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Yulia Prikazchikova

STRATEGIC ANALYSIS

Manual

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Ю.В. Приказчикова

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Рекомендовано методической комиссией Института экономики и предпринимательства ННГУ для иностранных студентов, обучающихся по направлению подготовки 38.03.01 «Экономика» (бакалавриат) на английском языке

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Учебно-методическое пособие предназначено для студентов института экономики и предпринимательства, обучающихся по направлению 38.03.01 «Экономика». Пособие содержит 4 раздела, в которых последовательно описывается необходимый инструментарий при проведении анализа хозяйствующих субъектов на современном этапе развития.

Ответственный за выпуск:
председатель методической комиссии ИЭП ННГУ,
к.э.н., доцент Летягина Е.Н.

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Part 1. The concept of strategy and strategic analysis

1.1. What is a strategy?

Any strategy is about creating and delivering the future. It is about winning, about leading a company to a future in which it is possible to compete more effectively and to achieve prosperity and sustainability.

There are a number of definitions of the term strategy. Consider some of them:

- In its broadest sense, strategy is the means by which individuals or organizations achieve their objectives (Robert M.Grant).
- Strategy is a plan, method or series of actions designed to achieve a specific goal (Wordsmyth Dictionary).
- Strategy is the determination of the long – rung goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals (Alfred Chandler).
- Strategy is the pattern of objectives, purposes or goals and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be (Kenneth Andrews).
- According to Oxford business vocabularly, strategy includes:
  - Goal – setting
  - Choice of strategic sector
  - Choice of growth model
  - Competition strategy
  - Functional responsibilities
- P. Druker specifies that strategy gives an answer to the following questions:
  - What is your business?
  - Who is your client?
  - What are the essential, valuable factors for your customer?

In general, strategy is a model of resources allocation, which allows firms to continue or modify its activity.

Common to definitions of business strategy is the notion that strategy is focused on achieving certain goals; that the critical actions that make up a strategy involve allocation of resources; and that strategy implies some consistency, integration or cohesiveness of decisions and actions.

1.2. Dimensions of a strategy

There are two dimensions of a strategy – the static and the dynamic. Static dimension presupposes competing for the present, dynamic – preparing for the future (Table 1).

Table 1

Dimensions of a strategy

Static	Dynamic
• Where are we competing? ❖ Product market scope ❖ Geographical scope ❖ Vertical scope	• What do we want to become? ❖ Vision statement
• How are we competing? ❖ What is the basis of our competitive advantage?	• What do we want to achieve? ❖ Mission statement ❖ Performance goals
	• How will we get there? ❖ Guidelines for development ❖ Priorities for capital expenditure, R&D ❖ Growth models: organic growth, M&A, alliances

1.3. Differences between corporate and business strategy

Two basic levels of strategy within an enterprise are distinguished.

The first one is corporate strategy, which defines the scope of the firm in terms of the industries and markets in which it competes. Corporate strategy decisions include:

- Choice over (investments) in diversification, vertical integration, acquisitions and new ventures
- The allocation of resources between the different businesses of the firm.

The second one is business strategy, which is concerned with how the firm competes within a particular industry or market. If the firm is to prosper within an industry, it must establish a competitive advantage over its rivals. Hence, this area of strategy is also referred to as competitive strategy.

Strategic choices can be distilled to two basic questions:

- Where to compete?
- How to compete?

The answers to these questions also define the major areas of a firm’s strategy: corporate strategy and business strategy.

Corporate strategy presupposes answering the question “where to compete”, business strategy – “how to compete”.

The distinction between corporate and business strategy may be expressed in the following terms. The basic question facing the firm is: "How do we make money?" The answer to this question corresponds to the two basic strategic choices: Where to compete? (In which industries and markets should we be?) and "How should we compete?"

The distinction between corporate strategy and business strategy corresponds to the organization structure of most large companies (Figure 1). Corporate strategy is the responsibility of the top management team and the corporate strategy staff. Business strategy is primarily the responsibility of divisional management.

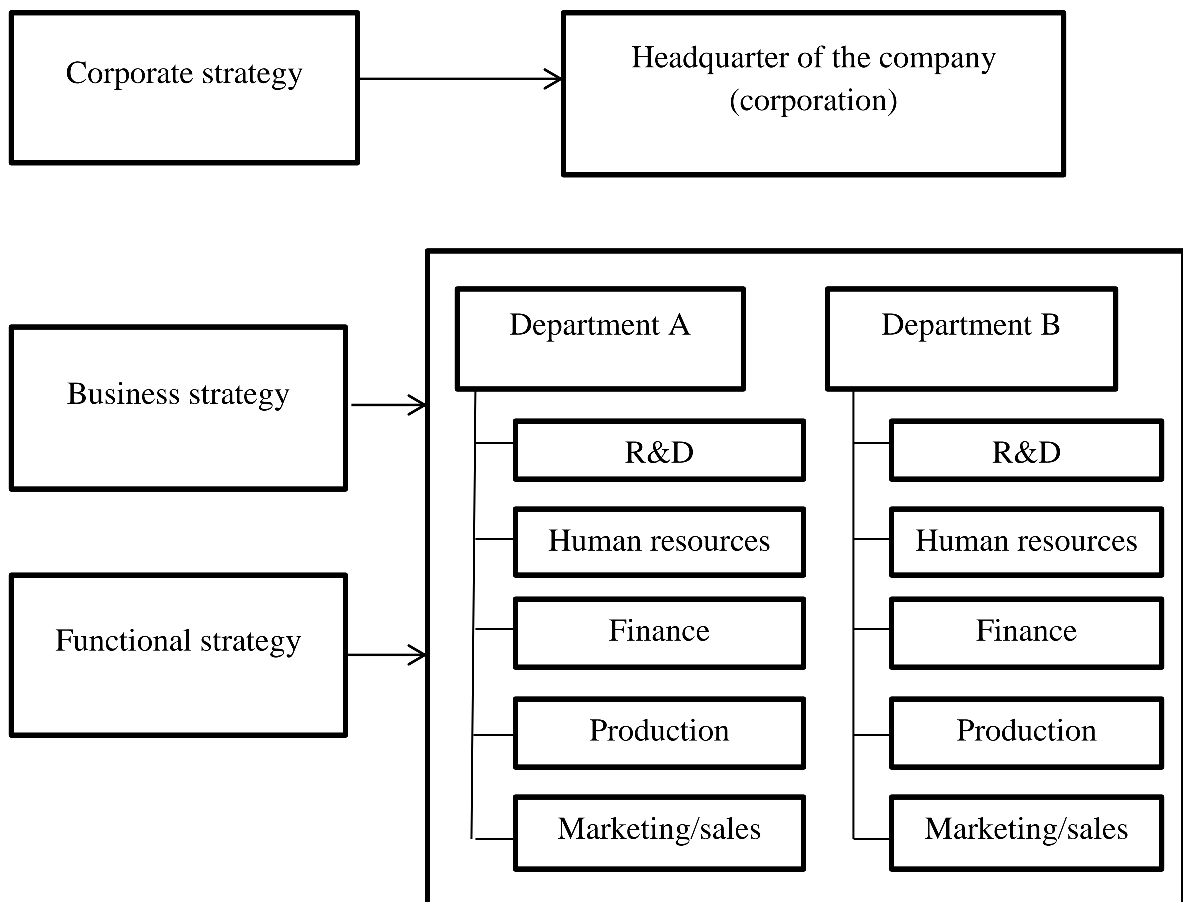

Figure 1. The levels of strategy and the organizational structure

Corporate and business strategies are the sources of superior profitability.

If we start from basics, the purpose of strategy is to achieve certain goals. For the firm, the basic goal is to survive and prosper. Survival, over the long term, requires that the firm earns a rate of return on its capital that exceeds its cost of capital. There are two possible ways of achieving this. First, the firm may locate within an industry where overall rates of return are attractive. Second, the firm may attain a position of advantage vis – a – vis its competitors within an industry, allowing it to earn a return in excess of the industry average (Figure 2).

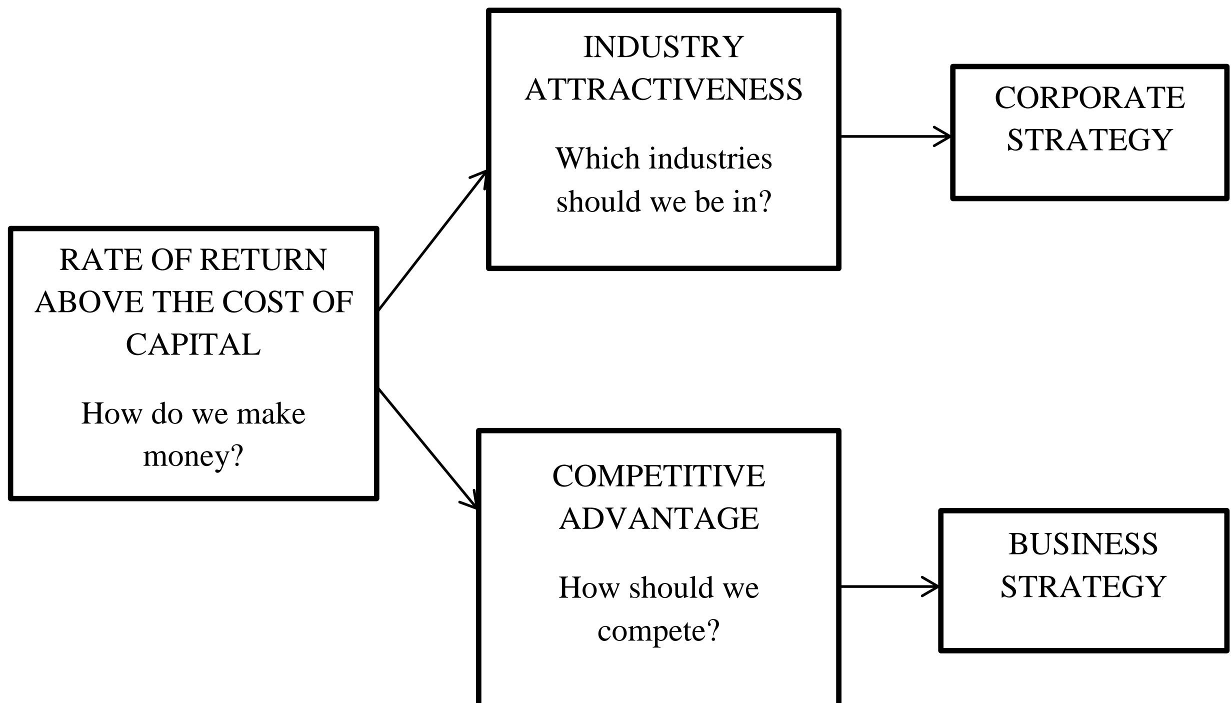

Figure 2. The sources of superior profitability

The task of business strategy is to determine how the firm will deploy its resources within its environment and so satisfy its long – term goals, and how to organize itself to implement that strategy.

1.4. Common elements in successful strategies

There are four common factors, which allow to develop a successful strategy (Figure 3).

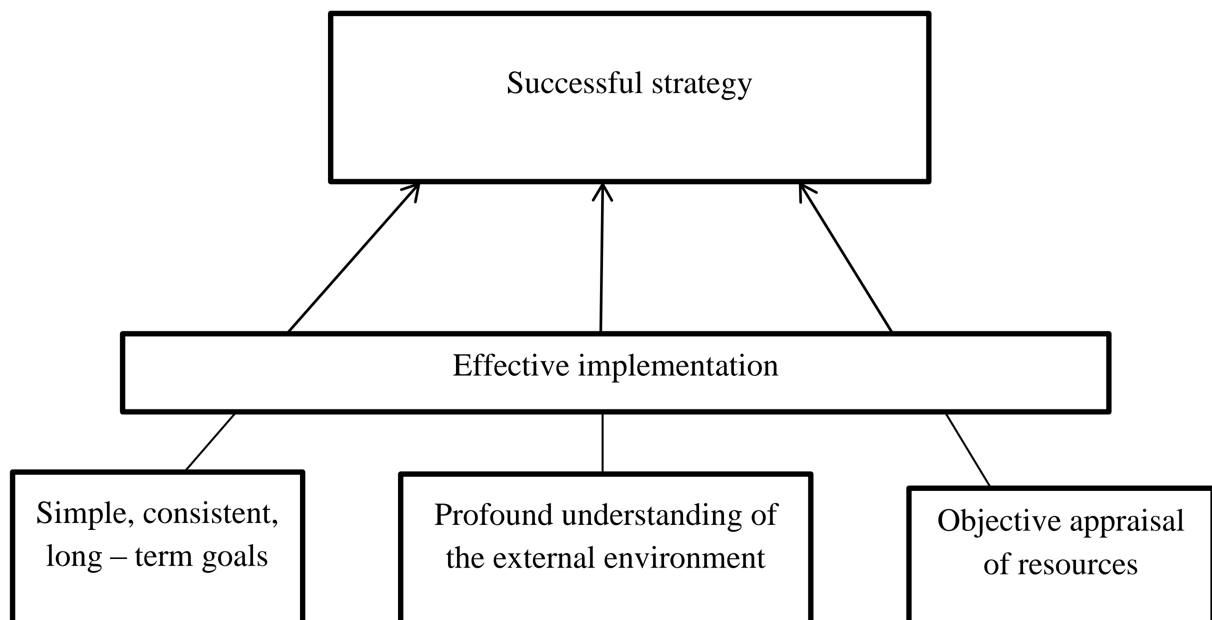

Figure 3. Common elements in successful strategies

1. Goals that are simple, consistent and long term.

To achieve success, individuals and managers of an organization must display a single – minded commitment to a clearly recognized goal that is pursued steadfastly over a substantial part of the lifetime.

2. Profound understanding of the external environment

To prosper, individuals and managers of a company need to design their strategies around a deep and insightful appreciation of the arena in which they compete.

