

# Conquering New Markets Through Military Strategy

How the LEGO Company  
Will Conquer the Middle Kingdom



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## 0. Executive Summary

It is said that in war, one must consider three things: the situation, the opponent and the terrain. For centuries then, generals have incorporated thorough analysis of the battle space with swift actions during the fog of war (Clausewitz, 1993). This paper thus seeks to discover how military strategic paradigms can be used to formulate a new eclectic framework that informs strategy formulation in international business.

This is done by exploring a military paradigm as presented in NATO's 'Comprehensive Operations Planning Directive' (COPD, 2010). The paradigm is used across the international military society, and the framework therefore arguably represents one of the most tested and modern approaches within the field. It provides a framework that based on a systemic approach to analysis and an effects-based approach to operations supports decision-makers to analyse strategic challenges and formulate appropriate causes of action within the frames of the competitive terrain.

The military paradigm is further supported with concepts from central business theories in order to assist the eclectic framework's applicability to international business strategies. Furthermore, the formulated framework is tested and illustrated by the case of the Danish LEGO Company's strategy in China.

The eclectic framework provides several contributions. First of all, it presents a generalizable framework that suggests guidance for strategic courses of action, making the formulation of the framework of general value. Secondly, it explicitly considers and integrates the competitors' strategic intent and capabilities, which it incorporates accordingly in strategy formulation. The papers biggest contribution is, however, that the formulated eclectic framework effectively incorporates strategy as a designed, planned and logical procedure, with strategy as an emerging and learning activity.

In this way, the eclectic framework can be of general use for strategy formulation in international business.

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## 1. Introduction - The Art of Strategy

If you know the enemy and know yourself, you need not fear the result of a hundred battles. If you know yourself but not the enemy, for every victory gained you will also suffer a defeat. If you know neither the enemy nor yourself, you will succumb in every battle.

Sun Tzu, The Art of War

Traditionally, strategy has been a military art. The Chinese military philosopher Sun Tzu's landmark work "The Art of War" (circa 500 BC) is one of the earliest written sources of strategy (Heuser, 2010), but it would take until the beginning of the 1960's before strategy as an art of war was transferred into the realm of business. This does, however, not mean that there was no strategy behind business decisions earlier, but until then, there were no formal theories for business strategy (Lasserre, 2012: 27).

Since then, however, academia has continuously developed new frameworks to analyse the competitive battlefields of international business, presenting new frameworks to assist managers in strategic decision-making. The introduction of military paradigms to strategic management is therefore not a new notion. Indeed, primary schools of thought as, e.g. the design school, find its roots and premises in classic military approaches (Mintzberg, 2009). What differentiates the framework presented in this paper is, however, that it follows a dialectic, systemic approach to analysis and an effects-based approach to operations as proposed by modern military strategy (NATO, 2010). Furthermore, it is supported with primary notions and concepts from business literature, effectively presenting an eclectic framework that supports strategy formulation in international business.

Modern military paradigms are formed on the premise that it is a natural precondition that substantial changes are bound to occur in the battlefield during the span of an operation. Consequently, military strategic paradigms must capture this dynamic in an appropriate way, that based on the new conditions and the available resources, support the formulation of appropriate strategic courses of action. As the reader later will appreciate, this approach allows for an initial strategy design based on logical analysis and planning. However, it also promotes the consideration and incorporation of significant changes in the strategic environment as they emerge, effectively suggesting a dynamic, incremental and actionable approach to strategy formulation, which will be presented in the form of the eclectic framework. Another characteristic of the paradigm formulated in the paper, is that it presents a generalizable and industry independent framework, that therefore can be of general value

in international business strategy. Finally, in the spirit of Sun Tzu as quoted above, the eclectic framework explicitly considers and integrates competitors' capabilities, competitive advantage and strategic intent, which it incorporates accordingly in strategy formulation.

Obviously, when it comes to strategy, analysis, planning, execution and revision of operations design are human matters, where managers lead and staff support. Consequently, intuition, judgement and timing remain paramount (NATO, 2010), and as with any model the eclectic framework is therefore meant as a tool to support strategic planning and decision-making - not an end in itself.

Furthermore, as the presented approach builds on the assumption that the strategic environment continuously is affected by a dialectic interaction of the various factors and forces, strategy formulation and execution should be a dialectic and interactive activity, with a continuous review and update of strategy design and execution. Finally, the opportunity the eclectic framework gives to include both data and theory in extended detail, should not necessarily be understood as a need for complex plan; rather, the eclectic framework is designed to help managers create a clear design, capable of providing the necessary guidance to plan, execute and revise strategy in international business.

### 1.1. Research question

The research question which this thesis evolves around, is thus:

*How can military strategic paradigms be used to formulate a new eclectic framework that informs strategy formulation in international business?*

To test and illustrate the findings of the new framework the LEGO Company's activities in China will be used as an illustrative example. The focus of the thesis is therefore more on the formulation of the eclectic framework and how the findings derived from the framework inform strategy formulation in business, using the case to illustrate and provide the reader with examples, while deriving strategic courses of action for the LEGO Company in China.

### 1.2. Sub-question

As the thesis seeks to explore how military strategic paradigms can be used to formulate an eclectic framework that informs strategy formulation in the realm of business, the research-question is elaborated with the following sub-question:

*Which concepts and variables from central, conventional business models can be included to support the eclectic framework's applicability to strategic business challenges?*

## 2. Delimitation of the Research Area

In the following section the research area is specified. This includes delimitations and a discussion of the theoretical framework.

### 2.1. Theoretical Framework

In the interest of keeping a clear focus and accommodating the limited scope of the paper, only one military strategic paradigm is used as the foundation for the formulation of the eclectic framework, namely NATO's Supreme Headquarters' Comprehensive Operations Planning Directive (COPD, 2010). The use of the paradigm is, however, appropriate for several reasons.

The COPD is used across the international NATO military community, and the paradigm that continuously is updated, is therefore arguably the most tested and modern within the field. It provides a framework that supports officers and other decision makers to analyse strategic challenges and formulate suitable strategic causes of action within the appropriate frames. Further, a strategic crisis or challenge within the NATO community is best understood by the complex and interrelated dynamics at play in a multi-dimensional, international, competitive environment, where multi-faceted analysis and comprehensive solutions consequently are needed in order to design strategy to address these challenges (NATO, 2010). In this way, NATO's comprehensive approach transcends what can be viewed as the art of war in its most trivial form, as it seeks to conceptualise and address a strategic challenge in a holistic way. As such, the comprehensive approach is not only founded on military doctrine, but also draws on and allows for considerations from other relevant disciplines, such as cultural studies, social and political science etc. (NATO, 2010). Consequently, NATO's COPD will be used as the military strategic paradigm forming the foundation and the structure for the eclectic framework.



As the eclectic framework, however, is formulated to address a business context, concepts and variables from international business theories are used to support the framework when appropriate. Thus, during the formulation of the basic elements of strategy and the determination of scale and scope, Porter (1990) and Collis & Rukstad (2008) are used to further elaborate on the concepts in a business context. In the next phase covering the analysis of the competitive terrain, Brett (2014) and Ghemawat (2009) are used to explain the influence of cultural differences and the way it affects business activities and demand, and Khanna & Palepu (2010) are further used to explain how the existence of institutional voids affects strategy in emerging markets. Later, an extension of Porter's Five Forces theory (2008) is used to ensure that all relevant actors influencing competition are included in the strategy formulation. Porter is used again later when deciding which force or strategic actions to consider. The application of some of the notions behind Porter's theories makes sense, as they support industry analysis and strategic business planning, and therefore supports the eclectic framework's applicability to a business context. Finally, Porter (1985) is used again during the capability analysis together with Luo (2000) to explain competitive advantage, critical business capabilities, and finally dynamic capabilities in business, which the COPD, naturally does not cover.

NATO's COPD thus provides the foundation and structure for the eclectic framework, while notions from the international business theories mentioned above support the framework's applicability to strategic business challenges.

## 2.2. The Case Study

As mentioned above, the case study is used to illustrate and test the eclectic framework in its right element. Indeed, the case of the Danish LEGO Company in China is a textbook testing ground for the eclectic framework, as it is an example of an international company charging into a new competitive battle field, where not only the terrain, but also some of the competitors and the rules of the game are different from what the company is accustomed to, making a foundation stemming from military strategy appropriate.

The research area is delimited to focus only on factors relevant for the research question and case study, i.e. the LEGO Company in China. This leads to a direct focus on the LEGO Company itself, i.e. LEGO A/S, thereby ignoring subsidiaries. Furthermore, the focus will be delimited to the LEGO

Company's main activities in the global industry for traditional toys<sup>1</sup>, i.e. their sales of construction toys. As such, the framework and the related analysis will not include the LEGO Group's activities in other industries, such as the clothing industry etc., as the costumer and competitor dynamics here are very different from that of the traditional toy industry.

Some of the logical consequences of this sharp delimitation are of cause that it excludes some of the interesting discussions of opportunities for MNCs like the LEGO Company to create value, e.g. through synergies by operating in different industries etc. The idea and value of the eclectic framework is, however, that it is of general applicability, allowing for both inclusion and exclusion of variables according to the strategic challenge at hand. As such, it can be shaped to fit the task, which here is the clearly delimited case study of the LEGO Company in China

As the case study is centred on the LEGO Company, the analysis will focus on the industry segment the company competes in, i.e. traditional toys. Naturally, there will be a focus on construction toys as it not only is the main product the company provides, but also as it by far represents the best selling segment within the industry in China (Euromonitor, 2015c). However, the analysis will also include substitute goods when appropriate, i.e. other toys the LEGO Company's customer group can purchase as substitute to LEGO, ranging from toy cars to Barbie dolls etc. which then directly competes with the LEGO bricks and thus influence strategy formulation.

As the scope is limited, only the LEGO Company's main competitor in the Chinese market Mattel Inc. is analysed. Mattel Inc. is interesting as it also represents a MNC that through its brand MEGA Bloks, also sells a range of high-end construction toys. Furthermore, the company's mission is to be the recognized leader in play, learning and development worldwide (Mattel Inc., 2016) thereby addressing the same market segment and is therefore seen as a direct competitor to the LEGO Company. Due to limited space, other existing or potential competitors in the industry segment are therefore not analysed. Consequently, the piracy industry that in many ways can be seen as an inherent threat for the LEGO Company in China is therefore not analysed, as it caters another customer segment through its different value proposition. Instead, the issue of piracy is discussed in the paragraph suggesting further research.

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<sup>1</sup> The LEGO Company defines their own industry as that of traditional toys (LEGO, 2016), whereas Euromonitor have a somewhat broader industry definition, i.e. the industry for traditional toys and games, which will be applied in the analysis of the case study, as most general analysis based on statistics and quantitative data from this segment.

As for the customers analysed, the company naturally serves industrial customers, intermediate customers, and end-consumers. The scope of the paper, however, delimits the focus of the analysis to the end-consumers, which makes sense as the LEGO Company's strategy includes a prioritized focus on their end-customers (Robertson, 2013).

### 3. Methodology, Research Strategy and Data

Before formulating the eclectic framework a discussion of the applied methodology is in order, to ensure an understanding of the assumptions the methodology applies.

#### 3.1. Systemic Approach to Analysis, Effects-Based Approach to Operations

As stated, the eclectic framework finds its foundation in NATO's COPD, which adheres to a systemic method in analysis and follows an effects-based approach in deriving strategic courses of action, in order to ensure the maximum effects of the resources applied (NATO, 2010)<sup>2</sup>. A systemic method compromises all relevant major elements in the engagement space that potentially are relevant to the outcome of the operation, usually including political, economic, social and other relevant systems. Further, it provides a comprehensive, holistic view of the fundamental system elements (nodes) and their relationship (links) to other relevant systems (Ozolek et al., 2006: 21-23).

The important notion to emphasize in the systemic approach is the interconnectedness of systems, and the central takeaway from the approach in relation to the formulation of the eclectic framework is thus to understand, that a system is interrelated in such a way, that an action that affects one part of the system also always affects other parts of it. In this way, interrelatedness guarantees that an action targeted at one variable will have side effects and possibly long term repercussions in the rest of the system (Ozolek et al., 2006).

As stated, the paradigm further applies an effects-based approach to operations, i.e. the part in the framework where systemic analysis is transformed into strategic courses of action. The framework utilizes an effects-based approach, as it contributes to the accomplishment of the strategic ends and allows for a more comprehensive selection of actions in strategy: actions are thus designed to create

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<sup>2</sup> When appropriate, the framework, however, also draws on the classic military theories in the form of Sun Tzu and Clausewitz, which the COPD also builds on. Furthermore, Ozolek et. al is used as a supplementary guide to exploring systemic analysis and effects-based operations.

effects that contribute to change the conditions in the engagement space by affecting the capabilities, behaviour or perceptions of actors in the strategic environment (NATO, 2010).

As the framework is based on military paradigms it further utilizes a dialectic method as proposed by Clausewitz (1993). The assumption behind the application of the dialectic method is, that in war - and international business for that matter – dialectic interaction of diverse factors and forces is continuous and inevitable. Military paradigms must therefore capture this dialectic interaction with a framework that both apprehends and addresses the unexpected developments unfolding in the strategic environment.

The dialectic method is applied to the eclectic framework as it combined with the systemic approach to analysis and the effects-based approach to operations, support the formulation of flexible, actionable strategies, that allows for the achievement of the desired ends within a continuously changing, strategic environment.

The method inspired by the military paradigm thus supports the formulation of strategy through preplanning in the preparation phase, but also supports strategy as an emerging, incremental and actionable process after the operations are initiated, and conditions in the strategic environment change.

As mentioned during the introduction to the theoretical framework, the method is supported with concepts and theories from international business when appropriate, to ensure the eclectic framework is applicable to the intended context.

### 3.2 Research Strategy and Data

The primary use of data is of qualitative nature, which informs and provides the principal basis for the analysis of the case study. The use of qualitative data is appropriate, as it supports not only a deeper understanding of the examined phenomena, but also supports an understanding of the interrelated dynamics at play in the competitive environment, which is vital for the holistic understanding of the case study.

When appropriate, however, the analysis is supported with processed quantitative data. The supplementary use of this type of data is pursued, as it supports the examination of the various

phenomena through a different lens. The data is thus used to supplement and support the findings based on the analysis of qualitative data, and as such, it is also used to verify and test the deduced findings. The use of supplementing research procedures and data sources is thus pursued in order to strengthen the research method (Reinecker, 2012: 244-248).

