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MODERN STRATEGIC ANALYSIS

Manual

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МИНИСТЕРСТВО ОБРАЗОВАНИЯ И НАУКИ РОССИЙСКОЙ ФЕДЕРАЦИИ

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Учебно-методическое пособие предназначено для студентов института экономики и предпринимательства, обучающихся по направлению 38.04.02 «Менеджмент». Пособие включает в себя теоретическую и практическую информацию по проведению стратегического анализа деятельности объекта исследования.

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CONTENT

Unit 1. Key principles of strategy and strategic analysis

1.1. Key principles underlying strategic positioning

Three key principles underlie strategic positioning:

- Strategy is the creation of a unique and valuable position, involving a different set of activities. Strategic position emerges from three distinct sources:
  - Serving few needs of many customers
  - Serving broad needs of few customers
  - Serving broad needs of many customers in a narrow market
- Strategy requires to make trade – offs in competing – to choose what not to do.

  Some competitive activities are incompatible; thus, gains in one area can be achieved only at the expense of another area.
- Strategy involves creating "fit" among a company's activities. Fit has to do with the ways a company's activities interact and reinforce one another.

Whether you are managing a team, a start – up business, a local government department, a large commercial organization, or a charity, having a good strategy attracts many benefits besides ensuring you're more likely to reach your goals. It also helps you to map out your future, attract funding, and establish a team of great people to work with.

Mapping your future

First, a good strategy acts as a road map. It should clearly identify where you want to be at a given point in time, say, three years. For example, one of your goals may be to increase sales by a factor of ten. Your strategy should set out how you will achieve this target. Boosting sales by this amount will clearly require actions bolder than printing a new sales leaflet.

A strategy has more than the destination in mind. It enables you to map the roads and junctions along the way, so that you can plot your way and, critically, measure your progress. Three years is too long to wait to see if you made the right decisions, and you need frequent reassurance that you are on the right road.

Attracting funding

Second, a clear strategy attracts interest and funding from third parties. This might be start – up finance for a new business, internal funding (where you have to compete with other teams for resources), or a bid for sponsorship. In every scenario, funders want to know that you are in control of the situation. They can't predict the future, so they seek reassurance from your confidence in your plan for the future. A considered strategy demonstrates that their funds will be well used and that they will receive a healthy and secure return.

Unifying the organization

Finally, a clear strategy acts as a unifying force within an organization. You may have worked in organizations where the staff focus only on their job and don't understand how it fits into wider processes and objectives (and perhaps don't even care). This results in confusion, frustration for staff and customers alike, and ultimately a short – term future for the organization.

By creating a clear strategy and sharing it with your team or organization, everyone knows where they are going; people are then far more likely to adjust their behavior to make the whole enterprise work better. A well – communicated strategy sends the message: "We're all in this together." Having a destination is very powerful in terms of human motivation because we are motivated in one of two ways: "away from pain" or "towards pleasure". The former leads to behavior that achieves a short – term result, but having moved away from pain we may end up in a place we are not so keen to be. If we move towards pleasure we will be more likely to achieve a goal that we want to sustain.

On the one hand, there are factors, which help to achieve success (fast track factors), on the other hand there are factors, which prevent to succeed (off track factors) (Table 1).

Table 1

Fast and off track factors

Fast track factors	**Off track factors**
Having a clear destination in mind	Being too busy with today to think about tomorrow
Being willing to deal with the big picture	Being too quick to say why something shouldn't happen
Knowing why you are better than your competitior	Not being able to quickly give the reasons why your business exists
Feeling "on top" of leading the business to a brighter future	Making decisions without referring to your overall strategic direction

Articles for discussion

1. Apple Computer, Inc.: Business Strategy

The Company is committed to bringing the best personal computing and music experience to students, educators, creative professionals, businesses, government agencies, and consumers through its innovative hardware, software, peripherals, services and internet offerings. The Company's business strategy leverages its unique ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers new products and solutions with superior ease – of – use, seamless integration, and innovative industrial design. The Company believes continual investment in research and development is critical to facilitate innovation of new and improved products and technologies. Besides updates to its existing line of personal computers and related software, services, peripherals, and networking solutions, the Company continues to capitalize on the convergence of digital consumer electronics and the computer by creating innovations like the iPod and iTunes Music Store. The Company's strategy also includes expanding its distribution network to reach more of its targeted customers effectively and provide them a high – quality sales and after – sales support experience.

Source: Apple Computer, Inc., 10 – K Report

2. A driving force in retail

Now nearly one hundred years old, the UK supermarket group Tesco has demonstrated strong strategic thinking throughout its history. It became a leader in new formats (such as self – service supermarkets) and grew initially by opening new stores then through acquisition. Anticipating changing prosperity and tastes in the 1970s, Tesco moved away from its discount format. To achieve further growth, it had to find new customers. Strategically it aimed to achieve this in a number of ways: continuing growth in its core UK market, and providing new non – food services to UK food customers; finding new food customers in other countries by opening stores in China, Poland, and Turkey, amongst other countries; and following its customers into new retailing services. Underlying much of its strategy is its "core purpose" – to "create value for customers to earn their lifetime loyalty". Tesco is now the third – largest grocery retailer in the world, with group sales of £51.8 billion, and 3,728 stores worldwide in 13 countries, employing 440,000 staff.

3. Japanese Companies rarely have strategies

The Japanese triggered a global revolution in operational effectiveness in the 1970s and 1980s, pioneering practices such as total quality management and continuous improvement. As a result, Japanese manufacturers enjoyed substantial cost and quality advantages for many years.

But Japanese companies rarely developed distinct strategic positions of the kind discussed in this article. Those that did – Sony, Canon and Sega, for example – were the exception rather than the rule. Most Japanese companies imitate and emulate one another. All rivals offer most if not all product varieties, features and services; they employ all channels and match one anothers' plant configurations.

The dangers of Japanese – style competition are now becoming easier to recognize. In the 1980s, with rivals operating far from the productivity frontier, it seemed possible to win on both cost and quality indefinitely. Japanese companies were all able to grow in an expanding domestic economy and by penetrating global markets. They appeared unstoppable. But as the gap in operational effectiveness narrows, Japanese companies are increasingly caught in a trap of their own making. If they are to escape the mutually destructive battles now ravaging their performance, Japanese companies will have to learn strategy.

To do so, they may have to overcome strong cultural barriers. Japan is notoriously consensus oriented, and companies have a strong tendency to mediate differences among individuals rather than accentuate them. Strategy, on the other hand, requires hard choices. The Japanese also have a deeply ingrained service tradition that predisposes them to go to great lengths to satisfy and need a customer expresses. Companies that compete in that way end up blurring their district positioning, becoming all things to all customers.

Source: M. Porter.

Question: What key principles of strategy are singled out in the articles?

1.2. Individual development strategies

Action steps are activities that support your ability to expand your knowledge or skills. These steps are developmental, helping you to prepare for growth opportunities.

Individual Development strategies may include:

- Receiving 360 degree feedback from your manager, colleagues or customers
- Shadow a supervisor, manager or colleague in a role which you're interested
- Becoming chair or a member of a project or task – force
- Cleaning – up an internal "mess"
- Asking for coaching or a mentor relationship from a supervisor or manager
- Coordinating or managing an event or presentation
- Developing a plan to improve in your weaker areas
- Stepping up to new assignments you normally might not work on
- Planning and implementing a new program, service or system
- Cross – training with a colleague in a position or department you're interested in
- Suggesting changes based on customer needs
- Teaching others a skill or process
- Volunteering to act as resource for a campus event
- Working to bring together a process – improvement team

Source: University of the Pacific

Question: What factors are the most important for creating individual development strategy?

1.3. The basic framework for carrying out strategic analysis

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

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 1).