3. Objective appraisal of resources

To be successful, strategies must be effective in exploiting internal strength, while protecting areas of weakness.

4. Effective implementation

Without effective implementation, the best – laid strategies are of little use.

The essential factors can be the following:

- effectiveness as leaders in terms of capacity to reach decisions,
- energy in strategy implementation and ability to foster loyalty and commitment among subordinates.

So, effective strategy implementation depends on effective marshaling of resources and capabilities and quick responses to changes in the competitive environment.

The role of strategy in success can be made in relation to most fields of human endeavor. Whether we look at warfare, chess, politics, sport or business, the success of individuals and organizations is seldom the outcome of a purely random process. Nor is superiority in initial endowments of skills and resources typically the determining factor. Strategies that build on the basic four elements almost always play an influential role.

Articles for discussion

1. **Corporate Planning in a Large U.S. Steel Company, 1965**
2. **Nokia's Strategy**

1.5. What is strategic analysis. Objects of strategic analysis

Strategic analysis is analysis of a company's external and internal environment (analysis of factors, which influence the company outside and insight).

Strategic analysis presupposes using different tools for estimation company's internal and internal environment. This action helps to develop adequate and successful strategy, the main

aim of which is to prosper within an industry and to achieve competitive advantages in the long term.

On the contemporary stage of development, strategic analysis must be carried out by every company if it wants to prosper and compete successfully.

In terms of economics, there are many objects of strategic analysis (Figure 4).

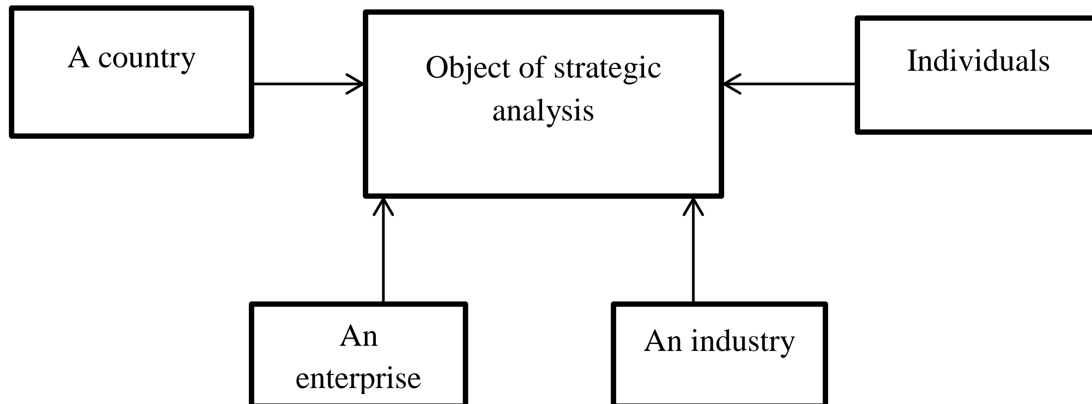

Figure 4. Possible objects of strategic analysis

1.6. The basic framework for strategic analysis

The four elements of a successful strategy (Figure 3) are recast into two groups – the firm and external environment (or internal and external environment) – with strategy forming a link between the two.

The firm consists of three sets of these elements:

- Goals and values (simple, consistent, long – term)
- Resources and capabilities (objective appraisal of it)
- Structure and systems (effective implementation)

The industry environment (profound understanding of the external environment) is defined by the firm's relationships with customers, competitors (rivals) and suppliers and by the factors which influence a company's activity from macroenvironment (political factors, economic factors, social – cultural factors, technological factors) (Figure 5).

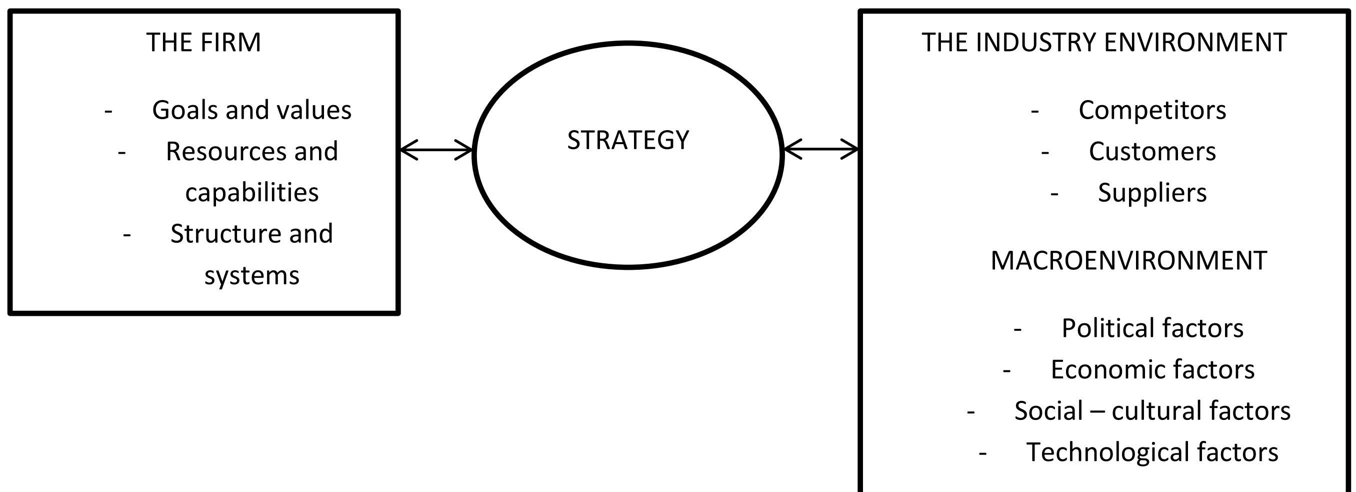

Figure 5. The basic framework for strategic analysis

Fundamental to this view of strategy as a link between the firm and its external environment is the notion of strategic fit. For a strategy to be successful, it must be consistent with the firm's external environment, and with its internal environment – its goals and values, resources and capabilities, and structure and systems. The failure of many companies is caused by lack of consistency with either the internal or external environment.

The notion of strategic fit extends beyond the simple notion that strategy must fit with the external and the internal environment of the firm. The principles of strategic fit extend to organizational design – what is called contingency theory and the view of the firm as a system of interlinked activities (contextuality and complementarity terms).

1.7.Review questions and practical tasks

1. In relation to the four characteristics of successful strategies (clear, consistent, long – term objectives; profound understanding of the environment; objective appraisal of resources and effective implementation), assess a company's strategy.
2. A firm's strategy can be described in terms of the answers to two questions: "Where are we competing?" and "How are we competing?" Applying these two questions, provide a concise description of Business strategies' articles.
3. Using the structure outlined in Table 1, describe the strategy of the university (business school) you attend.
4. What is your career strategy for the next five years? To what extent does your strategy fit with your long – term goals, the characteristics of the external environment and your own strengths and weaknesses?
5. What strategy did the organizations (Nokia, U.S. steel corporation) stick to to achieve success?

❖ Imagine, that you are a member of the Board of directors of a commercial enterprise, which provides educational services. Your strategic aim is to generate more profit to develop your institution. Thus, you have decided to open a new faculty, for example, nanotechnologies. You expect the faculty will be in demand. What should you consider to carry out your project successfully? What are the main corner stones of analysis? What will you look at first place?

Example:

Using the main scheme of successful strategy and the basic framework for strategic analysis, tell how you have ever used strategic analysis in your life?

For example, when I finished school I had to make strategic analysis of my further career.

- What long – term, simple goals did I pursue?
  - ❖ Getting a well – paid job
  - ❖ To get a qualification, enabling me to earn money.
- As for evaluating, understanding competition, how did I asses the competition? In other words, what was the competition for me at that time? What did I have to evaluate in terms of competition?
  - ❖ I had to evaluate my academic rating and my academic abilities, the number of other schoollivers with the same long – term goals; in other words, I had to evaluate competition between me and other schoollivers. Besides, I had to estimate supply of educational services (relevant educational services).
- What resources did I have and how was it possible to evaluate them?
  - ❖ After finishing school, I had the following resources: knowledge, financial resources.

(Entering the University, we can have the following resources).

6. What may be a reason for the company to carry out strategic analysis? What are the goals of strategic analysis?
7. What can we analyze strategically (from the economic view point)?
8. What is the difference between corporate and business strategies?
9. What components are included in the main scheme of successful strategy?
10. What elements are included in the basic framework for strategic analysis?

Part 2. Tools of strategic analysis

2.1. Industry analysis (microenvironment analysis)

The determinants of industry profit

The profits earned by the companies in an industry are determined by the following factors:

- The value of the product to customers
- The intensity of competition
- The bargaining power of producers relative to their suppliers and buyers.

Porter's five forces analysis

In practice there are many features of an industry that determine the intensity of competition and the level of profitability. A helpful, widely used framework for classifying and analyzing these factors was developed by Michael Porter of Harvard Business School. Porter's five forces of competition framework views the profitability and success of an industry as determined by five sources of competitive pressure. These five forces of competition include three sources of «horizontal» competition: competition from substitutes, competition from entrants, and competition from established rivals; and two sources of «vertical» competition: the power of suppliers and power of buyers (Figure 6, Figure 7, Figure 8, Table 2).

With the help of this method it is possible to define the market : how easy it is for new business to enter; how easy it is for customers to substitute the company's product or service for another; how much power suppliers and buyers there are on the market; and the overall degree of competition within the market. **Porter's 5 forces are used to collect data for SWOT – analysis.**

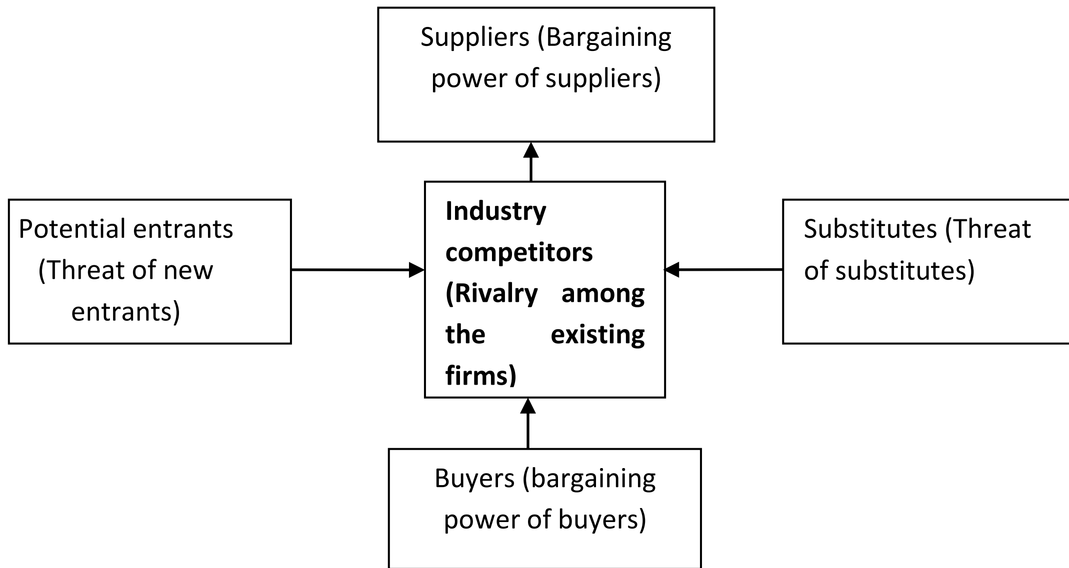

Figure 6. Porter's five forces of competition framework

Threat of entry

- capital requirements
- economies of scale
- absolute cost advantages
- product differentiation
- access to distribution channels
- government and legal barriers
- retaliation by established producers

Supplier power

Factors, determining power of suppliers relative to producers. Same as those determining power of producers relative to buyers

Industry rivalry

- concentration
- diversity of competitors
- product differentiation
- excess capacity and exit barriers

Threat of substitutes

- buyer propensity to substitute
- relative prices and performance of substitutes

Buyer power

Price Sensitivity	*Bargaining Power*
- cost of product relative to total cost	- size and concentration of buyers relative to producers
- product differentiation	- buyers' switching costs
- competition between buyers	- buyers' information
	- buyers' ability to backward preferences

Figure 7. The structural determinants of the five forces of competition

To understand the specificity of every force it is reasonable to develop a set of questions to every force and analyze it from the attractiveness view point for the existing companies' on the market. (Table 2)

Table 2

Porter's 5 forces

Force	Questions
Potential entrants	- Does the market require you to have particular knowledge to be successful? If yes, it hinders others entering - Hoe easy is it to set up a business on the market? Does it cost little money or much money? - Is branding important in the market? If yes, then brand building may be a problem for new entrants.
Potential substitutes	- How easy is it for customers to switch to another type of product or service (for example, to change from using a private car to a public train service)? Does your product have more advantages or not?
Power of supplier	**-** Where is the balance of power between suppliers and the firms in the market? Too much of supplier power makes the market unattractive. **-** How easy is it to switch to suppliers that offer an equivalent or superior product or service? (The easier, the better).
Power of buyers	- Where is the balance of power between buyers and the firms in the market? Too much of buyer power makes the market unattractive. - How many rivals do you have to supply your product or service? How easy would it be for your customer to drop you and use another?
Competition	- Is there room (space) on the market for all companies? If there is, particularly if the market is growing, then this increases the attractiveness. - Is the market contracting? If so, rivalry may be intense. If the market is contracting, a lot of companies will have to withdraw from the market.

Practical Task: Add your own questions to every force

There are approaches with an addition of one more force. This force (the sixth force) is complementary goods (if goods complement each other, individually they are of little value to customers) (Figure 8).

