**Chapter Three: External Environmental Analysis/scanning**

**3.1 The nature of external audit/scan**

External Environment consists of all those forces of external that affect the working of a business. It refers to the conditions, forces, events and situations within which business enterprises have to operate.

Environmental Scanning means an examination and study of the environment of a business unit in order to identify its survival and prosperity chances. It means observing the business environment both external and internal and understanding its implications for business opportunities. It also involves knowing beforehand the risks and uncertainties as well as threats to the business unit.

The purpose of an *external audit* is to develop a finite list of opportunities that could benefit a firm and threats that should be avoided. The external audit is not aimed at developing an exhaustive list of every possible factor that could influence the business; rather, it is aimed at **identifying key variables that offer actionable responses**. Firms should be able to respond either offensively or defensively to the factors by formulating strategies that take advantage of external opportunities or that minimize the impact of potential threats.

**Need For Environmental Scanning** Environmental Scanning is essential because of following reasons:

1) **Prime Influence** – Environment is a prime influence on the effectiveness of business strategies. If strategic planning is done without considering environment, it is likely to be defective. Besides, the success of the implementation of the strategy depends on the environmental factors.

2) **A tool to anticipate Changes** – Environmental scanning is a very useful tool not only to understand business surroundings, but also as a good instrument to anticipate the changes and be prepared to face the challenges of such changes.

3) **Time for adjustment** – A business unit cannot change the business activities overnight. It needs time to adjust with the changing environment. If it has to face the changed environment suddenly, it may be possible to make immediate changes according to the demand of the changed environment. Environmental scanning gives time to the company to get adjust to the changed environment.

4) **Early Warning system** - Environmental Scanning gives advance warning or danger signals of the adverse changes in environment. It helps the company to design defense mechanism to avoid future adverse effects of environment on the business activities e.g. with the changing marketing environment, many companies are adopting on-line marketing to survive in this competitive environment.

**3.2 Key External Forces**

*External forces* can be divided into five broad categories:

* 1. economic forces;
  2. social, cultural, demographic, and natural environment forces;
  3. political, governmental, and legal forces;
  4. technological forces; and
  5. competitive forces.

External forces affect the types of products developed, the nature of positioning and market segmentation strategies, the type of services offered, and the choice of businesses to acquire or sell. External forces directly affect both suppliers and distributors. Identifying and evaluating external opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives.

There are more competitive new technologies in world ever before.

**Economic Forces**

Increasing numbers of two-income households is an economic trend in the world. Individuals place a premium on time. Improved customer service, immediate availability, trouble-free operation of products and dependable maintenance and repair services are becoming more important. People today are more willing than ever to pay for good service if it limits inconvenience. E.g.unemployment rate, recession, Interest rate, Availability of credit, Level of disposable income, Inflation rates, Gross domestic product, Monetary policies, Fiscal policies, Tax rates and etc

Economic factors have a direct impact on the potential attractiveness of various strategies.

For example, when interest rates rise, funds needed for capital expansion become hard to get so it limits us our expansion strategy.When interest rates rise, discretionary income declines, and the demand for discretionary goods falls. When the value of the birr falls, tourism-oriented firms benefit because foreigners visit and vacation more in the Ethiopia.

**Social, Cultural, Demographic, and Natural Environment Forces**

Social, cultural, demographic, and environmental changes have a major impact on virtually all products, services, markets, and customers. Small, large, for-profit, and nonprofit organizations in all industries are being staggered and challenged by the opportunities and threats.

E.g. population changes by city, county, state, region, and country, waste mgt, recycling, air pollution, ozone depletion, endangered species, value placed on leisure time, no. of births/deaths, Life expectancy rates, Attitudes toward business, Lifestyles, Attitudes toward government, Attitudes toward work, Buying habits, Ethical concerns, Attitudes toward saving, Sex roles, Attitudes toward investing, Regional changes in tastes and preferences, Number of women and minority workers, Attitudes toward product quality, Attitudes toward customer service, Average level of education, Number of churches/mosques & their members size

**Political, Governmental, and Legal Forces**

Changes in patent laws, antitrust legislation, tax laws, and lobbying activities can affect firms significantly. The increasing global interdependence among economies, markets, governments, and organizations makes it imperative that firms consider the possible impact of political variables on the formulation and implementation of competitive strategies. For industries and firms that depend heavily on government contracts or subsidies, political forecasts can be the most important part of an external audit.