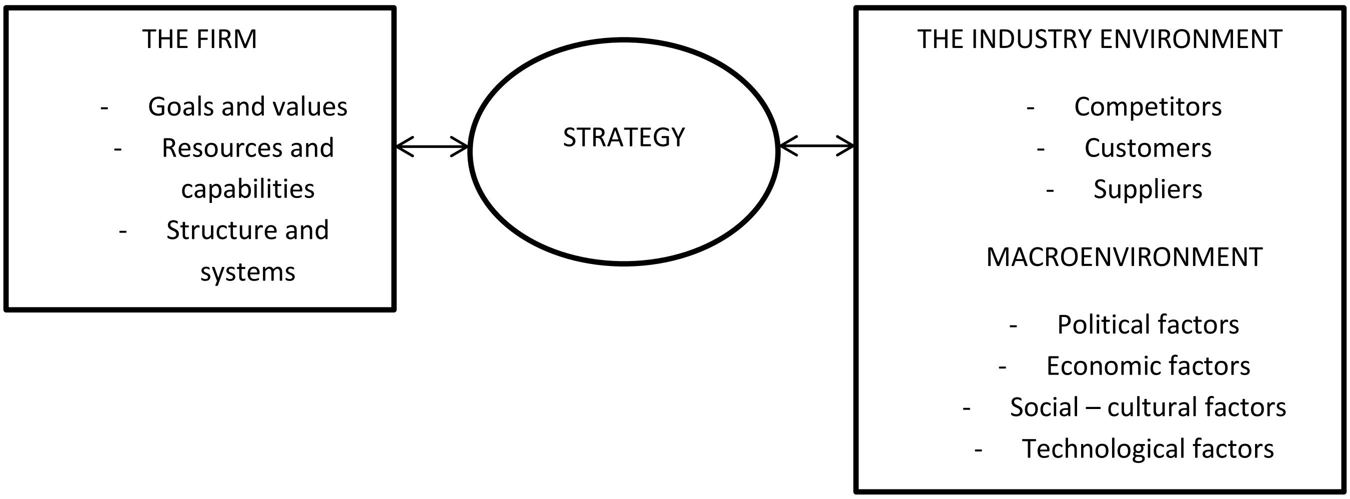

Figure 1. The basic framework for strategic analysis

Unit 2. Analysis of external and internal environment

2.1.External environment analysis

There are many factors which influence a company from external environment. These factors are necessary to analyze when making managerial decisions (Figure 2).

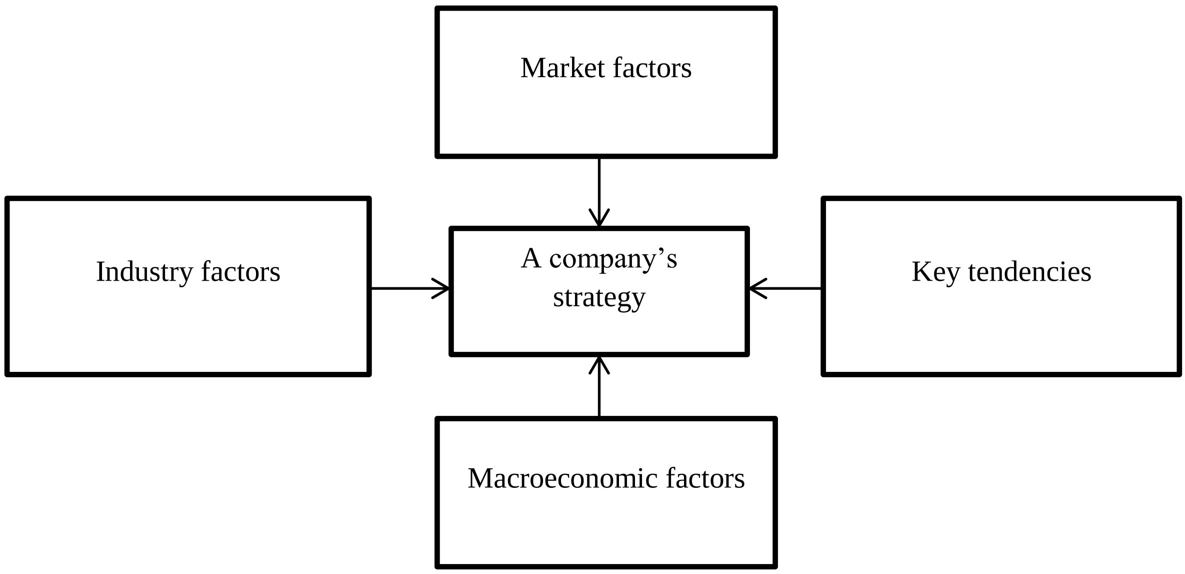

Figure 2. External factors which can influence a company's business activity

MARKET FACTORS

1. **Driving market forces** – defining the main forces, influencing a market and transforming it from the consumers and supply view point.

Key questions:

a) what driving forces do define consumer picture of a market?

b) what changes are possible in the nearest time?

c) where are the market moving?

2. Market segments – defining the main market segments, description of their attractiveness and new segments/ search.

Key questions:

a) what are the essential consumer segments?

b) where is the most growth potential?

c) what segments are loosing the value?

d) what peripheral segments do deserve attention?

3. Necessities and demand – ideas about market necessities and analysis of their satisfaction degree.

Key questions:

a) what the consumer need?

b) what requirements aren't satisfied?

c) what is really necessary for the consumer to perform the work?

d) where does demand grow?

e) where does demand fall?

4. **Switching costs** – components' description, connected with possible customers' switching to the companies – competitors.

Key questions:

a) what connects the client with the company and its offer?

b) what potential expenses do prevent from clients' switching from us to competitors?

c) how is it easy for the client to find similar offers on the market?

d) how the brand is important for the client?

5. **Profit attraction** – definition of the elements, which are meaningful for profit attraction and influences on prices.

Key questions:

a) which segments are in demand?

b) where is it possible to get superior profit?

c) can buyers easily find and acquire cheaper goods and services?

INDUSTRY FACTORS

1. **Competitors (stable companies)** – defining competitors with a strong position on the market and capabilities' assessment.

Key questions:

a) who are our competitors?

b) who dominates in our sector?

c) what are their strengths and weaknesses? Describe their main proposals.

d) what consumer segments do they mainly prefer?

e) what is their cost structure?

f) how can they influence our consumer segments, revenue flows and profit?

2. **Newbies** – new market participation' identification and defining whether they become competitors due to other business – models.

Key questions:

a) Are there newbies on the market?

b) How do they differ from other participants?

c) What competitive advantages or disadvantages do they have?

d) What they offer to the customer?

e) what customer segments do they prefer?

f) what is their cost structure?

g) to what extent can they influence our customer segments, revenue flow and profit?

3. **Substitutes: goods or services** – substitutes' description.

Key questions:

a) what goods or services can be a substitute for us?

b) is it expensive?

c) how easy is it for the customer to switch to these substitutes?

d) what traditional business – models do these substitutes use?

4. **Suppliers and other participants of value chain** – description of the main participants of value chain on the market and identifying new participants.

Key questions:

a) who are the main participants of value chain in the industry?

b) how does our business – model depend on these participants?

5. **Stakeholders** – who can influence our enterprise and business – model.

Key questions:

a) which stakeholders can influence a company's business – model?

b) what is the degree of shareholders' influence?

c) what is the degree of employees' influence?

d) what is the degree of government's influence?

KEY TENDENCIES

1. **Technological tendencies –** defining technological tendencies, which can threaten your business – model or will allow it to develop and improve.

Key questions:

a) what are the main technological trends on the market?

b) what technologies are offered (new opportunities, innovation tendencies etc.)?

c) what technologies do peripheral customers prefer?

2. **Law tendencies** – law and tendencies' description in the legislation, which can influence a company's business – model.

Key questions:

a) what legislative tendencies can influence the market?

b) what rules can influence a company's business – model?

c) what governments' measures or taxes can influence consumer demand?

3. **Socio – cultural tendencies** – description of social trends which can influence a company's business – model.

Key questions:

a) describe the main social tendencies. What changes in cultural or social values can influence a company's business – model?

b) what tendencies can influence a customer's behavior?

4. **Socio – economic tendencies** – description of the main socio – economic tendencies, which may be relevant to a company's business – model.

Key questions:

a) what are the main demographic tendencies?

b) characterize income and funds' distribution on the market.

c) Is net income high?

d) describe the scheme of customers' costs on the market (for example, on health, entertainment etc.).

e) where do population live? What is the urbanization level?

MACROECONOMIC FACTORS

1. **World market conditions –** description of general market conditions, existing on the contemporary stage of development in macroenvironment perspective.

Key questions:

a) is the economy in recession? Describe general situation on the market. What is the level of GDP (How does it change?)? What is the level of unemployment rate?