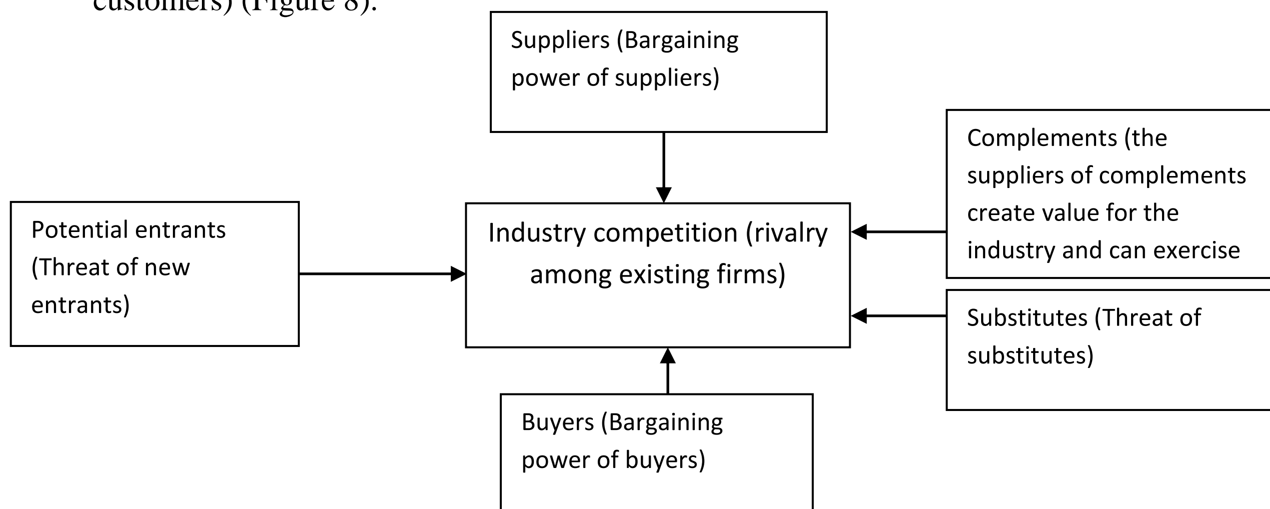

Figure 8. The scheme of Porter's 6 forces

Practical task: Carry out analysis of any industry, using Porter's 5 (6) forces

Example of Industry analysis

The Internet: Value Creator or Value Destroyer?

The diffusion of the internet during the late 1990s and the wave of e-business startups that sought to exploit it contributed to one of the most spectacular stock market booms in history. Webvan, Pets.com, Kozmo, eToys.com, and Boo.com burned through hundreds of millions of dollars of venture capital and achieved stock market values that reached $1.2 billion (in the case of Webvan) before descending into oblivion.

Could the application of strategic analysis to e-business have revealed the dubious profit potential of dotcoms? Applying five forces analysis to the sector offers some simple yet startling insights:

- SUBSTITUTES

Most new e-commerce startups were not fundamentally new businesses; they used a new distribution channel for existing goods and services: books (Amazon), airline tickets (Expedia), groceries (Peapod) and securities (E-trade). As such, they faced strong substitute competition from traditional retailers.

- THREAT OF ENTRY

Most e-commerce businesses are characterized by low costs of entry and ease of market access (setting up a web site costs little). Most markets suffered from many more entrants than the level of demand could support.

- RIVALRY

Ease of entry implied many competitors, the ubiquity of internet technology made differentiation difficult, while the internet's global span meant the absence of geographical niches.

- SUPPLIER POWER

The suppliers of web software and owners of major portals possessed significant bargaining power.

- BUYER POWER

The transparency of prices and low switching costs resulted in high price sensitivity of customers.

The implication is that most "e-tailing" markets – whether for books, securities, household goods or hotel accommodation, will tend to be highly competitive and, on average, will generate low margins. Will any e-businesses offer high profitability? The key is the potential to reduce rivalry and raise barriers to entry through strategies that exploit networks effects, economies of scale or product differentiation. For example, E-bay exploits network effects to dominate the person-to-person auction business. In books Amazon relies on scale economies and product differentiation through its range of customer services. Google exploits scale economies and differentiation based upon rapid innovation to dominate web search.

Sources: M.E.Porter. Strategy and the Internet. Harvard Business Review; The E-Commerce Winners. Business Week

Identifying key success factors

To survive and prosper in an industry, a firm must meet two criteria: first, it must supply what customers want to buy; second, it must survive competition. Hence, it is necessary to ask two questions:

1) What do our customers want?
2) What does the firm need to do to survive competition?

To answer the first question, a company should define the following parameters: Who are our customers? What are their needs? How do they choose between competing offerings?

The second question requires that a company examines the nature of competition in the industry. How intense is competition and what are its key dimensions?

Researching these factors, we can define the company's key success factors.

A basic framework for identifying key success factors is presented in Figure 9. Application of the framework to identify key success factors in three industries is outlined in Table 3.

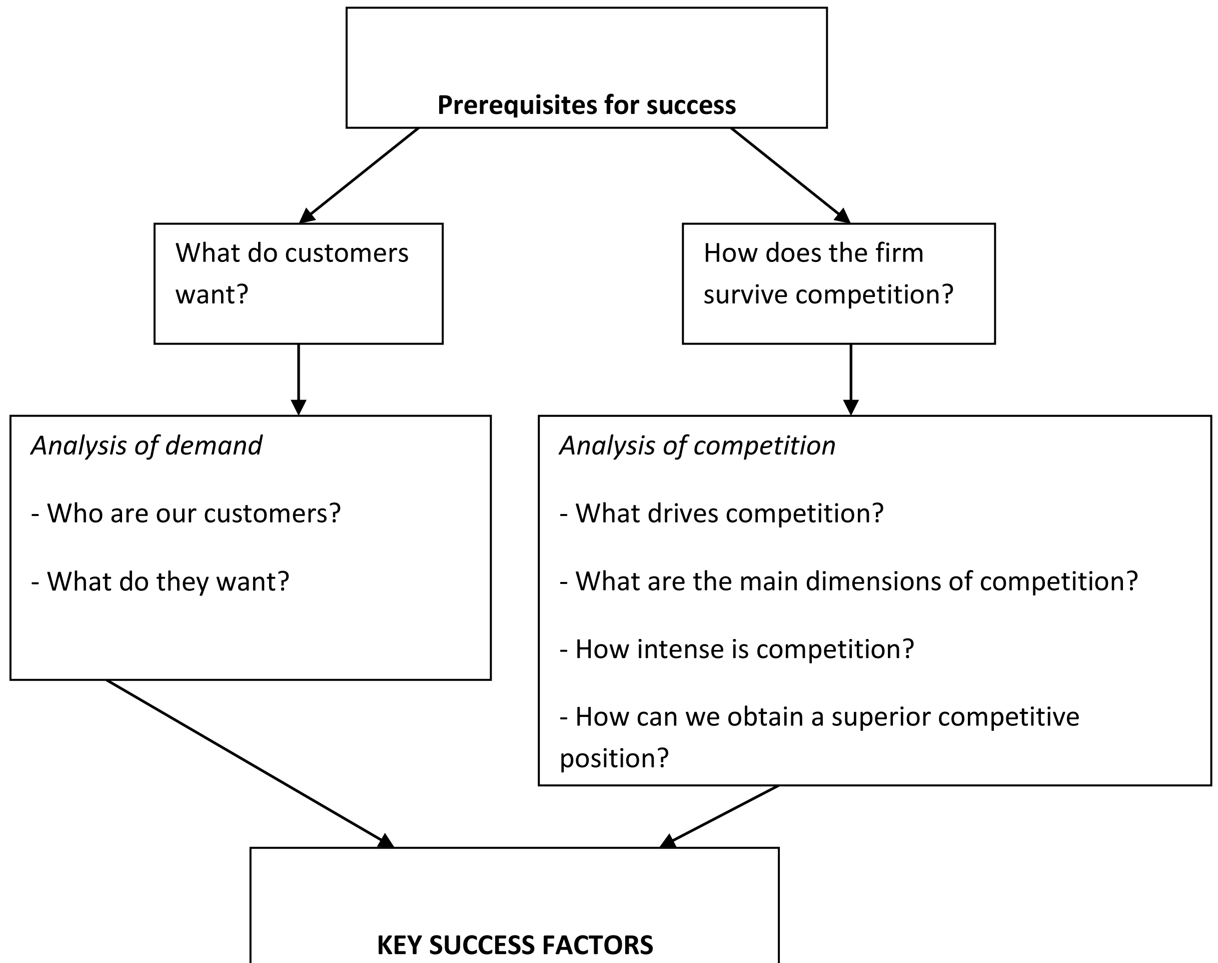

Figure 9. Identifying key success factors

Table 3

Identifying key success factors: steel, fashion clothing, supermarkets

	What do customers want? (Analysis of demand)	**How do firms survive competition? (Analysis of competition)**	**Key success factors**
Steel	- Low price - Product consistency - Reliability of supply - Specific technical specifications for special steels	- Commodity products, excess capacity, high fixed costs, exit barriers and substitute competition mean intense price competition and cyclical profitability - Decisive role belongs to cost efficiency and big financial resources	Cost efficiency requires: large – scale plants (=the scale effect), low – cost location (location in cheap areas), rapid capacity adjustment -Alternatively, high technology, small – scale plants can achieve low costs through flexibility and high productivity - Differentiation through technical specifications and service quality
Fashion clothing	- Diversity (a wide range) of customer preferences in terms of garment type, style, quality, color - Customers willing to pay premium for brand, style,	- Low barriers to entry and exit, low seller concentration, and buying power of retail chains imply intense competition - Differentiation can yield	- Combining differentiation with low costs - Differentiation requires speed of response to changing fashions, style,

	exclusivity and quality - Mass market is highly price sensitive	substantial price premium, but imitation is rapid (but other companies will copy this strategy quickly)	reputation and quality - Cost efficiency requires manufacture in low wage countries
Supermarkets	- Low prices - Convenient location - Wide range of products adapted to local preferences - Fresh/quality produce, good service, ease of parking, pleasant ambience	- Intensity of price competition depends on number and proximity of competitors - Bargaining power is a critical determinant of purchased goods cost	- Low costs require operational efficiency, scale – efficient stores, large aggregate purchases, low wage costs - Differentiation (Specialization) requires large stores (to allow wide product range), convenient location, convenient parking, familiarity with local customer preferences

Practical tasks: **Carry out the same analysis (Table 1, Figure 1) of the chosen industry**

An article for discussion - Probing for Key Success Factors

Question: What key success factors are singled out in the article?

Competitor analysis

The first stage of this analysis is competitive intelligence (collecting data about competitors). Competitive intelligence involves the systematic collection and analysis of public information about rivals for informing decision making. It has three main purposes:

- to forecast competitors' future strategies and decisions;
- to predict competitors' likely reactions to a firm's strategic initiatives;
- to determine how competitors' behavior can be influenced to make it more favorable (how the company can modify the competitors' behavior to make it more favorable for the company).

For all three purposes, the key requirement is to understand competitors in order to predict their responses to environmental changes and our own competitive moves. To understand competitors, it is important to be informed about them.

Competitive intelligence is not simply about collecting information. The problem is likely to be too much rather than too little information. The key is a systematic approach that makes it clear what information is required and for what purposes it will be used. The objective is to understand one's rival. Michael Porter proposes a four – part framework for predicting competitor behavior (Figure 10).

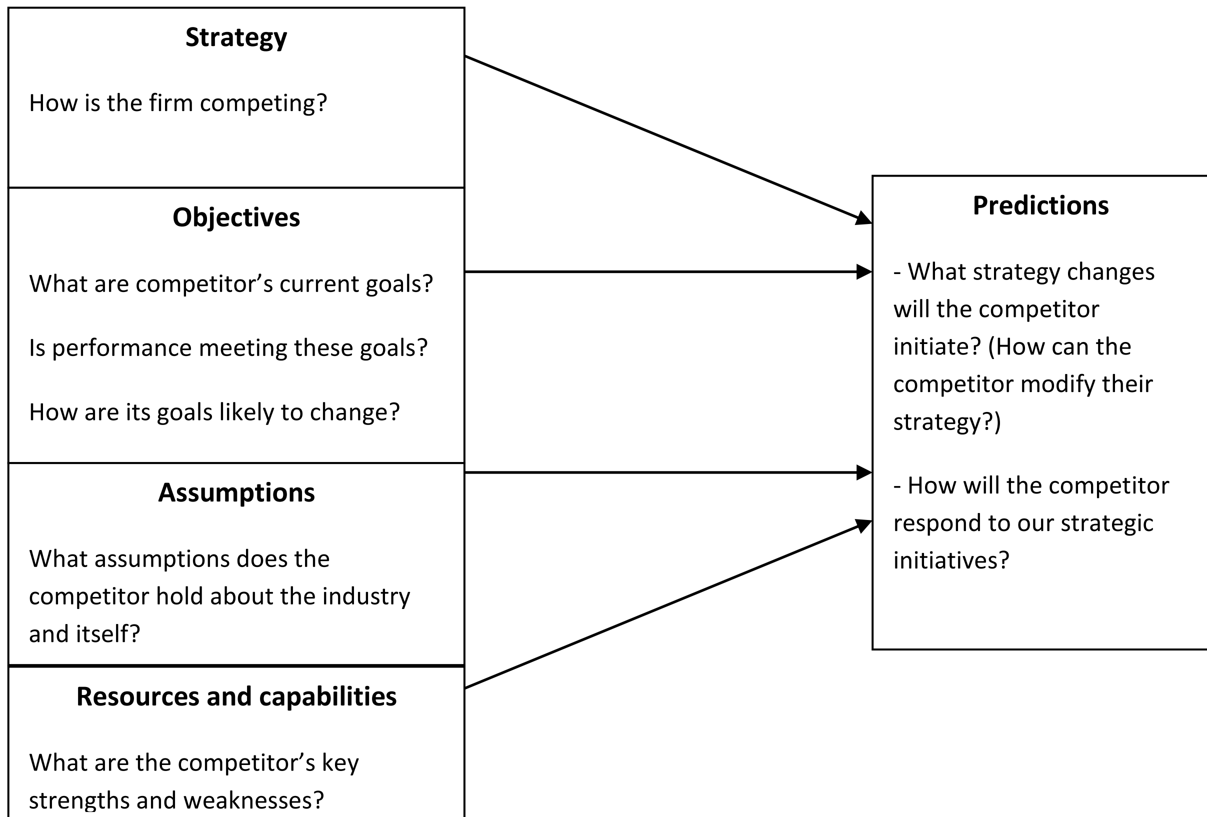

Figure 10. A framework for competitor analysis

Managers understand that they have to analyze rivalry. Sometimes they don't know what questions to ask themselves. The scheme of a framework for competitor analysis will help them to estimate their competitors.

