Three Business Plan Models to Help a Start-up with Strategic Analysis

Lessons from using SWOT, Porter’s Five Forces, and Price Equalizer to write a business plan

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Abstract

This paper examines three models used for business plan analysis. These models highlight some of the most important questions of the business: *What are my strengths and how do I compete?* More importantly, it gives founders a systematic tool to approach the creation of strategy for their business. There are three business planning tools presented here: Porter’s Five Forces, SWOT, and Price Equalizer.

Keywords

Business Plan, SWOT, Porter’s Five Forces, Price Equalizer, Affärsplan, Digital Affärsutveckling
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1 Introduction

This paper summarizes the learning lessons acquired from using three business strategy building tools: (1) Porter’s Five Forces (Porter, 2008), (2) SWOT, and (3) Price Equalizer by Olve et al. (2013). I hope this short paper will contribute to the theoretical knowledge on how these tools can be used to understand competition, create global strategic business goals, and create a pricing model for any business plan.

The choice of tools is based on a business strategy framework proposed by Peng (2013) in his work titled Global Strategic Management. In that work, the author describes definite steps to take to approach strategy design and how businesses need to analyze their surroundings and competitors to survive and thrive as a company.

2 Summary of Theories

2.1 SWOT

SWOT stands for Strengths, Weaknesses, Opportunities, and Threats. It is difficult to credit SWOT analysis to a single writer, although some credit the concept to Stanford Research Institute from 1960, which was led by a research team to find out what had gone wrong with some of the Fortune 500 companies (SRI, 2005). However, the concept of knowing yourself and your opponent’s strengths and weaknesses dates all the way back to Sun Tzu’s writings, which have remained a valid analysis tool for several thousand years (Peng, 2013, p. 12)

**Why use SWOT in a business plan?**

SWOT analysis (Figure 1) is a basic analytical framework used to understand the (S) Strengths, (W) Weaknesses, (O) Opportunities, and (T) Threats of the organization in question. Results from this analysis assist firms in reaching their goals, minimizing undesired outcomes, and maximizing desired results. The concept strongly advises the use of your own strengths and environment to create new strengths (opportunities) in addition to constantly analyzing how you can improve your company by finding its weaknesses.
Strengths

The internal strengths of the organization are what will help organizations be successful and excel in comparison to their competitors. These strengths will form the core competitive advantage used to gain an advantage over other companies. As an example, this could be a unique algorithm or a type of expertise that will differentiate your company’s product from other companies.

Weaknesses

Internal harmful weaknesses represent where an organization needs to improve in order to operate at the most competitive level. These weaknesses can be a lack of human capital, debt, or technical weakness. The weaknesses listed here should be honest. However, they should be within organizational control, which will allow the organization to improve these weaknesses and turn them into opportunities.

Opportunities

External origin of opportunities are external factors that attract opportunities, and these are the reason why your organization wants to develop, improve, and fulfill opportunities by turning them into positive outcomes.

Threats

External harmful threats to the organization are the factors in your environment that can create negative outcomes for the business. Many times these factors can be beyond your control and may place the organization at risk. The factors here should strategically lead to the creation of a risk-minimizing strategy.

2.2 Porter’s Five Forces

After the analysis of the SWOT framework, the organization’s management should have some understanding of their weaknesses and strengths (see Figure 2).
However, as Porter points out, much of the firm’s profit and power is affected by the firm’s competitiveness in the industry (Porter, 2008).

**Why use Porter’s Five Forces in a business plan?**

To build a strategy for a firm, the management must recognize one of the firm’s biggest threats: the competition.

Figure 2 - Porter's Five Forces (Porter, 2008)

**Threat of New Entrants**

The appearance of new entrants can shake up an industry, especially if new entrants in the market come from an existing company and are using existing capabilities, as exemplified by Porter (2008) with Pepsi in the bottled water industry and Apple in the music distribution industry. This threat puts a constant cap on how much profit one can make in an industry. This is especially true if there is a relatively low cost for entry into the market, such as the coffee industry, meaning that existing businesses must put constant effort into modernizing their menus and stores.

When measuring how difficult or easy it is to enter the market, Porter speaks extensively about **barriers to entry**.

