Analysis of the External Environment: Opportunities and Threats

LEARNING OBJECTIVES

Studying this chapter should provide you with the knowledge to:

1. Explain the importance of correctly identifying and choosing a firm's industries and markets.
2. Identify and measure the five major forces that shape average firm profitability within industries to evaluate the overall attractiveness of an industry.
3. Discuss how understanding the five forces that shape industry competition is useful as a starting point for developing strategy.
4. Discuss situations in which entry into both attractive and unattractive industries follows "new thinking" rather than conventional wisdom.
5. Identify the factors in the general environment that affect firm and industry profitability.

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Nokia and the Smartphone Industry

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Nokia, a long-time leader in the telecommunications equipment and mobile phone industry, got its start in that industry in 1981 when it acquired a 51 percent stake in a Finnish telecommunication firm. Since that time, Nokia has sold more mobile phones than any other company. The firm has been the world leader in market share since the mid-1980s. By 2008, Nokia's worldwide market share had reached 40 percent, more than double the approximately 18 percent market share of Samsung, its nearest rival. The Nokia brand was a top seller everywhere, including the United States, China, Latin America, and Africa.

Not only was Nokia the leader in handset manufacturing, offering value to its customers by manufacturing a full line of phones from the lowest end of the price range to the most expensive, the company also manufactured some of its own cell phone components, such as cameras and accessories. In addition, Nokia designed and manufactured network infrastructure equipment, launched a gaming device (N-Gage) that tapped into the entertainment and media markets, and owned Symbian, the leading operating system for the new generation of multifunctional 3G phones. In all, Nokia had 9 divisions producing products for a variety of industries, each with separate profit

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and loss accountability.[1] As late as 2003, Nokia appeared to have a competitive advantage in cell phones in the same way that Microsoft had an advantage in PC operating system software and Intel in microprocessors.

By 2010, however, Nokia had taken a nose dive. Although it still held a reasonable 32 percent of the worldwide market share of cell phones, the company commanded only 2 percent of the emerging smartphone market in North America. Nokia's profits had plunged 68 percent, from nearly €8 million in 2007 to only €3.3 million in 2009. Moreover, the firm's stock also tumbled, falling 86 percent from a high of $39.57 a share in October 2007 to $7.15 a share in April 2014.

What happened? To a large extent, Nokia was caught off guard by fundamental changes in the mobile phone industry from 2003 to the present. Before the introduction of 3G (third generation) smartphones, the cell phone manufacturing industry had power over its suppliers, the makers of chips, and other parts for cell phones. Software wasn't a big part of the picture and most handset makers programmed their own software. The firm that could make the most attractive phone with the best hardware features at the lowest cost outperformed others in the industry. For years, Nokia had offered unique value to its customers by having the latest and best hardware.

With the advent of 3G smartphones, however, software became the central differentiator. Today, most people buy a phone based on its operating system and the applications the operating system can run. Nokia did see the change coming and poured Research and Development (R&D) dollars into its own Symbian operating system, focusing on building the resources and capabilities necessary to compete in software. In 2003, 80 percent of all 3G phones—the first ones able to surf the Internet—were sold by companies that had licensed Nokia's Symbian operating system. In contrast, Microsoft, Nokia's major competitor at the time, had great difficulty with the early launch of Windows Mobile operating system for 3G smartphones. Several of Microsoft's partners abandoned Windows Mobile for Nokia's Symbian system.[2]

Nokia failed, however, to look more broadly at what the cell phone market was becoming and who might become its new competitors in that emerging market. It wasn't prepared to compete with them and couldn't sustain its competitive advantage. With the introduction of Apple's iPhone and Google's Android operating system, Nokia's share of operating systems plummeted so far that the company eventually teamed up with its old rival, Microsoft, to offer Windows Mobile 7 on Nokia phones.[3] But this did little to stop the onslaught from Apple and Samsung, who sold phones using Google's Android system. In the first quarter of 2011, Nokia sold 108.5 million handsets for a total of $9.4 billion. Apple, in contrast, sold only 18.6 million iPhones but made $11.9 billion.[4] Nokia had clearly lost the market for high-end phones to Apple and other phones running the Android operating system. In addition, Nokia's low-end handsets were under pressure from new Asian manufacturers. Indeed, thousands of new low-cost *Shanzhai manufacturers,* small Chinese firms focused on creating knockoff products, now make phones with names such as "Nckia." The Shanzhai manufacturers flooded the markets in China, India, the Middle East, and Africa, threatening to erode Nokia's market share in the remaining markets where Nokia was still dominant.[5]

Indeed, Nokia's position in cell phones became so stark that in 2013 it sold its entire cell phone business, the cornerstone of its previous success, to Microsoft. Not only did Nokia have to sell, but it did so at a shockingly low price of only €5.5 billion, off from the highest market capitalization of €110 billion during its glory days.[6]

Microsoft bought the rights to nearly all of Nokia except for the Nokia brand and its famous ringtone, leaving a hollowed-out Nokia without most of its critical resources and a two-year ban on selling any Nokia-branded phones. Microsoft merged Nokia's business into its Microsoft Mobile subsidiary, shut down production of all Nokia phones that didn't run the Windows Mobile operating system[7] and laid off 12,500 former Nokia workers.[8]

After the two-year ban was up, in 2015, Nokia attempted a comeback. It merged with the French telecommunications company Alcatel-Lucent in an all-stock trade that made Nokia the majority shareholder. This gave Nokia some future potentially strategic resources such as undersea cable capable of running 5G, a potential future revolution in telecommunications.[9]

The much smaller and poorer Nokia, however, was still intent on competing in the smartphone industry. On January 8, 2017, Nokia released its first smartphone since its collapse in 2010, the Nokia 6. The phone ran the Android operating system and might provide just the boost Nokia needs. It was initially sold only in China, but in spite of a price of $245 USD, it sold out its entire initial stock of 100,000 units in just 60 seconds with more than 1 million pre-orders within days of its opening![10]

In mid-February, 2017 Nokia's stock price was at $5 USD, down from its high of $58 in 2000 but up from its near-death low of $1.71 in July, 2012.[11]

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As described in Chapter 1, strategy involves crafting a plan to create competitive advantage—and superior profitability—in particular markets. This plan, however, is shaped by the landscape in which the firm competes. A firm's external environment provides both *opportunities*—ways of taking advantage of conditions in the environment to become more profitable—and *threats*—conditions in the competitive environment that endanger the profitability of the firm.[12] Successful firms have a deep understanding of their environment and constantly scan the horizon to see opportunities and threats as they emerge.[13]

One of the key threats a strategist must understand and cope with is competition. Often, however, managers define competition too narrowly, as if it occurred only among today's direct

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competitors. Nokia was so focused on Microsoft as its key competitor in the 3G operating system industry, and Motorola and Ericsson as its cell phone competitors, that it failed to effectively prepare for Apple's entry into the industry. Competition for profits goes beyond established industry competitors to include four other forces that shape industry attractiveness and profitability: *customers, suppliers, potential entrants*, and *substitute products*. Together, all five forces define an industry's structure and shape the competitive interactions—and profitability—of companies within that industry. Even though industries might appear to differ significantly, the principles that determine the underlying drivers of profitability are often the same. The global cell phone industry, for instance, appears to have nothing in common with the highly-profitable soft drink industry or the low-cost airline industry (i.e., Southwest and JetBlue). But to understand industry competition and profitability in these and other industries we must analyze the same five forces.

This chapter will help you to recognize the major threats and opportunities that make up the competitive landscape, both the industry forces and general macroeconomic forces that drive industry attractiveness—and profitability.

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