1. Competitor's current strategy

To forecast the competitor's behavior in the future, we must understand how they compete today. What is the strategy aimed at? What is the competitor's plan of actions to achieve the aims, stated in the strategy?

2. Competitor's objectives

To forecast how a competitor might change their strategy, we must identify their goals. The key issue is to understand whether a company is driven by financial goals or market goals. A company whose primary goal is attaining a market share is likely to be much more aggressive a competitor than one that is mainly interested in profitability.

The main factor here is that the more a company is satisfied with its present performance, the more likely it is to continue with their present strategy. On the other hand, if the competitor's activity doesn't bring the desirable result, a radical strategic change is likely.

3. Competitor's assumptions about the industry

A competitor's strategic decisions are conditioned by its perceptions of itself and its environment. These perceptions are guided by the beliefs that senior managers hold about their industry and the success factors within it (industry recipes). But this may be a delusion (these perceptions may be wrong). **The example of the practical task demonstrates this fact.**

4. Competitor's resources and capabilities

Evaluating the likelihood and seriousness of a competitor's potential challenge requires assessing the strength of that competitor's resources and capabilities. What are the competitor's financial resources, brand's strength, production means and management skills?

If our rival has a massive cash pile, it would be unwise for our company to unleash a price war by initiating price cuts. Conversely, if we direct our competitive initiative towards our rivals' weaknesses, it may be difficult for them to respond.

Practical tasks:

1. Read the text Motorcycle Myopia, find out the main idea of this text.

2. Find in this text a wrong opinion about the industry and itself.

3. Make competitors' analysis of the chosen company, using the basic framework (Figure 10).

Segmentation analysis

Initially it may be convenient to define industries broadly, but for a more detailed analysis of competition we need to focus on markets that are drawn more narrowly in terms of both products and geography. This process of disaggregating industries into specific markets is called segmentation.

Segmentation is particularly important if competition varies across the different submarkets within an industry such that some are more attractive than others. A company can avoid some of the problems of an unattractive industry by judicious segment selection.

Stages in segmentation analysis

The purpose of segmentation analysis is to identify attractive segments, to select strategies for different segments, and to determine how many segments to serve. The analysis proceeds in five stages.

1. Identify key segmentation variables.

The first stage of segmentation analysis is to determine the basis of segmentation. Segmentation decisions are essentially choices about which customers to serve and what to offer them: hence segmentation variables relate to the characteristics of customers and the product (Figure 11).

In the auto industry, color is probably not a good segmentation variable (white and red Honda Civics sell at much the same price); size is a better segmentation variable (full – size cars sell at a price premium over subcompact cars). Typically, segmentation analysis generates far too many segmentation variables. For our analysis to be manageable, we need to reduce these to two or three. To do this we need to:

- identify the most strategically significant segmentation variables. Which variables are most important in creating meaningful divisions in a market?
- combine segmentation variables that are closely correlated. Thus, in the restaurant industry, price level, service level (waiter service/self – service), cuisine (fast – food/ full meals), and alcohol license (wine served/soft drinks only) are likely to be closely related. We could use a single variable, restaurant type, with three categories – full – service restaurants, cafes, and fast – food outlets – as a proxy for all of these variables.

2. Construct a Segmentation Matrix.

Once the segmentation variables have been selected and discrete categories determined for each, the individual segments may be identified using a two - or three – dimensional matrix. Thus, the European metal container industry might be analyzed in a three - dimensional matrix.

3. Analyze Segment Attractiveness.

Profitability within an industry segment is determined by the same structural forces that determine profitability within an industry as a whole. As a result, Porter's five forces of competition framework is equally effective in relation to a segment as to an entire industry.

There are, however, a few differences. First, when analyzing the pressure of competition from substitute products, we are concerned not only with substitutes from other industries but, more importantly, substitutes from other segments within the same industry. Second, when considering entry into the segment, the main source of entrants is likely to be producers established in other segments within the same industry. The barriers that protect a segment from firms located in other segments are called barriers to mobility to distinguish them from the barriers to entry, which protect the industry as a whole. When barriers to mobility are low, then the superior returns of high – profit segments tend to be quickly eroded. Thus, the high margins earned on sport utility vehicles during the mid-1990s were competed away once most of the world's main auto producers had entered the segment.

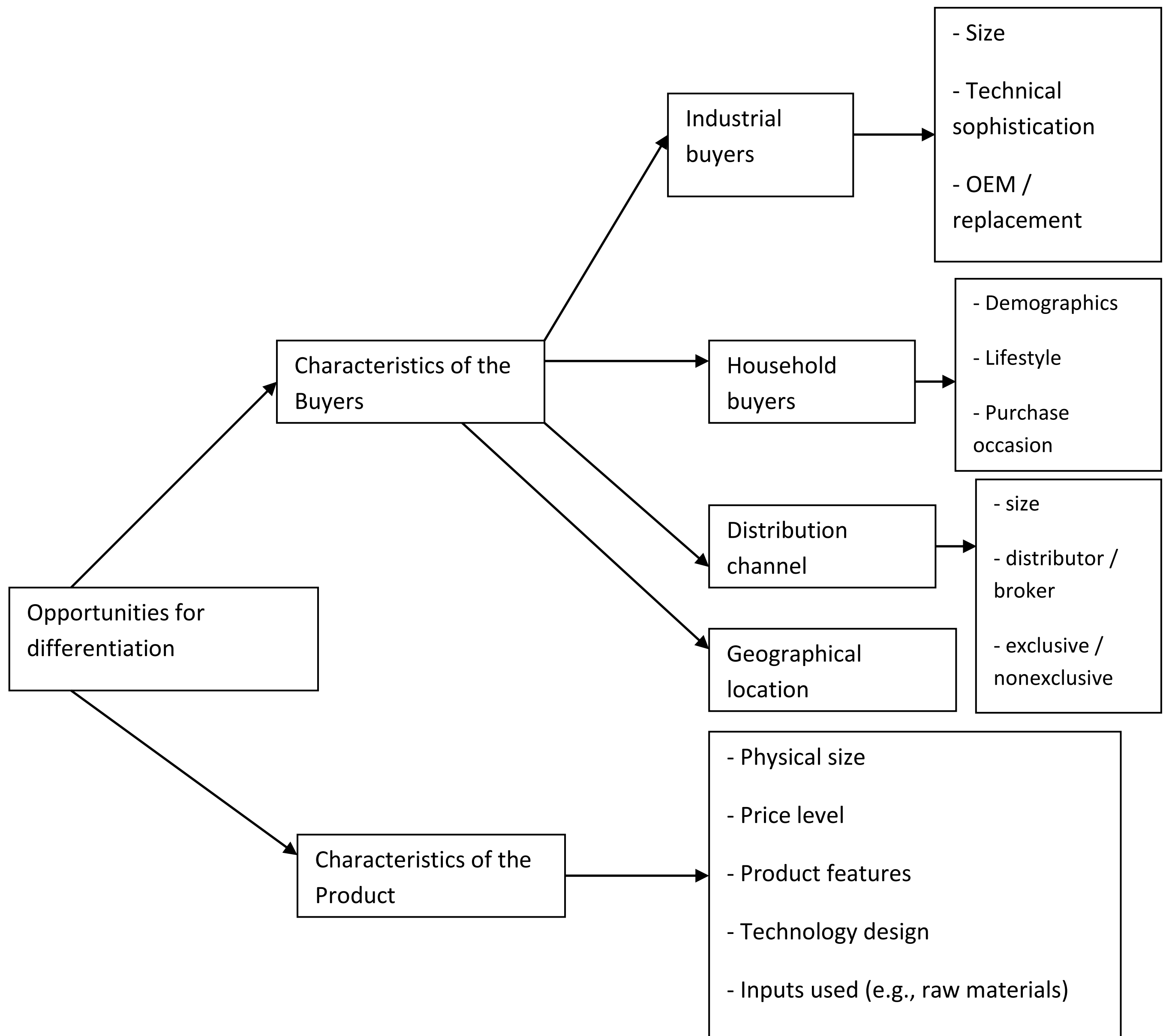

Figure 11. The basis for segmentation: the characteristics of buyers and products

Segmentation analysis can also be useful in identifying unexploited opportunities in an industry. For example, a segmentation matrix of the restaurant industry in a town or locality might reveal a number of empty segments. Companies that have built successful strategies by concentrating on unoccupied segments include Wal – Mart (discount stores in small towns), Enterprise Rent – A – Car (suburban locations), and Edward Jones (full – service brokerage for small investors in smaller cities). This can be an intermediate step in the quest for «blue oceans» - new markets untainted by competition.

4. Identify the Segment's Key Success Factors.

Differences in competitive structure and in customer preferences between segments result in different key success factors. By analyzing buyers' purchase criteria and the basis of competition within individual segments, we can identify key success factors for individual segments.

5. Select segment Scope.

Finally, a firm needs to decide whether it wishes to be a segment specialist, or compete across multiple segments. The advantages of a broad over a narrow segment focus depend on two main factors: similarity of key success factors and the presence of shared costs. If key success factors are different across segments, a firm will need to deploy distinct strategies and may have difficulties in drawing upon the same capabilities. Harley – Davidson's attempt to compete in sports motorcycles through its Buell brand has met limited success.

The ability to share costs across different segments has been a major factor in automobiles where very few specialist manufacturers survive and most of the world's main automakers offer a full range of vehicles allowing cost economies from common platforms and components.

Example: Segmentation of the European Metal Can Industry

1. Identify key segmentation variables and categories.

- identify possible segmentation variables. Raw material, can design, can size, customer size, customer's industry, location.

- reduce the number of segmentation variables. Which are most significant? Which are closely correlated and can be combined? Type of can, customer industry, customer location.

- identify discrete categories for each segmentation variable. Type of can: three – piece steel, two – piece steel, two – piece aluminum, general cans (small, typical), composite cans, aerosols. Type of customer: food processing (canning), fruit juice, pet food, soft drink, toiletries, beer, oil. Location: France, Germany, Spain/Portugal, Italy, U.K., Benelux.

2.Construct a segmentation matrix (Figure 12).

3. Analyze segment attractiveness. Apply five forces analysis to individual segments.

Apply Porter's five forces analysis to certain market segments. For example, the market of aluminum cans or cans' producers of nonalcoholic drinks (=soft drinks) in Italy can be analyzed in the following way (Figure 13).

Food processin
Fruit juice
Pet food
Soft drinks
Beer
Oil
France
Spain/ Portugal
Germ any
Italy
Three – piece steel
Two – piece steel
Two – piece aluminu m
General cans (small,
Compos ite cans
Aerosol s

Figure 12. Segmentation matrix for the European Metal Can Industry

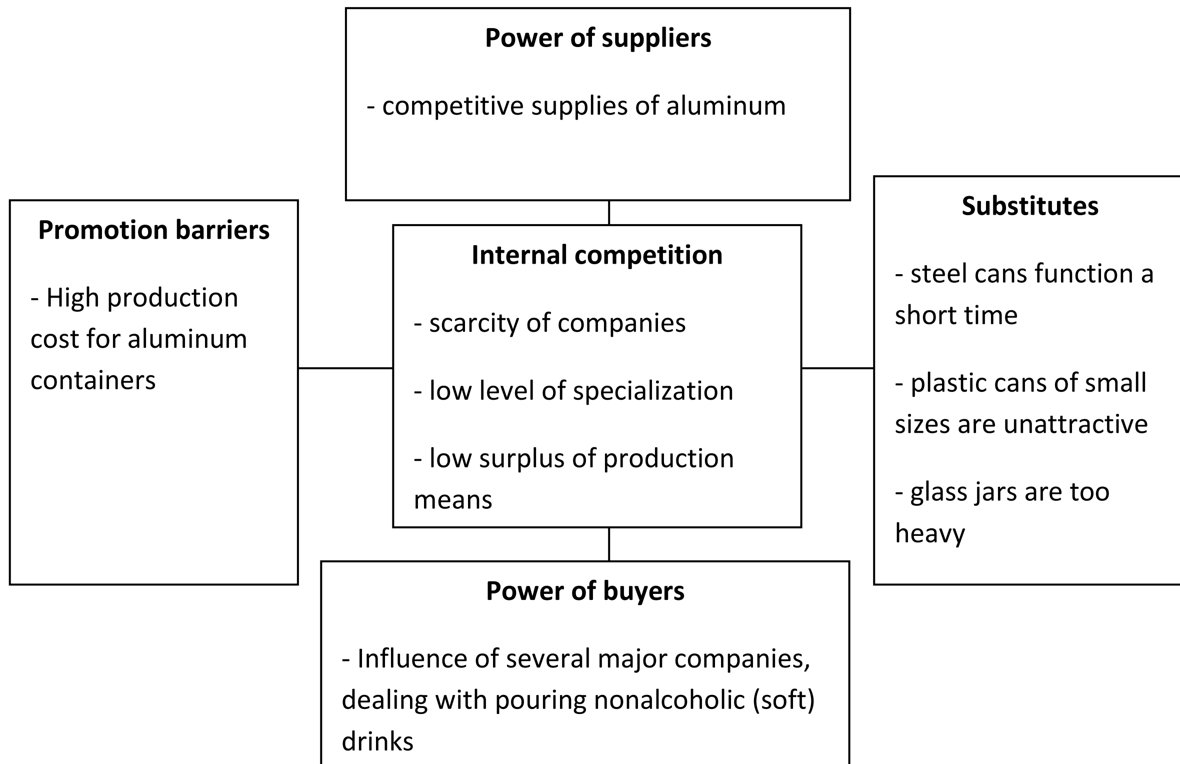

Figure 13. Porter's 5 forces analysis

4. Identify key success factors in each segment. Within each segment, how do customers choose, and what is needed to survive competition?