The quantitative data is derived from Multiple Source and Survey data analysis, e.g. by the use of industry analysis reports conducted by market experts, as e.g. Euromonitor International, McKinsey & Company, KPMG, Transparency International etc. The characteristics of this type of sources are, that they consist of various data sets analyzed prior to their use in the thesis. The sources are, however, chosen because of their scientific credibility and use of extensive amounts of reliable data<sup>3</sup>.

In the analysis of the LEGO Company and Mattel Inc. both primary and secondary data sources are used, in the form of publications or official statements from the respective companies, e.g. annual reports, company websites, strategy statements etc. Further, articles and books including interviews with top management regarding their respective strategies in China are also used. Finally, publications from business journals in the form of articles, reports etc. regarding the companies' activities are used as supplementary sources.

Naturally, this kind of data holds the risk of being either biased or distorted. In fact, many of the sources show an inherently positive attitude towards especially the LEGO Company, which leads to the assumption, that some of the sources are positively biased, perhaps due to the company's performance and success. Therefore, the sources are approached in an objective and critical manner, and crosschecked with other sources whenever possible and appropriate.

Additional qualitative data gathering in the form of interviews with the LEGO Company was also pursued, but was however, not possible. The implication of this is, that the end-state and the related strategic objectives formulated in the analysis are based on some assumptions, along with deductions drawn from the available sources and data referenced in the specific paragraphs.

However, as the principal value of the thesis lies in the formulation of the eclectic framework, and the purpose of the case study rather is to illustrate and test the framework, the applied data is evaluated

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<sup>3</sup> As an example McKinsey's 2016 'China Consumer & Retail Report' alone is based on surveys of 10,000 consumers, across 44 cities, representing 75% of China's GDP. The other reports are equally well founded in both analysis and data.

to be sufficient for the intended purpose. This thus relates to and partly answers the question of generalizability, which is a classic aspect to consider when utilizing a case study (Reinecker, 2012: 246). Indeed, the primary value of the thesis is principally related to the theoretical findings derived from the formulation of the eclectic framework, and the findings thus surpass the unique case study, and are thereby of a more general value for research purposes.

#### 4. Case Presentation - The LEGO Company

The LEGO Company was founded in 1932 by Ole Kirk Kristiansen, and even though Jørgen Vig Knudstrop is now CEO, the company is still owned by the founding family. Based on the world-famous LEGO bricks and their integrated system of play, the company sells toys, experiences and education materials for children in more than 140 markets (The LEGO Group, 2016).

The name LEGO is derived from the Danish phrase “LEg GOdt”<sup>4</sup> or in English play well, which embodies the company’s philosophy to strengthen children’s skills, logic and creativity through play. The philosophy of “good play” that strengthens children’s development, and the insight and foresight of consumer preferences and frames, has through more than 80 years helped the company through the depression and two global recessions (Robertson, 2013). The company’s motto “only the best is good enough” differentiates them from their competitors, and has given LEGO a special place and value all over the world (Robertson, 2013), allowing them to become the world’s most powerful brand in 2015 (Dill, 2015) and has further helped them to become the second-largest toy company in the industry, just after Mattel Inc.

LEGO is thus one of the world’s best known brands, but what is less known, is how the company came close to a collapse in 2003. The company, however, managed to turn their fortunes by fundamentally changing their strategy, leading to growth and profit before taxes that by far succeeded their biggest competitors in the industry. The results from their turn around in strategy is extremely impressive considering that the LEGO Company compete in an industry with few entry barriers, fierce, global competition, fast change in consumer demand and preferences, difficult production costs, and no patent protection of the company’s core product; i.e. the LEGO brick. The LEGO Company achieved the remarkable turnaround not just by rebuilding the company by focusing on their critical capabilities in order to create value for themselves and LEGO fans around the world (Robertson,

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<sup>4</sup> Further translating into “I construct” in Latin

2013:19). The company also managed to create an entirely new segment developing children through play. A segment it seems, that has universal value.

#### 4.1 The LEGO Company's Strategy in China

As of now, the LEGO Company's declared strategy is to further grow, innovate and globalize based on four specific pillars:

Sustaining core commercial and operational momentum

Leveraging digitalisation

Create the organization of the future

Expand the global presence (LEGO, 2016: 3)

The focus here will mainly be on the last pillar, which the company's strategy in China is a part of. The strategy is to target the new Chinese market through three operational lines: commercially by a 360° marketing campaign for the Chinese market, operationally through the establishment of a new factory in Jiaxing, and organisationally through the establishment of a centrally located main office in Shanghai (LEGO, 2013).

The purpose of the company's strategy is not just to use China as a mere low-cost manufacturing base. Rather, it is an integrated part of the company's global strategy to build what it refers to as a "third leg on the stool" in Asia, on top of its traditional markets of Europe and the US (Knudstrop in Grant, 2013).

Throughout the analysis, the LEGO Company's strategy will be explored further, where the eclectic framework will be used to purpose strategic courses of action in China.

#### 5. Theoretical Framework – Military Strategy to Conquer New Markets

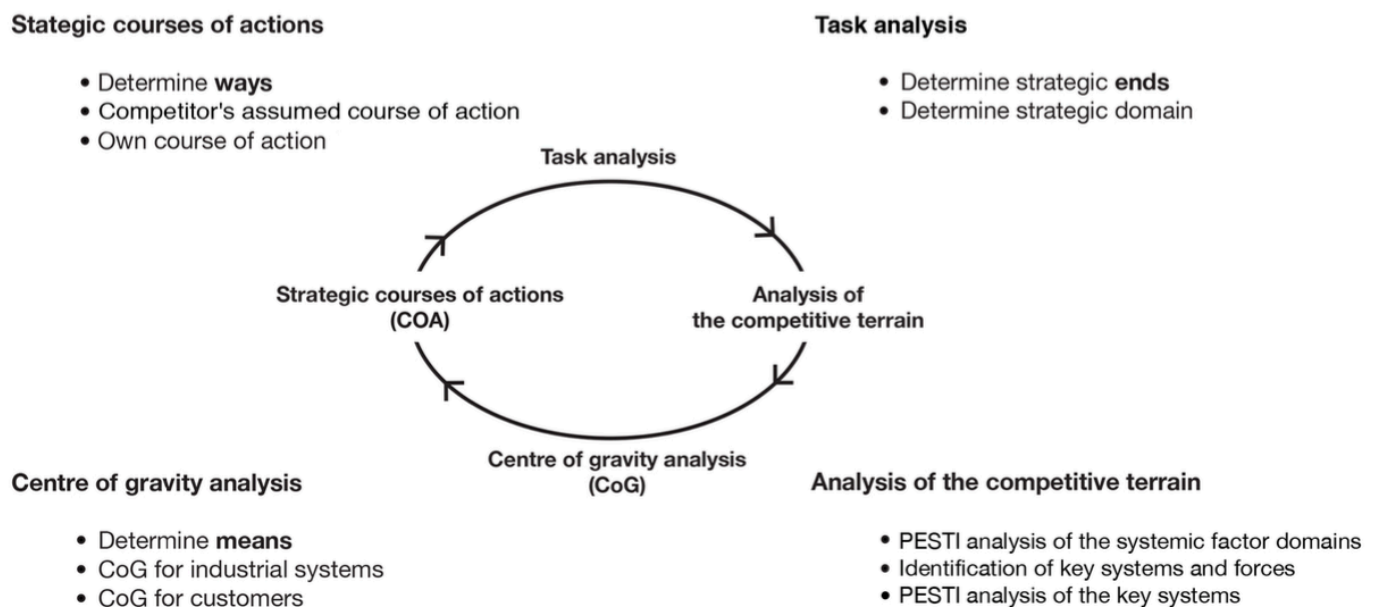
As mentioned the approach and structure proposed by NATO's Comprehensive Operations Planning Directive (COPD) forms the foundation for the eclectic framework. The comprehensive approach proposed in NATO's directive is formulated to meet current and future operation planning needs, and as such it is a tool to ensure a coordinated and coherent response to a strategic challenge, through courses of actions combining strategic *ends, means* and *ways* (NATO, 2010).

As the COPD indeed is comprehensive and reads into more than 400 pages, only the main phases most valuable for international business strategy are included. In the following, valuable features from NATO's COPD will thus be outlined in more detail and further supplemented with relevant academic theories, in order to create a new eclectic framework that informs strategy formulation in international business.

## 6. The Eclectic Framework

In the following the eclectic framework will thus be formulated. Throughout the various phases of the framework, one should continuously seek to find interim conclusions to help qualify the rough contours of the competitor's assumed course of action (CCOA) and accordingly also own course of action (OCCOA). As explained above, this leads to an approach that requires that the strategist revisits and reformulates his interim conclusions continuously throughout the various phases of the framework.

To provide the reader with a preliminary overview of the eclectic framework, the main phases are illustrated in the model below:





### 6.1. Task Analysis – Determine Strategic Ends

The first phase of the COPD is the task analysis. Here the overall goal or the strategic *end* of the operation is determined along with the nature, scale and scope of the task at hand. The purpose of the task analysis is thus to understand the overall lines and scope of the task and to set the framework for the following analysis. Consequently, the task analysis should focus on key strategic elements to get to the core of the challenge. In this way, the task analysis is an essential part of the model, as it creates the foundation for the following strategy formulation (NATO, 2010).

According to business theory, however, it is useful to formulate mission, value and vision statements before defining the strategic ends, in order to ensure that the formulated operations design falls within the desired metaphysical realm surrounding strategy. Theory thus suggests three additional statements; namely values, mission and vision statements, which will be transferred accordingly to the eclectic framework (Collis and Rukstad, 2008). These should, however, not be confused with strategic objectives or ends derived from military strategy used to drive a company's strategic business decisions as discussed later. These elements instead serve a different purpose. A *mission* statement should e.g. formulate the underlying motivation for founding the business in the first place, e.g. the contribution to society the company wishes to make. A company's *values* should express what the company believes in, and consequently how its employees should behave ethically. And finally, a company's *vision* is a statement of what the company aspires to be, e.g. to be the leading company in a specific industry, in a specific market etc. This is done to create a sense of purpose and to provide a way to guide strategy in accordance with the company's principles. Furthermore, the statements help to communicate not only the company's principles but also value proposition to relevant stakeholder (Collis and Rukstad, 2008). It thus follows, that it is an overarching, preliminary task to first ensure that the overarching mission, value and vision statements are clearly formulated, so that strategy formulation, starting at the task analysis with the determination of strategic ends, can be clearly formulated by managers throughout the organization, in a way that ensures it falls within the desired metaphysical realm surrounding the company.

Let us now resume to military paradigms, in order to define the overall goals or the strategic ends forming strategy and the related operations design. Here NATO's paradigm applies two concepts, i.e. end-state and objectives. The desired *end-state* (ES) should be understood as the situation, which needs to exist when an operation has been terminated on favourable terms. As such, an ES can consist of two components, one expressing what should be maintained and/or protected, and one stating what should be accomplished. As it is the individual, desired ES all actors are assumed to

strive for, it must be established prior to execution. This permits for the formulation of appropriate courses of action (COA) that anticipate competitors' assumed actions and further allows for the achievement of own strategic ends. In this way, ES is seen as the overall goal driving actors' actions, whereas *objectives* (OBJ) are understood as clearly defined, measurable and attainable goals to create the desired effects and conditions which will allow for the achievement of either a higher OBJ and/or the desired ES (NATO, 2009: 1-2).

Interestingly, these concepts and the logic behind their application are not altogether different from the concepts used in academic business literature to define strategic ends. However, NATO's dual concept of ES and OBJ allow for a qualitative differentiation and thus a prioritization of goals. This is first of all useful in the initial formulation of the operation's design during the preparation phase, as it sets out planned steering points for the achievement of the overall goal of the strategy. Secondly, it assists decision makers during the execution of operations, as it allows decision makers on the all levels to make strategic choices for trade-offs in competing. Finally, the dual concepts of strategic ends supports decision-making when conditions in the competitive landscape change, e.g. through a significant change in capabilities or demand, or the emergence of new threats etc. creates the need for adjustments in strategy design.

#### 6.1.2. Task Analysis - Determine Strategic Domain

After formulating the strategic ends, i.e. the ES and the related OBJ, the scale and the scope of the operations conducted needs to be determined. Or to put it in other words, the engagement space needs to be defined (NATO, 2010).

To relate this part of the military paradigm to business, the scope, or domain of the business has to be determined; i.e. the part of the landscape in which the firm will operate. Consequently, a company also needs to determine what boundaries it will not venture beyond (Collis and Rukstad, 2008: 84), which in combination with the strategic ends, additionally supports the formulation a successful, actionable strategy, as it further supports the necessary decisions in competition related to strategic trade-offs (Porter, 1996: 70).

When determining the scope of the business operations a company needs to consider three dimensions: customer offerings, vertical integration<sup>5</sup> and geographic scope (Collis and Rukstad, 2008: 86). The dimensions may vary in importance, however, they all support strategic positioning in the market (Porter, 1996) and further support strategic decision-making throughout the organization during the execution of operations (Collis and Rukstad, 2008: 86), as it allocates resources and guides activities toward the obtainment of the strategic ES.

For many companies the customer is the most important dimension. Defining which customers to cater can be done on several backgrounds, and the segmentation thus entails several considerations, which will be discussed in length later. In addition to deciding which specific customer's to target, the company must also decide which of the customers' demands they chose to cater, and thereby determine their product portfolio and value proposition. This is then followed by the choice of vertical integration that involves the scope of activities the company choses to internalize. Finally, the choice of geographical scope decides which countries or regions the company engages.

The clear delimitation of which customer offerings to provide, which vertical integration to pursue, and which geographic location to target is important as it promotes a sharp analysis and related strategic decisions of trade-offs in the quest to deliver value to customers, and create a profitable and valuable position in the market. It is, however, important to emphasize that the scope should not stipulate exactly what should be done within the outer boundaries set by the strategy - instead continuous innovation and initiative within these boundaries should be encouraged (Collis and Rukstad, 2008: 86).

