

4.3 The theory behind SWOT analysis

SWOT must be broken down into two parts. Strengths and weaknesses represent the current situation for the business. In effect it is 'What are we good at? What are we bad at?' Opportunities and threats are external to the business and therefore largely outside management's control.

Naturally the current business situation has to be considered in relation to competitors, so it is useful to analyse strengths and weaknesses with the help of a **benchmarking** exercise. This shows how the business performs on key variables compared with the best in the industry. Nissan UK may be pleased that its labour turnover has fallen from 12 per cent to 10 per cent, but if it sees that Jaguar Land Rover's achievement is 2 per cent, it will perceive there's more to be done.

Among the external factors that can give rise to opportunities or threats are the following:

- Economic changes such as the sharp fall in the price of oil at the beginning of 2015; this would threaten the future of alternative energy provision such as wind power – but provide an opportunity to a specialist producer of acrylic clothes, as acrylic is made from oil, and will now be much cheaper than cotton or wool.
- Technological change such as the development of graphene, a form of carbon that's one atom thick, yet – gram for gram – is one hundred times stronger than steel. In markets where weight matters hugely, such as aerospace, companies that fail to master the potential for graphene may find their futures under threat.

4.4 Internal considerations: strengths and weaknesses

A key starting point in analysing strengths and weaknesses is to distinguish between those that *are* and those that *matter*. Inditex (owner of Zara) publishes a huge amount of environmental and human resource data that is presented as a strength, but perhaps doesn't matter much in relation to overall business performance. Eighty per cent of staff are permanent and only 20 per cent temporary (out of nearly 120,000 staff). In an era of outsourcing and contract labour, this is admirable. But does it actually matter?

To address this issue companies use the concepts of KPIs: key performance indicators. These are the numbers

that a business acknowledges to be proper measures of strength or weakness. Typically these might include sales per employee, absenteeism, image ranking within the market sector and so on. These are measures that matter. Figure 4.1 shows how Tesco has prioritised returning the company's reputation to one that has empathy for customers as well as impressive size. This can be measured by regular quantitative research studies among Tesco users and non-users.

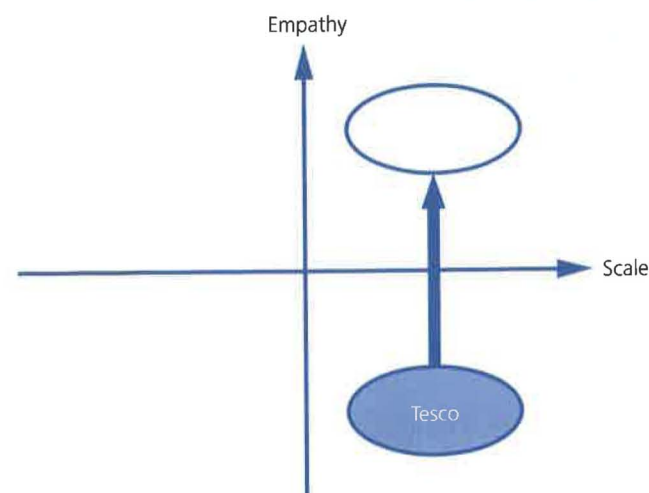


Figure 4.1 Logic chart (source: Tesco presentation by Dave Lewis, 23 October 2014)

When Googling 'KPIs', one site offered '75 KPIs for business success'. Actually that sounds like a recipe for disaster. What businesses need is relatively few KPIs that will – between them – add up to the achievement of the overall business goals. Among the most common KPIs are the following:

- Like-for-like sales, which show sales revenues this year compared with last, but eliminating any differences in shop floor space; so if a business has opened ten new stores in the past year, their sales will be excluded from the like-for-like comparison. On 6 January 2015 House of Fraser announced an 8 per cent improvement in Christmas 2014 like-for-like sales; the previous day John Lewis had boasted of its 4.8 per cent increase in like-for-like sales. In this case House of Fraser was the one showing strength.
- Market share: this is a number that every business cares hugely about. It is, after all, the ultimate comparison of you against your competitors. Even if your sales are rising rapidly you should worry if market share is falling; after all, when the market matures, continuing falls in market share would then mean falling sales. Rising market share is a strength; falling market share is a weakness.