2. **Stock markets** – description of current situation on stock markets from the financial view point.

Key questions:

a) how easy is it to get money on the market segment?

b) Is there access to startup capital, venture capital, government finance, market capital, loans?

c) Is it expensive to attract capital?

3. **Raw materials and other resources** – current prices and tendencies in the field of resources, necessary for a company's business – model.

Key questions:

a) describe the current situation of raw materials' and other resources' market, necessary for a company's business (for example, oil prices or labor costs);

b) is it easy to find resources, necessary for a company's business – model?

c) what price tendencies are observed on the market?

4. **Economic infrastructure** – description of economic infrastructure of the market.

Key questions:

a) describe the level of development of the market infrastructure (government infrastructure).

b) how can you characterize transport conditions, trade, quality of education, availability of suppliers and customers?

c) are personal and corporate taxes high on the market?

г) describe the level of development of public services, necessary for entrepreneurs.

д) how can we evaluate standard of living?

Practical task: choose a market for carrying out analysis and answer all the questions, mentioned above for this industry.

Industry analysis (microenvironment analysis)

There is a variety of market structures ranging from pure monopoly to the perfectly competitive. Types of market structure is presented in Table 2.

Table 2

Market structures' types

Type of market structure	Number of firms	Barriers to entry	Nature of product
Perfect competition	Very many	None	Homogeneous
Monopoly	One	High	Unique
Monopolistic competition	Many	None	Heterogeneous
Oligopoly	Few	Often high	Homogeneous / Differentiated

Market structure can influence the behavior of firms in the industry and the nature and intensity of competition.

Market structure can also influence company performance. The intensity of competition can affect profitability. In very competitive market, profits are likely to be lower than they would be were those markets to turn into an oligopoly or a monopoly.

Michael Porter provides a useful framework for analyzing the competitive environment of an industry. His Five Forces model can be used to identify and evaluate the main threats to the firms in an industry.

The Porter's model is often used in combination with other complementary tools such as the PESTLE – model that focuses on the wider environment.

Three of the forces are concerned with competition. The first, and the most important, is industry rivalry which involves competition from rivals already established in the industry. Next, there is competition from new entrants to the industry. Third, the industry may have to confront competition from products which carry out the same function for customers but provide the service in a radically different way.

The other forces are concerned with the industry customers and suppliers.

To understand the specificity of every force it is reasonable to develop a set of questions to every force (Table 3) and analyze it from the attractiveness view point for the existing company's on the market.

Table 3

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 more questions to every force and using information in the table carry out analysis of an industry.

It is reasonable to consider each force from risk view point. In other words, it is essential to understand whether the factor is considered as a threat or an opportunity. According to this approach a company's managers should take into account the factors which threaten a company's business activity (Table 4).

Table 4

The scheme of carrying out Porter's five forces analysis

Force	Risk's description	Appearance probability
…………	……………..	………………

Stages of carrying out Porter's five forces analysis:

1. Participants' characteristic from each force, which presuppose risk for a company (suppliers' characteristic, new participants' characteristic, substitutes' characteristic, customers' characteristic, existing competitors' characteristic).

Risk description from the definite force.

2. Defining appearance probability of the risk from 1 to 10 (it is essential to pay attention to the risk situation, which will occur with the probability more than 50%).

Porter's five forces model and its critics

Porter's Five Forces model has become part of the standard toolkit for managers and industrial analysis. However, it has been criticized on several grounds. Firstly, some of its underlying assumptions have been questioned, for example, the idea that firms develop competitive advantage by strengthening their position vis – a – vis the five forces of rivalry, customers, suppliers, substitutes, and entry barriers.

Critics claim that economic conditions have changed dramatically since the appearance of the model in the 1980s when the business environment was much more certain, making it easier for firms to plan ahead. They cite three developments that have made the environment much more dynamic and uncertain for business: digitalization and, in particular, the development of the internet and e – business; globalization resulting in firms finding themselves increasingly in a global market where rivals, buyers and suppliers may decide to move production to cheaper locations; and extensive deregulation which led to a reduction in government influence over industries such as airlines, utilities in the energy, telecoms and finance sectors, and helped lead to major restructuring in these sectors. A further line of criticism holds that a firm can not be evaluated simply by reference to five forces in its external environment. These critics, supporting a Resource – Based View, argue that internal strengths and weaknesses of the firm also need to be taken into account.

Porter’s supporters, while accepting the validity of some criticism, argue that the idea that all firms operate in an environment characterized by rivals, buyers, suppliers, entry barriers and substitutes remain valid. Some attempts have been made to extend the model. The inclusion of a sixth force, complementary products, has been proposed whilst others have suggested adding government (national and regional) and pressure groups as another force.

The message for managers is that, while the model remains a useful tool, enabling them to think about the current situation of their industry in a structured, easy – to – understand way, they need to be aware of its limitations when applying it.

Sources: Coyne and Sujit Balakrishnan (1996), Downes (1997), Brandenburger and Nalebuff (1996), Porter (2008).

Measuring market concentration

There are various ways of measuring market concentration. The most straightforward method is the CONCENTRATION RATIO (CR). This is usually calculated by taking the share of the largest firms in industry sales or output by value or by volume. CR2, CR3, CR10, and so on indicate the concentration ratio for the two, three, and ten firms in the industry.

A second method of calculation market concentration is provided by the HERFINDAHL – HIRSCHMANN INDEX (HHI). The HHI is calculated by summing the squares of the individual market shares of all the firms in the market. The HHI gives proportionately greater weight to the market shares of the largest firms. It gives a more accurate picture than the concentration ratio because it includes all firms in the calculation. Sometimes, there is a lack of information about the market shares of very small firms but this may not be important because such firms do not affect the HHI significantly. For example, a market containing five firms with market shares of 40%, 20%, 15%, and 10%, respectively, has an HHI of 2,550. The HHI ranges from close to zero in a perfectly competitive market to 10,000 in the case of a pure monopoly. The EU Commission seen an HHI of more than 1,000 in a market as indicating a level of concentration that could have adverse effects on competition. The Commission is especially concerned where firms are also protected by high entry barriers and where their market position faces little threat from innovation. It feels the same way when the share of the largest firm in the market, that is CR1, exceeds 40%. Consequently, in these markets, the Commission looks for evidence of firms abusing their market power and examines closely proposed mergers between firms in these markets that would raise concentration to an even higher level. Concentration figures can also be affected by the geographical focus of the information.

There are many other indices which can be used when assessing market concentration.

Learning Task:

1. Use the information on market shares in Table 5 to work out an HHI for the European beer market. Assume that the remaining firms in the beer market only hold tiny shares and that their inclusion would not significantly distort the result.
2. On the basis of your answer, discuss whether the EU Commission would be concerned, on competition grounds, were Heineken to propose a takeover of Carlsberg.
3. How does changing the geographical focus from the world to Europe affect the picture you get of market concentration? For example, are the same companies the market leaders in both Europe and the world? How does the CR 1,2,3 in Europe compare with the world concentration ratios?

Table 5

Companies' market share

Company	% share
Heineken	20.4
Carlsberg	17
Anheuser – Busch InBev	15.6
Others	47
Total	100

Source: Datamonitor, Beer in Europe, September 2010

What this shows is that a market can appear to be quite highly concentrated at one geographical level but fragmented at another. While Anheuser – Busch InBev holds around a quarter of the world market for beer, the figure is nearer 70% in Brazil (Datamonitor, Beer Brazil, September 2010).

Articles for discussion

1. Market power – good or bad?

Firms like to have market power because it reduces competitive risk and gives them more control over price and output decision.

The traditional case against market power is that it concentrates control in the hands of one, or a few firms. Low levels of competition and high barriers to entry allow firms to raise prices above the competitive level in order to reap abnormally high profits. High prices cause customers to buy less of the product, less is produced, and society as a whole is worse off. Furthermore, facing light competitive pressures, monopolists may not press down on costs of production resulting in resources not being used to maximum efficiency. In short, prices are higher, output less, and average cost of production greater under monopoly.

On the other hand, the Austrian School argue that dominant firms gain their position through competing better in the market place whether that be through price, new or better products, more effective advertising or distribution channels, or lower costs due to economies of scale. And higher prices, rather than indicating abuse of market power, simply reflect the value that consumers place on the goods and services provided.