## 6.2. Analysis of the Competitive Terrain

After the strategic ends and the scale and scope have been defined, the analysis of the domains and systems configuring the competitive terrain is conducted. As stated previously, the systemic perspective applied in military paradigms perceives the competitive terrain as a system of interconnected systems. The approach provides a comprehensive, holistic view of the central systemic elements (*nodes*) and their relationships (*links*) to other relevant systems. A system is thus perceived as a functional, physical, and/or behavioural related group of nodes, which are the tangible system elements, e.g. constructions, assets etc. that can be targeted directly through actions. The

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<sup>5</sup> Notice here how the scope is related to obtainment of competitive advantage, which consists of two parts; (1) customer value proposition, (2) the combination of activities meriting the value proposition (Lasserre, 2012).

links are in turn perceived as the behavioural or functional relationships between the systemic elements: e.g. manifested as the flow of money that enables a certain activity, or the preference that connects a customer with a company. As a system should be seen as an interconnected whole, the targeting of specific, strategic nodes can lead to strategic and sometimes decisive effects disproportionate with the resources applied, as changes in key nodes will affect the system as a whole (Ozolek et. Al, 2006: 21-25).

In the following paragraphs a purposed method for analysis of the engagement space will thus be explored. First the competitive environment will be studied by the use of an analytical acronym inspired by the military paradigm. Afterwards, the acronym will be applied to an international business context, by exploring the applicability of the factors in the appropriate setting.

#### 6.2.1. Systemic Approach to Analysis of the Competitive Terrain

The systemic perspective applied in NATO's military paradigm includes the significant systems in the engagement space that potentially are relevant to the success of the operation. NATO recognizes 6 typical domains or factor systems, and has created a related military acronym, PMESII, that forms the starting point for the analysis of the competitive terrain. As the perspective focuses on the interconnectedness of systems, the analysis further provides the platform for the later identification of key links, which in turn facilitates targeting of systemic vulnerabilities and identification of strategic opportunities (NATO, 2010).

The reader will soon appreciate that the acronym is somewhat similar to that of the popular PEST model. The interesting parts where the acronym formulated in the elective framework differentiates from the PEST model are, however, first of all, that the acronym in the military paradigm functions as a part of an integrated whole, where the interim conclusions drawn in this part of the analysis thus feeds directly into the subsequent phases of the framework. The second difference can be found by its application and the method by which the factor systems are approached. Indeed, if the systemic approach is applied, and the acronym is transferred into one of business, it essentially provides a model to first analyse the macro level through the initial analysis of the various systemic factor domains, i.e. the political domain, the economic etc. Later, the acronym can be used again to analyse each key player's ability to compete within the various domains<sup>6</sup>. The analysis of key links thus help to

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<sup>6</sup> This is referred to as the individual key player's PESTI systems

identify how the various systems are able to unfold, interact and affect one another throughout the different layers of the competitive terrain.

An additional value of the paradigm is that it adds an extra dynamic layer, as it creates a framework to conduct forecasts on how the various systems are expected to interact within the systemic factor domains in the future.

In this way, this part of the framework provides inputs for the later analytical phases through the interim conclusions and projections, which forms the stepping-stones for the subsequent assessment of strengths and weaknesses, that gives insights into possible courses of actions.

Obviously, when the military acronym is translated into one of business, the factor systems included in the model needs to be critically assessed to ensure their relevance. The PEST analysis mentioned above is one of the most popular tools for analysing both a market and its competitors. The variables in the model can thus be used to support the formulation of the eclectic acronym, as the factors equally provide a simple analytical framework that can help evaluate implications of entering unknown terrain by identifying potential threats and opportunities in a business context. Consequently, the factor systems of the PEST model will be included in the eclectic acronym to ensure the applicability to a business context.

As for the consideration of which variables to include from the two respective acronyms, it is important to emphasize that a market is defined by what is addressing it, be it a company, a business proposition, a product etc. In order to ensure that the included factors contribute with the desired analytical value, the user must therefore be conscious of how the market should be approached, in order to adjust the specific version of the acronym to the relevant context.

As the LEGO Company's business venture in China is used to illustrate the framework, only variables relevant to this focus are included in the model. However, as the eclectic framework is meant to function as a suggested directive, additional variables could of course prove to add supplementary value to another specific context, which therefore, always should be considered.

For now, however, additional factors that prove to be contributory causes or a more detailed perspective of the chosen variables, rather than strategic factors in their own right, are therefore

excluded<sup>7</sup>. In the following paragraph a conscious and precise selection of a few variables is therefore pursued, as this is the most powerful and precise approach, because it focuses on the strategic characteristics of the situation.

### 6.3. Analysis of the Competitive Terrain - PESTI

The approach when using the formulated eclectic acronym should therefore be identical with the one explained above. The formulation of the eclectic acronym will start by the identification the relevant systemic domains, and afterwards the additional features of the framework will be developed. As for the imminent discussion of which factors or systemic domains to include in the model, the eclectic acronym lists: PESTI, reading into, *Political, Economic, Socio-Cultural, Technological, and Infrastructure*<sup>8</sup>.

The reasoning behind the acronym is as follows: all the original factors from the PEST model are transferred to the new acronym, as they all represent structural, strategic factors or systemic domains, that influences how the various actors can unfold and compete in the market. As the original PEST factors are explained in length elsewhere, they will not be discussed in depth here. However, some brief comments on the alterations, i.e. 'socio-cultural' and 'infrastructure' transferred from NATO's PMESII model, are in order.

As the eclectic framework is especially formed for international business entities venturing into foreign, unknown markets, 'social' is translated into '*socio-cultural*' factors<sup>9</sup> in order to highlight the strategic importance of culture in international business. Naturally, socio-cultural factors are always important to consider, but these should be paid special attention when venturing into foreign markets, especially if the culture is dissimilar from what the company is accustomed to, and norms, preferences and perceptions consequently vary significantly. In this way, cultural differences can be said to affect both the individual systems but also system interaction in overall terms, as culture affects not only the links among internal systemic nodes, but also the key links connecting various systems (Salmoni et al.,

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<sup>7</sup> Legal factors are e.g. not chosen, as they tend to be a contributory factor of politics, but not the other way around. Consequently, legal framework is included under the factor, 'politics'.

<sup>8</sup> In the COPD the M in PMESII reads into Military, which covers the internal security aspects of a country (NATO, 2009: 1-3). The security aspects are of course, by no means irrelevant when conducting business activities, as it influences how systems can unfold. Security aspects are, however, in our context seen as a something caused by politics and are consequently included under the strategic factor 'politics' instead. Furthermore, the last I reads into information, which, however, here is classified as an element in infrastructure, i.e. soft infrastructure.

<sup>9</sup> Social and cultural factors are seen as a dialectic function of each other rather than independent strategic factors, and are therefore included as one structural factor, namely 'socio-cultural'.

2011). This is true on both the macro level, as it influences political institutions etc. but also on a micro level, as culture saturates all parts of society thus affecting perceptions, preferences, and actions.

Indeed, especially in international business, culture is particularly important as it naturally affects preferences and thereby also demand. Consequently, the interim conclusion drawn in this part of the analysis should inform the later customer analysis, which should have a focus on the cultural elements that affect the key links between the company and its local customers. Obviously, there are several elements in the international market that attribute to cultural differences, which often entail a need for local adaptations in products or services. The most important elements affecting the key links between a company and its local customers are differences in languages, ethnicities, religions and social norms. It thus follows that some industries are more affected by cultural differences than others. Companies that e.g. offer products or services with high linguistic content, products that affect cultural or national identity of consumers, products with features that vary in terms of size, standards, and packaging, or products that carry country-specific quality requirements, are particularly affected by cultural differences (Ghemawat, 2009: 140).

As is stated above, culture naturally also affects the link between the company and other relevant systems. Therefore, when interacting or negotiating internationally with say, government officials and local suppliers, or cooperating with local employees in subsidiaries, the interaction here also gains yet another layer, i.e. that of culture. Consequently, the interim conclusions drawn from the socio-cultural system should inform all relevant parts of the final strategy formulation. Despite the fact that the global market place continuously becomes more and more integrated, it is therefore still important that MNCs persistently are conscious of the fact that interests, priorities and preferences may vary greatly and that the affects form the socio-cultural system thus affect the overall rules on how companies can conduct business abroad (Brett, 2014).

The next paragraph relates to the second new factor, namely '*infrastructure*' that covers what is characterized as both hard and soft infrastructure. Hard infrastructure includes tangible aspects as roads, ports, the availability of resources, distances, weather etc., whereas soft infrastructure covers not only information and knowledge flows, but also market institutions (Khanna and Palepu, 2010: 85). Naturally, infrastructure plays a critical role for the ability for developed MNCs to execute their standard business models. However, especially in emerging markets infrastructure systems often lack vital elements or function in a significantly different way as compared to hard and soft infrastructure systems in developed markets. MNCs will therefore almost certainly be confronted with the presence

of institutional voids or deficient infrastructure when pursuing opportunities in emerging markets (Khanna and Palepu, 2010: 84-86). In this way the interim conclusions drawn from this domain can help companies to first identify these voids and shortages, in order to later formulate appropriate courses of actions on how to engage the market in relation to the institutional context.

#### 6.4. Identifying and Classifying Additional Key Systems

The five systemic PESTI domains structuring the competitive terrain have now been identified, which allows for the execution of the initial analysis of the engagement space. Before being able to conduct the subsequent phases of the analysis, it is, however, helpful to first conduct a preliminary analysis of the industry and identify the remaining key systems affecting competition and thereby also strategy formulation. In line with military strategy, what then follows is the identification of the remaining key systems or actors within the engagement space to enable the further analysis.

As stated earlier, the acronym namely also functions as starting point to identify key systems by specifically considering which actors influence and shape competition in the respective strategic domains. To give an example, when e.g. considering the economic domain during the initial macro analysis of the PESTI domains, factors such as economic development in general, GDP and distribution of wealth are first considered. Afterwards the micro forces within the specific strategic domains are considered, i.e. the key systems or forces shaping and influencing the economic domain; say, strong economic institutions influencing competition in the industry and so on. In this way, both the factors and forces influencing competition are explored, and additional, relevant key systems within the engagement space are thus also identified. After all key actors are identified, the acronym yet again serves as a dialectic framework through the analysis of each key actor's specific PESTI system<sup>10</sup>, which in turn serves as a platform for the subsequent capability analysis and identification of opportunities and threats.

As the eclectic framework, however, is formulated to assist strategy formulation in an international business context, it must be ensured that all relevant systems influencing the competitive environment in an industry are included. To this end, inspiration can be found through an extension of Porter's Five Forces. The Five Forces model explains how five key forces use their power to influence industry competition (Porter, 2008), and the application of some of the notions behind the theory makes

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<sup>10</sup> An actor's PESTI system should be understood as how each actor can unfold or compete in each of the PESTI domains



sense, as they support industry analysis and strategic planning. Later, a further extension of Porter's theory of forces will be applied, when we look on how systems can seek to create desired effects through actions in order to achieve their strategic OBJ. But for now, the dynamics of Porter's theory will be used as a method to identify general key systems in a competitive market.

The list of general key systems influencing competition thus reads into four main segments:<sup>11</sup>

- (1) *Own system*, or company
- (2) *Suppliers*
- (3) *Competitors*, existing and potential
- (4) Customers, industrial customers, intermediate customers, and end-consumers

These main system segments can of course be refined further according to the specific analytical requirements.

However, before conducting the PESTI analysis and the more thorough capability analysis in the later parts of the eclectic framework, a general classification of the various actors within the four key player segments can be useful, as their strategic implications should be considered in each of the various PESTI domains.

#### 6.4.1. Analysis of Additional Key Systems

When analysing the additional key actors or forces in the market the systemic perspective is applied as well. In practice this means, that there again should be a focus on the structure of the system along with its links to other systems, as it affects the system's ability to unfold within the engagement space.

As for own system, the analyst can e.g. consider the organizational structure, as it most likely will have strategic implications, especially in international business. This could e.g. include links to

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<sup>11</sup> Porter's original list of the five forces that shape industry competition, reads; 1. Rivalry among existing competitors, 2. Bargaining power of buyers, 3. Threat of substitute products or services, 4. Bargaining power of suppliers, 5. Threat of new entrants (Porter, 2008). Notice that potential entrants are included under potential competitors in our model. Further, substitutes are not included as an actor, as it is potential activities conducted by competitors.

subsidiaries or alliances with other companies, which e.g. can become relevant through joint ventures etc.

The same logic applies when analysing other industrial systems, i.e. suppliers and competitors. However, when it comes to competitors, a further classification can become helpful, where a natural subdivision is 'existing' and 'potential competitors'. As for the latter, the strategist can consider potential substitutes to identify likely emerging competitors. When analysing competitors in general, one should especially consider key links likely to give the rival company a competitive advantage. Links stemming from incumbency are e.g. often relevant, as it will likely lead to cost or quality benefits, or other advantages unavailable to foreign systems (Porter, 2008).

Finally the customer system needs to be analysed. Here again key links to the PESTI domains should be considered in order to assess aggregate demand. As for segmentation, the customer system can also naturally be divided into subgroups if needed. This can be done on several backgrounds, e.g. demographics, profession, spending habits, psychographics etc. (Collis and Rukstad, 2008: 86). Customer segmentation usually makes sense if the company wishes to target customer groups individually, e.g. through marketing campaigns, individual product development etc. and further analysis to support additional strategic initiatives thus is needed.

Naturally, the identification of key systems is directly tied to the considerations of the scale and scope of the engagement space made in the task analysis. Indeed, a common pitfall in microanalysis is rooted in either a too broad or too narrow definition of the industry, its participants and its products, which can lead to a focus on less relevant features and actors. Therefore, after identifying all relevant systems, the strategist should concentrate his main efforts on the analysis of the most important ones, as it is the most powerful systems that determine industry profitability and hence becomes most important for strategy formulation (Porter, 2008).

#### 6.4.2. Analysis of Key Actors' PESTI Systems

After the preliminary analysis of the PESTI structures and the identification of other relevant key systems, the analysis of each key actor's PESTI system must now be conducted. In other words, the analysis now moves from an overall macro level, to the micro level to explore how the individual key systems can unfold and compete within the various strategic domains and how they are related with the other key systems through their various key links. The purpose of this phase is thus to determine

the significance of each actor's PESTI system and its various elements in relation to the overall environment.