- Capacity utilisation: even a business that's enjoying rising sales may have a fall in utilisation if it has expanded its capacity too greatly. Ryanair suffered exactly this problem in 2012 and early 2013. Sales were rising, but not fast enough to fill all the planes they had bought. An aircraft order can take as long as five years to fulfil, so it's very hard to keep supply and demand in balance. The falling capacity utilisation forced Ryanair to mothball some of its planes, and then forced boss Michael O'Leary into an unexpected backtrack – switching the sales strategy to be far more positive about customer care – to attract more customers.

So how should a business use its KPIs to address its strengths and weaknesses? The answer is simply to break them down as much as possible into their component parts. Capacity utilisation can first be broken down into size of capacity and the level of customer demand. In Ryanair's case there was a recognition that – for the first time – stories about bad customer experiences were denting demand. So the cause of the weakness was identified and tackled. On 5 January 2015 Ryanair reported a 20 per cent rise in passenger numbers for December, with their load factor (capacity utilisation) up from 81 to 88 per cent. In effect they had managed to turn a weakness into a strength, in less than 18 months.

4.5 External considerations: opportunities and threats

These relate to the external context of the business. They are therefore outside the direct control of managers – though in some cases (governmental and political, for example) companies will do everything they can to influence the decisions made by others.

Demography

An important factor to bear in mind is **demography**, i.e. population change. In the UK the population is rising by just over 0.5 per cent a year, but more important changes are occurring in the age distribution of that population. Not long ago, economists despaired at how a shrinking working population would cope with the huge rise in the elderly. Now immigration has solved that problem – though it hasn't altered the business opportunities in the sharp rise in the number of elderly consumers. See Figure 4.2.

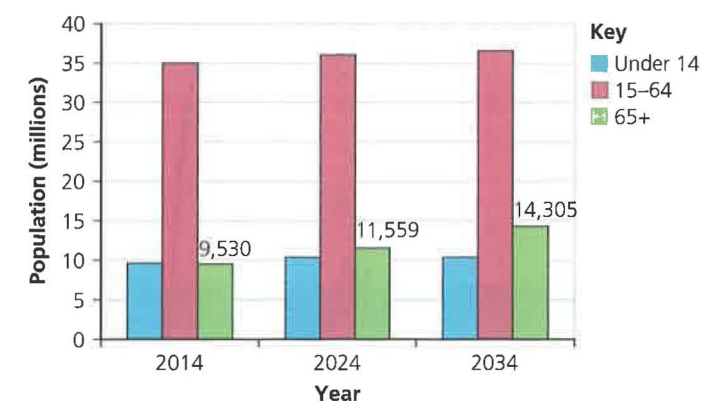


Figure 4.2 Changing age distribution 2014 to 2034 (source: Office of National Statistics 2014)

New laws and regulations

Changes in the law can have a dramatic effect on a business. A good example came from the regulation changes made to child car seats, which came into effect in September 2006. They forced all motorists to provide 'seat restraints' for children sitting in the back of a car. Children under the age of twelve must sit on a 'booster seat' and babies must have their own special car seat.

Overnight, this regulation created a huge boost for businesses like Britax, the car seat manufacturer, and Halfords, the biggest motoring retailer. Because the government gave 18 months' notice of the change, the companies had plenty of time to build production capacity and stock levels.

Technological factors

Technological change can also create opportunities and threats for firms. Before the advent of digital technology, ITV had only two competitors: the BBC and Channel 4. Today the situation is dizzying. Technological advances mean that ITV has to compete against the hundreds of channels provided by Sky and cable TV, plus subscription providers such as Netflix. In addition, the opening up of social media has provided indirect competition with conventional TV. These technological advances threaten ITV's ability to generate revenue from selling advertising slots. On the other hand, these same technological advances have created opportunities for the entrepreneurs behind Twitter, Facetime, Instagram and so many more.

