NOTE ON SWOT ANALYSIS

SWOT is an acronym that stands for Strengths, Weaknesses, Opportunities and Threats. Strengths and weaknesses are internal factors that can help or hurt our chances of succeeding, while opportunities and threats are external. We use these as we make business decisions, because we want to exploit strengths and opportunities, fix weaknesses, and avoid threats.

Textbooks do a good job describing environmental analysis and SWOT. The purpose of this document is to explain the four steps in conducting a SWOT analysis:

1. identify relevant macroenvironmental factors,
2. identify possible strengths and weaknesses,
3. compare the two to identify opportunities and threats, and
4. highlight the key SWOT factors.

1. Macroenvironment

We have no control over the macroenvironment, but since it can affect our customers, suppliers, competitors and business partners, we must understand what is going on. Later, we will compare our list of strengths and weaknesses to macroenvironment factors to identify opportunities and threats. For now, we list the possible external factors and; in step 3, we will see which might lead to opportunities and threats.

What we are looking for are changes in the macroenvironment that might affect *our* success. For example, while Krispy Kreme was expanding nationally, the low-carb craze hurt them badly and forced them to retrench..

Large, quick changes are the most important. As a sage once said, "Change offers both threats and opportunities." If we identify and react to relevant macroenvironmental issues sooner and better than our competitors, then we win. Procter & Gamble, for example, reversed declining sales of Downy fabric softener by taking advantage of consumers' growing sensitivity to the environment, specifically too much trash going to land fills. When they launched concentrated Ultra Downy in small bottles, fabric softener sales began to grow again after a long decline.

I split the macroenvironment into the broad and narrow. The difference is that the narrow macroenvironment is concerned with issues close to our business rather than more distant issues.

For the broad macroenvironment, I use the acronym STEEP as a checklist to make sure I don't forget any:

S	Social, cultural, demographic
T	Technology
E	Economy
E	Environment
P	Political, legal, regulatory

Examples of **social, cultural and demographic** factors, respectively, are an increased sense of insecurity because of terrorism, popular trends such as fashion, and an aging U.S. population.

Technology is changing all the time. New technology might affect our suppliers, our competitors and our customers. In addition, we might be able to take advantage of it in a new

product, to make our operations more efficient, or to serve our customers better. The Internet is an example of the latter.

The state of the **economy** affects all parties, too. In boom times, consumers are more willing to spend, but raw-material shortages might raise our costs. In a recession, customers cut back on spending, but we might be find better employees to hire.

The **environment** E refers to raw materials and pollution. People's attitudes towards the environment are covered in the S of STEEP, while regulations are part of the P of STEEP, which consists of **political, legal and regulatory** factors. Regulations are the law -- we must comply. Law suits and political threats might be enough to affect the behavior of a player.

I use the acronym MCCCS for the narrow macroenvironment:

M	Market
C	Customer
C	Channels of distribution
C	Competition
S	Suppliers

We are interested in the **market** for our product, new or contemplated. What is the growth rate of sales? Is it concentrated (few competitors) or fragmented (all competitors have a small share)? What is our rank for market share? Slow growing, concentrated markets are the toughest to enter, while fast growing, fragmented ones are the easiest.

Regarding the **customer**, we need to know where we stand from their perspective. How do they view our brand and product? How much of their purchases of this product category do we capture? Is a large fraction of our sales concentrated among a few customers or spread out over many? What do customers need? How do they shop and decide what to purchase?

We want to know similar things about **channels of distribution**. How do they view our brand and product? Do we have our fair share of their purchases of this product category? Is a large fraction of our sales and category sales concentrated among a few intermediaries or spread out over many? What do the channels need? How do they decide what to carry and offer to their customers?

The obvious **competitors** are in the same product category, like Coke and Pepsi. Other important competitors are also able to satisfy the needs of our customers. For instance, if I need to be in New York tomorrow for a meeting, I can fly Delta or US Airways, but I can also take other means of transportation such as Amtrak, a bus, or a rental car. Or maybe I do not actually have to be there to participate in the meeting. Then the competition is even broader, because I can attend the meeting by videoconference or through a web meeting service.

What we want to know about the competition is information such as market share, strengths and weaknesses, and how important our product category is to them, so we can gauge their possible reaction to our move.

Suppliers can affect our business with price changes and disruptions in delivery. They might also be helpful in making us more competitive.