In practical terms this means that all key systems, i.e. own company, suppliers, competitors, and customers are explored in each PESTI domain. Through this analysis knowledge is created that forms the basis for understanding the behaviour, capabilities and opportunities of the various main actors within the specific strategic domains. As the systemic analysis focus on the interrelatedness of systems, the PESTI analysis can thus help to determine opportunities and threats and how systems might be influenced, which serve as important inputs for the later phases of the eclectic framework.

Another practical point is that the analysis of the various PESTI systems naturally creates a deeper knowledge of the overall conditions of the engagement space. And as the analysis focuses on the interrelatedness of systems, it reveals insights on the effects needed to achieve strategic OBJ. In this way, the strategist can then use the knowledge formed in this part of the framework to revisit or even formulate new strategic OBJ to achieve the desired ES (NATO, 2009: 1-4).

#### 6.5 Centre of Gravity – Determine Means

After the preliminary analysis of the competitive terrain using the PESTI acronym, additional examination of keynotes, links, capabilities and vulnerabilities is needed in order to support strategic decision-making and targeting in the later phases of the framework. Further, as the comprehensive approach utilizes a systemic method, the aim of the system analysis is thus not only to identify vulnerabilities, but rather systemic vulnerabilities as actions targeted here can bring about desired strategic effects with a minimal use of resources (NATO, 2010).

In military strategy further analysis to identify opportunities and threats in the engagement space is conducted by identifying the centre of gravity (CoG) for own, allied and opposing forces. The concept originates from the 19<sup>th</sup> century general and military theorist Carl von Clausewitz, who examined how the dialectic interaction of diverse forces creates unexpected developments, calling for swift decisions in war (Clausewitz, 1993). To transfer the concept into a more palpable context, NATO describes CoG as a principal source of power that enables an actor to achieve his goal. Determining an opponent's CoG and deciding how best to neutralise it, while effectively protecting own CoG in order to achieve desired ES, is therefore the very essence of operational art which constitutes the foundation of military strategy (NATO, 2010: 1-12).

If the concept is translated into the context of international business, CoG can best be explained as the overall competitive advantages from which an organization, a group of allied companies, or any other relevant system derives its power to influence the competitive terrain and achieve its desired ES. In this way, the CoG is the means by which an organization can achieve its overall goal, and as such the identification of CoG builds on the interim conclusions from the PESTI, and the conclusions from the capability analysis made in the following CoG analysis.

However, before moving on to the CoG analysis itself, a few additional comments on the concept in international business context are in order. As stated above, a system's strategic CoG can be viewed as its competitive advantage, which in turn can be defined as critical capabilities that are difficult to replicate and are non-tradable. According to theory, there are several types of capabilities that can lead to competitive advantage. First, there are capabilities leading to a lower cost base, i.e. a cost leadership value proposition, and then capabilities leading to increased customer value, i.e. a differentiated value proposition (Porter in Lasserre, 2012: 42-44). Later, when we go through the subsequent phases, the reader will further appreciate how CoG in relation to competitive advantage can be integrated and deployed through strategy formulation in the eclectic framework. For now, however, an understanding of the concept is sufficient.

The CoG concept can be of value on all levels of analysis, as the concept is applicable to both the strategic, operational and tactical level. Furthermore, as CoG analysis can be directly related to the achievement of an organization's ES, it can support strategic decision-making throughout the organization. An example of a strategic CoG in a business context could be what in overall terms provides an organization with the power to achieve its ES. In practice that could stem from the overall power or competitive advantage<sup>12</sup> of an organization, e.g. knowledge capabilities that are firm-specific and difficult to imitate, brand, patents, economic strength, group structure or favourable alliances with relevant actors, special favoured position in a region or country, and so on. It thus follows, that a strategic CoG can be the system or the organization in itself. An operational CoG on the other hand, is likely to be the means by which an actor can achieve its operational OBJ, such as economies of scale and scope, distribution channels, personnel etc. An operational CoG may be concentrated in a specific geographical area or dispersed, and in these cases, the ability to prevent a CoG from

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<sup>12</sup> In this way CoG ties the knot on the point made in the discussion of the three critical components for a good strategy, i.e. objective, scope and advantage (Collis and Rukstad, 2008: 84).

manifesting or concentrating its effects could be decisive in defeating it. Finally, the tactical CoG tend to be specific resources at specific points that provide freedom of action and means for achieving tactical OBJ, and is therefore often related to the ability of concrete, tactical capability deployment and timing.

#### 6.5.1 Centre of Gravity Analysis

When a military strategist conducts his CoG analysis, it is divided into various interrelated phases: first CoG should be identified. Here the strategist should ask where the system in question is assumed to derive its “primary source” of strength, power and resistance. Then the system’s critical capabilities should be examined: i.e. the primary abilities, which constitute the CoG. Then, critical requirements should be identified: these are the essential conditions, resources and means for a critical capability to be fully operative. Finally critical vulnerabilities must be identified. Naturally all of these elements should be identified in the context of the given scenario, and as such, the CoG analysis is closely tied to the analysis performed in the previous phase (NATO, 2010: 2-3).

In the following paragraphs the concepts of the CoG analysis will be explored further and then transferred to the eclectic framework. CoG analysis in military strategy, however, is conducted with the aim of neutralising, bypassing or brining the opponent to a position of stalemate. Consequently, this form of analysis brings value to business strategy, as it provides a framework for analysis and strategy formulation to engage other business systems in the engagement space, i.e. competitors and suppliers. The way to engage customers is, however, naturally different, and competition in this light rather should be seen as war to gain the customers’ favour. For the sake of clarity then, the framework for CoG analysis for competitors and suppliers will be formulated first. Afterwards some small alterations will be introduced to suggest a framework for CoG analysis for customers, assisting the company’s formulation of their value proposition.

##### 6.5.1.1. CoG Analysis for Own System, Competitors and Suppliers: Critical Capabilities, Critical Requirements, and Critical Vulnerabilities

When conducting a CoG analysis there is no fixed starting point, but a logical place to start is to identify the critical capabilities, as they constitute the CoG. They are, however, not always salient, especially as they rarely consists of a single element, but rather are manifested as complex systems or structures whose power and strength comes from a number of critical capabilities, whose synergies provide the primary capacity for achieving specific OBJ (NATO, 2009: 1-15).

The critical capabilities are thus the source of the competitive advantage constituting the CoG. As resources, assets or competencies are said to be the three general sources of competitive advantage (Lasserre, 2012: 42-43), critical capabilities can stem from either one of the three, or ideally from synergies emerging from a combination of the three. To identify critical capabilities, the analyst can then consider the company's embedded, distinctive capabilities, including critical resources, assets, or competencies that are firm-specific, difficult to imitate, and has the potential to generate value and competitive advantage (Luo, 2000: 359).

In essence the critical capabilities require specific conditions or resources that are crucial for sustaining them; these are referred to as critical requirements. In this way, they are those requirements, which will reduce or completely eliminate critical capabilities if not met (NATO, 2009: 4-53).

When the concept is transferred to the eclectic framework, the term covers the requirements for company's critical capabilities to be fully operational. An example of this could be operational attributes, logistic capabilities, knowledge about local business practices, relationship building with relevant stakeholder (Luo, 2000: 360-361), or other conditions required for a company to deploy and exploit critical capabilities.

Finally, critical vulnerabilities must be identified. These exist when critical requirements are deficient and expose a critical capability to attack. The ability to exploit systemic critical vulnerabilities thus provides the potential to achieve strategic and sometimes decisive results disproportionate to the resources applied (NATO, 2010).

In business terms a critical vulnerability could be any condition that essentially degrade or limits a company's ability to exploit critical, strategic capabilities, such as lack of resources, deficient local knowledge, inferior local operational and logistic capabilities, and so on. The threat towards a critical capability can stem from other business entities or forces in the engagement space trying to attack or exploit a critical vulnerability. However, it can also stem from factors in the strategic PESTI domains themselves, effectively limiting a company's ability to deploy a critical capability. Such factors are therefore critical to identify and assess, especially in international business, as they seldom have the same implications for foreign as compared to local business entities. These factors are, however, not always salient. Some may even be intangible such as norms from the social domain either favouring

or disregarding foreign business entities, products and so on. Other factors are, however, more concrete as e.g. factors shaped in the political or economic domain, setting out laws promoting certain rules that may distort competition if not probably mitigated. Therefore, the factors and forces potentially creating a critical vulnerability must be identified in order to design competitive firm-level strategies to both protect and exploit the opportunities and threats in the engagement space manifested as the CoG.

This phase of the eclectic framework thus helps to determine the means by which the industrial systems can hope to achieve their OBJ in relation to competitors and suppliers within the PESTI framework. This is thus done by conducting an internal analysis of own company's CoG, as well as the CoG for other relevant industrial systems, i.e. suppliers and competitors.

#### 6.5.1.2. CoG Analysis for Customers: Critical Demand, Critical Requirements, and Critical Vulnerabilities

Finally, we arrive at the customers, who in a way can be defined as the most important key system, as it is their demand that justifies the business' existence. In the previous paragraph, a capability analysis was purposed in order to identify strengths and weaknesses. The purpose of this part of the CoG analysis is, however, different, as it rather is a quest for finding the strategic sweet spot in the market, where the company can meet the customers' demand in a way that competitors cannot. In other words, CoG analysis here becomes related to finding a unique, sustainable value position in the market, and the proposed parameters thus become: critical demand, critical requirements, and critical vulnerabilities.

When conducting the analysis, the logical place to start is to first identify the critical demand, as it constitutes the CoG. Naturally, in order to formulate an appropriate value proposition to create a sustainable, competitive position in the market, one needs to identify and consider what the primary demand is, i.e. critical preferences in product or service characteristics. The critical requirements then become the prerequisites for the customers to be able to acquire the products, ranging from affordability, willingness to spend, consumer confidence, but also accessibility. Finally, critical vulnerabilities once again exist when a critical requirement is deficient, e.g. if changes in the PESTI

structures are volatile and suddenly results in either a change in preferences and thereby demand, or if changes impacts e.g. income, legal framework etc. which affects accessibility.<sup>13</sup>

To summarize, the CoG analysis for industrial systems identifies strengths and weaknesses, which assist strategic targeting, while CoG analysis for customers supports the formulation of the company's appropriate value proposition. A practical, but nonetheless important point to emphasize, is that the critical capabilities and critical demands may constitute a single or several CoG, respectively. Further, it is important to notice that if either the OBJ or available sources of power change during an operation, the CoG might change as well, which in practice calls for flexible strategy formulation.

The attentive reader will therefore soon appreciate, that the CoG analysis and the related strategic operations thus not only is related to capability possession, but rather the possession of dynamic capabilities in the broadest terms. The reason for this is that the appreciation of the dynamics of the CoG analysis - and later, the ability to successfully exploit the opportunities identified during the analysis - requires an application of dynamic capabilities, which encompasses not only capability possession, but also capability deployment and upgrading (Luo, 2000).

#### 6.5.2. CoG Analysis Matrix

In order to further clarify how the various concepts of the CoG analysis are interrelated, the following matrix can serve as a tool to support the analysis.<sup>14</sup>

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<sup>13</sup> Notice here how the PESTI domains become relevant once again. Indeed there are can be several findings from the previous PESTI analysis that become relevant, not only from the tangible conditions but also from the intangible factors from the social sphere that can help identify and predict consumer preferences and needs.

<sup>14</sup> The matrix is inspired by NATO's CoG matrix (NATO, 2010: 4-43).



## Centre of Gravity Analysis Matrix

### Assessed Strategic Ends

What is the actor's desired ES and what conditions does he seek to achieve through his actions?

#### CoG

... is the principal source of power for achieving strategic ends and the point at which all resources should be focused on

What is the primary source of power or sustainable competitive advantages upon which and actor depends to accomplish his strategic OBJ?

- the value proposition that caters the critical demand in a way competitors cannot
- the unique activities that allows the system alone to deliver the customer value proposition

→ to be targeted in a competitor and protected in own company  
→ to be provided for customers in a way competitors cannot

#### Critical Capabilities or Demand

... are some primary sources (resources/assets/competencies) that gives the CoG its strength.  
... or the primary demand that merits the value proposition.

What are the primary means that enables the CoG to gain and maintain dominant influence over a competitor or the market, such as to threaten or coerce a competitor, or to control the market?

What product or service features is the critical demand characterized by?

- to be influenced/denied to a competitor and exploited in own company
- to be accommodated in a customer

#### Critical Vulnerabilities

... exists when critical requirements are deficient and exposes a critical capability or prevents the company from accommodating the critical demand.

What are the weaknesses in key systemic elements, essential conditions characteristics, capabilities and relationships through which the CoG may be influenced? What are the critical impediments for supplying the critical demand?

- to be targeted in a competitor and protected in own company
- to be mitigated in a customer

#### Critical Requirements

... special conditions or resources that are essential for sustaining critical capabilities  
... or special conditions required for the customer to acquire the product or service.

What are the key systemic elements, essential conditions characteristics, capabilities and relationships required to generate and sustain the CoG, such as specific assets, resources, and relationships with other actors?

- to be denied to a competitor and maintained in own company
- to be mitigated in a customer

### Conclusion

Which critical vulnerabilities should be target in the competitor, protected in own company, and mitigated in a customer, in order to change and/or exploit the strategic means, or critical capabilities, relationships and behaviour in ways that leads to improved conditions and obtainment of strategic ends?

## 6.6. Strategic Actions and Deployment of Power - Determine Ways

Once the critical parameters for all actors have been identified, the strategist must determine the ways in which the various CoG should be addressed. This requires further analysis of essential conditions and critical resources required to generate, deploy and sustain the power of the CoG, as well as the ability to exploit any vulnerabilities by deployment of the various instruments of power (NATO, 2009: 1-15).

In terms of the eclectic framework, this means that the interim conclusions drawn from the CoG analysis now will be used to decide which actions to consider in order to create the desired effects, ultimately leading up to the model's two parent variables; namely, competitor's course of action CCOA and finally, own course of action OCOA, or our chosen strategy design. This, however, is based on an assessment and application of appropriate instruments of power, which will be explored in the following paragraphs.

### 6.6.1. Instruments of Power

According to military theory, key systems and conditions in the various strategic domains can be influenced by the application of different instruments of power<sup>15</sup> deployed through strategic actions to either protect or target the various CoG (NATO, 2009: 1-4).