Forces are that should gathered information for best utilizing the opportunities and to best defend the threats are Government regulations or deregulations, Changes in tax laws, Special tariffs, Political instability, and location of government Protests, Number of patents, Changes in patent laws, Environmental protection laws, Level of defense expenditures, Legislation on equal employment, Level of government subsidies, Antitrust legislation.

**Technological Forces**

Technological advancements can dramatically affect organizations’ products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation/spread of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers.

Technological advancements can create new competitive advantages that are more powerful than existing advantages. No company or industry today is insulated against emerging technological developments. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit. Technological changes are rapid and to keep pace with it, businessmen need to be alert and flexible in order to quickly incorporate them in their business organization so as to survive and succeed in the competitive business world.

The *Internet* has changed the very nature of opportunities and threats by altering the life cycles of products, increasing the speed of distribution, creating new products and services, erasing limitations of traditional geographic markets, and changing the historical trade-off between production standardization and flexibility. The Internet is altering economies of scale, changing entry barriers, and redefining the relationship between industries and various suppliers, creditors, customers, and competitors.

Technological forces represent major opportunities and threats that must be considered in formulating strategies. Technological advancements can **dramatically** affect organizations’ products, services, markets, suppliers, distributors, competitors, customers, manufacturing processes, marketing practices, and competitive position. Technological advancements can create new markets, result in a proliferation of new and improved products, change the relative competitive cost positions in an industry, and render existing products and services obsolete. Technological changes can reduce or eliminate cost barriers between businesses, create shorter production runs, create shortages in technical skills, and result in changing values and expectations of employees, managers, and customers.

Technological advancements can create new competitive advantages that are more powerful than existing advantages. In high-tech industries, identification and evaluation of key technological opportunities and threats can be the most important part of the external strategic-management audit.

Firms should pursue strategies that take advantage of technological opportunities to achieve sustainable, competitive advantages in the marketplace.

**Competitive Forces**

## Competitive Forces

An important part of an external audit is **identifying rival firms** and determining their strengths, weaknesses, capabilities, opportunities, threats, objectives, and strategies.

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons.

**Key Questions about Competitors**

1. What are the major competitors’ strengths?
2. What are the major competitors’ weaknesses?
3. What are the major competitors’ objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years?
11. Why have these rankings changed that way?
12. What is the nature of supplier and distributor relationships in this industry?
13. To what extent could substitute products or services be a threat to competitors in this industry?

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information.

Competition in virtually all industries can be described as intense—and sometimes as cutthroat.

**3.3 The Process of Performing an External Audit**

The process of performing an external audit must involve as many managers and employees as possible. Involvement in the strategic-management process can lead to understanding and commitment from organizational members. Individuals appreciate having the opportunity to contribute ideas and to gain a better understanding of their firms’ industry, competitors, and markets.

## To perform an external audit, a company first must gather competitive intelligence and information about economic, social, cultural, demographic, environmental, political, governmental, legal, and technological trends.

## Information should be assimilated and evaluated

## Making series of meetings of managers is needed to collectively identify the most important opportunities and threats facing the firm

## Prioritized factors identified, from 1 for the most important opportunity/threat to 20 for the least important opportunity/threat.

## Must involve as many managers and employees as possible

**Competitive Intelligence(CI) Programs**

*Competitive intelligence* is a systematic and ethical process for gathering and analyzing information about the competition’s activities and general business trends to further a business’s own goals.

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors’ weaknesses can represent external opportunities; major competitors’ strengths may represent key threats.

Firms need an effective competitive intelligence program. The three basic objectives of a CI program are (1) to provide a general understanding of an **industry** and its **competitors**, (2) to identify areas in which competitors are **vulnerable** and to assess the impact **strategic** actions would have on competitors, and (3) to identify **potentialmoves** that a competitor might make that would endanger a firm’s position in the market.

Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organization— from the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include **flexibility, usefulness, timeliness,** and **cross-functional cooperation**.

Sources of competitive information include **trade journals**, **newspaper articles**, and **government filings**, as well as **customers**, **suppliers**, **distributors**, **competitors** themselves, and the **Internet**.

Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark her or his efforts against best-in-class competitors so that the challenge becomes personal.

**Market Commonality and Resource Similarity**

By definition, competitors are firms that offer similar products and services in the same market. *Market commonality* can be defined as the number and significance of markets that a firm competes in with rivals. *Resource similarity* is the extent to which the type and amount of a firm’s internal resources are comparable to a rival. One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm’s value chain.

## Competitive Analysis: Porter’s Five-Forces Model

The five forces framework developed by Michael porter is the most widely known tool for analyzing the competitive environment, which helps in explaining how forces in the competitive environment shape strategies and affect performance. However, these five forces are not independent of each other. Pressures from one direction can trigger off changes in another which is capable of shifting sources of competition.

*Porter’s Five-Forces of competitive analysis of the industry:-*

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

**Rivalry among Competing Firms-**Rivalry among competing firms is usually the **most powerful** of the five competitive forces.

**Conditions That Cause High Rivalry among Competing Firms**

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry’s products
5. Falling product/service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

**Potential Entry of New Competitors**

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist’s job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms’ strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

**Potential Development of Substitute Products**

In many industries, firms are in close competition with producers of substitute products in other industries. Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers’ switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms’ plans for increased capacity and market penetration.

**Bargaining Power of Suppliers**

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a **large number of suppliers**, when there are only a **few good substitute raw** materials, or when the cost of **switching raw materials is especially costly**.

It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, and development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are **unreliable**, too **costly**, or not capable of meeting a firm’s needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

In more and more industries, sellers are forging **strategicpartnerships** with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers.

## Bargaining Power of Consumers

When customers are **concentrated** or **large** or **buy** in **volume**, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer **extended warranties** or **specialservices** to gain customer loyalty whenever the bargaining power of consumers is **substantial**. Bargaining power of consumers also is higher when the products being purchased are **standard** or **undifferentiated**. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

1. If they can inexpensively switch to competing brands or substitutes
2. If they are particularly important to the seller
3. If sellers are struggling in the face of falling consumer demand
4. If they are informed about sellers’ products, prices, and costs
5. If they have discretion in whether and when they purchase the product

**4.5 Sources of information**

Source of information for performing an external audit are:-

* magazines,
* trade journals, and
* newspapers
* Internet
* Suppliers, distributors, salespersons, customers, and competitors represent other sources of vital information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders’ meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

**4.6 Forecasting Tools and Techniques**

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers **often must rely on published** forecasts to effectively identify key external opportunities and threats.

People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives.

The question, therefore, is not whether we should forecast but rather **how we can best forecast** to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential.

Forecasting tools can be broadly categorized into:-

1. Quantitative techniques 2. qualitative techniques

**Quantitative techniques**

Quantitative forecasts are most appropriate when **historical data are available** and when the relationships among key variables are expected to remain the same in the future. *Linear regression*, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

**Making Assumptions**

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic management process forward. Assumptions are needed **only for future trends** and **events** that are most likely to have a significant effect on the company’s business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies.

If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

**3.7 Industry Analysis: The External Factor Evaluation (EFE) Matrix**

An *External Factor Evaluation (EFE)* Matrix allows strategists to summarize and evaluate economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive information. The EFE Matrix can be developed in five steps:

1. List key external factors as identified in the external-audit process. Include a total of 15 to 20 factors, including both opportunities and threats that affect the firm and its industry. List the opportunities first and then the threats. Be as specific as possible, using percentages, ratios, and comparative numbers whenever possible.

2. Assign to each factor a weight that ranges from 0.0 (not important) to 1.0 (very important). The weight indicates the **relative importance** of that factor to being successful in the firm’s industry**. Opportunities often receive higher weights** than threats, but threats can receive high weights if they are especially severe or threatening.

Appropriate weights can be determined by comparing successful with unsuccessful competitors or by discussing the factor and reaching a group consensus.