5. Analyze attraction of broad versus narrow segment scope.

- What is the potential to share costs and transfer skills across segments?
- How similar are key success factors between segments?
- Are there benefits of segment specialization?

Articles for discussion:

1. **Resource utilization: Revival at Walt Disney**
2. **When your competitive advantage walks out the door: Gucci**

Practical task:

Carry out segmentation analysis of an industry, using stages of segmentation analysis and the example of the European Metal Industry segmentation.

2.2. Analysis of a company's resources and capabilities. Organization structure analysis

Strategy is concerned with matching a firm's resources and capabilities to the opportunities that arise in the external environment (Figure 14).

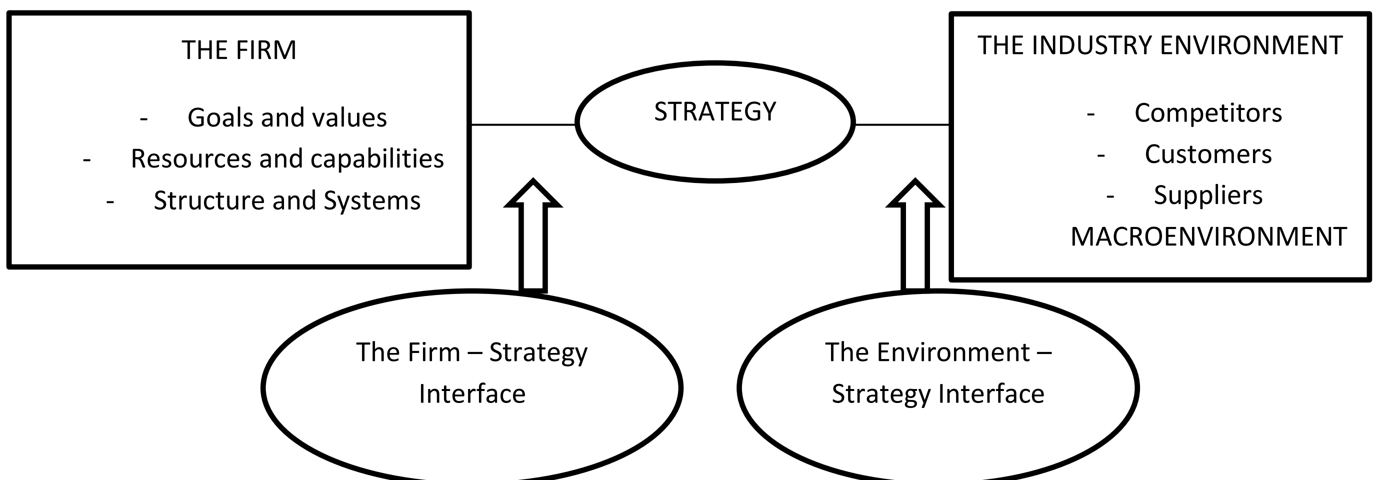

Figure 14. Analyzing resources and capabilities: the interface between strategy and the firm

It is important to distinguish between the resources and capabilities of the firm. Resources define capabilities.

Resources are the productive assets owned by the firm. Capabilities are what the firm can do. Individual resources do not confer competitive advantage. They must work together to create organizational capability. It is capability that is the essence of superior performance.

The relationships among resources, capabilities and competitive advantage are shown in the Figure 15.

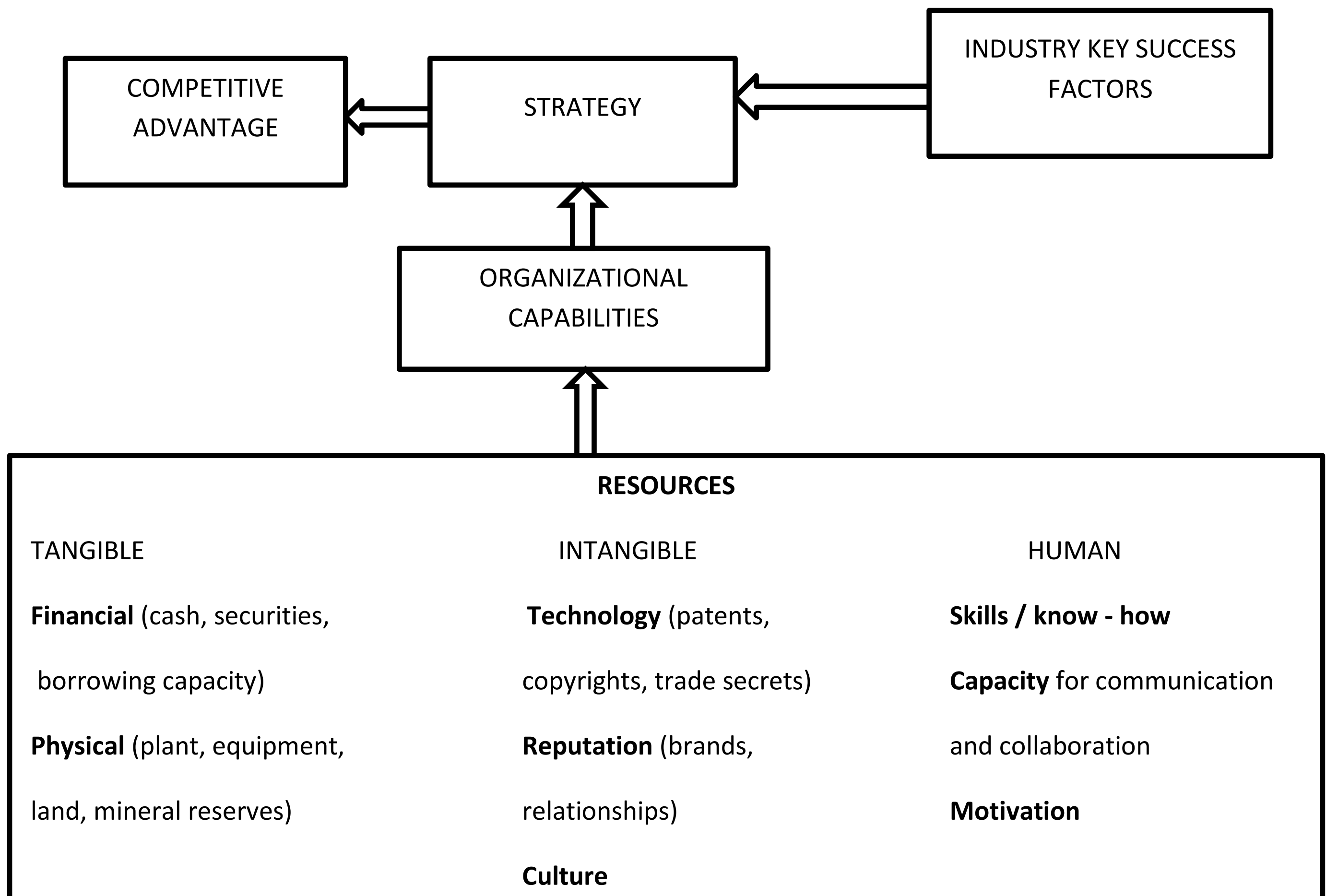

Figure 15. The links among resources, capabilities and competitive advantage

Resources

Tangible resources

Tangible resources are the easiest to identify and evaluate: financial resources and physical assets are identified and valued in the firm's financial statements.

Once we have fuller information on a company's tangible resources we explore how we can create additional value from them. This requires that we address two key questions:

- What opportunities exist for economizing on their use?

It may be possible to use fewer resources to support the same level of business, or to use the existing resources to support a larger volume of business.

- What are the possibilities for employing existing assets more profitably?

Intangible resources

For most companies, intangible resources are more valuable than tangible resources.

Brand names and other trademarks are a form of reputational asset: their value is in the confidence they instill in customers. Different approaches can be used to estimate brand value (or "brand equity"). One method takes the price premium attributable to a brand, multiplies it by the brand's annual sales volume, then calculates the present value of this revenue stream.

The value of a company's brands can be increased by extending the range of products over which a company markets its brands.

Like reputation, technology is an intangible asset whose value is not evident from most companies' balance sheets. Intellectual property – patents, copyrights, trade secrets, and trademarks – comprise technological and artistic resources where ownership is defined in law.

Human resources

The firm's human resources comprise the expertise and effort offered by employees. Like intangible resources, human resources do not appear on the firm's balance sheet – for the simple reason that the firm does not own its employees.

Organizational capabilities

Core competences, according to Hamel and Prahalad, are those that:

- Make a disproportionate contribution to ultimate customer value, or to the efficiency with which that value is delivered and
- Provide a basis for entering new markets.

Classifying capabilities.

A functional classification of a company's capabilities are presented in Table 4.

Table 4

A functional classification of organizational capabilities

Functional area	Capability
Corporate functions	Financial control Management development Strategic innovation Multidivisional coordination Acquisition management International management
Management information	Comprehensive, integrated MIS network linked to managerial decision making
Research and development	Research Innovative new product development Fast – cycle new product development
Operations	Efficiency in volume manufacturing

	Continuous improvements in operations Flexibility and speed of response
Product design	Design capability
Marketing	Brand management Building reputation for quality Responsiveness to market trends
Sales and distribution	Effective sales promotion and execution Efficiency and speed of order processing Speed of distribution Customer services

Appraising resources and capabilities

The profits that a firm obtains from its resources and capabilities depend on three factors: their abilities to establish a competitive advantage, to sustain that competitive advantage and to appropriate the returns to that competitive advantage. Each of these depends on a number of characteristics. Figure 16 shows the key relationships.

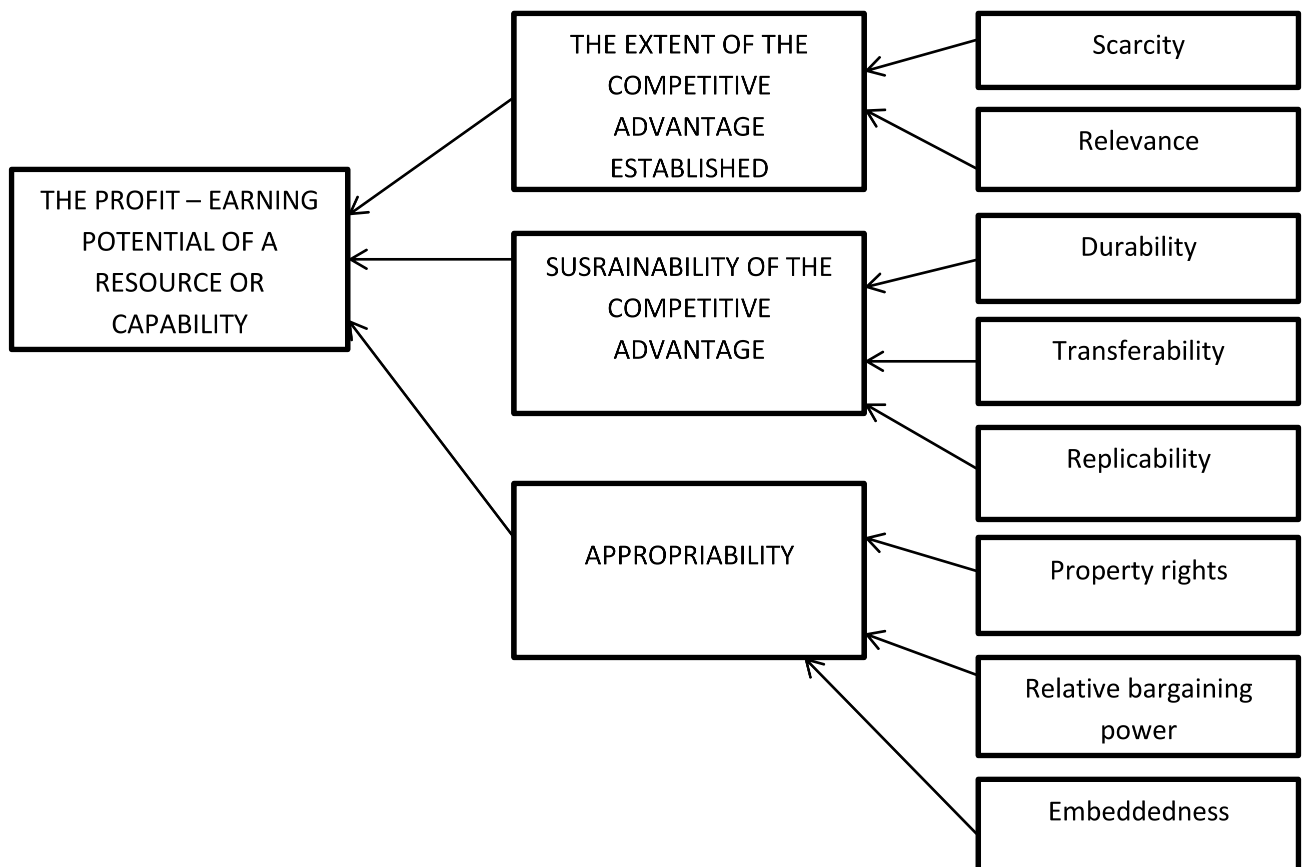

Figure 16. Appraising the strategic importance of resources and capabilities

Stages of carrying out analysis of a firm's resources and capabilities:

Step 1. Identify the key resources and capabilities

Step 2. Appraising resources and capabilities (assessing importance, assessing relative strengths, bringing together importance and relative strength)

Step 3. Developing strategy implications (Exploiting key strengths, managing key weaknesses, what about superfluous strengths?).