Schumpeter and Galbraith assert that firms need to be large, have a significant market share, and be protected by barriers to entry to induce them to invest in the risky R&D that society needs to advance technologically.

Source: George J. Stigler, Monopoly, The Concise Encyclopedia of Economics, available at www.econlib.org; Leibenstein (1978); D.T. Armentanto, A Critique of Neoclassical and Austrian Monopoly Theory, available at http://mises.org; Schumpeter (1976); Galbraith (1967).

2. Market Concentration in the Energy Market

3. Apple

4. The Car Industry – The Struggle for New Geographical Markets

5. International joint ventures – cooperation not competition

6. Pharmaceuticals and the Threat from Substitutes

Case Study

Global Advertising

Questions:

1. How concentrated is the global advertising industry? Does the global level of market concentration reflect the situation in national markets?
2. Industry rivalry can take various forms. Explain what these different forms are and indicate which you would expect to be important in this industry.
3. Assess the bargaining power of buyers in the industry. How has this changed with the development of new communication technology?
4. With reference to the barriers to entry to this market, discuss the likelihood of new entry.
5. Why are India and China so attractive to the big advertising agencies? Why might merger and acquisition be an attractive way for big firms like Omnicon and Publics to enter the Indian and Chinese markets?

Practical tasks:

Choose an Industry for analysis and answer the following questions:

- Are there many firms or only few?
- Are firms a similar size?
- Is the market growing or declining?
- Is product differentiation important?
- How high are fixed costs as a % of total costs?
- Do additions to production capacity increase total industry capacity significantly?
- Are there any significant barriers to entry?
- Is there significant excess capacity in the industry?
- Do existing firms have the power to prevent entry?
- Is there any significant competition from substitutes?
- Is there a large number of small buyers/suppliers or a few large buyers/suppliers?
- Does the product constitute a large proportion of customer costs?
- Do input purchases constitute a large proportion of supplier revenues?
- Do customers/suppliers have the ability to take over firms in the industry?
- Are firms in the industry dependent on complementary products?

Macroenvironment analysis

Macroenvironment is changing radically and becoming much less predictable due to:

- The accelerating rate of globalization
- The information technology revolution
- The increasing economic and political weight of countries such as China, India and Russi
- International institutions like the WTO and the EU is becoming increasingly important influences on the global environment, as have NGOs with their vocal opposition to free trade and investment, and their success in getting environmental issues, such as climate change onto the political agenda of national governments and international agencies.

Articles for discussion

1. **Complexity and Turbulence – China is Changing the World**
2. **Global Threats – Cybercrime**

Constant monitoring of all external issues can be done by PESTLE model. PESTLE is an acronym for the Political, Economic/financial, Social, Technological, Legal and Ecological factors.

It is often used to identify opportunities and threats, which can be combined with an analysis of a firm's strengths and weaknesses, to produce a SWOT model.

1. Political and legal environment

The political and legal environment is made up of the various political and legal systems under which business operates. We treat these together here because political institutions, such as governments and parliaments, pass laws and establish regulations which shape the legal environment within which business operates. The courts, the police and prisons ensure that the laws are enforced and lawbreakers are punished. Political regimes range from the liberal democratic systems of North America and Europe, to the Communist regimes of China and Vietnam, to military dictatorship in Burma.

Some industries, like oil, need to pay particular attention to their political environment because they operate in a very politically sensitive sector – energy.

Methods of Influencing the State:

- Lobbying
- State consultation with business
- Promises of threats
- Direct Access to government ministers and civil servants
- Employment and exchange of personnel
- Giving Money or Gifts

Articles for discussion:

1. **Political Turbulence and the Cocoa Industry**
2. **Lobbying – the Banks and Basel III**
3. **Dispute at the World Trade Organization**
4. **How big a role for law?**

Neoliberals argue that the law should play a minimalist role in society. It should act as the guarantor of private property. Property in this sense refers to assets such as land, housing, company shares, works of art, intellectual property, and so on. The law should protect the rights to property, in other words, the right to own, sell, lend, give away, or bequeath assets and should enforce contractual agreements. Friedman (2002), referring to the privatization programme in Russia said:

Privatization is meaningless if you don't have the rule of law. What does it mean to privatize if you do not have security of property, if you can't use your property as you want to?

Neoliberals argue that this is vital for the operation of the market by, for example, reducing the costs of transactions between buyers and sellers. These views draw heavily on the ideas of Hayek, Von Mises, Schumpeter and Friedman.

Critics of the neoliberal position argue that the law has got to do much more than guarantee private property. According to this school of thought, markets can lead to undesirable outcomes which domestic and international law should try to prevent, for example, the behavior of financial institutions that led to the global financial crisis, the creation of monopolies, or damage to the environment. Ownership of an asset should not give the right to do as one pleases. The law should stop the owner of a coal – fired power station from polluting the air. Furthermore, the law needs to respond to major disparities in income and wealth and gender inequalities and to ensure the human right to health and education.

Sources: Glinavos 2008; Friedman 2002; Stiglitz 2010; Patel 2009

Learning Task 1:

Examine the table below which shows the average level of tariff protection afforded by the authorities in Lesser Developed Countries (LDCs) and Developed Economies.

1. Compare and contrast the level of protection given by governments to their domestic producers in developing/emerging economies and developed/rich economies.
2. Discuss the protection given to farmers by:

a) Developing countries. Advance reasons for this.

b) Japan heavily protects its rice farmers. Why should that be the case?

3. A more detailed breakdown of tariff protection shows that Vietnam provides a very high level of protection to its processed food sector. What are the implications of that level of protection for domestic producers of processed food products in Vietnam and for foreign food processors wishing to enter the Vietnamese market?

Table 6

Country	Average tariffs on imports 2009		
	Total	Agriculture	Non – Agriculture
China	9.6	15.6	8.7
Colombia	12.5	16.8	11.8

Japan	4.9	21	2.5
Nigeria	11.2	15.5	10.5
USA	3.5	4.7	3.3
Vietnam	10.9	18.9	9.7

Learning Task 2:

Read the Article " Lobbying – The Banks and Basel III". Explain the powerful influence of the banking industry on regulatory agencies. Assess whether the success of the banks in watering down regulations is good for the financial stability of the global economy.

Learning Task 3:

This task lets to review understanding of the different branches of the state. Allocate the following people to the appropriate branch of the state (Table 7).

Table 7

	Legislative	Executive	Judical
Prime Minister of China The Cabinet Secretary (UK) President of the EU Commission The chief of police Vice President of Microsoft Supreme Court judge in the USA Governor of the Punjab Commander of the armed forces The Queen of Britain			

Case Study 1:

Shell in Nigeria

Questions:

1. Describe the political and social environment in Nigeria.
2. Analyze the Nigerian environment in terms of opportunities and threats for foreign energy firms like Shell.
3. Why might a company like Shell be interested in finding out what was being done in government ministers in Nigeria?
4. What are the implications of Shell's infiltration of the Nigerian government for rivals in the oil and gas industry?
5. How would you explain the links between Shell and the US embassy in Nigeria?

Case Study 2:

Trafigura and the Ivory Coast

Questions:

1. Which system of law would Trafigura have faced in the Dutch courts? What would be the major differences had the case been heard in English courts?
2. Discuss the arguments for and against the company paying compensation to those needing medical treatment and to the Ivorian government while continuing to deny that the waste caused any medical harm.
3. What legal mechanisms did the company use to protect its position? In the light of globalization, assess the success of these mechanisms for Trafigura.
4. The legal system ib the Ivory Coast is based on the French civil law model and on customary law. There is political and social instability and the president is seen by some commentators as a despot. What issues do these raise for Trafigura dealing with political and legal authorities in the Ivory Coast?

2. Economic and Financial Environment

The economic and financial environment comprises forces that affect large areas of the economy like the rate of economic growth, interest rates, exchange rates and inflation and the policies of domestic and international institutions that influence these economic variables.

Articles for discussion:

1. Is China's growth sustainable?

Not everybody believes that China's growth will continue at the rate estimated by the IMF. There are those who think the rate could be halved to a very modest, at least by Chinese standards, 5%. Some of the problems very familiar to Western economies are beginning to appear in the Chinese economy, especially inflation, which in November 2010 reached 5.1%. Chinese growth has been export and investment lead and it is argued that this is no longer sustainable. Global demand is slowing and internal policies aimed at promoting growth may well lead to further inflationary pressures with easier money going into speculative rather than productive investment. Indeed much of the investment has been in property which has led to another feature familiar to westerners, a property boom. An average size apartment in Beijing can cost US$450,000 way out of the reach of the average Chinese worker. Many of the benefits of Chinese growth have accrued to a small minority with the result that income inequality has risen and with it increased social tensions.