A military force, or a MNC for that matter, can however, often only exercise control over some of the instruments of power that shape competition in the engagement space.<sup>16</sup> Consequently, the strategist must first be aware of how the strategic factors and key systems create effects within the engagement space in order to take a position that is more profitable and less vulnerable to attack. Furthermore, he must naturally be able to critically assess and apply own instruments of power in order to achieve desired ES.

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<sup>15</sup> Military doctrine in the COPD calls for an application of one or a combination of the following power instruments: military, political, economic or civilian. The first two instruments are more destructive or cohesive by nature, whereas the last two are more conducive and holistic in nature, as they focus more on positive incentives. For a more thorough explanation of the use of power in the comprehensive approach, see NATO, 2009: 1-4.

<sup>16</sup> An example here could be several of the structures in the PESTI domains, that MNC may or may not be able to influence. A comprehensive approach can however in some cases help to influence these more static structures, e.g. through lobbying when it comes to politics, or through building own distribution channels in infrastructure, and so on.

To review the framework build in the eclectic framework thus far, we first have the structures within the systemic PESTI domains that in a way functions as what Porter refers to as factors (Porter, 2008: 86) as these systems in themselves constitute the strategic structures that set the outer frames to how other systems can evolve and interact within these domains. The factors within the strategic domains thus set the outer framework for key system interaction. The various key systems then interact within these frames in accordance with their capabilities, essentially aiming to influence each other by seeking to apply their will and power on other systems' CoG in order to achieve their OBJ and desired ES.

The concept power is therefore best understood as the ability to induce or influence other systems by deployment of force and critical capabilities targeted at the various CoG (NATO, 2010). When the concept is transferred to the eclectic framework, it can to some extent be understood in relation to an extension of Porter's theory on forces explaining how competition is formed (Porter, 2008: 86). The reason that powers in part can be understood in this way, is that power here represents a system's capacity to shape competition, either through critical demand or through the deployment of critical capabilities. As such, power embodies the ability and strength to determine industry's long run profit potential, and in this way, the deployment of power determines how the value created by the industry is divided. An understanding of the competitive forces along with an appreciation of the underlying sources of power thus provides a framework for anticipating and influencing competition in the engagement space.

In relation to this discussion, it is important to remember that the eclectic framework seeks to capture the dynamics of system interaction. Therefore, one should appreciate, that along with the key systems, i.e. competitors, suppliers etc., the systemic PESTI factors themselves also change over time, as they too, are a function of system interaction. The strategic factors and key systems thus shape and reshape each other through continuous interaction, and the strength with which a system actively is able to alter the strategic environment in its favour, is referred to as power. In this way, a system's power should be understood as the possession of powerful critical capabilities, whereas power instruments in turn, are seen as the concrete actions or deployment of power<sup>17</sup>. As such, power instruments are a function of not only critical capabilities or demand, but also requirements and vulnerabilities, as the concept covers a system's ability to deploy its power in the concrete

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<sup>17</sup> Power instruments are thus manifestet through strategic ways

environment, and thus relates more to the concrete application of force to create the desired strategic effects.

An understanding of the underlying factors, forces and related power instruments that shape and influence competitive interaction thus further deepens the understanding of a company's strengths and weaknesses vis-à-vis other systems, and as such, guide the strategist further towards possible strategic actions through the appropriate application of power targeted at the other systems' CoG.

#### 6.6.1.1. Instruments of Power – Destructive and Conductive Power

Having defined the concept of power and instruments of power in overall terms, we will now categorize two classes of power, namely destructive and conductive power. In the comprehensive approach the application of both destructive powers, as to subdue or coerce rivals, and more conductive and holistic powers, as to e.g. rebuild systems or societies, can be utilized (NATO, 2009: 1-4). We will apply this philosophy to the eclectic framework, in order to support the design of competitive, comprehensive strategies.

Destructive power is targeted at the competitor, and is related to the term combat power, which is the effects created by combining the dynamics of manoeuvre, tactics, and leadership (NATO, 2010). As we will discover in the following, the exclusive use of destructive powers to subdue or destroy rivals is, however, not always the most beneficial in the long run, as it leads to wars of attrition.

This is the case in business as well, where they often are fought with a strong focus on operational effectiveness and a pressure on costs, which usually results in zero-sum competition with static and declining prices that essentially compromises companies' ability to invest in their business, thereby degrading overall value creation for all stakeholders in the long run (Porter, 1996: 64).

The deployment of power should therefore rather include a combination of both destructive and conductive power to first of all ensure company survival, and secondly to enable the company to outmanoeuvre its competitors by assuming a unique, sustainable value position in the engagement space. In the eclectic framework then, destructive power is related with either destroying or acquiring value from other actors who seek conditions that are in contrast with own goals. The use of conductive power, however, is rather related to the creation of value whose synergies sometimes benefit more than just the system itself, thereby creating positive-sum competition.

To summarize, when considering the appropriate deployment of power the company should seek to balance the use of destructive and conductive power to assume a unique, sustainable value position in the engagement space, by balancing power tools of coercion, corporation and negotiation to both claim and create value in the market.

### 6.7. Analyse Opposing COAs

Now we have reached the phase for developing COAs, which is the final phase in the framework before the finalizing the initial strategy formulation. When considering the appropriate strategic actions, the interim conclusions are revisited in order to decide which power instruments to deploy.

Military paradigms state, that before developing OCOAs, the strategist must estimate opposing COAs including the most likely and most threatening COA for each opposing system in order to include a explicit consideration of these in the strategy. The analysis of the different stages of the opposing COAs provides the strategist with a more dynamic understanding of opponents' capabilities that may be able to pre-empt or prevent own actions, as well as the inherent risks created by his actions. Naturally, the development of OCOA must be able to accommodate for assumed actions and determine how it may be possible to influence other actors' decision-making and capabilities through physical and non-physical actions under different conditions (NATO, 2010: 4-54 – 4-55).

As for COA in general, several tentative ones should be developed and tested for viability, to decide weather the COA should be adjusted or rejected. NATO suggests six criteria, where we will apply five of them the eclectic framework:

- (1) *Suitability*. Does the COA accomplish the mission, i.e. OBJ and ES?
- (2) *Acceptability*. Are the likely achievements from the COA worth the expected costs?
- (3) *Feasibility*. Is the COA possible given the time, space and resources likely to be available in the engagement space?
- (4) *Exclusivity*. Is the COA sufficiently different form other COA to clearly differentiate its relative advantages and disadvantages?
- (5) *Completeness*. Is the COA complete? Does it answer when, who, what, why and how? (NATO, 2010: 4-57)

As the reader can appreciate, this checklist can easily be used as a litmus test for any suggested cause of action in business strategy and can therefore be of general use for managers on all levels. After the strategist or manager has chosen the strongest COA, he is ready to develop his initial operations design or strategy formulation, which essentially is a chain build from the interim conclusions drawn from the various phases of the framework.

#### 6.8. Operational Design and Initial Strategy Formulation

The operational design provides the critical link between the strategic challenge and the required strategic ends. It applies operational art, or the combination of ends, means and ways, in transforming the situation prior to starting the campaign by formulating strategic OBJ along with the various lines of operation. These lines of operations will thus lead to the accomplishment of tactic, operational and strategic OBJ and finally the obtainment of the desired ES (NATO, 2010: 4-45).

When we transfer this to the eclectic framework it means that the operational design, or initial strategy formulation, is expressed by various lines of operations that address the CoG for each represented key system, i.e. competitors, suppliers and customers. The operational design should, however, not be seen as plan set in stone, but rather as a flexible strategy to deal with foreseen and unforeseen events. In practice this means that if the conditions or CoG should change during the campaign, the strategist revisits the appropriate phase in the eclectic framework, and with the new conclusions drawn from this, he then adjusts his operational design accordingly.

An additional strength of this final phase of the eclectic framework, is that the strategy formulation can help communicate top management's overall goal in a transparent and unequivocal way. Furthermore, as it can be used on all levels as it provides a common ground for further refinement of overall OCOAs, and as such it supports the synchronisation and coordination of the endeavours over the cause of the strategic campaign. Finally, it can be used as a tool to assess the progress of the strategy and consequently to make adjustments if required.

#### 6.9. Using the Eclectic Framework

The eclectic framework effectively guides the user through the appropriate phases of strategy formulation, starting with the task analysis where the outer frames are drawn and the strategic ends are defined. Then the competitive terrain is analysed by first studying the systemic PESTI domains, which serves as a platform for analysing the key systems in the industry, i.e. own company, suppliers,

competitors, and finally customers. Afterwards the strategic means or critical capabilities are determined by exploring the industrial players' CoG, whereas the customers' CoG serves as a tool to identify an appropriate value proposition to cater the critical demand. This leads to the formulation of strategic ways, which is based on the critical demand in the market, the competitor's assumed CCOA and own CoG. This effectively leads to the formulation of the initial operations design presenting OCOA that thus constitutes the critical link between end, means and ways.

What is represented here is thus the main phases of the eclectic framework. However, strategy in the eclectic framework is formulated to support strategic courses of action in order to create the desired effects needed to achieve the strategic objectives. Therefore, significant changes in the competitive terrain are an inherent part of operations, which the eclectic framework naturally must be able to address. It therefore suggests a dialectic approach, meaning that when significant changes occurs in the strategic terrain - e.g. by a significant change in critical capabilities or demand - the strategist returns to the appropriate phases in the framework and adjust his strategy accordingly. In this way, the eclectic framework should be considers more as a wheel where strategy formulation continuously is in progress. As we have seen through the various phases, it namely not only allows for strategy as preplanning through the systemic approach to analysis - indeed, through the combination with the effects-based approach and the continuous dialectic process that commence once the business operations have been initiated, the framework also allows for strategy formulation as an emerging activity.

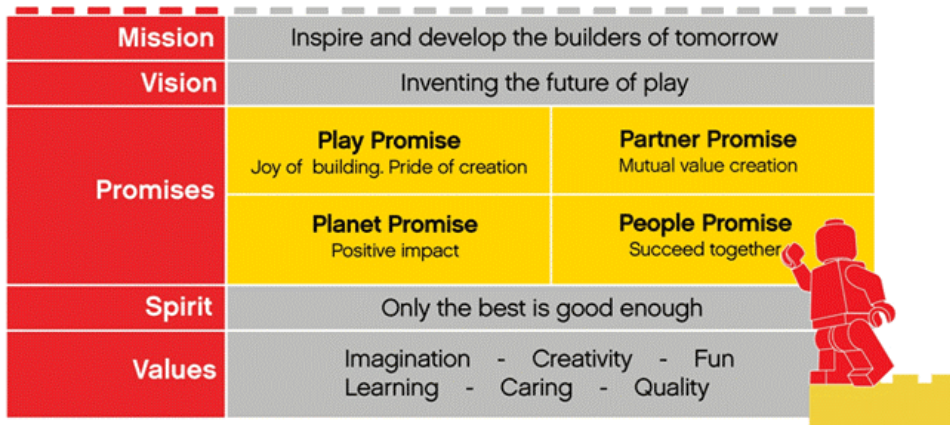
## 7. Analysis: The LEGO Company in China

In the following an analysis on the LEGO Company in China will be conducted to test and illustrate the eclectic framework. The analysis, however, will primarily reflect the process of strategy as preplanning, as the practice of emerging strategies is a dynamic, dialectic activity commenced after the operations are initiated.

The analysis thus includes the incremental progress through the various phases of the eclectic framework, completed in the operations design and the LEGO Company's suggested COA in China.

### 7.1. Task Analysis – Determine Ends

Before the strategic ends are determined, the metaphysical realm surrounding the LEGO Company's strategy is determined, i.e. their values, mission and vision. These can be determined through the 'LEGO Brand Framework', illustrated below:



According to the LEGO Company the Brand Framework forms the foundation for their strategies and their long-term priorities, and highlights their value proposition along with the expectations stakeholders have to the company (LEGO, 2016b).

As for the core elements in the company's strategy in the Chinese market, the CEO Jørgen Vig Knudstorp has declared that the company seeks to become the number one toy brand in China (Knudstorp in Wagstaff, 2016). The CEO has further described the company as a unique niche player in the toy industry, as they focus almost exclusively on high-end construction toys. Their quest for becoming the strongest player in China must therefore not compromise their values, which on another occasion has lead the CEO to state: "We would never be the biggest, but being the best was good enough" (Knudstorp in Robertson, 2013: 129). The desired end-state (ES) the LEGO Company strives for in the Chinese market is therefore established as follows:

*Within the fragmented industry of traditional toys, the LEGO Company has maintained and fortified its position as the strongest and most successful company, as measured in sales and revenue. Further, the LEGO brand has maintained its status as the most popular brand in the general market, as*



*measured in brand share. Finally, the LEGO Company has obtained a stronger strategic position in the market, by a further acquisition of market share as compared to their competitors.*<sup>18</sup>

As the reader can appreciate, the ES has two components: one stating what the company should maintain and protect, and one expressing what the company should accomplish in the market.

As for the objectives (OBJ) that are the clearly defined and attainable goals used to reach the ES, these can naturally be broken down and specified appropriately to match the specific level<sup>19</sup> one formulates the strategy for. However, for the sake of clarity, we will keep the formulation of OBJ on a very general level. As the company separates its strategy in three individual lines of operation, it makes sense to follow the same division, namely operational, commercial, and organizational (LEGO, 2016a). The OBJ are deducted later in the eclectic framework as they are an integrated part of the chosen OCOA. But for the convenience of the reader they are listed in the following to create a clearer image of the following analysis:

Operational OBJ:	The Jiaxing factory should be fully operational in 2017, and be able to supply 70-80% of products delivered to the Asian market.
Commercial OBJ:	Licencing: continue to integrate licensing in selected product lines. Leverage digitalisation: develop synergies through digital integration in LEGO products, and create and develop Chinese online platforms, i.e. customer forums and e-commerce platform. Marketing: tailor, execute and later update 360° marketing strategy.
Organizational OBJ:	Strengthen organizational structure to support operational and commercial OBJ.

#### 7.1.2. Task Analysis - Determine Domain

As stated in the task analysis the scale and scope of the business operations includes three dimensions, i.e. geographical scope, customer offerings, and vertical integration.

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<sup>18</sup> The ES and OBJ are thus based on assumptions and deductions not only by the references above, but also deductions made from general official statements from the LEGO Company, their official strategy formulation (LEGO, 2016) and their general strategic actions and initiatives in China, which points to these strategic ends.