Another useful Michael Porter tool, if your textbook covers it, is the Five Forces that drive industry competition. It helps us analyze the Competition, Channels of distribution (or Customer if we sell direct), and Suppliers elements of the STEEP-MCCCS checklist. Briefly, the Five Forces are:

> Industry rivalry. This concerns the narrow competition. We look at factors such as industry growth rate, number of and relative sizes of competitors, cost structure, and intangibles like corporate culture to determine how competitors might react to our actions.
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> New entrants. These are companies that are not in the industry yet but might enter it with similar products, if the barriers to entry are not too high.
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> Substitutes. This concerns broad competition, in other words, products different from the current industry's that can also satisfy our customers' needs. For example, Delta Airlines and Continental can both fly me to New York, while I can take Amtrak, drive, or attend via a web conference instead.
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> Suppliers. When suppliers have great bargaining leverage, they can affect industry competition through actions such as raising prices and allocating their products.
>
> Buyers. Buyers with leverage can also affect the industry by playing the competitors off against one another, getting better deals.

As you identify macroenvironmental factors, they might remind you of a strength or weakness that you overlooked earlier. If so, be sure to add it to your list.

2. Internal -- strengths and weaknesses

We have some sense of the company, the product, and the general situation. The purpose of this step is to identify the company's strengths and weaknesses, the positive (strength) or negative (weakness) factors of the company. In other words, strengths help us to reach our goal, while weaknesses hinder us from getting there.

Strengths are capabilities, skills, assets, traits or resources that give the company a competitive advantage. Examples include:

* patent, trademark or copyright
* brand name
* special engineering and design capability
* management discipline
* employees with special abilities
* loyal customers
* special manufacturing abilities or equipment
* special access to inputs (labor, material).

Most of these relate to only the product P. You might also find strengths regarding positioning and the other three of the Four Ps. For instance, one of Procter & Gamble's strengths is its strong relationships with supermarkets. In addition, strengths can be found in other functions, such as financial strength.

Unless it is obvious, like a patent, be sure the explanation includes why the capability, skill, asset, trait or resource gives the company a competitive edge. For example, if you omitted the boldest phrases below, it would not be at all clear why these items are strengths:

* six manufacturing plants across the USA **ensuring reliable delivery to all customers**

* freshest ingredients **based on contracts giving us preferred treatment**
* employee training programs **with a proprietary learning model**.

Weaknesses, of course, are the opposites of strengths -- the lack of a capability, asset, resource, trait or skill that prevents the company from matching or exceeding the competition in some regard. Examples include lack of patents and a tarnished brand name.

The best strengths are enduring. Your product might have a unique, important feature which is a strength, but if the competition can copy it, then it's not much of a strength. In contrast, patents, trademarks and copyrights have legal protection. Some strengths do not have that kind of protection but can still last a long time, such as reputation, loyal customers, and strong relationships with retailers. Enduring strengths ought to be the focus of your SWOT analysis.

Be sure to identify real strengths and weaknesses. Sometimes an item is mistaken for a strength (or a weakness) when it is actually evidence of a strength (or a symptom of a weakness). Examples include:

* sales level
* sales growth
* market share or rank
* price
* cost
* profitability
* employee turnover.

Note that none of these is a capability, skill, asset, trait or resource. A true strength or weakness is the explanation for the evidence or symptom. An example is high price listed erroneously as a weakness. It might be a symptom of a weakness that raises cost, a symptom of a management weakness, or perhaps a deliberate decision for premium pricing.

Similarly, strengths and weaknesses ought not include marketing decisions. For instance, a product feature that is now better than any competitive product (such as lighter, faster or better tasting) is only a temporary advantage if competitors can copy it. If the company can prevent competitors from copying it, though, such as with a patent or proprietary manufacturing technique, then the means of prevention is the real strength.

Analysis can uncover strengths and weaknesses. Value-chain analysis, if your textbook includes this topic, is a good tool to identify in a systematic way strengths and weaknesses. This analysis was developed by Michael Porter of Harvard Business School, who is a recognized guru of corporate strategy. Briefly, this analysis examines the various activities of an organization to find where customer value is actually being created:

* primary activities

    inbound logistics
    operations
    outbound logistics
    marketing and sales
    service

* support activities

    general administration
    human resource management

research, technology and systems development
procurement.

Since we are brainstorming in this first step, we include all ideas so far and create two lists, one of all likely strengths, the other of all likely weaknesses. Later, we will use strengths and weaknesses to make sound decisions. For example, if a company wants to compete on price, then it must have low-cost production and logistics as strengths.