So some argue it is now time to slow growth and restructure the economy by boosting domestic consumption and productive investment and address some of the problems of income inequality, a lack of public services and pollution.

Sources: Financial Times, 17 November 2010, 23 December 2010

2. Globalization: the free market

3. The US Dollar Exchange Rate

Practical Task: **Describe barriers to Globalization (Government regulation, cultural and geographical distance).**

Learning Task:

In 2009, EADS, a Eurozone aerospace company and the parent of Airbus, reported ongoing concerns about the weakness of the US dollar against the euro. Aircraft, internationally, are priced in dollars so Airbus was finding it increasingly difficult to compete with its major rival, the US firm, Boeing. The problem had been a long – standing one because the dollar had fallen by 30% in value against the euro between 2000 and 2009. In 2006, the company estimated that it needed to cut costs by $3 billion annually to offset the losses caused by the decline in the dollar. By the following year, the euro had risen another 20 cents which meant that Airbus had to find a further $3 billion of savings. The company, fearful of being driven out of business, responded by cutting costs, increasing the quantity of suppliers bought in the USA, looking to expand in the United States, and trying to sell off European factories. It had also taken out insurance policies, the technical name for this being hedging, to protect itself against unfavorable movements in the dollar. The costs of the policies had been rising and the company expected an adverse effect of these on its 2010 results to the tune of 1 billion euro.

1. Explain how the weakness of the dollar makes it more difficult for Airbus to compete with Boeing.
2. Analyze how the responses by Airbus would help it compete more effectively with Boeing.
3. Go to the exchange rate section of the Federal Reserve website to find out how the value of the dollar has changed against the euro since 2009. Do the changes make life easier or harder for Airbus?

Sources: www. BusinessWeek.com, 17 January, 16 November and 20 December 2007; EADS Annual review 2009.

Case study 1:

Lehman Goes Bankrupt

Questions:

1. Advance reasons for Lehman going Bankrupt.
2. Why is confidence so important in financial markets? Illustrate by reference to the Lehman case.
3. How would you assess the role played by:

- The ratings agencies;
- Lehman's auditors
- The regulatory authorities.

4. Analyze the spillover effects of the Lehman collapse to other financial institutions and other countries.

Case study 2:

Two Turkeys Do Not Make an Eagle – Or Do They?

Questions:

1. Given that the alliance between Microsoft and Nokia is cross – border, what potential problems might be encountered?
2. Why is the smartphone important for:

- Mobile handset producers
- Software producers
- PC manufacturers.

3. Analyze the role played by competition in the tie – up of Nokia and Microsoft.
4. Outline the benefits and disadvantages of the tie – up between Nokia and Microsoft to each company.
5. Discuss the implications of the partnership for rivals such as Apple and Google.

Case study 3:

Brazil

Questions:

1. What factors might account for the rise of the Brazilian economy?
2. Explain how the growth of the middle class can help and hinder the Brazilian economy.
3. Explain what is meant by a currency war and why it is in nobody's interest.
4. How does the appreciation of the Real threaten the growth prospects of the Brazilian economy?

Case study 4:

AXA and the Global Business Environment

Questions:

1. In April 2010 AXA moved from a dual board structure of governance (with a Management Board and Supervisory Board) to a single board structure with a Board of Directors. Explain what this means, why they have decided to change, and how it will help AXA to deal with the external environment.
2. How would the sub – prime crisis of 2008 affect AXA?
3. Explain how an ageing population, such as that of Japan and several European countries, would be beneficial to AXA.
4. Identify and prioritize AXA's stakeholders as at 2010. Justify your decisions.

3.Socio – cultural environment

The socio – cultural environment is concerned with the social organization and structure of society. This includes many social and cultural characteristics which can vary significantly from one society to another. Social aspects include the distribution of income and wealth, the structures of employment and unemployment, living and working conditions, health, education, population characteristics including size and breakdown by age, gender and ethnic group, social class, the degree of urbanization and the provision of welfare for the population in the form of education, health care, unemployment benefits, pensions and so on. The cultural components cover areas like language, religion, diet, values and norms, attitudes, beliefs and practices, social relationships, how people interact and lifestyles.

National cultures can vary significantly from one country to another and the differences can be reflected by employees in the workplace and by consumers in the market.

In Hofstede's research, it is identified five dimensions of culture:

- Individualism: reflects the degree to which people in a country act as individuals rather than as members of a group. Individualistic cultures value the rights of the individual over those of the group. By contrast, cultures low in individualism and high in collectivism emphasize the interests of the group rather than the individual. The USA, The Netherlands, France and Germany are highly individualistic while countries in Asia, Africa and Latin America score low on this dimension.
- Uncertainty avoidance: refers to the extent to which people prefer structured to unstructured situations. Societies tolerant of ambiguity, the unknown and the unfamiliar score highly on this dimension. They operate with fewer rules and do not attempt to

control all events or outcomes. Cultures with an aversion to uncertainty try to cling to rules and seek ways to control their environment. Latin America, Africa, France, Germany and Japan have low tolerance levels of uncertainty in contrast to China and the UK. The USA lies somewhere in the middle.

- Masculinity: reflects the degree to which masculine values such as competition, assertiveness, a clear role distinction between men and women, money, income, job promotions, and status over feminine values like cooperation, quality of life and human relationships. The USA, Japan and certain South American countries, like Venezuela score highly on masculinity while Nordic countries and Africa score low.
- Power distance: shows the degree of inequality accepted as normal in a society. High power distance cultures accept, and are marked by significant levels of inequality and hierarchy such as the differences in social class. Low power distance societies value equality and egalitarianism. In Latin America, Thailand and Arab countries hierarchies are very important and power is distributed very unequally. Less powerful members of organizations, those on the lower rungs of the hierarchy, expect and accept the unequal distribution of power. In the USA and Nordic countries there is low acceptance of differences in power and a greater desire for equality.
- Long term/short term: long – term cultures make decisions based on long – term thinking and value perseverance and thrifty behavior such as saving for the future. Brazil, India and China have a long – term orientation. At the other extreme, the USA, Britain, Spain, Nigeria and Pakistan focus on the short term while most European countries lie somewhere in the middle.

Cultural characteristics have important implications for international business.

Articles for discussion:

1. **Hofstede and his critics**
2. **Homogenization of management?**
3. **Proctor and Gamble Unilever and Sustainability**
4. **Cultural Distance – Domino's Pizza**

Practical Task:

Read the article "Culture and Purchasing" and using Hofstede's model carry out the same analysis.

Culture and Purchasing

Hewett (2006) used Hofstede's model to investigate the impact of culture on the behavior of industrial purchasing managers in Latin America and in the USA. The research results were similar to those found by Hofstede in his research.

Hewett found that the uncertainty avoidance dimension was a major influence on buyer behavior. Her research showed that Latin America buyers tended to be loyal to suppliers even when there had been problems with the supplier's performance. US buyers were more likely switch to get a better price or quality or as a result of supply problems. She concludes that, in cultures with low uncertainty avoidance such as the USA, sellers may have to work harder to ensure repeat business because buyers in such cultures will see a decision to switch suppliers as low risk. On the other hand, in cultures with an aversion to uncertainty like Latin America, where customers are loyal to existing suppliers, sellers would be well advised to focus on retaining customers rather than trying to win new customers.

Source: Hewett 2006

Learning Task:

Some goods and services are more sensitive than others to cultural differences (Table 8). Ghemawat did some research on the impact of culture and found the following:

Table 8

More sensitive products	Less sensitive products
Meat	Cameras
Cereals	Road vehicles
Tobacco	Cork and wood
Office machines	Electricity

Discuss and advance explanations for Ghemawat's findings.