<sup>19</sup> That is, broken down to e.g. specific time periods, or bench marks e.g. with specific percentage growth in sales etc.

Originally, the LEGO Company had a uniform strategy for all of Asia. However, in 2014 the company decided to formulate a strategy exclusively targeted at the Chinese market, which is now considered to be a vital part of their overall strategy. The strategy spans over 2015-2017, and in this time frame the tangible impacts are measured and directed through the formulated OBJ.<sup>20</sup> However, the strategic activities usually have a longer perspective and their full benefits will therefore first be fully realized over time.

The LEGO Company describes itself as a unique niche player in the toy industry, as they focus almost exclusively on high-end construction toys, and therefore only target customers who prefer to build and create within the frames offered by their system of play. In general, the company seeks to be gender and age neutral, creating a brand with universal appeal (Robertson, 2014: 129-130). The company defines their core customer group as simply as boys and girls "aged 1,5-11 years, who appreciate hands-on activities like creative building and roleplaying" (LEGO, 2016c). The specific LEGO lines, however, also target wider age groups, and each line is therefore customized to target specific customer groups based on either gender, age or both. Some lines, like LEGO Disney Princess, are e.g target directly girls, whereas other lines, are gender neutral but more age centered, like e.g. DUBLO for pre-schoolers, LEGO Tech for the more experienced builders, and LEGO Architecture for grown up LEGO aficionados (the LEGO Group, 2016a).

As for direct customer offerings, the product portfolio for the Chinese market is essentially the same as can be found worldwide. What then differentiates the approach to the Chinese market is therefore not the product offerings, but rather how they are communicated and marketed to the Chinese customers. In this endeavour, the company has e.g. established a LEGO 'hub' in Shanghai, and has further established special LEGO Education Centres to help promote LEGO products through their educational value (The LEGO Group, 2016d)

As for vertical integration the company has essentially internalized all value adding activities, whereas support activities not generating value or drawing on the company's core competencies are externalized (Robertson, 2013). According to LEGO's COO, Bali Padda, it is a fundamental part of the

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<sup>20</sup> As is the case with our own analysis. The main focus will be on the current state of affairs and the near future, but as the frame work is build to formulate business strategy a longer time span is considered as well. Further, as the LEGO Company's OBJ are unknown, the reader should remember that the OBJ presented in the analysis are based on some assumptions, as mentioned before.

company's overall strategy, to have full control of the entire production process, in order to deliver products of a consistently high quality and safety in harmony with the company values. Furthermore, the company's strategy includes having production close to their core markets in order to secure short delivery times and world-class service to customers (The LEGO Group, 2013). In essence then, the company's global value chain is focused on four main activities all surrounding their main product, the LEGO brick:

- (1) Development of plastic material and products
- (2) Production of the LEGO bricks
- (3) Distribution and logistics
- (4) Sale and marketing (Robertson, 2013)

The strategy for the Chinese market is set to be an integrated part of the overall global strategy, and the Danish founded MNC has decided to keep R&D activities almost exclusively in the HQ in Billund<sup>21</sup>. The strategy for China, however, involves the three remaining core tasks. As for manufacturing of LEGO products, the company has establishing its own LEGO factory in Jiaxing, which is expected to be fully operational in 2017 and deliver approximately 70-80% of all products sold in the region. As for distribution, the company has established a regional distribution center in Shanghai (The LEGO Group, 2013), and as for the last pillar the company launched 360° marketing strategy in 2015, targeting the Chinese market.

## 7.2. Analysis of the Competitive Terrain

As the outer frames of the strategy have been drawn, what now follows is the analysis of the competitive engagement space. As stated earlier, the systemic PESTI analysis can help to identify additional systems influencing competition in the various strategic domains. However, before conducting the PESTI analysis it self, it is helpful to first identify the main systems influencing the LEGO Company's competitive terrain in China.

The list of general key systems<sup>22</sup> influencing the competitive terrain in China is listed as:

- (1) Own system: LEGO

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<sup>21</sup> The Company has, however, established LEGO 'hubs' in London, Enfield and Singapore to support their three core regional markets, i.e. Europe, the US, and Asia (The LEGO Group, 2012).

<sup>22</sup> For a more extended explanation of the chosen systems, see paragraph 2. 'Delimitation of the Research Area'

- (2) Suppliers: suppliers of raw materials, parts and finished goods<sup>23</sup>
- (3) Competitors: Mattel Inc. (MEGA Bloks)
- (4) Customers: end-consumers

As the extent of the paper is limited, the main system segments are not divided further into more differentiated segments. Instead the main efforts in the following analysis are focused on the above listed systems, as they are viewed as the most important for LEGO's strategy in China.

### 7.3 PESTI Analysis of the Systemic Factors Shaping the Competitive Terrain

In the following the Chinese market will be analysed by the application of the formulated PESTI acronym. The analysis will be conducted with the LEGO Company at the centre, but when appropriate, interim conclusions on the domains' influence on other key systems will also be drawn. By an application of the systemic approach a preliminary analysis of the factors influencing the strategic environment in the engagement space, will thus be conducted. Furthermore, the possible future changes in the domains will be explored, which along with the current state of affairs help formulate the interim conclusions that will feed into the subsequent phases of the eclectic directive.

#### 7.3.1. The Political System and Rule of Law

China's political system is fundamentally different from what is found in the western world, which has several strategic implications for foreign business systems entering the Chinese market. Paradoxes from having a strictly controlled communist system seeking to drive a modern capitalistic economy are therefore rampant, which creates a business environment for MNCs that is opaque at best, and criminal at worst.

There are, however, positive developments in the political system, seeking to create a more benign business environment for MNCs. As both the LEGO Company and its main competitor, Mattel Inc., have production facilities in China, the government's five-year economic plan from April 2015 is important, as it presents new industrial guidelines for foreign businesses manufacturing goods in China. Through the new guidelines the government seeks to create a more investor-friendly and competitive environment for foreign companies. An important relaxation is concerning JV, effectively reducing the number of industries where JV with a Chinese partner are required. This means that

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<sup>23</sup> As we saw in the previous paragraph, the LEGO company has essentially internalized all value adding activities which means their supplier list is relatively short. For a full list see 'LEGO's Supplier List' (LEGO, 2014)

foreign investors are able to create fully foreign owned companies or subsidiaries in those adjusted industries, either through new set-ups or M&A (Heffels Spiegeler, 2015).

In overall terms, however, one of the most significant characteristics in China's political system is, that it opposed to all other G-20 economies is a communist led state, where China's Communist Party (CCP) heavily dominates state and society. The political system, however, is neither very monolithic nor strictly hierarchical, as political leaders and institutions often represent different interests (Lawrence & Martin, 2013). This, however, often paints an opaque picture for foreign business systems, making it difficult to manoeuvre in the Chinese market, where cumbersome and/or corrupt bureaucracy can affect competitors differently and in unexpected ways. Indeed, the CCP is widely perceived to support rule by law, i.e. law as a tool for governance, where the party holds it self above the law and denies judiciary independence (Lawrence & Martin, 2013: 17), which leads to a situation where transparency is low, and uncertainty and corruption becomes an inherent part of doing business (Transparency International, 2015)<sup>24</sup>.

An important related issue concerning China's weak rule of law, is the government's recurring inability to protect commercial trademark and patent rights. Since China's entry in the WTO in 2001, the country has been obliged to enforce commercial rights. China, however, still harbours the world's most thriving piracy industry, where copies of everything from luxury designer bags to LEGO bricks are rampant. Indeed, the piracy industry is so sophisticated that there are several examples, where exact copies of LEGO box sets are found the very day after the authentic boxes have been launched to the Chinese market. The government has, however, made slow progress to adhere to WTO patent laws, and on few occasions, supported some of the LEGO Company's many legal complaints, lastly in 2003 ruling that the Chinese Coko Toy Company in 33 out of 53 items had infringed the LEGO Company's copyright (BBC, 2003).

#### 7.3.1.1. Forecasts on the Political System and Interim Conclusions

The government's inability to protect commercial rights is important to dwell upon here, as it affects the LEGO Company disproportionately as opposed to their competitors, as their brand is one of their main sources of competitive advantage. As we have seen, pirate copying of LEGO products is flourishing in China, and even established Chinese companies often produce direct copies of LEGO

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<sup>24</sup> China ranks 83/168 countries in the 'Corruption Perceptions Index' and is ranked as 27<sup>th</sup> out of 28 countries in the 'Bribes Payers Index' (Transparency International, 2015).

design, while other companies unlawfully are able to affiliate themselves with the LEGO brand, without continuous and persistent legal repercussions<sup>25</sup> (Quartz, 2013).

Even though the Chinese authorities have made substantial progress in creating a legal framework to promote the authority of courts in commercial disputes, there are still substantial problems in enforcing central government policies across China's large provinces (BBC, 2003).

This naturally distorts competition for the LEGO Company. And as we will explore further during the CoG analysis, the phenomenon of not only pirate copying but also plagiarism of brands can threaten the LEGO Company disproportionately, as the LEGO brand is a main element of the company's CoG<sup>26</sup>.

### 7.3.2. The Economic System

China is considered world leader in gross value of industrial output (CIA, 2016), including the manufacturing of consumer products such as traditional toys and games.

In 2014 China surpassed the US and became the world's greatest economy<sup>27</sup>, and the country further represent the largest population and biggest labor force in the world. Per capita income, however, still remains low<sup>28</sup> (CIA, 2016). This however, reflects a considerable discrepant in income distribution, and the sheer size of the market thus means that millions of Chinese are able to purchase more than just necessities for their children. The demand for expensive quality toys in the market has thus risen considerably (Euromonitor, 2015a).

Despite of China's newly earned rank among the world's leading economies, the country was presented with severe economic challenges in 2015; GDP growth dropped to a 25-year low, foreign reserves fell drastically, corporate debt soared, and the stock market dropped by nearly 50 percent (McKinsey Global Institute, 2016a).

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<sup>25</sup> The LEGO Company's last patent on 'clutch power' expired in 1988, effectually allowing any company to produce a plastic brick compatible with the LEGO brick, as long as they do not use the LEGO logo. The legal issues concerning copying of LEGO products have therefore primarily concerned trademark law rather than patenting (Robertson, 2013).

<sup>26</sup> Forecasts on the projected implications for China's newly initiated laws, i.e. economic laws and abolition of 'one-child policy', will be discussed in the paragraphs concerning economic and socio-cultural factors.

<sup>27</sup> Measured in PPP. GDP: USD 19.39 trillion (2015 est.), USD 18.14 trillion (2014 est.) (CIA, 2016)

<sup>28</sup> This will be explored further in the CoG analysis of the customer segment.

Despite of the resent economic downturn, China remains the biggest growing market for traditional toys in the world, and especially construction toys are seen as a key growth driver in the market (Euromonitor, 2016c)<sup>29</sup>.

#### 7.3.2.1. Forecasts on the Economic System and Interim Conclusions

The resent economic downturn has created financial volatility across the globe, and fear of a general, permanent slow down in China's real economy. Forecasts on the economic domain, however, can be broadly divided into two segments.

The first builds on the assumption that the country simply has not established the basis for a sustainable economy. The domain is e.g. said to lack a competitive, dynamic private-enterprise structure, and that the economy has exhausted the possible value derived from low cost labor and heavy FDI, which will lead to a general economic down turn.

If it this assumption holds to be true, this will naturally have negative consequences in the future for all business entities, foreign and domestic, operating in China.

However, the other projection is more positive about China's economic future. The argument goes that despite the fact that the structures in the economy present significant challenges, the reforms initiated in 2015 will help to support both the micro and macro structures of the economic domain, e.g. by the relaxation on limitations on foreign business systems operating in China, and by supporting innovation and domestic consumption. What further supports the positive outlook not only for the economy in general, but also for the industry, is that the private sector in China is vibrant and growing, and is projected to follow a positive trend in the feature (McKinsey Quarterly, 2015). As for the projections on annual household incomes, which naturally become important for the demand of the industry's goods, the figures are also promising; more than 50 percent of urban households are thus predicted to be in the middle class by 2022<sup>30</sup>, with an annual household income of USD 20,000

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<sup>29</sup>For a datagraphics, see appendix 11.3. 'Data Graphics of the Toy Industry in China'

<sup>30</sup> According to Euromonitor consistant stock market fluctuations will have limited effect on China's GDP growth and consumer wealth. Effects on consumer wealth are expected to be limited as corporate equity holdings represent less that 10% of aggregate household wealth, and, more importantly, are owned by less than a 10th of all households, meaning that the majority of households will not be affected by stock market fluctuations (Euromoniter, 2015a).

– 40,000 - an increase of more than 100 million households over the coming decade (McKinsey & Company, 2014)

If the forecast holds, the rise in personal income will assumedly become a driver for general economic growth, but will also directly benefit the industry through an assumed higher demand on the industry's goods.

### 7.3.3. The Socio-Cultural System

As we explored earlier, socio-cultural norms naturally affects preferences and thereby also demand. As for direct local adaption, the industry for traditional toys is not necessarily as directly affected, as long as the products have a general appeal to children across nationalities. Naturally, however, demand will rise accordingly if the products represent values directly tapping into local norms and preferences. Let us therefore look closer on the Chinese values and norms shaping preferences in the market.

For more than two millennia the Chinese social-cultural life has been rooted in Confucianism, and still today, it inspires and forms many aspects of Chinese existence. Confucianism is characterized by a great respect for the family and by an optimistic view of the human nature, believing that people are improvable through individual and collective endeavour. This naturally means that all activities focusing on either family or activities demanding logical thinking, creativity or concentration, are highly valued and pursued in Chinese culture.

The Chinese 'one-child policy' mandated in 1979 together with the Confucius' focus on personal improvement and education has led to what is referred to as 'the little emperor syndrome' with families' almost extreme focus on the only child's development and education. Consequently, private education along with goods and services focusing on children's development is a flourishing multibillion-dollar business in China (McKinsey & Company, 2014). Furthermore, as a result of the extreme focus on children's education, their schedules are extremely structured and planned, usually only allowing for an average of one hour of play per day (Rasmussen, 2015) thereby creating a unique market opportunity for suppliers of toys and games developing children's creativity and logical thinking.