3. External -- opportunities and threats

All competitors face the same STEEP factors, and even many MCCCS, but some companies react in horror to a change in the macroenvironment, while others jump for joy. How can this be? The answer is because that change combines with a weakness of the first company to create a threat, while for the other company, the same change combines with a strength to present an opportunity.

An opportunity is a favorable combination of circumstances that offer the chance for advancement, to paraphrase the definition found in *The American Heritage Dictionary*, 2d college edition. In business, it is a specific measure of success, such as increased sales in a new market, increased sales to existing customers, or greater financial strength from lowered cost.

Actions are not opportunities but ways to achieve them -- opportunities are strategic in nature, while actions are tactical. For instance, for the opportunity of increased sales, some actions are to:

* enhance an existing product
* develop a new product
* enter a new geographical territory
* acquire another business.

None of these is an opportunity, although each might lead to one.

Threats are possible unfavorable outcomes such as sales lost to a competitor, lost sales from a weak economy, lower profit from higher raw-material costs, or even bankruptcy.

In this third step of the SWOT analysis, we compare combinations of the STEEP-MCCCS factors and our strengths and weaknesses to identify opportunities and threats. Opportunities occur when we can use strengths to take advantage of changes in the macroenvironment, as noted above for P&G's Downy fabric softener.

In another example, Southwest Airlines began as an airline within Texas and thus avoided federal regulations. They had the foresight to see Greyhound buses running between large Texas cities as their direct competition, and then had the discipline to squeeze their costs. They were able to lower their fares and prospered. When federal airline deregulation occurred, they seized the opportunity for increased revenue by attracting economy-minded passengers on interstate flights. This opportunity is the combination of federal airline deregulation (a macroenvironmental factor affecting all airlines) and Southwest's strengths of management foresight and discipline.

Conversely, a threat is the combination of one or more weaknesses and changes in the macroenvironment. For example, at the time of deregulation, Southwest Airlines had far less capital than most interstate carriers. This weakness combined with federal airline deregulation resulted in the threat of bankruptcy if even one interstate carrier targeted interstate passengers seeking to save money on their flights.

Note that the same macroenvironmental factor helps to create both the opportunity and the threat. This is not necessarily the case and is in fact uncommon.

Since we are still brainstorming, we include all ideas so far and create two more lists, one of all possible opportunities, the other of all possible threats.

4. SWOT factors

We now have all the information we need for the SWOT analysis (Strengths, Weaknesses, Opportunities and Threats), that helps us to identify the factors that will either help us to succeed or else hinder us. In this step, we focus on the important elements.

Start by identifying one or two (no more!) key opportunities and one or two (no more!) key threats. Then select the strengths and weaknesses from step 3 that created them. These are the results of the SWOT analysis. As we make decisions later, we always try to take advantage of these strengths and opportunities, fix these weaknesses, and avoid these threats.

One way to show the results of this analysis is to summarize them in a SWOT table; another is to use numbered or bulleted lists. Since it is important to focus on the few, key issues, you ought to include only the elements from the previous paragraph. Delete all the rest, or else put them in an appendix.

Including the SWOT analysis in a report

When you write up a completed SWOT analysis, provide a brief explanation of each element in step 4. Be sure to include the combinations of strengths/weaknesses and the relevant macroenvironmental factors that create each opportunity and threat. If you want to keep a record of all the detail you generated in steps 1-3, do so in an appendix, but spare the reader those details in the body of the document.

Check your work by answering these questions:

1. Is each strength a capability, skill, asset, trait or resource possessed by the organization (rather than evidence of a strength) that gives them an edge over the competition, and related to one of the key opportunities?
2. Is each weakness the lack of a capability, skill, asset, trait or resource (rather than a symptom of a weakness) that gives the competition an edge over them, and related to one of the key threats?
3. Is the list of macroenvironmental factors in the body of the report limited to those related to the few, important opportunities and threats?
4. Does each opportunity define success rather than an action?
5. Does each threat define a possible bad outcome for the organization?
6. Is there a description of the combination of the strength(s) and macroenvironmental factor(s) that create each opportunity?
7. Is there a description of the combination of the weakness(es) and macroenvironmental factor(s) that create each threat?

If each answer is yes, then you have completed an excellent SWOT analysis.

Example

Let's use the Southwest Airlines example above to demonstrate the four steps. For brevity, this example is limited to one opportunity and one threat.

Step 1a – strength. Because Southwest Airlines saw their competition as Greyhound, they focused on lowering costs and became the low-cost airline. Their strengths are management foresight and discipline that continue to make this happen.