The sum of all weights assigned to the factors must equal 1.0.

3. Assign a rating between 1 and 4 to each key external factor to indicate how effectively the firm’s current strategies respond to the factor, where 4 = *the responseis superior*, 3 = *the response is above average*, 2 = *the response is average* and 1 = *the response is poor*. Ratings are based on effectiveness of the firm’s strategies.

Ratings are thus company-based, whereas the weights in Step 2 are industry-based. It is important to note that both threats and opportunities can receive a 1, 2, 3, or 4.

4. Multiply each factor’s weight by its rating to determine a weighted score.

5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of the number of key opportunities and threats included in an EFE Matrix, the highest possible total weighted score for an organization is 4.0 and the lowest possible total weighted score is 1.0. The average total weighted score is 2.5. A total weighted score of 4.0 indicates that an organization is responding in an outstanding way to existing opportunities and threats in its industry. In other words, the firm’s strategies effectively take advantage of existing opportunities and minimize the potential adverse effects of external threats. A total score of 1.0 indicates that the firm’s strategies are not capitalizing on opportunities or avoiding external threats.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Key External Factors | | Weight | Rating | Weighted Score |
| Opportunities | | | | |
| 1 | Rowan County is growing 8% annually in population | 0.05 | 3 | 0.15 |
| 2 | TDB University is expanding 6% annually | 0.08 | 4 | 0.32 |
| 3 | Major competitor across town recently ceased operations | 0.08 | 3 | 0.24 |
| 4 | Demand for going to cinema growing 10% annually | 0.07 | 2 | 0.14 |
| 5 | **Two new neighborhoods being developed within 3 miles** | 0.09 | 1 | 0.09 |
| 6 | Disposable income among citizens grew 5% in prior year | 0.06 | 3 | 0.18 |
| 7 | Unemployment rate in county declined to 3.1% | 0.03 | 2 | 0.06 |
|  | Threats |  |  |  |
| 8 | Trend toward healthy eating eroding concession sales | 0.12 | 4 | 0.48 |
| 9 | Demand for online movies and DVDs growing 10% annually | 0.06 | 2 | 0.12 |
| 10 | Commercial property adjacent to cinemas for sale | 0.06 | 3 | 0.18 |
| 11 | TDB University installing an on-campus movie theatre | 0.04 | 3 | 0.12 |
| 12 | County and city property taxes increasing 25% this year | 0.08 | 2 | 0.16 |
| 13 | Local religious groups object to R-rated movies being shown | 0.04 | 3 | 0.12 |
| 14 | Movies rented from local Blockbuster store up 12% | 0.08 | 2 | 0.16 |
| 15 | **Movies rented last quarter from Time Warner up 15%** | 0.06 | 1 | 0.06 |
|  | **Total** | **1.00** |  | **2.58** |

An example of an EFE Matrix is provided in the above Table for American’s ten-theatre cinema complex. Note that the most important factor to being successful in this business is “Trend toward healthy eating eroding concession sales” as indicated by the 0.12 weight. Also note that the local cinema is doing excellent in regard to handling two factors, “TDB University is expanding 6 percent annually” and “Trend toward healthy eating eroding concession sales.” Perhaps the cinema **is placing flyers on campus** and also **adding yogurt** and **healthy drinks to its concession menu**. Note that you may have a 1, 2, 3, or 4 anywhere down the Rating column. Note also that the factors are stated in quantitative terms to the extent possible, rather than being stated in vague terms. Quantify the factors as much as possible in constructing an EFE Matrix. Finally, note that the total weighted score of 2.58 is above the average (midpoint) of 2.5, so this cinema business is doing **pretty well**, taking advantage of the external opportunities and avoiding the threats facing the firm. There is definitely room for improvement, though, because the highest total weighted score would be 4.0. As indicated by ratings of 1, this **business needs to capitalize more** on the “**two new neighborhoods nearby” opportunity** and the “**movies rented from Time Warner” threat**.

Note also that there are many percentage-based factors among the group. Be quantitative to the extent possible! Note also that the ratings range from 1 to 4 on both the opportunities and threats.

