cost of changing strategy
increases as the need for change becomes more obvious. So
firms require 'strategic' forecasts, forecasts used to
understand the future changes in the industry environment
which may require major shifts in the firm's operations. A
thorough understanding of the industry environment and
its likely future should help the strategic decision-maker to
develop more appropriate strategies.

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