Internal scanning and situational analysis

Learning outcomes
At the end of this module you should be able to:

- analyse an organisation's internal strategic capabilities;
- apply the concept of domain choice; and
- apply the SWOT framework to a maritime organisation.

Topics
4.1 The nature of an internal audit
   4.1.2 Finance and accounting
4.2 Types of internal strategic capabilities
   4.2.1 Business level strategic capabilities
   4.2.2 Corporate level strategic capabilities
4.3 Methods of identifying internal capabilities
   4.3.1 Some problems with portfolio analysis
   4.3.2 Analysing strategic capabilities: an example
4.4 Domain choice
4.5 Framework for SWOT analysis
   4.5.1 Applying the SWOT framework
   4.5.2 Assessing your SWOT analysis
4.6 Global issues for the 21st century

Quotes of note

The measure of success is not whether you have a tough problem to deal with, but whether it's the same problem you had last year.

John Foster Dulles

The greatest mistake managers make when evaluating their resources is failing to assess them relative to competitors.

David Collis & Cynthia Montgomery
Introduction

From an organisation's external environment, we now turn inward and look at the organisation's internal environment. Together, both external and internal environments affect the organisation's current competitive position - where it is now, and where it is possible for it to go - so they must always be analysed in tandem. One without the other can easily lead to a misleading picture of the organisation's competitive environment, which in turn can lead to disastrous business decisions.

What does the internal environment include? Chiefly, all internal capabilities and resources that are under an organisation's control and which determine the organisation's competitive strengths and weaknesses comprise the internal environment. In this module we shall look at some practical ways of scanning (or monitoring), classifying and then analysing these capabilities and resources to understand our unique situation.

Along the way we shall also provide some useful advice regarding the use of popular assessment tools like the portfolio analysis and the SWOT analysis.

We shall explore the concept of domain choice. A really functional concept hiding behind a fancy name, it simply means pulling together your findings from both external and internal assessment so that you can decide which direction(s) would be the most feasible for your organisation to pursue. To close our discussion, we will provide some maritime examples of a SWOT analysis.

4.1 The nature of an internal audit

We will start our study with a basic textbook reading. This reading takes a functional area approach to evaluating the organisation's strengths and weakness. Later in this module, we will go beyond the subject matter of the textbooks to elaborate on types of internal strategic capabilities, particularly as related to organisations in the maritime industry. Use this reading to familiarise yourself with the commonly used terminology.

Reading


Key strategic management concept

A company's value chain identifies the primary activities that create value for customers and the related support activities.
4.1.1 Finance and accounting

The next reading covers finance and accounting. First, we will examine some general concepts as an introduction. Financial condition is often considered the single best measure of an organisation’s competitive position. The financial ‘health’ of an organisation is directly linked to strategic goals and objectives. You will note the emphasis on financial ratios. Ratios are simply a way of looking at one number in relation to another number. Four types of financial ratios appear in such analyses:

- **Profitability ratios** provide information regarding a firm’s overall economic performance.
- **Liquidity ratios** measure a firm’s capacity to meet its short-term financial obligations.
- **Leverage ratios** indicate a firm’s financial risk, that is, the relative proportion of its debt to its equity.
- **Activity ratios** reflect a firm’s efficient or inefficient use of its resources.

The first three ratios are the most useful in assessing the financial performance component of the balanced scorecard. These measures allow you to assess the financial returns (that is, the profitability) of a firm, given the risk associated with its financial liabilities or debt (that is, its liquidity and leverage). The fourth type of ratio, the activity ratio, is more applicable in assessment from the operations perspective. For instance, inventory turns — activity ratios that measure the efficient use of inventories — are used for assessing part of the order fulfilment process.