A framework for analyzing resources and capabilities you can see in the Figure 17.

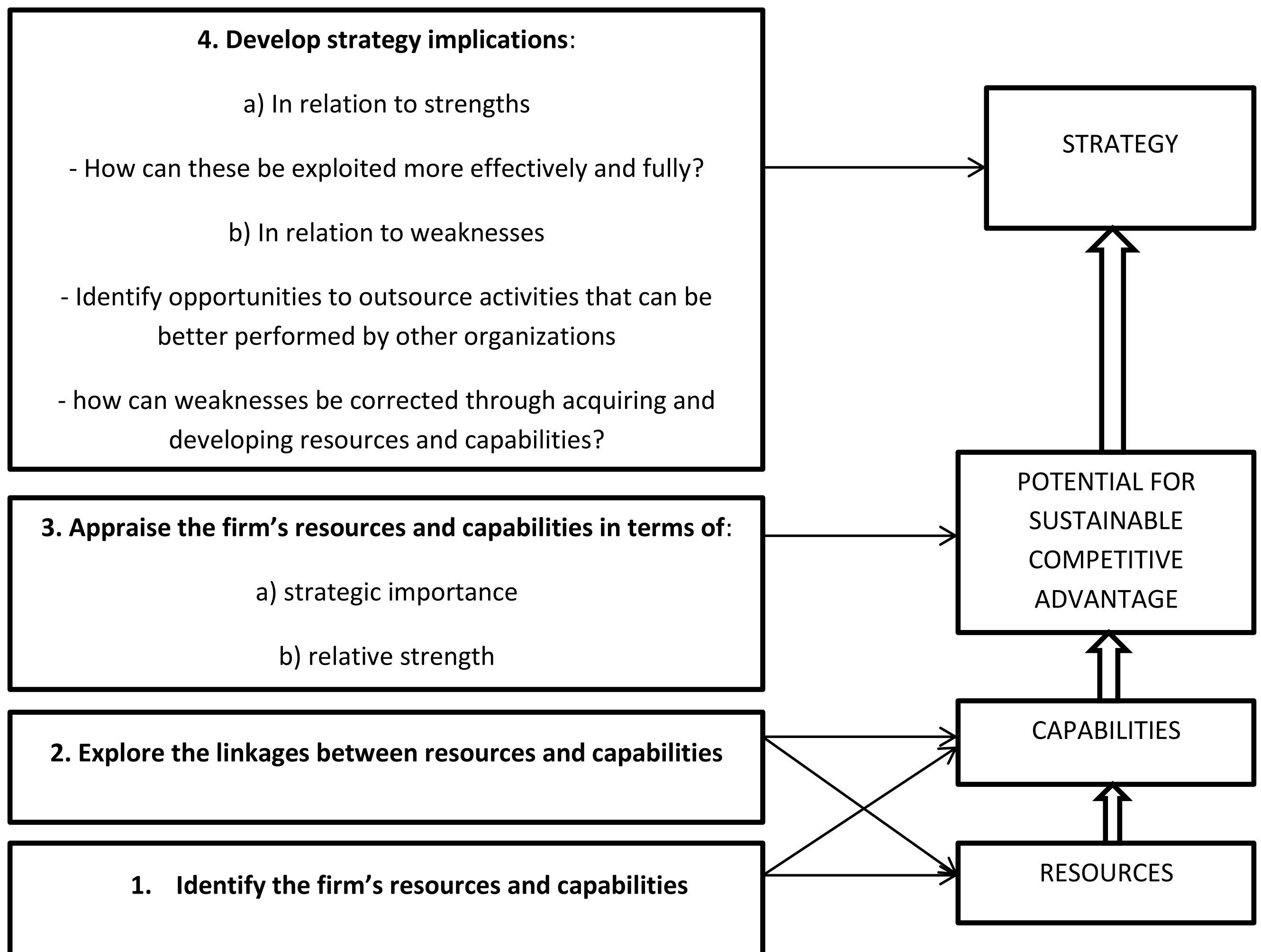

Figure 17. A framework for analyzing resources and capabilities

Practical tasks:

1. Assess a company's resources and capabilities using different schemes.

2. Evaluate a company's brand value.

Organization structure analysis

A corporation is an organization that has a legal identity – it can own property, enter contacts, sue and be sued. Such a legal identity is essential to the operation of a business enterprise that involves more than a few people.

There are two big problems in an organization's management: the coordination problem (presupposes answer the question "In the absence of goal conflict, how do individuals harmonize their different activities?) and the cooperation problem (who have divergent goals?).

Cooperation problems:

- Problem of agency (an agency relationships).

Several mechanisms are available to management for achieving goal alignment within organizations:

- Control mechanisms
- Performance incentives
- Shared values.

Coordination problems:

Among the mechanism for coordination, the following can be found in all companies:

- Rules and directives
- Routines
- Mutual adjustment.

Hierarchy is an efficient solution to the problem of coordination in organizing complex tasks. Multinational, multiproduct companies are continually grappling with the issue of whether they should be structured around product divisions, country subsidiaries, or functional departments, and periodically they undergo the disruption of changing from one another. Some of the principle bases for grouping employees are common tasks, products, geography and process.

Coordination requirements are not the only consideration in deciding how to group together employees and activities within the firm. Additional factors that influence the efficiency of different organizational arrangements include:

- Economies of scale
- Economies of utilization
- Learning
- Standardization of control systems.

Structural forms of organizations:

- The functional structure
- The multidivisional structure
- Matrix structures

Several organizational forms have been identified which, although they comprise some hierarchical elements, are sufficiently distinctive to be regarded as alternative organizational forms:

- Adhocracies
- Team – based and project – based organizations
- Networks.

These different organizational forms share several common characteristics:

- A focus on coordination rather than control
- Reliance on coordination by mutual adjustment
- Individuals in multiple organizational roles

The relationship between management systems and organizational structure:

Management systems provide the mechanisms of communication, decision making, and control that allow companies to solve the problems of achieving both coordination and cooperation. Four management systems are of primary importance: the information systems, the strategic planning systems, the financial systems, and the human resource management systems.

Corporate culture as a control mechanism comprises the beliefs, values and behavioral norms of the company, which influence how employees think and believe.

The complexity of carrying out strategic analysis depends on the type of organization structure, a company's access to the necessary information, the number of competitors.

Carrying out strategic analysis when doing business abroad is several times more difficult because:

- There are many global factors which influence a company's activity
- It is necessary to take into account national tradition of doing business on the external market.

Example: **General Electric: organizational structure (2009)**

Practical tasks:

1. Describe organizational structure of a company

2. Single out cooperation and coordination problems of a company and characterize it.

2.3. Macroenvironment analysis

PESTLE – analysis (STEEP – analysis)

PESTLE – analysis is analysis of macroenvironment.

The PESTLE – analysis tool was developed to help identify and understand macroeconomic forces that may have impact on an organization, such as global and national economic factors (for example, growth or recession), changes in technology and etc. (Figure 18).

PESTLE – analysis divides these forces into six factors: political, economic, social, technological, legal, and environmental.

PESTLE – analysis may be considered as a source of SWOT – analysis, as a stage, preliminary to the Swot – analysis. It's a stage of data collection.

The output of PESTLE – analysis can be used in conjunction with SWOT – analysis to explore further how the macroeconomic factors, which the company has identified may impact on the organization.

The government's policy

The company must know:

First, what programs are implemented by the government?

Second, what are the government's plans, concerning different industries and regions of the country?

Third, what changes in law are possible as a result of passing new regulations and norms?

At that it is necessary to know the basic features of the political system: what ideology defines the government's policy; how stable the government is; how capable it is of pursuing its own policy; what's the degree of the public displeasure and how powerful their opposition is?

Economy

Studying economy presupposes analysis of certain indices (index): the volume of gross national product, the inflation rate, the level of unemployment, the interest rate, labor productivity, tax rate (taxation norm), payment balance, savings and etc.

It is necessary to pay attention to the following indices: the general level of economic development in the region; natural resources excavation; climate; the level of competition development; the structure of the population; the level of education and qualification of the workforce; the rate of salary (the average salary).

Ecology

Questions, connected with this factor:

1) The first question: what ecological problems does the company have to face?

2) The second one is if the company has competitors, who exploit ecological (environmental) protection issues in their marketing policy? Do they succeed in it?

3) The third question: does the company have equipment, which protects the environment from harmful waste?

4) Does the company use secondary raw materials?

5) Does the company implement new methods of secondary, recycled raw materials when organizing production?

6) Is the product environmentally friendly or not?

Society

Social issues influence the company:

1) people's attitude to work and the standard of living

2) culture and customs existing in the society

3) different human values

4) the growth and migration of the population

5) the level of education

6) people’s mobility (transition of one social layer into another, a higher one)

Legal component

Strategic analysis researches here:

1) the degree of law protection (of legal security)

2) dynamism of the legal environment

3) the company should find out how obligatory the legal norms to itself; if it is possible to go round these norms; what financial punishments are used in case of law breaking.

Practical task: collect data for SWOT – analysis with the help of PESTLE factors.

An Article

What’s wrong with PESTLE?

It is common to refer to this kind of analysis as a PESTLE analysis but the great danger of this terminology is that the purpose of the analysis is forgotten, that is to identify key external drivers and their implications for the industry environment and the organization’s stakeholders. Too often the exercise ends up with a long list of external issues with something in each section of the PESTLE but with no appreciation or analysis of their implications. Moreover it is often difficult to classify some as say, political, social, legal or economic. A rise in taxes could be classified in any one of those four categories. The truth is that it doesn’t matter. There does not need to be something in each section and it does not matter whether issues are political or economic etc. as long as the main issues are identified and a careful analysis is undertaken of the impact then that is all that is required. It is also sometimes difficult to classify issues as opportunities or threats as often an issue can be both. Again it doesn’t matter. Global warming may be a threat in that it is likely to increase energy bills but it could also be an opportunity in the search for new products and new and more efficient production methods. The same could be said about the classification of internal issues as strengths or weaknesses.

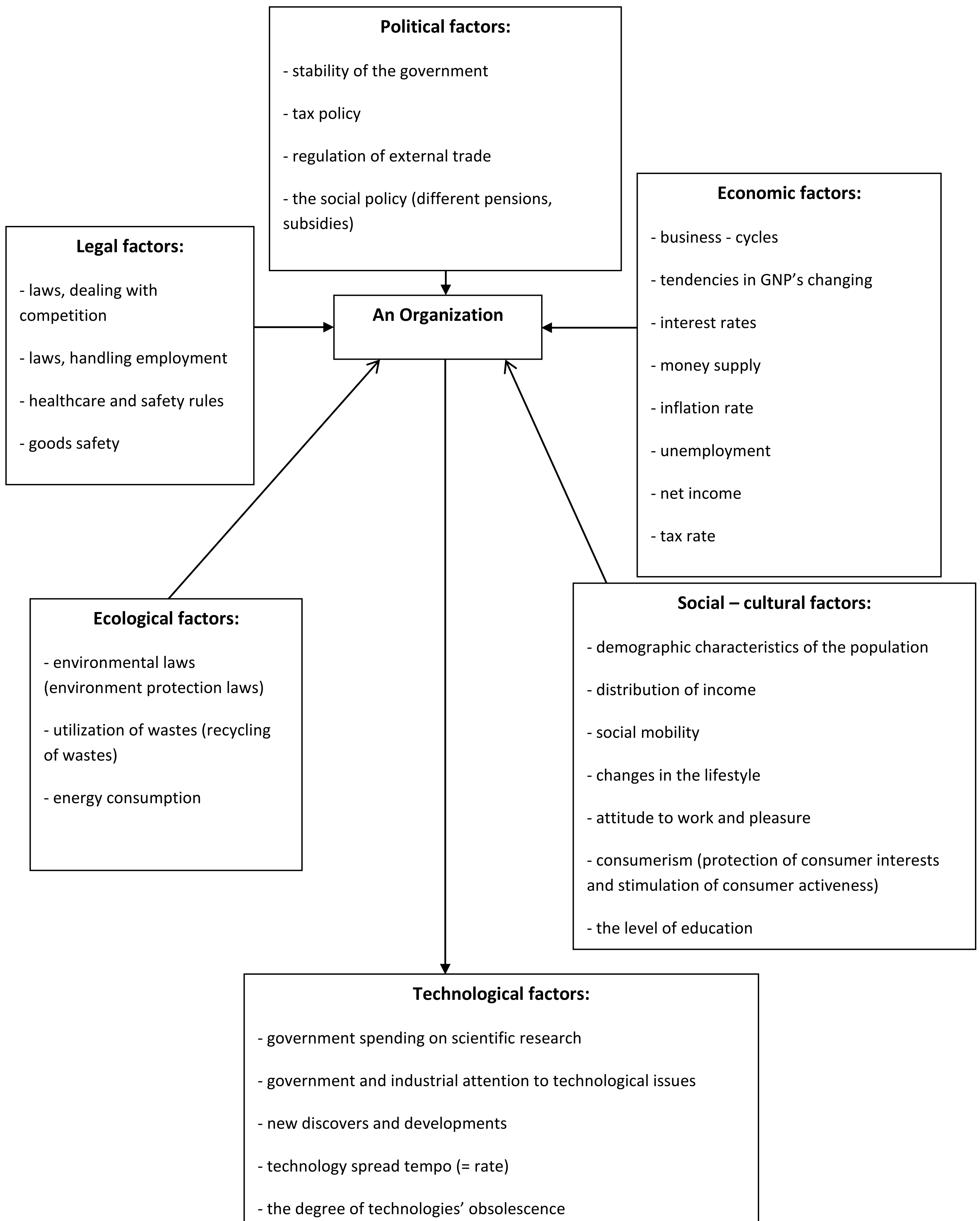

Figure 18. Factors, determined by the environment

SWOT – model

Swot – analysis is an overall view on the company's position at a certain moment on the market. Swot – analysis consists of four components: strengths, weaknesses, opportunities, threats (Table 5).