Case Study:

Culture and a Failed Joint Venture

Questions:

1. Explain the various cultural dimensions applied by Elenkov and Fileva:

- Universalism/Particularism
- Specific/Diffuse
- Achievement/Ascription

2. Compare and contrast the similarities and differences between the models of Tromprnaats and Hofstede.
3. Discuss how cultural differences caused problems in the Rover joint venture.
4. Trompenaars identifies the USA, Canada, Australia and Switzerland as having a universalist culture. What issues might companies from these countries encounter when considering setting up operations in a particular culture?
5. Trompenaars identifies China and Venezuela as espousing ascription norms and values. What issues might companies from these countries encounter when considering setting up operations in an achievement culture?

Case study 2:

The Bangladesh Garment Industry

Questions:

1. Do western companies have any responsibility for the conditions in Bangladeshi garment factories? Explain your answer.
2. How can western companies improve working conditions in these factories?
3. Do western consumers share any responsibility? Is there anything they can do or should governments intervene?

4. Technological Environment

In simple terms, technology refers to know – how or the pool of ideas or knowledge available to society. Business is particularly interested in advances in knowledge that it can exploit commercially. Technology offers business the prospect of:

- Turning new ideas into new or improved products or production techniques;
- Entering new markets;
- Boosting revenues;
- Cutting costs;
- Increasing profits.

Technology involves much uncertainty. Firms can pump lots of resources into research and development, be at the cutting edge of technology with new products that technically excel those of their competitors, but that does not guarantee success. Big pharmaceutical companies have increased their spending on research and development significantly but have found that the number of new drugs being generated has fallen. As a result, they have had to rely on old drugs for their revenues, look for ways of cutting costs, and going for mergers

(PricewaterhouseCoopers 2007). These technology uncertainties make it more difficult for business to carry out long – range planning.

An article for discussion

1. The Internet – how revolutionary?

Some commentators argue that the internet is an earth – shaking innovation compared with previous examples of technological advance, such as railways or telephone networks. None can match the impact of the internet and the speed of its penetration in society. It has led to the emergence of new industries, business models, organizational structures and new companies such as Amazon, Google, Apple, eBay, YouTube, Wikipedia, Skype and Vodafone and has revolutionized interaction through social networks like Facebook and Bebo. Internet companies have put intense competitive pressure on firms operating in sectors like book and music retailing, telecommunications. Civil aviation and holiday travel.

Sceptics like Samuelson (2000) contend that the internet did not spread faster than other innovations, that it is a work in progress and that many other innovations have outstripped it in terms of impact, for example, indoor plumbing and electricity. Critics also claim that the internet has not had much impact on productivity. Chang (2010) maintains that it has not been as important as domestic appliances that have cut the amount of time taken for housework, allowed women to enter the labor market and abolished domestic service as an occupation.

Sources: Samuelson, R. J., Newsweek, 24 January 2000; Hof, R.D., "A New Era of Bright Hopes and Terrible Fears", Businessweek, 4 October 1999; Chang 2010

Research shows that the rate of innovation varies from sector to sector, industry to industry, by size of firm, and by geographical location.

In terms of firm size, the larger the firm, the more likely it is to be an innovator even in low tech industries. Historically manufacturing firms have carried out most R&D.

Technical advance is driven by a complex combination of factors in the firm's external environment: the intensity of competition, relationships with customers and suppliers and government policies.

Technology opens up all sorts of domestic and foreign opportunities for businesses who are ready to take advantage of them. On the other hand, it can also pose many threats to firms who are unaware of, and unprepared for, technical change.

Learning Task:

This task requires you to examine links between R&D expenditure and company performance.

Improved performance arising from technology can enhance a company's share performance. The R&D Scoreboard suggests that share prices (and sales growth) in companies with the highest R&D intensity perform better than the average. The Table 9 taken from the 2010 Scoreboard shows R&D expenditure as a % of sales revenue.

Table 9

R&D expenditures in different corporations

Corporation	R&D expenditures
GlaxoSmithKline	12.8%
AstraZeneca	13.5%
BT	4.9%
Unilever	2.2%
Royal Dutch Shell	0.4%
Royal Bank of Scotland	1.4%
HSBC	1%
Rolls Royce	4.5%
Airbus	14.7%
BP	0.2%

1. Choose a high spending and a low spending company from the table. Construct a graph of changes in their share prices over the last five years.
2. Comment on the relative share performance of the two companies. Identify a range of technological and other factors that could have influenced their share price.

Case study:

Web 2.0

Questions:

1. What is Web 2.0?
2. Analyze the opportunities opened up by market Web 2.0 technologies for firms:

- Carrying out market research
- Promoting their products.

3. What are the potential pitfalls for firms wishing to use Web 2.0 technologies. How could business try to avoid such pitfalls?

4. What do you think McKinsey means by cocreation? Explore the possible implications of this for business wishing to protect its intellectual property rights.
5. Discuss the implications for business of the greater use of blogs in the emerging markets of China and South Korea.

Articles for discussion (self – readings):

1. **New Technology**
2. **Samsung**
3. **Nanotechnology**
4. **China and the Internet**

5. The Ecological Environment

In recent decades there has been increasing concern, both nationally and globally, about the interaction between human beings, the economic systems they establish, and the earth's natural environment.

Environmental challenges are a global phenomenon. Global warming is not confined within national borders but affects the while world.

There is growing pressure on the political authorities to respond to these ecological threats. There are a number of possible policy responses, all of which have implications for business:

- Tax the polluter;
- Subsidize firms who manage to reduce activities that harm the environment, for example, by switching to non – polluting sources of energy;
- Use regulations to control the amount of pollution generated by business;
- Promote the creation of environmentally friendly technologies.

An article for discussion

ExxonMobil versus the Environmentalists

PESTLE analysis

PESTLE - analysis is recommended to carry out in the following way (Table 10).

Таблица 10

The scheme of carrying out PESTLE - analysis

Factor	Factor's characteristic	Appearance probability (>50%) From 1 to 10	Influence (positive +/ negative -)
…………… ………..		……………………………….	……………………………

Risk assessment

When doing business in a definite country it is essential to evaluate a country's risk.

Country risk refers to the possibility of the business climate changing in such a way as to negatively affect the way in which business operates. Sources of risk include:

- Change in political leadership;
- Radical change in philosophy of political leadership;
- Civil unrest between ethnic groups, races and religions;
- Corrupt political leadership;
- Weak political leadership;
- Reliability of the infrastructure;
- Supply chain disruption;
- Economic risks such as the volatility of the economy and foreign exchange problems;
- Organized crime;
- Poor relationships with other countries;
- Wars;
- Terrorism;
- Piracy.

Many commercial organizations provide assessment of a country's risk. The EIU, for example, assesses countries for a variety of risks. Country ratings are based on ten categories of risk:

- Security;
- Political stability;
- Government effectiveness;
- Legal and regulatory;
- Macroeconomic;
- Foreign trade and payments;

- Financial;
- Tax policy;
- Labor market;
- Infrastructure.

The World Economic Forum also produces a global risks report which identifies 37 major risks. The main risks are:

- The global macroeconomic imbalances, currency volatility, fiscal crises and asset price collapse;
- The illegal economy: state fragility, illicit trade, organized crime and corruption;
- The “water – food – energy” nexus: shortages could lead to political instability.

Practical Task:

Using different sources compare the risk of doing business in China, Australia, Italy, Russia etc.

Evaluation of the effectiveness of managing risk situation on the market can be organized in the following way:

1. Risk situation is identified
2. Risk situation is described
3. Appearance probability of risk situation is defined (up to 100%)
4. Risk situations with appearance probability more than 50% are singled out
5. Weights of risk situations are outlined
6. A company’s opportunities of risk situation management are assessed (use the scale from 1 to 5)
    - 0.0. - it is impossible to manage risk situation
    - 1.0. - it is observed weak ability to manage risk situation
    - 2.0. - a company’s ability to manage risk situation is below the average
    - 3.0. - average ability to manage risk situation
    - 4.0. - a company’s ability to manage risk situation is above the average
    - 5.0. – high ability to manage risk situation.
7. Windowed estimate is defined (multiplying value of the column 5 by the column 6 in the table)
8. Total windowed estimate is calculated and conclusions about a company’s opportunities to manage risk situations are made up.

Table 11

The scheme of carrying out risk analysis

Possible risk situation	Risk situation description	Appearance possibility of risk situation (p)	Choice of risk factors among all of them (p>50%)	Weight of risk situation (w)	Windowed estimate of risk situation (W)

Risk factors can be defined on the stage of Porter's five forces analysis, PESTLE – analysis and analysis of a company's internal environment.