Financial ratios have been widely used since before the turn of the century, and they will undoubtedly remain an important part of business evaluation. However, there are caveats and limitations to using traditional financial accounting. The most important caveat: *financial ratios must be viewed within the context of a particular strategy*. For example, an escalating debt/equity ratio may be a cause for concern or it may be a reflection of a strategic move to take advantage of an opportunity to quickly expand the business. You will need to consider the strategy a company is pursuing before judging what constitutes a good or bad ratio. Ratio analysis is so basic to good strategic analysis that we have included a reading on the topic, although students will have completed the topic in another subject. Spend some time on this reading:

***Reading***


***and then***

4.2 Types of internal strategic capabilities

We said in the first module that strategic decision-making can occur at any level of the organisation; however, when it comes to the question of beating the competition, two organisational levels become more critical than others. These are the corporate and business levels.

Before we go into the specifics of each level, it will be useful to recall another point we made in Module 1. If a company is a single business company (an example might be a port or a freight forwarder), then the corporate and business levels are normally collapsed into the business level. If, however, a company is involved in many businesses (for example, trucking, stevedoring, ship management, banking or investment), then the corporate and business levels are kept distinct from one another.

We digress from a 'textbook' type discussion, at this point, (as generally they focus on functional levels) and consider some maritime examples of different levels.

4.2.1 Business level strategic capabilities

An environmental assessment at the business level normally examines four main types of strategic capabilities. Strategic capabilities are those elements in the organisation that can be identified as areas of strength that can assist in achieving the corporate strategy. The four main types of these strategic capabilities are:

- technical
- managerial
- informational
- organisational

However, do not limit yourself to these four capabilities. Be holistic and creative: are there other strategic capabilities that you think may apply to the particular requirements of the company in question? If there are, use them. For instance, would ethical capabilities be of strategic importance? Would they be a key strength or weakness to a company trying to compete in the maritime industry? Think about this for a moment.

Once you have identified all relevant strategic capabilities, the next step is to identify the functional areas of the business and evaluate them in terms of this common set of capabilities. For most organisations, functional areas will include marketing, operations (and/or production), research and development (or technical), finance and accounting and general management (or administration). However, you will come across a few companies that have some units that clearly do not fit.

For example, many companies in the maritime industry have a number of specialist service units, such as corporate planning or industrial relations. Under these
circumstances, do not worry too much about the titles; consider them as part of the functional level and include them in your analysis.

Figure 4.1 is an example of a single-business company with five functional areas (finance, personnel, commercial operations, technical operations and marketing). An analysis of the company’s internal environment would mean evaluating each of these functional areas in terms of their internal strategic capabilities (technical, managerial, informational, organisational and ‘other capabilities’ if this is applicable).

![Diagram of a single-business shipping company with functional areas]

**Figure 4.1 Strategic capabilities at the business level**

### 4.2.2 Corporate level strategic capabilities

An environmental analysis at the corporate level must include an evaluation of an organisation’s general, portfolio and financial capabilities. Portfolio capabilities will be covered later in this module and in our discussion in Module 6 of strategy selection.

Figure 4.2 is an example of a diversified company with five different businesses (aviation, inland transport, shipping, investment property, industrial trading). Unlike our single-business company whose strengths and weaknesses were analysed based on the performance of its functional areas, at the corporate level the diversified company’s internal environment is analysed in terms of each business’s general, portfolio and financial strengths and weaknesses. The performance of all the business units is then aggregated into a **general profile of the company’s corporate-level capabilities.**
Figure 4.2  Strategic capabilities at the corporate level

For diversified companies, business-level capabilities must also be assessed to provide a complete picture of the company’s competitive strengths and weaknesses. Therefore, at the corporate level, the company’s five main business units are collectively analysed in terms of their general, portfolio and financial capabilities. At the business level all the functional areas of each business unit are analysed in terms of their technical, managerial, informational and organisational capabilities. This integration is illustrated in Figure 4.3.
Figure 4.3 Corporate and business level strategic capabilities for a diversified company

Consider this

Following our discussion stop for a moment and think about the levels in a company you are familiar with and how you would structure an analysis.
4.3 Methods of identifying internal capabilities

No matter what area of business you may be in, to be competitive in today's environment, you must know your capabilities and be able to marshal them to your greatest advantage.

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**Key strategic management concept**

Successful strategists seek to capitalise on what an organisation does best - its expertise, resource strengths, and strongest competitive capabilities.