Commodity prices

Commodities are internationally traded goods that include oil, copper, wheat and cocoa. Commodities are normally

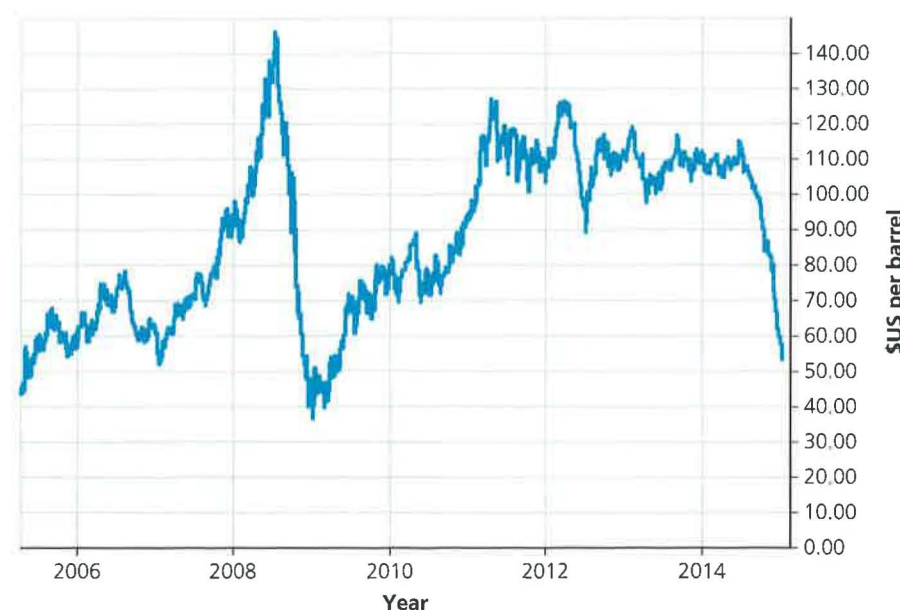


Figure 4.3 Oil prices 2006–January 2015

bought by firms as raw materials. As Figure 4.3 shows, the price of oil has fluctuated dramatically between 2006 and 2015. The price of oil is an important external influence for most firms. It not only affects transport costs directly, but also affects the costs of road building, as oil forms a key part of road construction materials.

Oil is also a very important raw material. Even companies such as Apple will be affected by rising oil prices because it will cost Apple more to buy in the plastic pellets needed to produce the casings for its laptop computers, iPads and iPhones. The price of oil is determined by the relative strength of the world supply and the world

demand for oil. The world oil price is beyond the control of any single firm, making it an excellent example of an external influence.

Economic factors

Individual firms have no influence over economy-wide factors such as the rate of economic growth, the level of unemployment and the rate of inflation. However, these factors will definitely affect firms. Firms will also be affected by government fiscal and monetary policy responses. For more details see Chapter 45 of the AS book (*Business Year 1* for Edexcel).

Real business

If the SWOT technique were applied to the hotel industry, Table 4.1 might be a reasonable summary of the findings.

Strengths	Opportunities
<ul style="list-style-type: none"> Inward tourism has been rising steadily: a major strength in London and Edinburgh The industry has quite a high, positive income elasticity, so as people get more affluent they use hotels more 	<ul style="list-style-type: none"> British hotels such as the Ritz, the Savoy and Claridges are world-famous; this gives huge potential for growth overseas After five years of dither, the British government committed itself in 2015 to cutting the crazily high price of a visa for Chinese citizens; this should help boost tourist numbers
Weaknesses	Threats
<ul style="list-style-type: none"> Inherently a seasonal business, especially away from city centres such as London; this makes cash flow and capacity utilisation problematic Lack of commitment by young English people means the industry is heavily reliant on immigrant – and therefore possibly transient – labour 	<ul style="list-style-type: none"> Airbnb threatens to offer unmatched price competition from individuals renting out their own rooms – an online/clicks threat to hotel bricks Economic downturns hit the hotel industry hard. When the next economic recession begins, hotels will be among the hardest hit

Table 4.1 Strengths, weaknesses, opportunities and threats for the UK hotel industry

'Build your weaknesses until they become your strengths.'