An article for discussion

1. Starbucks in India

Questions:

1. India's urban population is estimated to grow by 230 million in the next 20 years. Analyze the consequences of this growth for the Indian economy.
2. Explain the attraction of the Indian economy as an investment location.
3. Investigate how easy it would be for a Western company to establish a new business in India.
4. Starbucks has chosen to enter the Indian economy with a domestic partner. Explain why this might be a more attractive proposition than direct investment.
5. What risks will Starbucks face in entering the Indian economy?

Review Questions and Tasks

- What is globalization?
- How fast is globalization occurring?
- Where is globalization mainly taking place? Why should that be the case?
- Identify the main:
- Indicators of globalization
- Drivers of globalization
- Facilitators of globalization
- What are the important barriers to globalization? Explain why operating in the international business environment is much more complex than in the firm's domestic business environment.
- What implications does your answer to question 1 have for planning a firm's strategy?

- Select an enterprise of your choice operating internationally. Select one issue from each of the PESTLE sectors and analyze the impact on a company (consider the industry environment and stakeholders).
- What does the following concepts mean:

- Technological advance
- Applied research
- Innovation
- Technological diffusion
- Intellectual property.
- Discuss how multinational companies could contribute to the international diffusion of technology. Illustrate your answer with examples.
- Explain why innovation is important for big firms in the consumer electronics/pharmaceutical industry.
- What is state? Why is it important for the pharmaceutical industry? Explain with examples.
- Why do business prefer to operate in countries that are politically stable? Discuss how businesses might feel about producing in countries where there is political stability but also a dictatorship.
- To what extent do you agree that globalization has undermined the power of the nation state? Give evidence to support your arguments.
- Find an example of a firm or industry that has tried to influence government policy. Identify the methods used and try to evaluate how effective they have been.
- Why is the legal environment important for business?
- Explain why knowledge of different legal systems would be useful for firms involved in international trade and investment. Discuss why the level of interest rates and inflation are important for international business.
- Explain, using examples, what is meant by cultural relativism.
- You are working for a large multinational drinks company wanting to set up a bottling plant overseas. In order to obtain planning permission you need to make a facilitation payment (bribe) to a local politician but your company has a strict no bribes policy. The building of the plant will be subcontracted to a domestic construction company and one way round this would be to inflate the payment to this company so that they could make the facilitation payment. What would you do? Justify your decision.

- Why is the range of measures that businesses themselves can make in response to ecological problems?
- How can government ensure businesses adhere to their ecological ewsponsibilities?

2.2. Internal environment analysis

Classification of a firm's resources

Internal environment analysis presupposes evaluation of a company's potential resources and capabilities.

A company's resources are divided into three groups:

1. Tangible resources
2. Intangible resources
3. Human resources

Capabilities' classification

A functional classification of a company's capabilities are presented in Table 12.

Table 12

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

The scheme of carrying out internal environment analysis is showed in Table 13.

The following aspects of internal environment are evaluated:

- Marketing
- Product
- Distribution
- Finance
- Technologies
- Buildings and equipment, materials
- Personnel and management effectiveness
- A company's structure

Table 13

The scheme of carrying out a company's internal environment

Factor	Characteristic	Estimation
---------	--------	--------

When carrying out a company's internal environment analysis it is recommended to use the scale from 1 to 10.

SWOT – analysis is the final stage of carrying out factor analysis. It is necessary to include in SWOT – model the factors which were considered on the previous stages (on the stage of Porter's five forces analysis, PESTLE – analysis and internal environment analysis).

SWOT – analysis is recommended to carry out in the following way (Table 14):

Table 14

The scheme of carrying out SWOT - analysis

Factor	Weight	Estimation	Integral variable
Strengths ……… ……… ……… ……… Total	 ……. …… …… …… 100%	 ………. ……… ……… ………	 Weight * Estimation Weight * Estimation Weight * Estimation Weight * Estimation Total
Weaknesses ……… ………. Total	 …….. ……. 100%		 Weight * Estimation Weight * Estimation Total
Opportunities ………. ………. Total	 ……… ……… 100%		 Weight * Estimation Weight * Estimation Total

Threats ………. ……… Total	 ………. ………. 100%		 Weight * Estimation Weight * Estimation Total

After calculation of integral values, strengths and opportunities are summed up and weaknesses and threats are summed up. So, after carrying out this analysis it will be possible to evaluate a company's position on the market.

2.3. Types of competitive advantage: Cost and differentiation

Cost Advantage

There are seven principal determinants of a firm's unit costs (cost per unit of output) relative to its competitors (Cost drivers) (Figure 3).

The relative importance of these different cost drivers varies across industries, across firms within an industry and across the different activities within a firm. By examining each of these different cost drivers in relation to a particular firm we can do the following:

- Analyze a firm's cost position relative to its competitors and diagnose the sources of inefficiency,
- Make recommendations as to how a firm can improve its cost drivers

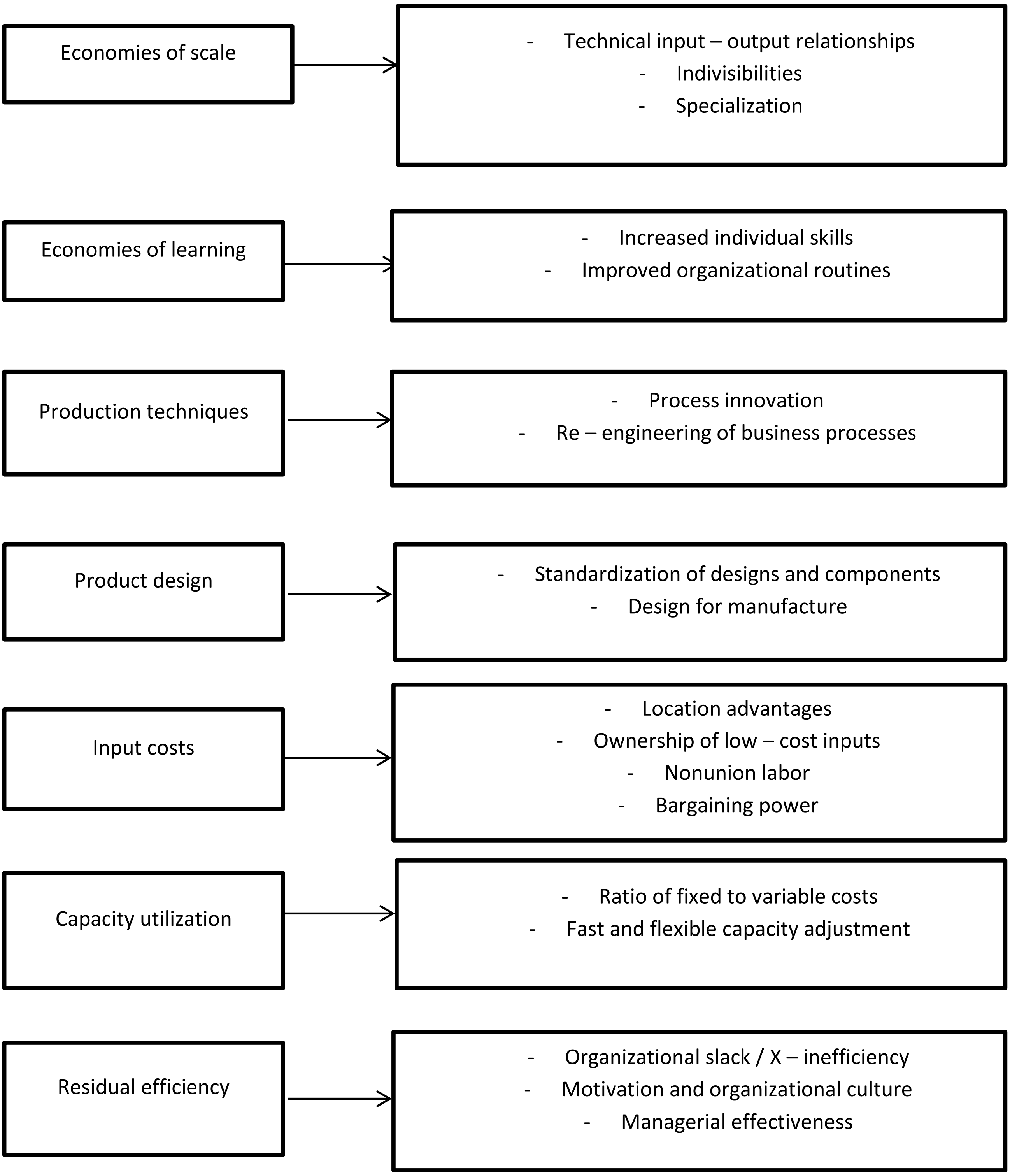

Figure 3. The drivers of cost advantage

Differentiation Advantage

The potential for differentiating a product or service is partly determined by its physical characteristics.