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So how do you go about identifying your specific capabilities? What methods are there available for doing this? There are a number of portfolio analyses that focus on capabilities at the corporate level involving relationships between the businesses in the organisation's portfolio. The following reading covers these briefly. Skim read it to obtain a general overview of the concept. I am sure you will have heard of some of these before.

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**Reading**


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**4.3.1 Some problems with portfolio analysis**

The portfolio category warrants special mention here, because in practice it is always the least understood, and quite often the most misused area at the corporate level of management.

The BCG matrix, the first of these models to be developed, has stood the test of time very well; it is still well used and applied in the general business area as well as in the maritime industry. However, it is limited in its use. A number of researchers at the Harvard Business School have clearly demonstrated that market share becomes less relevant in highly specialised areas like the shipping industry where there are so many niche markets.

Because of the BCG's limitations, many people have turned towards other models like the GE planning grid and the many latter-day variations (for example, the Directional Policy matrix, the Thompson-Strickland matrix, the Grand Strategy matrix, and the McKinsey screen). As conceptual constructs, all of these models are improvements over the BCG matrix and they help managers to assess their business units. To use them effectively, however, does require experience and sound judgement.
If you are a novice at this game do not be disheartened by such precautions. You will never gain experience unless you are willing to dirty your hands (even if it means having to eat humble pie every now and then). Therefore, my advice to you is to go ahead and play with these various methods. Use your time in this subject for (relatively) risk-free experimentation!

One last thing: while the evidence to date is not conclusive, there is research evidence to suggest that life cycle portfolios (like product life cycles and the Arthur D. Little matrix), which are mostly manufacturing-based, are less applicable to service industries than originally thought. So again, be careful how you use them!

### 4.3.2 Analysing strategic capabilities: an example

Here is a practical illustration of how the strategic capabilities of a company can be analysed. For our example, we shall use the Peninsular & Oriental Steam Navigation Company, more commonly known as P&O. Data used for this analysis are real, but are not provided here so as to avoid distraction from the objective of this section.

At the time of the analysis P&O had the following six single business units:

- services
- passenger shipping
- container and bulk shipping
- P&O Australia
- housing, construction and development
- investment property

If we were to analyse the performance of each business unit in terms of its financial contribution to the company, how would we go about it? (1) We would analyse the company’s corporate profile, and then (2) analyse the strengths and weaknesses of each business.

**Step 1: Analyse the corporate profile.**

**Objective**
Appraise the individual performance of the six business units of P&O on the basis of key financial criteria.

**Method**
This can be done by using a derivative of the Du Pont Capital Efficiency ratio. This ratio measures the efficient use of (a) revenue earned, (b) operating profits and (c) asset utility based upon current disposable values. The formula is:

\[
\frac{\text{operating profit}}{\text{turnover}} = \times 100 \times \frac{\text{turnover}}{\text{current asset value}} = \frac{\text{profit}}{\text{current asset value}}
\]
Results

Using the Du Pont formula and based on P&O data, the following ranking is arrived at:

<table>
<thead>
<tr>
<th>Rank</th>
<th>Business units</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>P&amp;O Australia</td>
<td>28.6</td>
</tr>
<tr>
<td>2</td>
<td>Container and bulk shipping</td>
<td>16.8</td>
</tr>
<tr>
<td>3</td>
<td>Housing, construction and development</td>
<td>13.5</td>
</tr>
<tr>
<td>4</td>
<td>Services</td>
<td>10.8</td>
</tr>
<tr>
<td>5</td>
<td>Investment property</td>
<td>5.5</td>
</tr>
<tr>
<td>6</td>
<td>Passenger shipping</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Note the emergence of three distinct groups of performed: (a) P&O Australia, which is clearly the star performer; (b) container and bulk shipping, housing, construction and development, and services, which are lagging not far behind; and (c) investment property and passenger shipping, which are putting in a very poor performance.

When plotted on a portfolio matrix which is based on earning (profit / turnover) and market growth potential (turnover / current asset value) the six business units assume the following positions (see Figure 4.4):

Figure 4.4  P & O’s corporate portfolio
Step 2: Analyse each business' strengths and weaknesses.