Strengths and weaknesses are under the company's control. Opportunities and threats are outside the company's control.

The scheme of Swot – analysis (if talking about a particular company).

Table 5

Factors taking into account when carrying out a company's SWOT - analysis

Factors		
Internal	***Strengths*** 1) **high competence and qualification of staff** 2) **high quality of the goods and services produced** 3) **the popularity of the trade mark (the popularity of the brand)** 4) **the best production (facilities, means of production)** 5) **unique, cutting edge technology** 6) **proved and reliable suppliers** 7) **price competitiveness (price advantage, competitive pricing)** 8) **good (adequate) understanding of consumers** 9) **modern equipment** 10) **a reliable distribution network** 11) **good (high) competitive skills (competitive efficiency)** 12) **a good reputation within the organization** 13) **adequate, reliable financial resources** 14) **access to unique resources** 15) **advertisement, which is the most effective in the whole industry (efficient, skillful, successful advertisement)** 16) **proved and reliable management** 17) **clearly expressed strategy**	***Weaknesses*** 1) **high costs of production** 2) **considerable wearing out of equipment** 3) **high costs of production in comparison with the main competitors** 4) **lack/shortage of finance** 5) **absence (= unavailability = inaccessibility) of financing, which is necessary to change the strategy** 6) **low corporate motivation of staff** 7) **low level of customer service** 8) **absence of consumer analysis** 9) **absence of a clearly expressed strategy and inconsistency of its implementation** 10) **bad reputation of the company on the market** 11) **not skilled, inexperienced staff (unskilled staff, unskillful staff, unqualified staff, poorly – skilled staff)** 12) **narrow range of production** 13) **obsolete technologies and equipment (obsolete production techniques)** 14) **inadequate (= inefficient) marketing (= market policy = promotion of the product)** 15) **inefficient (= inflexibility), superficial management (= superficiality of management) Superficial**

External	***Opportunities*** 1) **availability (= accessibility) of resources** 2) **favorable shift in currency rates** 3) **weakening of limiting laws** 4) **appearance of new technologies** 5) **widening of the product range** 6) **growth of demand (growth in demand)** 7) **growth in the standard of living** 8) **lowering of trade barriers when penetrating foreign (= external) markets** 9) **decreasing the number of competitors due to appearance of trading barriers to the market** 10) **low activity of competitors** 11) **serving additional groups of consumers**	***Threats*** 1) **deceleration of market growth** 2) **changes in consumers' tastes** 3) **unfavorable shift in currency rates** 4) **growth of competition (toughening of competition)** 5) **appearance of foreign competitors with products of low cost (of low price)** 6) **introduction of alternative goods and services into the market** 7) **appearance of new competitors on the market** 8) **adoption (= introduction) of new legislative limitations (= of new legal limitations)** 9) **growth of the tax burden** 10) **decrease of birth rate** 11) **toughening of suppliers' terms** 12) **sensitive to the instability of exterior business conditions**

Practical tasks:

1. Learn all the factors, add your own factors in the table.

2. Carry out Swot – analysis of a country

3. Choose a company, which you will analyze strategically and carry out SWOT– analysis of this company.

An Article

What's wrong with SWOT?

Distinguishing between the external and the internal environment of the firm is common to most approaches to strategy analysis. The best known and most widely used of these approaches is the "SWOT" framework, which classifies the various influences on a form's strategy into four categories: Strengths, Weaknesses, Opportunities and Threats. The first two – strengths and Weaknesses – relate to the internal environment; the last two – opportunities and threats – relate to the external environment.

Which is better, a two – way distinction between internal and external influences or the four – way SWOT taxonomy? The key issue is whether it is sensible and worthwhile to classify internal factors into strengths and weaknesses and external factors into opportunities and threats. In practice, such distinctions are difficult:

- Is Global warming a threat or an opportunity to the world's automobile producers? Global warming may encourage governments to raise taxes on motor fuels and support public transport, thereby threatening the demand for private motoring. At the same time, these circumstances create an opportunity for developing new, fuel – efficient cars that may encourage consumers to scrap their gas – guzzlers.

The lesson here is that an arbitrary classification of external factors into opportunities and threats, and internal factors into strengths and weaknesses, is less important than a careful identification of these external and internal factors followed by an appraisal of their implications. Gtant's approach to strategy analysis favors a simple two – way classification of internal and external factors. What will characterize our strategic appraisal will be the rigor and depth of our analysis of these factors, rather than a superficial categorization into strengths or weaknesses, and opportunities or threats.

2.4. Additional tools of strategic analysis

- **General electric matrix**
- **BCG matrix**
- **ADL – LC model**
- **The system of balanced variables**
- **Scenario modelling**

Practical task: Carry out analysis of a company, using one of the additional tools of strategic analysis

2.5. Review questions

1. What are the stages of carrying out competitor analysis?
2. What can we analyze using Porter's five forces model? Characterize each force.
3. For what purposes is PESTLE model used?
4. What is the difference between PESTE, PESTLE and STEEP abbreviation?
5. What stages of segmentation analysis are singled out?
6. What is the main difference between resources and capabilities?
7. How can we asses a company's resources and capabilities?
8. What approaches to a brand's value estimation do you know?
9. What are the main problems in an organization management?

PART 3. Analysis of competitive advantages

3.1. The emergence of Competitive Advantage

1. External and internal sources of change (Figure 19).

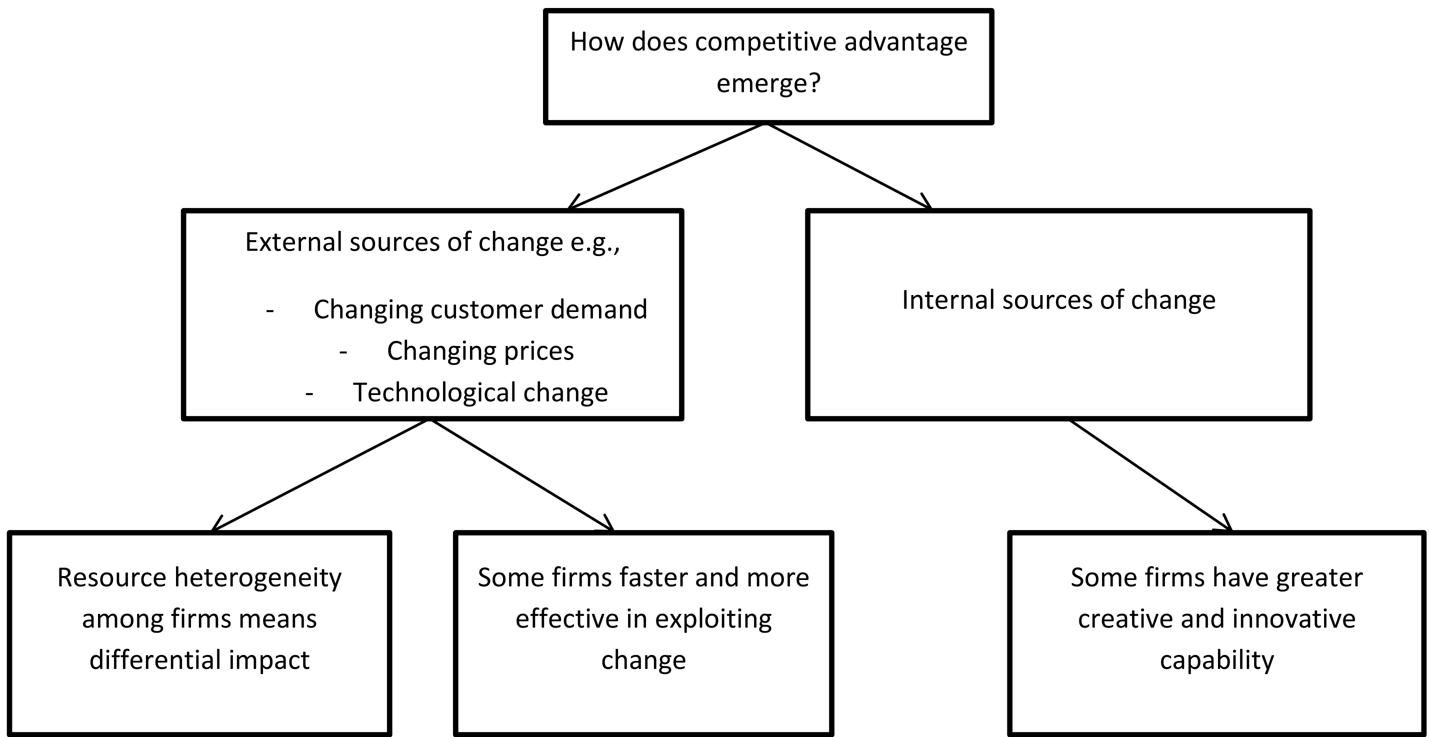

Figure 19. Sources of change

The extent to which external change creates competitive advantage and disadvantage depends on the magnitude of the change and the extent of firms' strategic differences. The more turbulent an industry's environment, the greater the number of sources of change and the greater the differences in firms' resources and capabilities.

2. Competitive advantage from responsiveness to change

Responsiveness involves one of two key capabilities. The first is the ability to anticipate changes in the external environment. The second is speed.

3. Competitive advantage from innovation

Internal changes is explained by innovation.

Strategic innovations tend to involve pioneering along one or more dimensions of strategy:

4. New industries

Some companies launch products which create a whole new market.

5. New customer segments

Creating new customer segments for existing product concepts can also open up vast new market spaces.

6. New sources of competitive advantage.

3.2. Sustaining competitive advantage

Once established, competitive advantage is subject to erosion by competition. The speed with which competitive advantage is undermined depends on the ability of competitors to challenge either by imitation or innovation. Imitation is the most direct form of competition; thus, for competitive advantage to be sustained over time, barriers to imitation must exist. It is necessary to use isolating mechanisms. The more effective these isolating mechanisms are, the longer competitive advantage can be sustained against the onslaught of rivals.

To identify the sources of isolating mechanisms, we need to examine the process of competitive imitation. For one firm successfully to imitate the strategy of another, it must meet four conditions (Table 6):

- Identification
- Incentive
- Diagnosis
- Resource acquisition

Table 6

Sustaining competitive advantage: types of isolating mechanism

Requirement for imitation	**Isolating mechanism**
Identification	Obscure superior performance
Incentives for imitation	Deterrence: signal aggressive intentions to imitators Preemption: exploit all available investment opportunities
Diagnosis	Rely on multiple sources of competitive advantage to create “causa; ambiguity”
Resource acquisition	Base competitive advantage on resources and capabilities that are immobile and difficult to replicate

3.3. Competitive advantage in different market settings

To identify opportunities for establishing and sustaining competitive advantage requires that we understand the competitive process in the specific market.

- Efficient Markets.

The absence of competitive advantage

- Competitive advantage in Trading Markets.

For competitive advantage to exist, imperfections (or “inefficiencies”) must be introduced into the competitive process. In trading markets, several types of imperfections to the competitive process create opportunities for competitive advantage.

- Imperfect availability of information

- Transaction costs
- Systematic behavioral trends
- Overshooting.

➢ Competitive advantage in Production Markets.

The transitory nature of competitive advantage in trading markets is a result of the characteristics of the resources required to compete: finance and information.

The most important characteristics of different markets are presented in Figure 20.

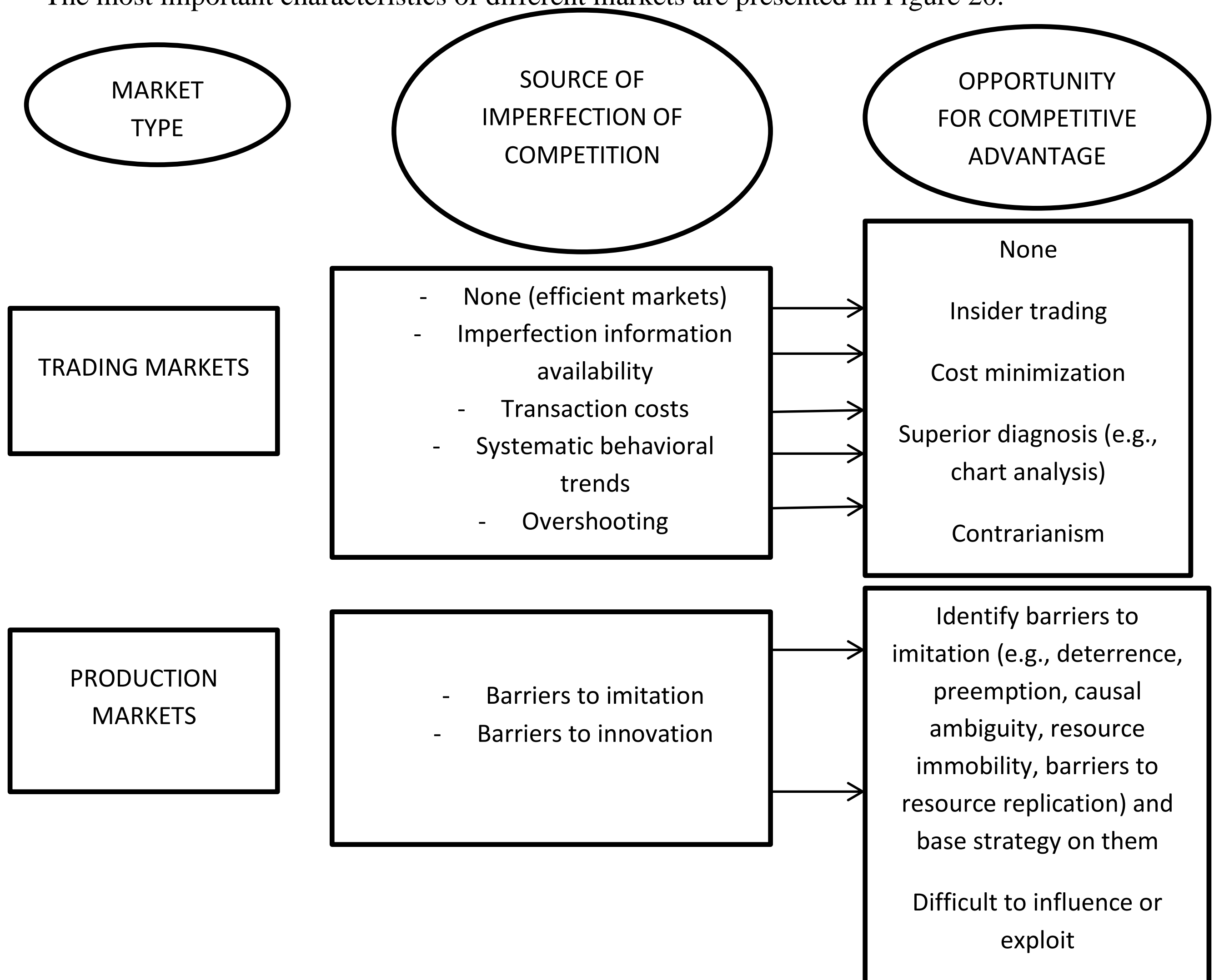

Figure 20. Competitive advantage in different industry settings: trading and production