**4.8 The Competitive Profile Matrix (CPM)**

The *Competitive Profile Matrix (CPM)* **identifies a firm’s major competitors** and its particular **strengths** and **weaknesses** in relation to a sample firm’s strategic position. The weights and total weighted scores in both a CPM and an EFE have the same meaning. However, *critical success* factors in a CPM include **both internal** and **external issues**; therefore, the ratings refer to strengths and weaknesses, where 4 = major strength, 3 = minor strength, 2 = minor weakness, and 1 = major weakness. The critical success factors in a CPM are not grouped into opportunities and threats as they are in an EFE. In a CPM, the ratings and total weighted scores for rival firms can be compared to the sample firm. This comparative analysis provides important **internal strategic information**.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | Company 1 | | Company 2 | | Company 3 | |
| Critical Success  Factors | Weight | Rating | Weighted  Score | Rating | Weighted  Score | Rating | Weighted  Score |
| Market share | 0.15 | 3 | 0.45 | 2 | 0.30 | 4 | 0.60 |
| Inventory system | 0.08 | 2 | 0.16 | 2 | 0.16 | 4 | 0.32 |
| Financial position | 0.10 | 2 | 0.20 | 3 | 0.30 | 4 | 0.40 |
| Product quality | 0.08 | 3 | 0.24 | 4 | 0.32 | 3 | 0.24 |
| Consumer loyalty | 0.02 | 3 | 0.06 | 3 | 0.06 | 4 | 0.08 |
| Sales distribution | 0.10 | 3 | 0.30 | 2 | 0.20 | 3 | 0.30 |
| Global expansion | 0.15 | 3 | 0.45 | 2 | 0.30 | 4 | 0.60 |
| Organization structure | 0.05 | 3 | 0.15 | 4 | 0.20 | 2 | 0.10 |
| Production capacity | 0.04 | 3 | 0.12 | 2 | 0.08 | 4 | 0.16 |
| E-commerce | 0.10 | 3 | 0.30 | 1 | 0.20 | 4 | 0.40 |
| Customer service | 0.10 | 3 | 0.30 | 2 | 0.20 | 4 | 0.40 |
| Price competitive | 0.02 | 4 | 0.08 | 1 | 0.02 | 3 | 0.06 |
| Management experience | 0.01 | 2 | 0.02 | 4 | 0.04 | 2 | 0.02 |
| **Total** | **1.00** |  | **2.83** |  | **2.28** |  | **3.68** |

*Note:* (1) The ratings values are as follows: 1 = major weakness, 2 = minor weakness, 3 = minor strength, 4 = major strength.

(2) As indicated by the total weighted score of 2.28, Competitor 2 is weakest.

Note that Company 2 has the **best product quality** and **management experience**; Company 3 has the **best market shareand inventory system**; and Company 1 has the **best price** as indicated by the ratings. Avoid assigning duplicate ratings on any row in a CPM.

A word on interpretation: Just because one firm receives a 3.2 rating and another receives a 2.80 rating in a Competitive Profile Matrix, it does not follow that the first firm is 20 percent better than the second. Numbers reveal the relative strengths of firms, but their implied precision is an illusion. Numbers are not magic. The aim is not to arrive at a single number, but rather to assimilate and evaluate information in a meaningful way that aids in decision making.

A major responsibility of strategists is to ensure development of an effective external audit system. This includes using information technology to devise a competitive intelligence system that works. The external-audit approach described above can be used effectively by any size or type of organization. Typically, the external-audit process is more informal in small firms, but the need to understand key trends and events is no less important for these firms. The EFE Matrix and Porter’s Five-Forces Model can help strategists **evaluate** the **market** and **industry**, but these tools must be accompanied by good **intuitive judgment**. Multinational firms especially need a **systematic** and **effective** external audit system because external forces among foreign countries vary so greatly.

Firms that do not mobilize and empower their managers and employees to identify, monitor, forecast, and evaluate key external forces may fail to anticipate emerging opportunities and threats and, consequently, may pursue ineffective strategies, miss opportunities, and invite organizational demise. Firms not taking advantage of the Internet are technologically falling behind.