Objective
Analyse each business unit's strengths and weaknesses to arrive at a complete picture of P&O's corporate-level internal capabilities.

Method
Several methods could be used to answer the question:

- Do a subjective assessment: survey key executives, hold a brainstorming session or conduct an expert review.
- Develop some quantitative measure of assessment.
- Use a mix of assessment measures, including a good dose of experience, judgment and good old 'gut sense'.

Of the three, the last would be most useful as it would yield richer and more reliable data. This was the method used to reach the following findings.

Results
Findings are summarised in Figure 4.5. This corporate profile is an aggregate of the strengths and weaknesses of each business unit.
Managerial
Corporate image, social responsibility
Leadership
Speed of response to changing conditions
Flexibility of organisational structure
Management communication and control
Entrepreneurial orientation
Ability to attract and retain highly creative people
Ability to meet changing technology
Ability to handle economic fundamentals
Competitive
Uniqueness and quality of service
Customer loyalty and satisfaction
Market share and advantage taken if potential exists
R&D investment for new market development
High barriers to entry in company's markets
Bargaining power of suppliers and buyers
Customer concentration
Cross elasticities of demand of company's service
Rivalry amongst competitors
Financial
Access to capital when required
Capital investment, capacity to meet demand
Degree of capital utilisation
Profitability
Liquidity
Ease of exit from markets
Ability to compete on prices
Stability of costs
Ability to sustain business cycles
Technical
Technical and operational skills
Resource and personal utilisation
Level of technology used
Intensity of labour in service
Economies of scales
Newness of technology
Technical obsolescence in capital

Figure 4.5 P&O's corporate strengths and weaknesses
4.4 Domain choice

The following reading provides a concise discussion of domain choice. You will note the reading is a 1990 publication. However, it is concise and certainly not dated. It leads us nicely into our next section.

Reading (Refer end of Module)


So, basically, Montanari et al (1990) suggest we combine the external assessment and the internal strategic capabilities analysis in a SWOT analysis to determine what is feasible for an organisation, to enable selection of the domain in which the firm should conduct business.

In the next section we will consider the SWOT analysis in further detail providing an example. Later (in the Capstone activities) you will be given a reading containing another real-life maritime example and asked some questions.

4.5 Framework for SWOT analysis

By far the most popular and widely used tool for drawing the internal and external environment together is the SWOT analysis. We will spend some time on this now so that you are well prepared to complete your assessment.

A good SWOT analysis enables you to identify all the opportunities and threats in the external environment, and all the strengths and weaknesses in the internal. However, what you do with this information is up to you. If you pass up opportunities or are daunted by threats because of this or that weakness, (the ‘oh, but we cannot possibly do that’ syndrome), do not blame the method for your inability to find novel solutions. You are simply not thinking strategically. A strategic manager would look at this mixed bag of goods, get the imagination going and find ways of making the best out of the situation.

For instance, say we have a company that is doing really well but is faced with massive tax liabilities. One might say that the law and the taxman must be obeyed, so the company should pay up. Another may think strategically and say, ‘we know we have to pay tax, but let us cut down our liabilities by diversifying into shipping where there are good tax shelters’. However, there is one hitch – the company does not have any shipping expertise. Should this stop it from venturing into shipping? Absolutely not!

The company can play with different alternatives. It can go out and hire the necessary experts, set up a joint venture with a reputable shipping company, or even embark on a take-over bid or a merger.
Remember what strategic management is all about: it is about creating or manipulating conditions that will help your company propel itself into a strong(er) competitive position. Certainly, it is not about meekly accepting what the politicians and the market hand out to you. Neither does it mean mechanically and blindly applying 'management tools', however good they may be said to be. If such tools do not exactly fit your particular circumstances, adapt them or search for other alternatives. There are plenty of them about.

As Montanari et al (1990) point out, domain choice is where you bring your analysis of the external and internal environments together under the same framework. This analysis should provide managers with comprehensive information as to how well the organisation is doing, and what feasible directions it can pursue in the future.

