External Environment Analysis

Most organizations face external contexts that are complex, dynamic and increasingly global. This makes the context increasingly difficult to interpret. To cope with often incomplete and ambiguous contextual data, and to increase their understanding of the general external context, organizations engage in a process called 'external environmental analysis'. All managers, including HR managers, need to be aware of the importance of scanning the external context in a systematic way.

A number of models exist that can help managers in analysing the external environment. Such models provide a framework to identify external opportunities and threats. Opportunities arise when an organization can take advantage of conditions in its external environment to formulate and implement strategies that enable it to improve performance. Threats arise when conditions in the external environment endanger the integrity of the organization's activities.

As shown in Exhibit 1 (below) an organization's external environment has two major parts:
• macroenvironment
• industry

The macro environment is composed of social, economic, political and technological elements in the broader society that can influence an industry and the organizations within it. The industry environment is the set of factors that directly influences an organization and its actions and responses. Managers have to analyse competitive forces in an industry's environment in order to identify the opportunities and threats confronting an organization. A popular framework for doing this is Michael Porter's 'five-forces' model. This model identifies five competitive forces that shape industry's profit potential (as measured by the long-term return on investment): (1) the bargaining power of suppliers, (2) the threat of new entrants, (3) the threat of product substitutes, (4) the bargaining power of buyers and (5) the intensity of rivalry among established organizations within an industry.

Within most industries, there are groups of organizations in which each member follows the same basic strategy as others in the groups but follows a different strategy from that of firms in other groups. These groups of organizations are referred to as strategic groups. (see C. Hill and G. Jones, (1998) *Strategic Management Theory*. New York: Houghton Mifflin).

Exhibit 1 The external environment
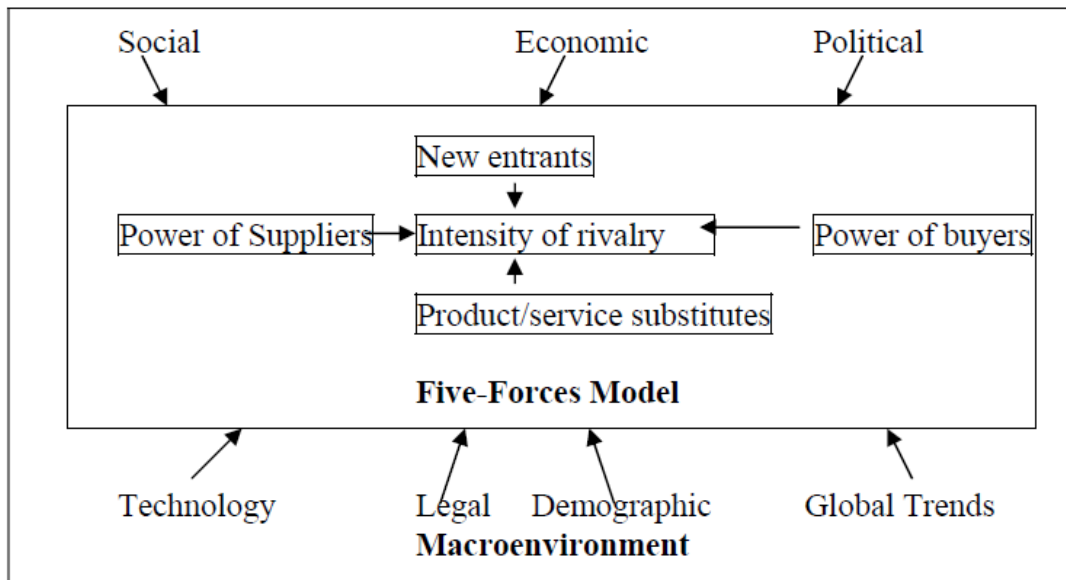
Analyzing the macroenvironment
To increase their understanding of the macroenvironment and to help develop a 'strategic plan', human resource managers can engage in a process called 'external environment analysis'.

This process typically includes four activities:

- Scanning-identifying early signals of macroenvironment changes and trends

- Monitoring-detecting meaning through ongoing observations of macro-environmental changes and trends

- Forecasting-developing projections of anticipated outcomes based on monitored changes and trends

- Assessing-determining the importance of macroenvironmental changes and trends for the organization's strategic plans.

Step 1: Identify potential opportunities
Scan the macroenvironment around your own organization or an organization you are studying. Consider economic, technological, legal, political, social, demographic and global

trends. Write down 3 - 6 potential opportunities for growth and profitability over the next 3 to 5 years.

Potential opportunities for the organization:
1. _____
2. _____
3. _____
4. _____
5. _____
6. _____

Step 2: Identify potential threats

Scanning the macroenvironment, write down 3 - 6 potential threats that can endanger the integrity and profitability of the organization's operation.

Potential threats to the organization:
1. _____
2. _____
3. _____
4. _____
5. _____
6. _____

Step 3: Conduct an analysis of industry environment

The five-forces model allows an organization to systematically analyse its relationships with other strategic competitors. In general, an attractive industry (in terms of long-term ROI) has high entry barriers, suppliers and buyers with low bargaining power, few threats from product/service substitutes and relatively moderate rivalry. Conversely, a less attractive industry has low entry barriers, suppliers and buyers with strong bargaining positions, strong competitive threats from product/service substitutes, and intense rivalry among competitive firms. Use the following checklist to identify potential threats to your organization or one you are studying.

- Increase in bargaining power of suppliers?
- Increase in bargaining power of buyers?
- Increase in new domestic competition?
- Increase in new or substitute products or services?
- Increase in rivalry among established firms?

Step 4: Evaluate the importance of the changes for the organization's strategies.

This step focuses on determining the timing and importance of external environmental changes for the organization's strategies. Managers must include both macro and industry changes in their analyses. Common questions to pose include: How will macroenvironmental forces impact on the organization? What will our competitors do in the future? Where do we hold an advantage over our competitors? How will this change our business strategy?

Complete the following steps and actions to deal with the effects of environmental changes and trends on the strategic management of the organization.

What are the 3 - 6 most important changes/trends facing the organization?	What actions should management take to cope with these environmental chanes/ trends
1	
2	
3	
4	
5	
6	

The list should be discussed with your key stakeholders to ensure consensus.

The five-forces model has been criticized for giving insufficient attention to the importance of internal organization differences (for example the quality of a firm's human resources, and technological, physical and financial resources). An organization will not be successful just because it is based in an attractive industry. As strategic management and leadership theorists remind us, to be successful, an organization requires distinctive competencies, resources, capabilities and leadership.