Knute Rockne, US football player and coach

4.6 What can firms do to influence opportunities and threats?

Organisations seem to spend an increasing amount of time and senior manpower on attempting to influence – even control – their environment. In some ways this is logical. Why would you wait for a train to hit you if you could a) stop it setting off or b) find out when it was coming and then get out of the way? So businesses began – many years ago – to 'lobby' their MPs. **Lobbying** usually meant local businesses going to London to put their case to their MPs, who would then ask questions in parliament. Today lobbying is an industry which allows unelected, professional lobbyists access to ministers or even the prime minister. Tony Blair made significant policy changes after personal lobbying by Formula 1 boss Bernie Ecclestone. David Cameron met media baron Rupert Murdoch on seven occasions between 2010 and 2012. There must come a point when the term lobbying should no longer be used for such direct involvements.

The point remains a simple one, though. Companies want to encourage favourable legislation and discourage unfavourable legislation (from the perspective of the companies) and switch the balance of taxation away from companies and towards households. In many ways this is perfectly sensible. The only problem comes when legitimate influence goes too far. Young mothers, skilled workers and those with disabilities are groups with as much right to lobby the government as business. They just don't have as much money or as much access to those with power.

'Strengths are not activities you're good at, they're activities that strengthen you.'

Marcus Buckingham, business consultant

'So it is said that if you do not know others and do not know yourself, you will be imperiled in every single battle; if you do not know others but do know yourself, you win one and lose one; if you know others and know yourself, you will not be imperiled in a hundred battles.'

Sun Tzu: The Art of War (written about 500 BC)

'Strength does not come from winning. Your struggles develop your strengths.'

Arnold Schwarzenegger, film star and politician

Five whys and a how

Questions	Answers
Why may it be hard for some senior managements to get to know their company's strengths and weaknesses?	Because they aren't asking the right questions of the right people; they're operating in their own boardroom bubble, like Tesco in the period 2007–2013/2014.
Why don't all strengths matter?	Because some have little bearing on the company's success or failure; consistent use of the colour orange may be one of easyJet's strengths, but does it make a difference to sales?
Why do some companies focus on their strengths while others tackle their weaknesses?	Most strategists would say build on your strengths, but Ryanair showed in 2014/2015 the value of tackling their (service) weakness; so there's no single 'right' way.
Why do some firms seem blind to their opportunities?	Up until early 2015 neither Primark nor Topshop had opened a single store in China; this lack of ambition is hard to fathom; a risk-averse board perhaps?
Why do threats so often seem to hit companies by surprise?	If they'd been anticipated they may never have emerged as a real threat; it's unexpected events such as the severity of the 2009 financial crash that threaten a firm's stability.
How often should a business conduct a SWOT analysis?	Many keep an ongoing one, updated each year. There's a case for starting from scratch every year, so that the material is really up to date.

4.7 SWOT analysis – evaluation

Regarding strengths and weaknesses the most important factor is to distinguish fact from hearsay or even delusion. One of the key characteristics of bosses who turn out to be failures is that they insulate themselves from real news. They effectively lock themselves away, listening only to ‘yes-men’ (usually men) and visiting the real world only as the Queen does – with plenty of warning and lots of security. Fred Goodwin, boss of RBS bank (which had to be bailed out by £46 billion from UK taxpayers in 2009) knew little about the real strengths

and nothing of the weaknesses of his own business. If the person at the top is blind, it’s very hard for others to see.