Although some of you are probably already familiar with the SWOT method, it will not hurt to reiterate the main components of this framework:

- Opportunities and threats are based on the external environment of the organisation and are thus considered from a market perspective (that is, factors outside the organisation).
- Strengths and weaknesses are based on the internal environment and are thus considered from an organisational perspective (that is, factors within the organisation).
- Opportunities, threats, strengths and weaknesses are evaluated in terms of major environmental facets (for example, economic, organisational, political, social and technological facets).
- Equal weight need not necessarily be applied to each of the environmental facets. Some facets will be more important than others.

This is where the two-step approach introduced in Module 3 can help you. Remember the steps?

**Step 1:** Identify all relevant factors.

**Step 2:** From among the factors identified in step 1, choose those that would have the most direct and significant impact on the organisation and make these the focus of your analysis.

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**Strategic management concept**

Successful strategists aim at capturing a company's best growth opportunities and creating defenses against external threats to its competitive position and future performance.
4.5.1 Applying the SWOT framework

For our P&O example, findings about the external and internal environments are pulled together under the SWOT framework in Table 4.1 below. Note, some strategists prefer not to use a table but to set the analysis out under headings. Either way is acceptable and it is very much up to the individual organisation. Our later example is set out under headings.

Table 4.1 A full assessment of P&O’s environment

<table>
<thead>
<tr>
<th>Economic</th>
<th>Company oriented</th>
<th>Market oriented</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strength</strong></td>
<td>Access to capital when required.</td>
<td>Depressed market conditions give opportunity to acquire key companies.</td>
</tr>
<tr>
<td></td>
<td>Ability to sustain business cycles.</td>
<td>Changing trading patterns; Pacific region forecast to be major growth area.</td>
</tr>
<tr>
<td></td>
<td>Quality asset base and earnings.</td>
<td>Resources available in international market not expected to rise.</td>
</tr>
<tr>
<td></td>
<td>Diversity of earning.</td>
<td>EC will give good growth to well positioned companies.</td>
</tr>
<tr>
<td></td>
<td>Economies of scale from operations.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Decentralised group (6 SBU).</td>
<td></td>
</tr>
<tr>
<td><strong>Weakness</strong></td>
<td>Profitability low.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>High substitution effect of services.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Some SBU's not interrelated; total synergy of group is weakened.</td>
<td></td>
</tr>
<tr>
<td><strong>Opportunity</strong></td>
<td>Depressed market conditions give opportunity to acquire key companies.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Changing trading patterns; Pacific region forecast to be major growth area.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Resources available in international market not expected to rise.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EC will give good growth to well positioned companies.</td>
<td></td>
</tr>
<tr>
<td><strong>Threat</strong></td>
<td>Passenger shipping threatens to become more competitive.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Oversupply of ships expected to depress earnings potential.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Geographical spread of SBU's gives high exposure (currency risk).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Trend is conglomerate diversification; threat is that more stability offers less opportunity to the well placed.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>As a result of above, trade cycles may get shorter.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EC may involve price wars and wave of predatory takeovers—niche markets may be greatly reduced.</td>
<td></td>
</tr>
<tr>
<td>Politics</td>
<td>Company oriented</td>
<td>Market oriented</td>
</tr>
<tr>
<td>----------</td>
<td>------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>Healthy contributions to Government are a source of insurance. Management skills to take full advantage of legislation and fiscal policies.</td>
<td>Having a high public profile, exposed to vagaries of publicity.</td>
<td>Diversified into key industries protecting against country discrimination. Political action will continue to present industry with opportunities (embargoes change trading patterns). Geographical speed of business units increases country risk exposure (anti-trust legislation, unfair trading practices). Protectionism in trade (subsidies). EC policy may influence remaining trade areas to form their own block; trade will be dominated by bi/unilateral agreements.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technological</th>
<th>Strength</th>
<th>Weakness</th>
<th>Opportunity</th>
<th>Threat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to meet changing technology. Good technical skills.</td>
<td>R and D investment in new market developments.</td>
<td>Ageing fleet and lags on building give good prospects for companies with modern technology. Technological advancements (computers, automation) will enhance integration and communications; promote more specialised services. Market conditions allow new technology to be purchased by acquisitions.</td>
<td>Substitutes advancing at greater speed; Shipping technology limited to making existing technology more efficient. Airline industry developed new designs and expanding into higher value container area of demand.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Social</th>
<th>Entrepreneurial orientation</th>
<th>Succession of leadership</th>
<th>Marginal utility of human resources likely to increase. Increased interaction with different cultures and religions will give greater knowledge in expanding trade.</th>
<th>Nationalistic pride of some cultures, Japa, Korea, will restrict trade opportunities and increase transfer of technology and skills to the disadvantage of some large diverse companies will have greatest exposure.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate image and social responsibility. Ability to attract and retain highly creative people. All of the above is under the guidance of strong leadership. Chairman: J. Sterling.</td>
<td>Extent to which new leader or management could emanate the same strengths without present champion figure.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Activity - Test your understanding