#### 7.3.3.1. Forecasts on the Socio-Cultural System and Interim Conclusions

As stated earlier, a scenario with significant long-term decline in GDP is not viewed as the most likely. However, even if aggregate consumer spending should decline, toys and games focusing on children's development are set to outperform most other non-essential products in the long run, due to favorable demographics and socio-cultural values, making a potential short term flattening of demand less important.

As for demographics, the Chinese government implemented a new law on January 1<sup>st</sup> 2016, allowing couples to have two children instead of just one, in order to address China's demographic and economic challenges. Currently, China has the largest population in the world with a staggering 233 million people under the age of 14, and with an average of only 1.6 children born per woman in 2015 (CIA, 2016) Chinese households are in a relatively better position to spend on non-essentials for their children as compared to other emerging markets (Euromonitor, 2015a). Even if the abolition of the 'one-child policy' will have just a small positive effect on birth rates, the main target group for the industry will still grow significantly, thus creating further favorable demographics for the industry in the future. In addition to favorable demographics along with the forecasted rise in household income, the new generation of parents generally shows a greater propensity to consume, especially on high-end family oriented goods (McKinsey & Company, 2016), which further supports a positive forecast for the industry in China.<sup>31</sup>

This thus shows positive opportunities for industry in general. However, the LEGO Company is projected to have relatively more positive forecasts in opposition to their competitor, Mattel Inc., due to their strong lines of skills-based construction toys that clicks perfectly with the socio-cultural values.

#### 7.3.4. The Technological System

Production wise China is one of the biggest countries of opportunity, which is supported by the technological opportunities in the country. Along with creating a climate that is increasingly more benign towards international business activities in general, China has made a significant shift towards a services and skills-based economy, creating a production platform that not only offer an abundant of low cost labor, but also a vast pool of skilled and well educated workers. Indeed, education and

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<sup>31</sup> As for the related question of disposable income and affordability, which is important in forecasting potential sales, especially in the high-end non-essential like quality toys, disposable income per capita is projected to reach USD 14,505 by 2030 (Euromonitor, 2015a).

support for research and high technology innovation has become a high-priority area for the Chinese government that seeks to create a climate attracting and supporting international business activities in a wider range of industries, creating a climate where new production technologies and products are being developed in China (KPMD, 2010).

As we saw previously, education is highly valued in China, leading to relatively high education rates as compared to other emerging markets, which is further supported by increased government spending and focus on the area. From 2001 to 2009 e.g. the number of annual graduates increased six fold (KPMD, 2010) and the literacy rate is now above 96 % with an increasing number of graduates (CIA, 2016) creating a climate where new production technologies and products are being developed in China, which further supports production in a broader range of industries, requiring more skilled labor.

#### 7.3.4.1. Forecasts on the Technological System and Interim Conclusions

The Ministry of Education has issued a medium to long-term reform to further support the sustainable development of the labor force and the science and research platforms in the years ahead (KPMD, 2010: 3). Furthermore, in order to mitigate the extensive corruption and misuse of funds, the Government has announced plans to reshape federal science funding, introducing reforms delegating power to independent institutes after 2017 in order to curb corruption and inefficiency (Grant: 2014). The reforms are seen to support the industry in general, as they will secure a sustainable, skilled labor force in the years to come, and create a climate promoting not just low cost production, but also a platform for possible innovation of both products and production technologies for MNCs operating in China.

The challenges in the technological domain are thus related to the challenges of how China manages to move from a manufacturing to an innovation driven economy. As we have seen previously, the LEGO Company has established a hub in Shanghai employed with both international and local staff workers to ensure the continued ability to tap into local knowledge and opportunities. However, the company has decided to maintain heavier activities and operations involving R&D etc. near the Danish HQ, which makes China's potential challenges in reconfiguring its economy to a more innovation based one, less of an issue for the company.

### 7.3.5. The Infrastructure System

China is the fourth largest country in the world, and is richly endowed in natural resources (CIA, 2016) providing inputs for production in a wide range of industries. China has invested heavily in both hard and soft infrastructure, which has greatly improved the opportunities for MNCs to conduct business operations in the country. However, being an emerging market, many vital features are still either deficient or function in significantly different ways.

In terms of hard infrastructure the government has invested heavily in the expansion of the transportation system, which facilitates logistics within China. Furthermore, with a coastline covering approximately 14,500 km the country possesses some of the largest ports in the world, effectively supporting in and outbound logistics. In terms of energy supplies, China is both the number one producer and consumer of electricity, and the country additionally has a stable supply of other energy resources (CIA, 2016) and other vital inputs, which greatly facilitates production of goods. However, as China is still a emerging market, the quality of the transportation system, availability of resources etc., thus vary greatly from province to province.

As for soft infrastructure<sup>32</sup> and knowledge flows, the use of the Internet has expanded massively in China to a total of 626.6 million users, which now not only constitutes the largest population of Internet users in the world (CIA, 2016) but also the world's largest e-commerce market (McKinsey, 2016: 10). There are, however, severe issues with the use of secure payments online, creating problems for companies and customers alike. However, if these can be mitigated online platforms and e-commerce represent a huge business opportunity in China (McKinsey, 2016).

As for broadcasting media, all are either owned by or affiliated with the CCP (CIA, 2016). The government thus maintains the authority to approve all commercials, before broadcasting which naturally can have an impact on companies' general ability to launch comprehensive full-scale marketing campaigns.

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<sup>32</sup> The quality, characteristics and related implications of political institutions that have an extensive influence on all institutions and systems operating in China have already been discussed. The key takeaway when assessing Chinese institutions in general is thus to emphasize the high-level of corruption, and the related difficulties for foreigners to maneuver in the institutional environment.

#### 7.3.5.1. Forecasts on the Infrastructure System and Interim Conclusions

It is evident that despite of the quantum leap China has taken, it is still in many ways a developing market in terms of infrastructure and institutional voids. Consequently, industry participants must mitigate these deficiencies by developing appropriate strategies. Modernization and development of logistics and supply chain systems within China can therefore be a key enabler for increasing productivity in many sectors. As we have seen, hard infrastructure supporting logistics is developing by both public and private initiatives, but most business are still compelled to invest considerable resources in developing a supply chain systems with in China (McKinsey, 2014).

As we have seen, however, the quality of the transportation system, availability of resources etc., vary greatly from province to province. Therefore, the deficiencies in the overall system in China can be mitigated by strategic placements of production sites etc. As for the Jiaxing province where the LEGO Company is currently constructing its new factory only 100 km from the Group's hub in Shanghai, the site is ranked 25 on the list of 100 best cities for foreign investment in China. Moreover, the site provides all the necessities in terms of hard infrastructure the company needs for production and distribution of its goods to their customers in China and the rest of Asia (The LEGO Group, 2013).

As for soft infrastructure, the high levels of red tape in the Chinese government can create uncertainty, and strict government control of media and Internet can create obstacles for MNCs' when they wish to deploy comprehensive marketing strategies, which therefore must be addressed accordingly. The sheer size of the e-commerce market can, however, represents huge opportunities for MNCs if the issues concerning secure online payment can be mitigated.

#### 7.4. Analysis of the Systemic Forces Shaping the Competitive Terrain

Having now conducted a preliminary analysis of the systemic factors structuring competitive interaction, the interim conclusions drawn from the PESTI analysis are now transferred to the next phase of the framework, i.e. the analysis of the systemic forces structuring the engagement space and the CoG analysis.

The overall purpose of the CoG analysis in its entirety is as to identify the strategic sweet spot in the market, where the LEGO Company based on its critical capabilities, can meet the Chinese customers' critical demand in a way that competitors cannot. Therefore, it makes sense to first analyse the Chinese customers' CoG, as their critical demand should function as one of the focal points for determining where companies should focus their resources. After the market demand is determined,

the capabilities or means of the relevant industrial systems are determined. This is done by first analysing Mattel Inc.'s<sup>33</sup> principal source of powers, which together with the market's critical demand is used as the backdrop to determine the LEGO Company's CoG.

Remember that there is no fixed starting point for the CoG analysis, which in practical terms is a dialectic and dynamic approach. However, as strategy formulation in the eclectic framework seeks to utilize own strengths by targeting own critical capabilities at the customers' CoG in a way that competitors' offerings cannot given characteristics of the engagement space, it makes sense to structure the analysis through these phases.

What we then gain from this phase of the analysis is the LEGO Company's proposed value proposition based on the critical demand, along with an identification of strengths and weakness of the main competitors based on their CoG. After the analysis, the findings are transferred to the subsequent phase to formulate appropriate courses of action (COA).

Before focusing directly on the individual key systems, a general overview of the industry and its systemic forces is, however, appropriate as it naturally affects and forms the competitive terrain along with the PESTI structures.

#### 7.4.1. Overview of the Competitive Terrain of the Toy Industry in China

As stated previously, the industry is shaped by the key systems presented earlier in the analysis. The selected segments within the various key systems are analysed during the CoG analysis, however, in addition to the CoG analysis of key systems, a short presentation of the industry is appropriate, as it naturally affects and shapes the competitive terrain.

China by far represents the largest growth market in the world for traditional toys, and as we have seen previously, favourable socio-economic factors remain instrumental in sustaining market growth. Within the industry the primary growth driver has been a surge in demand and sales for construction toys, which by far is seen as the fastest growing segment (Euromonitor, 2015c).<sup>34</sup> As related to industry participants, the market, however, remains extremely fragmented. More than 70% of the

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<sup>33</sup> Due to the limited scope of the paper, a CoG analysis of suppliers is omitted. This is however possible, as the LEGO Company essentially has internalized its entire value chain, which consequently makes suppliers less important in the specific context.

<sup>34</sup> For a datagraphic, see appendix 11.3. 'Data Graphics of the Toy Industry in China'

market is thus occupied by companies with less than 0,1% market share, and only 7 companies amount for a company share larger than 1%. The LEGO Company and Mattel Inc. who amounts to 2,8% and 1,9% company share respectively, thus represent some of the largest companies in the industry (Euromonitor, 2016e).

#### 7.4.2. CoG Analysis for LEGO's Chinese Customers: Critical Demands, Critical Requirements, and Critical Vulnerabilities

The following CoG analysis of the Chinese customers can together with the subsequent phases help to identify a unique, sustainable value position in the market. Let us start with the critical demand that constitutes the CoG. i.e. the trends or critical preferences that should shape the LEGO Company's value proposition in the Chinese market.

In general the modern Chinese consumers are becoming more selective about how they spend their money, which leads the market from broad based market growth towards new shapes of consumer trends. The first trend is a clear preference towards premium products and brands, with a growth in sales outpacing that of mass and value segments. Indeed, 50% of Chinese consumers seek the best and most expensive products, which is a significant increase over the previous years (McKinsey, 2016: 3). An interesting feature here is that foreign brands still hold the leadership position in the premium segment, indicating a preference towards multinational premium brands, vs. the value and mass segments where local brands are gaining market share from foreign incumbents (McKinsey, 2016: 7). The trend towards the premium segment goes in hand with an increased loyalty towards brands (McKinsey, 2016: 8). This does, however, not mean that Chinese customers are slow at adopting new trends or brands, as long as they cater their preferences. In fact, especially the young consumers are increasingly focused on customised products in order to show individuality, and Chinese consumers are adopting new products, services and retail experience at rates unseen in developed markets (McKinsey, 2016:12) making it possible for premium multinational brands to cater to the market with new product offerings, despite the fact that the communication of their value proposition to the Chinese customers through comprehensive marketing approaches can be challenging due to the foreign nature of the soft infrastructure domain .

Another new trend amongst Chinese consumers is an increased focus on a balanced life with a healthy living. This trend has among other things been sparked by a number of health scandals, e.g. involving food safety issues, where thousands of infants died due to poor control and standards concerning baby milk. As a consequence, Chinese consumers now have an increased focus on

safety and health issues, especially when purchasing goods for their infants, creating a preference towards brands promising to deliver quality goods (McKinsey, 2016), thereby also toys living up to safety standards.

The last new tendency in China reflecting on consumer trends is an increased family focus. Having a happy and balanced family thus increasingly defines success for the Chinese, and though they continue to pursue social status and wealth, the importance on family, and thereby also children, has grown steadily over the last few years (McKinsey, 2016: 9).

Some of the evolving trends reflect emerging values, whereas others stem from socio-cultural values deeply rooted in society shaping preferences, which was also discussed previously. A important point to emphasize when discussing trends and critical demand, is the Chinese parents' demand for goods and services developing logical thinking, creativity and personal development (Jensen, 2013). As we saw earlier, Chinese children are usually only allowed one hour of play a day, which creates a unique value proposition for skills-based play and toys, as it feeds directly into the values and demands discussed above.

As for the critical requirements for the customers to be able to acquire their critical demand, several factors come in play. The first are affordability and willingness to spend. As we have already seen, personal income has risen steadily and unemployment has remained low, and as a consequence, consumer confidence has remained remarkably resilient over the last couple of years<sup>35</sup>. Despite of the bleaker outlook for the Chinese economy then, consumer confidence encourages consumers to continue their spending habits. This is also reflected in the industry's impressive growth rates in sales in the Chinese market during the recent years. However, beneath the confidence lays a significant change in the way Chinese consumers spend their money (McKinsey, 2016), which we also discussed previously. These trends, however, are favourable for the industry of quality toys allowing Children to concentrate and develop skills, and even to spend time with their parents, building a universe together, which construction toys often promote.

The second important factor as related to critical requirements is accessibility. Naturally, this can be influenced by several factors, e.g. by changes in the PESTI structures, say a change in legal

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<sup>35</sup> 55% of Chinese consumers are confident their incomes will increase significantly over the next 5 years, which reflects a minimal 2% drop from 2012. By comparison, in the US and the UK only 32% and 30% respectively, are confident their income will increase within the same time frame (McKinsey, 2016: 3).

structures, or infrastructure that can limit both companies' ability to deliver the demanded goods, but also the customers' ability to acquire them.<sup>36</sup>

As for critical vulnerabilities the biggest threat is thus a drastic fall in demand of high-end toys due to deficient critical requirements, e.g. drastic fall in disposable income or even changes in critical preferences. However, as we have seen in our PESTI analysis, the first is not viewed as very likely. The second is not viewed highly likely either, as the critical demand has deep socio-cultural roots. Companies should, nevertheless, pay close attention to changes in customer demand, in order to be able to adapt and update their value proposition when needed, and target the CoG.