In analyzing differentiation opportunities, we can distinguish tangible and intangible dimensions of differentiation. Tangible differentiation is concerned with the observable characteristics of a product or service that are relevant to customers' preferences and choice process. These include size, shape, color, weight, design, material and technology. Tangible differentiation also includes the performance of the product or service in terms of reliability, consistency, taste, speed, durability and safety.

Opportunities for intangible differentiation arise because the value that customers perceive in a product or service does not depend exclusively on the tangible aspects of the offering. There are few products where customer choice is determined solely by observable product features or objective performance criteria. Social, emotional, psychological and esthetic considerations are present in choices over all products and services. The desires for status, exclusivity, individuality and security are powerful motivational forces in choices relating to most customer goods. Where a product or service is meeting complex customer needs, differentiation choices involve the overall image of the firm and its offering. Image differentiation is especially important for those products and services whose qualities and performance are difficult to ascertain at the time of purchase ("experience goods"). These include cosmetics, medical services and education.

The demand side of differentiation (Differentiation analysis from the demand view point)

Successful differentiation involves matching customers' demand for differentiation with the firm's capacity to supply differentiation. Analyzing customer demand enables us to determine which product characteristics have the potential to create value for customers, customers' willingness to pay for differentiation and a company's optimal competitive positioning in terms of differentiation variables.

Analyzing demand begins with understanding why customers buy a product or service (Figure 4).

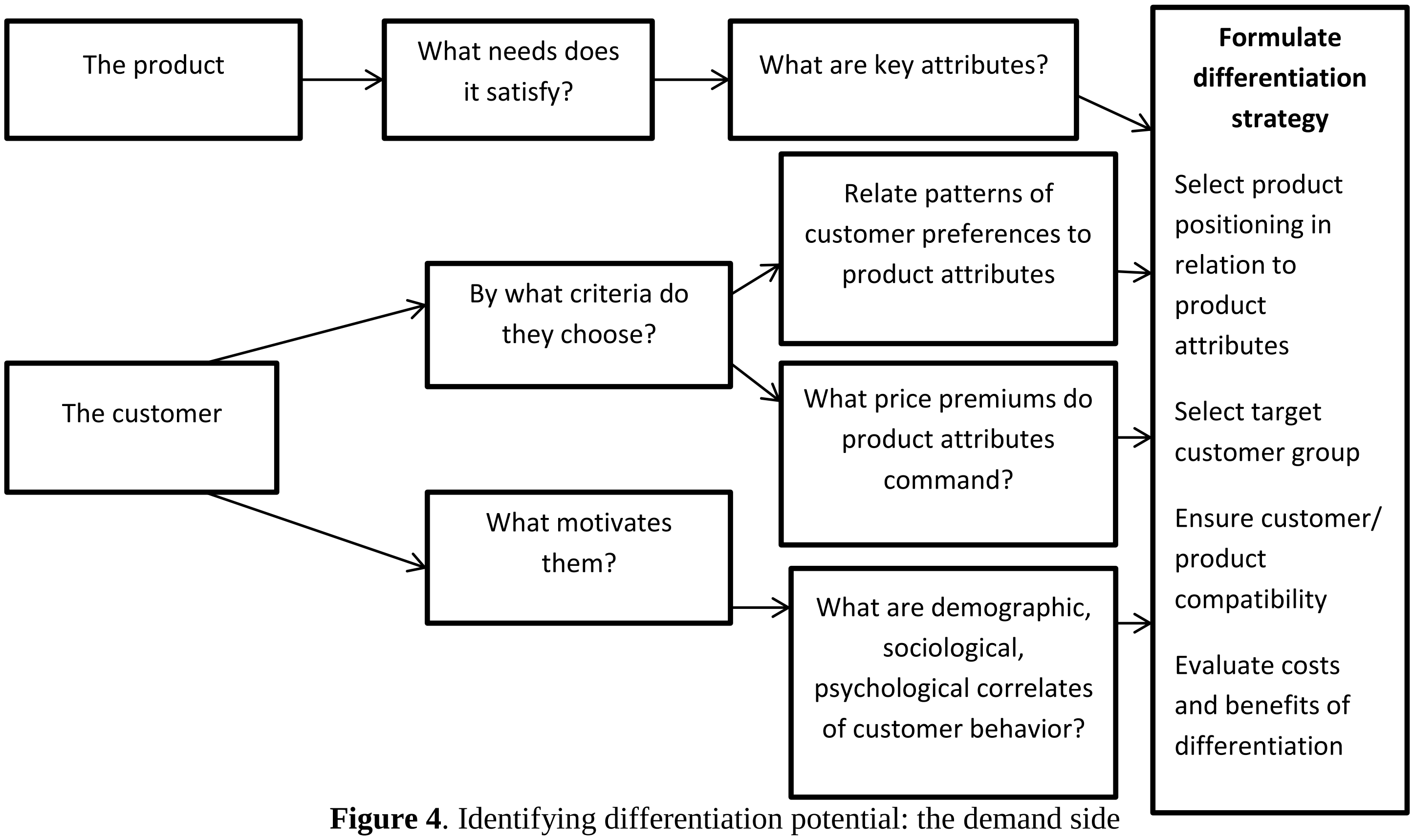

Figure 4. Identifying differentiation potential: the demand side

The supply side of differentiation (Differentiation analysis from the supply view point)

Creating differentiation advantage depends on a firm's ability to offer differentiation. To identify the firm's potential to supply differentiation, we need to examine the activities that the firm performs and the resources it has access to.

The drivers of uniqueness.

Differentiation is concerned with the provision of uniqueness. A firm's opportunities for creating uniqueness in its offerings to customers are not located within a particular function or activity, but can arise in virtually everything that it does.

Michael Porter identifies a number of drivers of uniqueness that are decision variables for the firm:

1. Product features and product performance
2. Complementary services (such as credit, delivery, repair)
3. Intensity of marketing activities (such as rate of advertising spending)
4. Technology embodied in design and manufacture
5. The quality of purchased inputs
6. Procedures influencing the conduct of each of the activities (for example, rigor of quality control, service procedures, frequency of sales visits to a customer)
7. The skills and experience of employees
8. Location (for example, with retail stores)

9. The degree of vertical integration (which influences a firm's ability to control inputs and intermediate processes).

Product integrity

Signaling and reputation (differentiation is only effective if it is communicated to customers).

Brands (Brand names and the advertising that supports them are especially important as signals of quality and consistency – because a brand is a valuable asset, it acts as a disincentive to provide poor quality. For many consumer goods (and some producer goods) companies, their brand is their most important asset.

The costs of differentiation (Differentiation adds cost).

Value chain analysis of producer goods

Using the value chain to identify opportunities for differentiation advantage involves four principle stages:

1. Construct a value chain for the firm and the customer
2. Identify the drivers of uniqueness in each activity
3. Select the most promising differentiation variables for the firm
4. Locate linkages between the value chain of the firm and that of the buyer.

Practical task: Using the main schemes carry out analysis of competitive advantages of any company.

Unit 3. Analysis of a company's competitive position on the external markets

There are many factors which influence a company's position on an external market. It is essential to take all influential factors into account. To obtain detailed information about external environment and a company's internal opportunities, about the degree of correspondence of a company's internal potential to external conditions it is reasonable to divide all the factors into two groups. The first one is the factors which influence a company's activity from the demand view point. The second one is the factors influence from the supply view point. The competitive position of a company on the external market will be defined by the ability to correspond to the factors of demand and supply.

Practical task: Using the scheme of analysis of a company's position on the external markets, carry out analysis of three companies, functioning on the external markets (choose three companies within one industry).

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