Given the data provided in Table 4.1 identify the areas of growth for P&O. If you were the strategic manager what recommendations would you make?

One final word of advice. An important area we highlighted in Module 3, and one that we must stress again here, is the importance of providing a clear picture of the current overall competitive environment of an organisation. As we said earlier, a careful and thorough analysis of all relevant trends and conditions is fundamental to survival. When it is your turn to do a real-life environmental assessment, remember this one cardinal rule!

An aside: Get real

Winning companies see the environment for what it is and themselves for what they are. It is all too easy to see things as we wish them to be not as they are.

Like everyone else business people are prone to overestimate their own strengths and their competitors’ weaknesses. There are eight realities that companies most often fail to perceive:

- your strength in your market
- your quality, especially as compared with that of your competitors
- what your customer thinks of you
- why your non-customers aren’t doing business with you
- the potency of your competitors
- the cost position of your competitors especially as compared with your own
- the potential impact of merging technologies and market segments
- your projection for your products future.


Strategic management concept

Always attempt to see the environment for what it is and yourself for what you are when you are analysing your business.

4.5.2 Assessing your SWOT analysis

It is always good practice to evaluate any assessment you undertake, so whenever you do a SWOT analysis, check whether you are covering, or have covered, all major items. The following checklist can be a useful tool.
### SWOT analysis

1. Is the SWOT comprehensive enough (i.e., have all major areas been covered)?
2. Are the most critical factors clearly identified?
3. Where applicable, are these critical factors ordered according to importance?
4. Is there a strong correlation between the factors mentioned in the SWOT and
   a. prevailing conditions in the environment?
   b. major changes in recent years?
   c. key trends and prospects for the future?
5. Do the stated opportunities, threats, strengths, and weaknesses deal exclusively with strategic concerns (i.e., do not include operational matters)?
6. Does each identified opportunity, threat, strength, and weakness meet the
   following test?
   a. If the organisation has no direct control over it, then it is either an
      opportunity or a threat.
   b. If it has the power to change it, then it is either a strength or a weakness.
7. For service areas (administration, finance, etc.) does the SWOT address two
   levels of concern?
   a. at one level, how well they service specific sectors within the organisation
   b. at another, how well their service stands up to competition from outside the
      organisation

### Presentation of results

8. Are the opportunities, threats, strengths, and weaknesses stated in clear,
   concise, and specific terms (i.e., not ambiguous at all)?
9. Are the results presented in a well-organised manner (i.e., presented in the form
   of an executive summary and highlighting key areas of importance and
   concern)?
10. Where supporting data/details are provided, are these clearly linked to the key
    issues raised in the executive summary?
11. Are these supporting data/details attached to the summary (i.e., as appendices)?
12. Overall, is the information provided adequate enough to aid the organisation in
    its strategic decision-making?

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**Figure 4.6** SWOT checklist
Key strategic management principle
Identifying and thoroughly understanding the strategic issues a company faces is a prerequisite to effective strategy making.