Article for discussion: Urban Outfitte

Practical task: Describe competitive advantages of a company

3.4. Review questions

1. How does competitive advantage emerge?

2. What types of isolating mechanisms do you know?

3. What is isolating mechanism?

4. What barriers to imitation and innovation do you know?

PART 4. Carrying out strategic analysis when doing business on the external markets

4.1. Internationalization patterns. Internationalization influence on competition

Internationalization occurs through trade – the sale and shipment of goods and services from one country to another – and direct investment – building or acquiring productive assets in another country. On this basis it is possible to identify different types of industry according to the extent and mode of their internationalization (Figure 21).

Patterns of Internationalization:

- Sheltered industries
- Trading industries
- Multidomestic industries
- Global industries

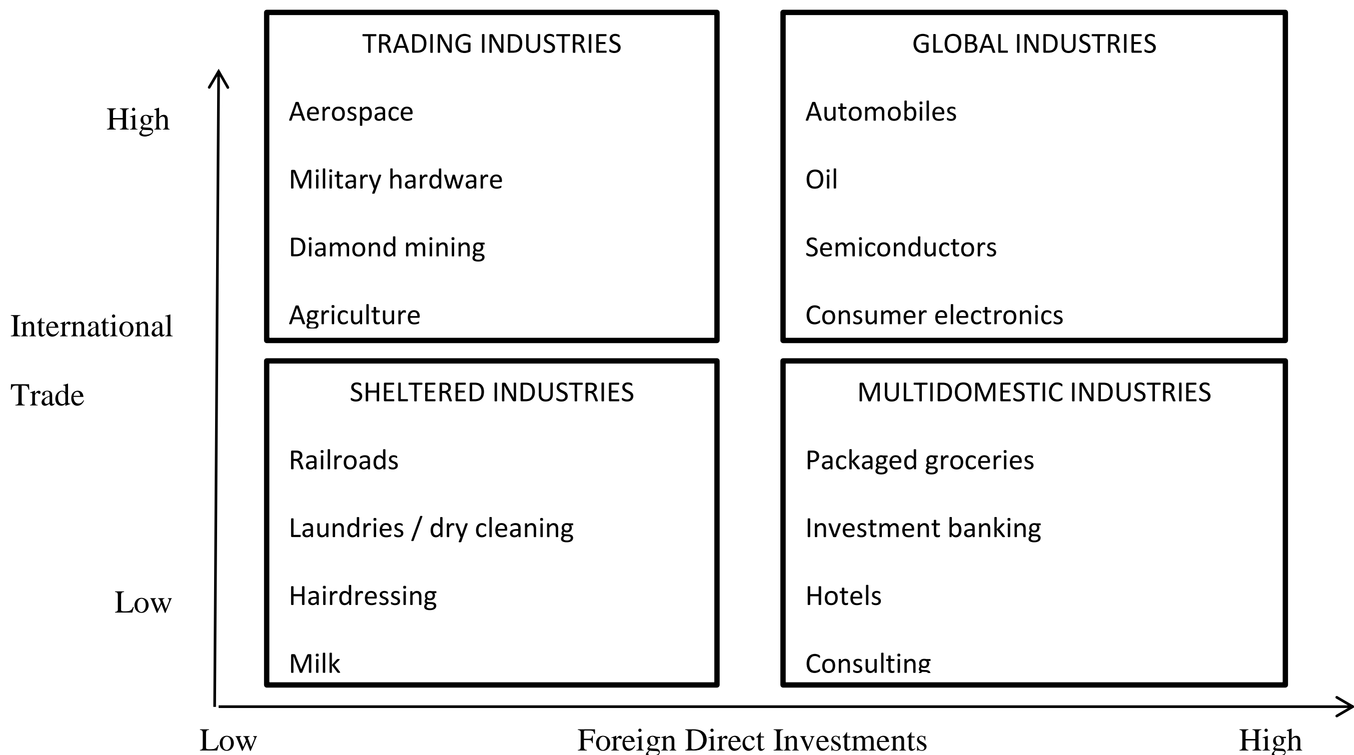

Figure 21. Internationalization patterns

Internationalization influence on competition

Internationalization usually means more competition and lower industry profitability.

Using porter's five forces of competition framework to analyze the impact of internationalization on competition and industry profitability. If we define the industry in terms of the national market, internationalization directly influences three of the five forces of competition.

- Competition from potential entrants.

Barriers to entry into most national markets have fallen substantially. Tariff reductions, falling real costs of transportation, the removal of exchange controls, internationalization of standards, and convergence between customer preferences have made it much easier for producers in one country to supply customers in another. Many of the entry barriers that were effective against potential domestic entrants may be ineffective against potential entrants that are established producers in overseas countries.

- Rivalry among existing firms.

Internationalization increases internal rivalry primarily because it increases the number of firms competing within each national market – it lowers seller concentration.

Increasing global concentration is often accompanied by falling concentration in national markets.

Internationalization intensifies rivalry, first, by increasing the diversity of competitors in terms of goals, strategies and cost structures and, second, when internationalization occurs through direct investment in new plants, excess capacity increases.

- Increasing the bargaining power of buyers.

A further implication of the internationalization of business is that large customers can exercise their buying power far more effectively. Global sourcing provides a key tool for cost reduction by manufacturers.

4.2. Analyzing competitive advantage in an international context

National influences on competitiveness: comparative advantage

The effect of national resource availability on international competitiveness is the subject of the theory of comparative advantage. The term “comparative advantage” refers to the relative efficiencies of producing different products.

Competitive advantage in an international context you can see in Figure 22.

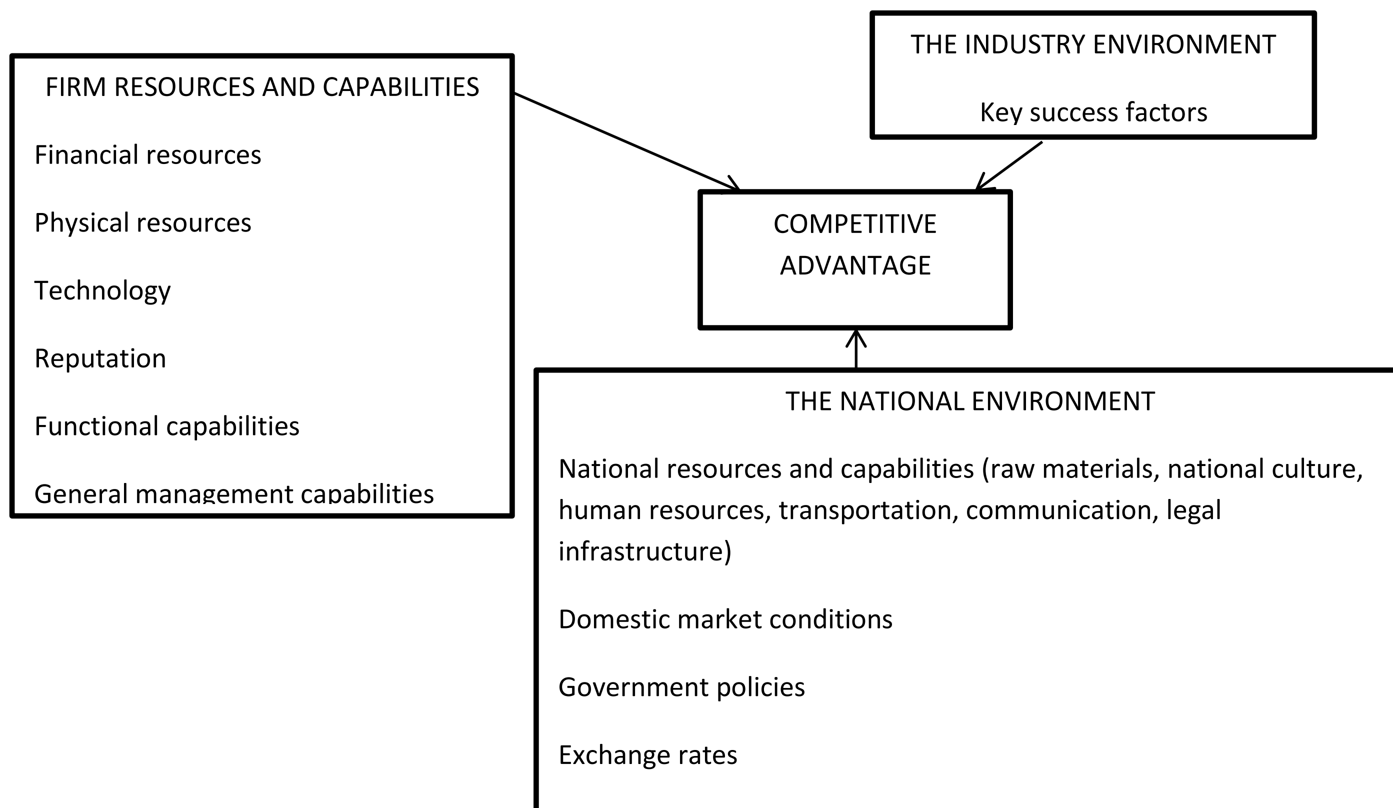

Figure 22. Competitive advantage in an international context

The decision of where to manufacture requires consideration of three sets of factors:

- National resource availability.
- Firm – specific competitive advantages.
- Tradability.

4.3. Analysis of Foreign entry strategies

We need to understand how the firm weights the merits of different market entry modes. Five key factors are relevant:

1. Is the firm's competitive advantage based on firm – specific or country – specific resources?

If the firm's competitive advantage is country based, the firm must exploit an overseas market by exporting.

2. Is the product tradable and what are the barriers to trade?

If the product is not tradable because of transportation constraints or import restrictions, then accessing that market requires entry either by investing in overseas production facilities or by licensing the use of key resources to local companies within the overseas market.

3. Does the firm possess the full range of resources and capabilities for establishing a competitive advantage in the overseas market?

Competing in an overseas market is likely to require that the firm acquires additional resources and capabilities, particularly, those related to marketing and distributing in an unfamiliar market.

4. Can the firm directly appropriate the returns to its resources?

Whether a firm licenses the use of its resources or chooses to exploit them directly (either through exporting or direct investment) depends partly on appropriability considerations.

5. What transaction costs are involved?

A key issue that arises in the licensing of a firm's trademarks or technology concerns the transaction costs of negotiating, monitoring and enforcing the terms of such agreements as compared with internationalization through a fully owned subsidiary.

Multinationals tend to predominate in industries where:

- Firm – specific intangible resources such as brands and technology are important (transaction costs in licensing the use of these resources favor direct investment);
- Exporting is subject to transaction costs (for example, through tariffs or import restrictions);
- Customer preferences are reasonably similar between countries.

Possible strategies of a company's entry foreign markets

Export

Contract management

Contract production

Licensing

Franchise

Strategic alliances and joint ventures

Foreign branch

Foreign affiliate

Multinational strategies

A global strategy is one that views the world as a single, if segmented, market. The main benefits of global strategy:

- Cost benefits of scale and replication
- Serving global customers
- Exploiting national resources – arbitrage benefits

- Learning benefits
- Competing strategically

For all the advantages of global strategy, the evidence of the past decade is that national differences in customer preferences continue to exert a powerful influence in most markets: products designed to meet the needs of the "global customer" tend to be unappealing to most consumers.

There is a great number of national differences' sources:

- Laws and government decisions
- Distribution channels
- Different target countries for different markets.

So, the main criterion of a company's successful functioning on external markets is to pay attention on the national preferences and traditions.

Article for discussion: McDonald's Goes "Glocal"

Practical tasks:

1. Answer the questions set in 4.3. (Choose a company for carrying out analysis)

2. If the company is going to enter an external market what strategy is more reasonable for this purpose and why? (Choose a company for carrying out analysis)

3. Single out advantages and disadvantages of each foreign strategy mentioned above.

4. If speaking about a definite company: Is it reasonable to follow global strategy? Explain your answer.

4.4. Review questions

1. What patterns of internationalization can be singled out?
2. What aspects influence on competition from the internationalization view point?
3. In what cases is it reasonable and essential to follow global strategy for a company?

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Юлия Викторовна **Приказчикова**

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университет им. Н.И. Лобачевского».
603950, Нижний Новгород, пр. Гагарина, 23.