**Economies of scale**

These barriers can be economies of scale, where it is cheaper to produce large volumes in order to offer the item for a lower cost. These economies of scale also create a network effect, where buyers patronize the company and attract new buyers.
High switching cost
The switch cost of the customer could simply be too expensive to move to a new entrant.

High capital investment
To build a competitive product, there might also be a high capital investment fee for research and development, buying facilities, and building up inventory.

Incumbency advantage
There might also be an incumbency advantage, which comes from the quality of the product, established identities, or geographic location. An example here is Wal-Mart, which has established their stores away from traditional shopping centers.

Unequal distribution network access
The distribution network could be tied up so that only a few can access the network. For example, low-cost airlines tend to avoid selling their tickets using travel agents as travel agents favor more expensive airlines.

Restrictive government policy
The government can directly affect the ease of entry by making it impossibly difficult or very easy. As an example, industries like insurance companies and banks have higher entry costs because of regulations.

Bargaining Power of Suppliers
By gaining enough power in the industry, a supplier could raise the prices on their product, which would erode the profitability of others in the network. An example is what Microsoft did in the 1990s. They increased the price for their operating system, which eroded profitability for hardware PC makers. There are some markers to indicate if a given supplier is powerful:

- If a supplier is more concentrated than the industry. In this example again, Microsoft had a near monopoly in the 1990s compared to PC makers with an incredible variety of suppliers.
- If a supplier does not depend on others in the supplier group to create revenue
- If a supplier offers products that are different from others in the supply network

Bargaining Power of Buyers
Powerful buyers can force down prices and demand better quality goods, thereby driving up costs for the industry. The buyers have power if they have the following markets:

- If the buyer is large compared to an average buyer in the segment, then their influence will be greater and they can use their influence to negotiate better prices.
- If there is no differentiation and products are standardized, then buyers can pick and choose between vendors.
• If the industry is too profitable, buyers may start backward integration; more specifically, they will try to make the product themselves.

The Threat of Substitutes
A substitute is a product within the industry that performs a similar function as another product or service. As an example, video conferencing is a substitute for travel. E-mail is a substitute for fax. The danger of a substitute is that they can easily be overlooked as they may seem to be different in their function. Typical indicators of a high threat of substitutes can be when the price-to-performance ratio is compared to the industry’s product. The new substitute has a much lower price, in time or in money, to pay for a similar function. An example of this is the popularity of Skype for international video and audio calls rather than conventional telephones.

Rivalry among Existing Competitors
This is when competitors fight for resources, discounts, advertising, and improvement within the same industry. A very high intensity of rivalry drives the profit margins down. The intensity of a rivalry is greatest if competitors are roughly the same size and strength, if industry growth is slow, or if exit barriers are high with specialized assets.

2.3 Price Equalizer by Olve
This pricing model was developed by Olve et al. (2013) through collaboration with Ericsson to understand today’s pricing models for the Internet economy.

Why use it?
The Price Equalizer by Olve et al. (2013) helps to define a pricing strategy for a product or service, including visualizing it as an easy-to-understand sound equalizer (see Figure 3). By adjusting the variables (as one does with a sound equalizer), management can quickly create a pricing model for their business plan.
3 Expectations and Results

Porter’s Five Forces

The expectation from this analysis is to understand potential competition and how one can base marketing, management, and pricing strategy on that understanding.

While results show that there is some competition in the market, what it also shows is that the threat of a substitute and the centralized power of suppliers is more important. Given that the video streaming services on which our business focuses is centralized in very few streaming companies (Twitch.tv, YouTube), the threat is
high that the dominant streaming services will simply backward integrate the same technology themselves.

**SWOT**

Our expectation was to find points not mentioned in Porter’s Five Forces. This analysis is mostly a look into the inner origin of strength and weakness, like the experience of the team, while also looking for what weaknesses and threats can be turned into opportunities, or at least minimized.