4.6 Global issues for the 21st century
- As more industries become more internationally competitive it will become harder to sustain competitive advantage, unless an organisation has a distinctive competency that is not only durable but also hard to imitate.
- Expect corporate culture and human resources to increase in importance in a highly competitive global industry. New products and new technologies are easier to duplicate than the intangible aspects of corporate culture and human resources. This has implications for the maritime industry, which is service (as opposed to product) orientated.

Conclusion
Internal strategic capabilities can be located at two levels within an organisation: corporate and business. Business-level strategic capabilities are based on the main competencies of the organisation as they relate to each of the organisation’s functional areas. They normally include technical, managerial, informational and organisational capabilities.

Corporate-level strategic capabilities are based on how well the organisation is able to balance its portfolio of business units. These capabilities are of three kinds: general, portfolio and financial.

Domain choice brings the external and internal environments together under the same framework. This analysis focuses only on those factors that have a direct and significant impact on the organisation, and the environment in which it competes. This analysis provides managers with considerable information on how well the organisation is doing and on which directions are the most feasible to pursue in the future.
References


*Lloyd's Shipping Economist* (June 1988). 'Conferring on ship finance', pp. 6-12.


*Lloyd's Ship Manager* (September 1987). 'Efficiency and internationalism dominates Norwegian banking scene', p. 27.


*Port Development International* (September 1987). ' Bulk shipping in the Pacific area', pp. 61-64.

*Port Development International* (September 1987). 'Australian coal export prospects defined', pp. 60-64.


20 Strategic Management
Reading
Domain Choice

The environmental assessment highlights the elements or stakeholders that offer the most favorable opportunities to the organization. The internal strategic capabilities analysis identifies the organizational resources available to pursue the recognized opportunities. The strategic manager should combine these analyses in a SWOT and/or strategic capabilities analysis to determine what is feasible for the organization. This is an important choice, for it determines the firm’s specific business arena for the next planning cycle. The name given to this portion of the task environment with its associated elements and stakeholders is the firm’s domain—all of the organizations, agencies, groups, or individuals in the task environment with which the manager chooses to transact business.

According to this definition, when a manager chooses opportunities to pursue, he or she also determines the elements and stakeholders in the firm’s task environment. If the manager chooses to conduct business in residential construction in Dallas, then Dallas customers, suppliers, local laws, labor, financing, and regional economy all become part of the firm’s task environment. However, the construction company manager is not required to conduct business with all of these elements in the firm’s
task environment. The strategic manager initially has a choice of the elements and stakeholders with which he or she will conduct business. Typically, the manager will depend on referrals from other contractors or previous business acquaintances to select only a few suppliers, banks, and so on, with which to conduct business. Through this process the manager selects the elements and stakeholders that compose the firm’s domain from all possible elements and stakeholders in the task environment.

Selection of a firm’s domain should follow a systematic procedure that produces the greatest opportunities while limiting the threats to the organization’s survival. Table 3.4 specifies the steps for such a procedure.

The first step in the selection process is to review the results of the environmental assessment. If the firm is newly formed and not committed to an industry or current markets, the assessment can produce a broad list of opportunities. However, in most cases the firm’s task environments are partially defined by the existing markets in which the firm operates. Next, the manager identifies the greatest opportunities and determines which task environments are associated with the new opportunities. This information can usually be taken directly from the opportunities and threats (O&T) analysis conducted in the environmental assessment.

Also available from the O&T analysis is information about the threats that accompany each opportunity. These threats are evaluated for each of the opportunities selected in Step 2. Especially important is to identify any terminal threats associated with a particular task environment. Terminal threats are those that have a high prob-
**Table 3.4 Domain Selection**