Step 1b – weakness. Southwest Airlines has much less capital than interstate carriers.

Step 2 – macroenvironment. The federal government passed legislation that the airlines would be deregulated for interstate flights in 1978. Until then Southwest flew only within Texas and thus avoided federal regulation.

Step 3a – opportunity. The combination of Southwest's strengths of discipline and management practices to become the low-cost carrier and the imminent change of airline deregulation created an opportunity for Southwest's expanded business with economy-minded interstate passengers.

Step 3b – threat. The combination of Southwest's financial weakness and the imminent change of airline deregulation created the threat of bankruptcy if one interstate carrier targeted interstate passengers seeking to save money on their flights.

Step 4 – SWOT table. These factors result in the following portion of a SWOT table:

Strengths	**Weaknesses**
1. Foresight 2. Discipline	1. Low capital
Opportunities	**Threats**
1. Increased sales from a new market of economy-minded interstate passengers	1. Bankruptcy

Adding SWOT analysis to a document. The steps above show how you do the analysis, but not all this detail belongs in a report. Following the advice in "Including the SWOT analysis in a report" above, we would not include steps 1-3 in our document, unless in an appendix. We would present the SWOT table from step 4 along with brief explanations of any items requiring it, and a description of each combination creating an opportunity threat from step 3. The rest of this section would be added to a document about Southwest Airlines after a heading such as "SWOT analysis results":

At the time of airline deregulation, Southwest had the strengths of management foresight and discipline that allowed them to be the low-cost airline, because they had seen their main competition as Greyhound buses and consequently worked on lowering their fares. Since their flights were limited to within Texas, however, they were much weaker in financial resources than the interstate carriers. The following table shows the results of a SWOT analysis on Southwest Airlines.

Strengths	Weaknesses
1. Foresight 2. Discipline	1. Low capital
Opportunities	**Threats**
1. Increased sales from a new market of economy-minded interstate passengers	1. Bankruptcy

The opportunity was created when the strengths of management foresight and discipline combined with federal airline deregulation, allowing Southwest to carry passengers across the Texas border. The threat was created by the combination of Southwest's weak finances and the same airline deregulation, which also allowed any existing interstate carrier to target economy-minded passengers.

Next steps

With the SWOT complete, you will be ready to continue your analysis and ultimately to make successful recommendations. The SWOT serves as a key part of the justification for all following conclusions and recommendations. Think of it as building a solid foundation for the entire plan -- a sloppy job in this early step will doom all later steps.

You must justify each recommendation using a chain of logic. What this means is that after you make a recommendation, you explain why it will help the company succeed by citing facts already presented (including assumptions), your analysis of those facts, prior recommendations, or a combination of those items.

At a minimum, your set of recommendations must take advantage of each key strength and opportunity, fix or minimize all key weaknesses, and avoid threats. If you don't, the reader will wonder, "Now, they told me this was a big threat [or weakness], but why aren't they doing anything about it?"

Working definitions

Important terms introduced in this note include:

SWOT -- an acronym for Strengths, Weaknesses, Opportunities and Threats

macroenvironment -- external factors over which an organization has no control, and which can affect its customers, suppliers, competitors and business partners

strength -- a capability, skill, asset, trait or resource possessed by the organization that provides it with an edge over the competition; evidence of a strength is not a strength

weakness -- the lack of a capability, skill, asset, trait or resource that prevents the organization from matching the competition; a symptom is not a weakness

opportunity -- a specific, promising measure of success; an opportunity is created by the combination of one or more strengths and one or more macroenvironmental factors; an action is not an opportunity

threat -- a possible unfavorable outcome; a threat is created by the combination of one or more weaknesses and one or more macroenvironmental factors; macroenvironmental factors by themselves are not threats.

Summary

The four steps in conducting a SWOT analysis are:

1. identify possible strengths and weaknesses by looking inside the company for capabilities, assets, resources, traits and skills that help us to maintain a competitive advantage, or else the lack of those items that keep us from matching the competition,
2. identify relevant macroenvironmental factors that might affect our customers, suppliers, competitors and business partners, by looking at broad factors (STEEP) and narrow (MCCCS),
3. compare strengths and weaknesses to macroenvironmental factors to identify opportunities and threats; an opportunity arises through the combination of one or more strengths and a macroenvironmental factor, while a threat is the combination of one or more weaknesses and an macroenvironmental factor,
4. highlight the key SWOT factors to focus on the few, important issues confronting the business.

With the SWOT complete, you are ready to identify objectives and then to make recommendations to achieve them.