The result is that the **Threat** contains both similar and new topics: the threat of a substitute from competitor products and the threat of government regulations and security issues. This gives some food for thought: If, by sharing computer resources with a video streaming service, the viewer earns a subscription worth a certain amount of money, do they need to tax it as income? Will the regulatory bodies consider this as the sharing of personal data, even if only computer power is shared? SWOT is designed to bring up these kinds of questions; as a result, we have integrated a risk-minimizing strategy to tackle these questions and problematic situations early.

**Price Equalizer**

Expectations from using Price Equalizer include understanding how we will price the product. The multiple variables included in the formula provide insight on the negotiation points. Moreover, Price Equalizer provides insight on how the pricing structure would reflect revenue prediction for the business plan.

In our results, we have decided to price the entire system as one solution with subscription-based pricing. To our knowledge, there was no direct competitor with exactly the same solution. Thus, the price was based on Azure and Amazon AWS pricing for video encoding per minute.

4 **Theory Evaluation**

A theory is a group of different ideas that try to explain specific phenomena (Gregor, 2002). My theory evaluation, therefore, was to find specific theories that will help me explain: (1) the competition I am facing, (2) my strengths and weaknesses, and (3) my pricing model. Work by Corley & Gioia (2011) has helped to evaluate my theory selection. Corley speaks about two dimensions that need to be fulfilled by a theory to be a viable contributor: (1) originality and (2) utility.

The first dimension is originality, in this case, satisfied by Porter’s Five Forces, which is revelatory and original. The Porter’s Five Forces technique is widely used by many businesses worldwide as well as studies in MBA courses. It also serves as a great practical utility to map the playing field of competitors, suppliers, and buyers.

Originality and practical utility are also fulfilled by SWOT and Price Equalizer. SWOT helped me map my company’s strengths and prepare for various threats. Price Equalizer helped establish a practical view of the pricing structure.
5 Discussion

5.1 Advantages

*Porter’s Five Forces*

This approach gives a broad overview on why some competitors or suppliers will gain more or less bargaining power. Porter describes this in great detail in his paper (Porter, 2008). Based solely on this analysis, it is already possible to create a strategy on how to begin conversations with suppliers and buyers as well as what to look for and how to strategize around switching-cost, pricing, and deals.

*SWOT*

This analysis creates a list of inner strengths of the organization, which can become a focal point and a starting guide for the company. This analysis has great practical utility.

*Price Equalizer*

This framework helps to visualize our pricing strategy using different variables.

5.2 Disadvantages

*Porter’s Five Forces*

This technique needs to be constantly reworked; the drawing board today might look very different in just a few months because while writing our business plan, it was hard for us to know exactly who our competitors or suppliers would be at that time.

*SWOT*

It felt as though a SWOT analysis would need more complementing parts to analyze deeper external, geopolitical, and policy factors. SWOT would work best with a PEST analysis as a complement, which can add political, economic, social, and technological factors.

*Price Equalizer*

It is hard to get custom pricing as we would then have to add and modify variables to the Price Equalizer framework. The framework was built in 2013, and it feels as if some parts might be missing. As an example, pricing based on ad-supported business, data reselling, and freemium products are missing.

5.3 Recommendations

*Why and How to Use These Theories*

Work on SWOT and Porter’s Five Forces early in your business plan. SWOT will highlight the strengths and opportunities you need to utilize to attract investors. Meanwhile, Porter’s Five Forces will focus on suppliers, buyers, and competitors. Having a better understanding of who is actually going to buy or supply your firm will make it easier to create a value chain and, later, establish appropriate pricing.
Come back to SWOT and Porter’s Five Forces multiple times as the business plan is a living document; you will get new ideas as you develop it. In my case, after working on SWOT multiple times, I realized that my business plan’s greatest weakness was its reliance on a single technology stack (blockchain). In the end, I had to exclude blockchain as a core technology stack as it was not the technology stack that was my focus; it was a solution to a computing problem. The blockchain was certainly one of the ways to solve it, but it was not the core of the idea.

Future Research

I suggest that the Price Equalizer by Olve et al. (2013) can be developed to support a more Internet-based payment mechanism. SWOT is a great tool to provide an overview, but today, one must think more about the environment and politics when it comes to developing Internet-based services. As more and more regulations like the General Data Protection Regulation (GDPR) appear, they will significantly affect how Internet-based services are developed.
6 References