<table>
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<th>Step</th>
<th>Procedure</th>
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<tr>
<td>1</td>
<td>Review the results of the environmental assessment.</td>
</tr>
<tr>
<td>2</td>
<td>Select the greatest opportunities and determine their task environments.</td>
</tr>
</tbody>
</table>
| 3    | Evaluate the threats that exist in each task environment selected in Step 2.  
|      | a. Check for any terminal threats.  
|      | b. Describe the remaining threats. |
| 4    | Analyze internal strategic capabilities, and compare the capabilities of the organization with the demands of the opportunity. |
| 5    | Select the task environments with no terminal threats and the fewest nonterminal threats that fall within the capabilities of the organization. |
| 6    | Consider all environmental and organizational constraints that are operating on each task environment.  
|      | a. Accept the constraints.  
|      | b. Eliminate the constraints. |
| 7    | Select the task environments that offer the greatest opportunities and fewest nonterminal threats and that fall within the firm's capabilities in Step 4. |
| 8    | List all of the organizations and agencies with which the firm should or must establish relationships (e.g., suppliers, distributors, customers). |
| 9    | Evaluate all of the organizations and agencies in Step 8 to determine which of these should be selected for inclusion in the firm's domain. |

ability of occurrence and can cause the firm to fail. If a task environment associated with an opportunity contains a terminal threat, this task environment should be eliminated from further consideration. The strategic manager then describes any remaining nonterminal threats that are a part of the opportunities that have not been eliminated.

Next the manager analyzes internal strategic capabilities to identify the firm's capabilities. The manager compares these capabilities with the demands of the new opportunity.

In Step 5, the strategic manager makes an initial selection of all task environments that have minimal threats and fall within the organization's capabilities. Before the manager can make a final selection, he or she must consider the constraints on the selection process. These constraints limit the feasibility of some opportunities for a particular organization. For example, if the manager insists on maintaining total ownership of the business, this constraint may limit the opportunities available to the firm to obtain funding. Basically, the manager has two ways to deal with these constraints. The manager either can accept the constraints as legitimate and incorporate them into the selection process, or can eliminate their influence from the process.

In light of the accepted constraints, the manager narrows the selection of the task environments to those that will form the basis for the firm's operations and relationships. Once the manager selects the task environments associated with the best opportunities, all elements and stakeholders within these task environments become part of the firm's newly expanded task environment. This expanded task environment
includes all relevant elements and stakeholders from both the old and the new businesses of the firm.

To identify these elements and stakeholders, the manager lists the organizations and agencies with which the firm should or must establish relationships. This step involves an evaluation of the organizations that may be part of the firm’s domain. Here, the manager selects those organizations that are critical to the success of the firm or that provide the firm with a competitive advantage. Some regulatory agencies must be part of the firm’s task environment. For example, the Securities and Exchange Commission must be in the firm’s domain if the firm is in the securities industry. The Environmental Protection Agency must be part of the domain of a firm in the mining industry. The Internal Revenue Service is a necessary stakeholder in the domain of a firm headquartered in the United States.

The firm may select other organizations to be part of the domain because they improve organizational performance. For example, a supplier that has a reputation for high-quality materials would be a good selection for the firm’s domain. Or a useful addition to the domain might be a distributor with a reputation for hiring aggressive sales personnel. Many suppliers or distributors from which to select may exist in the task environment, but only certain ones can give the firm a competitive advantage. The last step in the selection process is therefore actually to select the organizations and agencies that will compose the firm’s domain.

In reality, most organizations do not follow this ideal process for domain selection. Except for new entrepreneurial organizations, most firms have served specific markets for a number of years and have established relationships with suppliers and regulators. Furthermore, over the years an organization has developed a culture, which is difficult to change in the short term. Therefore, for most established organizations, the selection of a domain is constrained by factors beyond the manager’s control.

Nor should all of these steps be followed in practice. Many organizations currently operate in secure and profitable task environments, and their CEOs do not wish to modify them in any way. For these organizations, managers need only follow the steps that identify and weight threats and constraints. Even the manager of a stable and secure firm wants to protect the organization from events that could threaten its survival.

**Summary**

Internal strategic capabilities are located at two levels of strategy development: corporate and business. At the business level, strategic capabilities consist of the human, material, and informational resources of the firm that enable it to pursue the opportunities in its environment. The types of capabilities that exist in the firm can be managerial, technical, information, or organizational. Major locations for capabilities are the marketing, R&D, production/operations, finance, and management functions of the firm. Knowing the type and location of organizational capabilities allows the manager to determine the firm’s ability to take advantage of environmental opportunities.