An important aspect of any evaluation of external factors is to distinguish between external change that is predictable and change that is not. For example, tourist businesses had five years to plan for the opportunities opened up by the 2012 London Olympics. By contrast no one would have expected that the Brazilians would have staged huge protests against their government immediately before the 2014 World Cup. Managers that fail to deal with predictable events are exceptionally weak. Those that succeed in unexpected situations are especially impressive.

Key terms

Benchmarking: comparing your own performance with that of rivals, to try to identify and learn from best practice.

Demography: factors relating to the population, such as changes in the number of older people or in the level of immigration.

Lobbying: the term originated in the ‘lobby’ between the House of Commons and House of Lords; it was where electors came to talk to their local MP.

4.8 Workbook

Revision questions

(30 marks; 30 minutes)

- 1 a) State two possible strengths and two weaknesses of McDonald’s. (4)
b) Explain how McDonald’s might tackle one of those weaknesses. (4)
- 2 Explain how a company such as Cadbury might be affected by a decision by Britain to withdraw from the European Union. (4)
- 3 Explain two possible reasons why a company might reject an opportunity. (6)
- 4 Explain how the quote from Sun Tzu (see page 25) relates to SWOT analysis. (4)
- 5 Several parts of Britain have suffered from floods in recent years. Explain how a retail business might prepare for that. (4)
- 6 Outline one UK business opportunity and one business threat that may emerge from global warming. (4)

Revision activities

Data response

Rolls-Royce to shed 2,600 jobs

John Rishton, chief executive of Rolls-Royce, sought to show he had a firm grip on the struggling FTSE 100 engineer as he unveiled the company’s biggest job reduction programme in six years. Analysts welcomed initiatives that would reduce the group’s 55,000 workforce by 2,600 and bring down annual costs by £80 million when fully implemented. However some raised concerns about the ability of the UK’s flagship industrial company to innovate in future if the cuts hit its engineering capability.



Figure 4.4 Rolls-Royce engine on a Boeing 787 Dreamliner

‘This implies they are firing engineers. That is surprising to me,’ said Christian Laughlin of Bernstein Research. Mr Rishton insisted the reduction would not hit the group’s ability to compete against its bigger rivals, such as General Electric. ‘The measures announced today will ... contribute towards Rolls-Royce becoming a stronger and more profitable company,’ he said. ‘We will work ... to achieve the necessary reductions on a voluntary basis where possible, while making sure we retain the skills needed for the future.’

A large engineering team had been required for the development phase of the Trent 1000 and Trent XWB engines, the group said, but with the development phase complete, the need for engineers was reduced. These two engines are the main engines for the hugely successful Boeing Dreamliner and Airbus A350 wide-bodied jets. Orders for the Trent 1000 and Trent XWB run into tens of £billions.

The news of the job cuts sent shares in Rolls-Royce 1.4 per cent higher to close at 846p. The market took heart from signals that another cost-cutting programme was being planned for the power systems and marine business. The current job cuts would come over the next 18 months and largely be made across its aerospace division. The majority of the job cuts would be achieved in 2015. Two-thirds of the 2,600 job cuts will come in the UK. The company employs 24,800 people in Britain out of 55,200 worldwide. The job cuts will include engineers as well as managerial, operational and administrative positions.

Rolls-Royce is the world’s second largest aero-engine maker, with a market share of 34 per cent.

(Source: *Financial Times*, 4 November 2014)

Questions (20 marks; 25 minutes)

- 1 Based on the information provided, carry out a SWOT analysis on Rolls-Royce Aero Engines. (20)

Extended writing

- 1 Tesco is a complex organisation employing half a million staff in more than 20 countries. Evaluate whether the boss of Tesco can be expected to know fully the company’s strengths, weaknesses, opportunities and threats. (20)
- 2 Consider an online or social media business that you use regularly and know well. Briefly research its company history and financial background. Then conduct a full analysis of its strengths, weaknesses, opportunities and threats. (20)