The value proposition constituting the customers' CoG is thus a demand for high-end skills-based toys, delivered by a premium brand promising quality, and that commercially is assessable through e-markets, and in practical terms has qualities compatible with digital features or online platforms.

#### 7.4.3. CoG Analysis for Main Competitor, Mattel Inc.: Critical Capabilities, Critical Requirements, and Critical Vulnerabilities

Let us now set out to explore Mattel Inc. and thereby also MEGA Bloks' means, i.e. their critical capabilities, requirements and vulnerabilities, in order to determine their primary source of power to achieve their assumed ends in the Chinese market. In this way we will explore their competitive advantages and their value proposition in order to later determine appropriate COA.

However, it is appropriate to first establish Mattel Inc.'s assumed ES in the Chinese market. Mattel's ES is based on assumptions formed by their general statements concerning the issue, their activities in the market and their general modus operandi. Mattel Inc.'s assumed ES for the fragmented Chinese market is thus: to become the largest company in the general industry in China as measured in sales and brand share through a broad value proposition and increasingly larger brand portfolio focusing on synergies stemming from licensing and digitalization.

As for determining Mattel's critical capabilities leading to increased customer value through a differentiated value proposition, performance, product portfolio, quality and brand share will be considered. In 2015, the company reported global revenue of USD 5.7 billion, making it the largest

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<sup>36</sup> Remember that changes in the PESTI structures are less dynamic than the forces in the market. Therefore, other changes in the PESTI structures are not likely to have the greatest impact in the short run. Should they, however, change, they can have implications for all key systems.



toy company in the world as measured in revenue. Mattel has, however, been struggling on several fronts over the recent years. In 2015, Mattel's global revenue thus fell with 5%, and the company suffered a 26% decline in net profits (Zander, 2016). For Mattel, business in China has been problematic, and the company has had several failed initiatives with their previous strategies in the market. In 2015, Mattel had a total brand share of only 2%,<sup>37</sup> primarily accounting for sales in Fisher-Price and Barbie. Mattel's remaining brands are far less popular in China, and as for their share in construction toys, which are very popular in China, MEGA BLOKS was thus not even represented (Euromonitor, 2016d). Business, however, is improving in the Chinese market for Mattel, which according to the company had its best year in China in 2015, experiencing double-digit growth (Global Times, 2016).

As for product portfolio, Mattel Inc. has a very broad portfolio of subsidiaries with globally popular brands, including but not limited to the ones listed above. Mattel therefore provides an enormous range of differentiated products, which provide them with an opportunity to cater to a wider range of customers through a broader value proposition. In addition to this, Mattel is a global heavy weight, drawing on vast financial resources and capabilities from the various subsidiaries, which, if fine-tuned and adjusted to the market's CoG, could lead to competitive advantage.

Mattel Inc., however, has not yet been very successful with deploying their critical capabilities in the market, and Chinese customers it seems, do not find their brands or toys as appealing as customers in the West. Mattel have launched several initiatives to make their products more relevant, e.g. by introducing Asian Barbie dolls etc. It seems however, that Mattel's brands do not have the same universal appeal as that of LEGO's, and in order to target the Chinese customer's CoG more precisely, it is therefore a critical requirement that Mattel rethinks and adjusts their product and brand portfolio through the deployment of dynamic capabilities. At the time being, Mattel's value proposition does namely not cater the critical demand directly, through a strong brand delivering skill-based toys promoting learning and creativity, that at the same time is family focused, and creates a space for children to interact with their parents, effectively creating value for both parties. In 2015, however, Mattel for the first time launched a new series of locally designed toys for the Chinese market (Global Times, 2016). In essence, the products are the same as seen elsewhere, but their exteriors are designed to look and feel more 'Chinese'. In general when Mattel seeks to expand their capabilities of portfolio, the company do this by acquiring other companies who own or capture the desire

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<sup>37</sup> It should, however, be noticed that the industry for traditional toys and games in China is very fragmented, and that Mattel Inc. thus accounts for the third largest brand-share in China (Euromonitor, 2016)

desired capabilities, brand or market share. All through 2015 e.g., Mattel Inc. and Hasbro, the world's third largest toy company, has held confidential meetings, spurring rumours about a possible merger between the two toy giants (Hammond et al, 2016).

A further issue reflecting on Mattel's brands is that of quality concerns, which previously has resulted in a large amount of product recalls on Chinese produced Mattel toys<sup>38</sup>, which to make matters worse, created a tense relationship to the Chinese government, and resulted in an official apology from the company to the government and the Chinese people (Thottam: 2007). Mattel has, however, sharpened its focus and is now determined to deliver quality toys living up to all safety standards. Despite of this, a new scandal arose in 2013. This time, however, the scandal did not involve product safety, but rather included the safety and abuse of Chinese workers in Mattel's Chinese supplier factories, which naturally has damaged the company's reputation and brand value (China Labor Watch, 2013).

As for capabilities leading to a cost-leadership value proposition in the engagement space, there are some further inherent challenges for Mattel, which among other things are related to the discussion above. As we have seen, Mattel should have the inherent critical capabilities to develop and manufacture toys catering the critical demand in the market. This, however, would cost them a considerable amount of resources, as they have to drastically modify products and thereby also the related activities. Consequently, they cannot produce the same value to the market at the same cost, as companies that already target the CoG more precisely through their current business activities. In addition to this, Mattel has in general experienced challenges related to their cost base, and their operating margin has e.g. been in a 5-year decline with an average of -9.7% (Mattel Inc, 2015). Mattel, however, already have operating facilities in China which not only gives them access to low-cost labour, but also allows them to be close to the market.

As for Mattel's overall critical capability possession, which among other things is manifested through their broad brand and product portfolio, it should enable them to target a wide segment of customers through their broad value proposition. It seems, however, that they have not yet been able to address the critical requirements needed to target the critical demand, which effectively have limited them from gaining a significant, sustainable competitive advantage in a way that is difficult for competitors to imitate. Mattel's inability to adjust their critical capabilities and exploit them through the deployment of

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<sup>38</sup> In 2007 e.g., Mattel Inc. was forced to recall 18 million products.

dynamic capabilities in order to target the market's CoG at a low cost through a strong, unique value proposition, can therefore be seen their critical vulnerability.

Mattel Inc.'s CoG is thus their broad brand and product portfolio. As for their specific value proposition, it can be presented as a broad portfolio of high-end premium quality toy brands, usually with gender specific lines or brands, providing a very broad variety of toys and accessories ranging from fashion dolls to action figures, video games and construction toys. Mattel usually provides a broad line of fashion or 'trend toys' e.g. through licensing of new Disney or Hollywood figures, which is supported by the company's strong digital competencies. Lastly, almost all Mattel's toys represent an inherently Western and specifically 'American' look and feel<sup>39</sup>.

However, as we have seen, there are some significant discrepancies between Mattel's value proposition and the critical demand in the market. As for Mattel Inc's MEGA Block's value proposition, they, in line with LEGO, provide high-end quality construction toys. However, their lines are specifically build around the popular figures or brand forming the lines, e.g. 'American Girl', 'Ninja Turtles', 'Call of Duty' etc.,<sup>40</sup> rather than the construction blocks themselves.<sup>41</sup>

#### 7.4.4. CoG Analysis for the LEGO Company: Critical Capabilities, Critical Requirements, and Critical Vulnerabilities

On the backdrop of the analysis of the Chinese customers' CoG, which can help to identify the appropriate value proposition for the market, and the analysis of the main competitor Mattel Inc.'s CoG, which helps to identify systemic vulnerabilities, we will now set out to analyse the LEGO Company's CoG in the Chinese market. In other words, we will determine the critical capabilities, requirements and vulnerabilities that determine the primary source of power for the LEGO Company to create the effects required to achieve their OBJ within the market.

As for the critical capabilities leading to increased customer value, we will again consider performance, product portfolio, quality and brand value. As for performance, the LEGO Company has had an extraordinary period of global success, and more importantly, impressive growth in the Chinese market. In 2015, the company thus reported global revenue worth USD 5.2 billion, making it

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<sup>39</sup> For example, blond, Vestern clad Barbies, Action Man in a variety of American assault uniforms etc.

<sup>40</sup> In opposition to LEGO's lines that has the LEGO brick in the centre, where the different lines represent various universes all compatible with the LEGO system of play.

<sup>41</sup> In line with Mattel's other brands, MEGA Bloks has an inherently 'American' look and feel to it, along with the main share of products representing 'fashion' or 'trend' toys.

the second largest toy company world, as measured in revenue, only outperformed by Mattel Inc.'s staggering revenue of USD 5.7 billion. Moreover, the LEGO Company reported a 31% increase in net profit, which makes it the most successful company in the business (Zander, 2016). The results are extremely impressive and allowed the company to outperform the global market development that experienced single-digit growth rates in most regions, and even declining sales in regions as South America and Russia. The LEGO Company on the other hand, experienced double-digit growth in all its main markets (ScandAsia, 2015) with China as its biggest success, showing an impressive growth with more than 30% in 2015, making the LEGO Company the fastest growing toy company in China (Reuters, 2016) thereby outpacing Mattel Inc.'s performance.

The performance is also noteworthy as the company compared to its large competitors, has a very slim product portfolio. Naturally, the company has benefited from brand synergies e.g. by the Oscar nominated LEGO movie, but its source of revenue is essentially build around the LEGO Brand, the LEGO brick and the system of play surrounding it<sup>42</sup>. LEGO's popularity in China is reflected in its brand share, where the LEGO brand alone amounted to 2,8% in their new market, only superseded by the local Yaoji Poker with 3% (Euromonitor, 2016d). As such the LEGO brand can be seen as the number one brand in the Chinese toy market, whereas Yaoji Poker<sup>43</sup> claims the place among companies providing games. As the company has made no local adjustments to its products delivered to the Chinese market, the LEGO brand and products thus seem to have universal value and appeal – indeed the LEGO brand was ranked as the most powerful brand in the world in 2015<sup>44</sup> (Dill, 2015).

If we look closer at LEGO's critical capabilities as related to their value proposition, and investigate how well it already relates to and targets the Chinese customers' CoG, there are some interesting matches. The first one is the Chinese increased demand for premium brands promising supreme quality, which LEGO, with their number one brand and no product recalls for more than half a decade, is a hallmark for (Rasmussen: 2015). Furthermore, the company's value proposition of skills-

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<sup>42</sup> It should be noticed that eventhough the company builds its products around the LEGO bricks, they continously focus on creating a balanced product portfolio (i.e. not one overly dependent on one hit toy), that taps into their customers demands (Robertson, 2013: 106).

<sup>43</sup> As stated the local Yaoji Poker supplies traditional games to the Chinese market, and as it based on its direct customer offerings thus not is viewed as a direct competitor to LEGO as compared to Mattel, Yaoji Poker is only highlighted as and example of other players on in the highly fragmented Chinese market.

<sup>44</sup> Each year, the global consultancy Brand Finance ranks the world's most powerful brands. To determine which brands are considered most powerful, the consultancy examines companies' investment in marketing, equity measured in goodwill of customers and staff, and the impact of marketing and goodwill on the company's preformance (Dill, 2015).

based toys promoting learning through both logical thinking and creativity fits well with the Chinese customers' preferences. The company's critical capability to understand children, and the interplay between kids and their parents, and their capability to develop toys promoting this, further creates value for both the adult buyers and the children receiving the toys.

The company thus has a dual value proposition for the market; for the children, the LEGO bricks enable them to have fun, play, construct, learn new skills, and create a new LEGO universe the way they prefer it to be. For the parents on the other hand, they provide their children with an opportunity to concentrate and learn while having fun with the LEGO systems, without the intermediation of a computer or a television, ensuring their children learn the logical and creative skills required in the 21<sup>st</sup> century, enabling them to adapt to the changing world. LEGO thus presents a unique value for both parties, and further creates a space where children and grownups can come closer together through play<sup>45</sup> (the LEGO Group, 2016c).

The LEGO Company's value proposition of learning through play, and their inherent element of fun, also fits well with young Chinese parents wishing for a more balanced life for their children. When using LEGO one does not necessarily need to follow the instructions, but one can have fun while learning and creating. The value proposition also echoes the emerging need for the Chinese children to show more individuality and stand out from the crowd, as the LEGO bricks can be assembled in whichever way the user wishes them to. All of these things thus lead to a unique, differentiated value proposition that is difficult for competitors to imitate.

As for capabilities leading to a lower cost base, the company's operating model is remarkably well organized, leading many experts to evaluate it as the most efficient in the world. Last year the company reported a remarkable growth in operating margin of 34% (Rasmussen: 2015), which reflects the LEGO Company's ability to deliver a higher value at a relatively lower cost as compared to their main competitor, Mattel Inc.

As for overall critical capability possession, the LEGO Company have shown a remarkable ability to keep reinventing their core product, i.e. the LEGO brick and the system of play surrounding it, in a way that stays true to the LEGO brand. Through the deployment of dynamic capabilities the company

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<sup>45</sup>Notice the relationship to the LEGO brand framework as presented in paragraph 7.1. 'Task Analysis – Determine Ends'

has managed to keep making LEGO relevant for children all over the world, e.g. through licensing, with their popular Star Wars and Harry Potter sets, but also through development of own popular lines and initiatives as e.g. Bionicle and LEGO Ideas. All of the lines and platforms have different features, but they are all build on the LEGO system of play, reflecting how the company is able to reinvent their main product in relevant and modern ways. Despite of the company's product portfolio is thinner than that of Mattel, in the sense that it is build tightly around the LEGO brick, the LEGO Company manages to keep creating a differentiated product portfolio that is relevant and appealing to their customers through a strong value proposition, while keeping the unmistakable LEGO characteristics and feel.

In this way it is a critical requirement that the company keeps nourishing their ability to reinvent their products in a way that insures their value proposition fits the critical demand in a relevant way. This naturally requires, that the company stay close to their customers. In practice the company does this through their extensive customer surveys, and co-development platforms, but also through their Shanghai hub gathering local workers and knowhow for the company. Furthermore, their local production with a rapid, low cost response time to demand is deemed as important to maintain the competitive position.

Naturally, the relationship with other relevant stakeholders is also an important prerequisite for the company to be able to deploy their capabilities. Especially the CCP becomes important in communist China. As we have seen previously, corruption is immense, and the business environment is opaque, which poses a challenge for all MNCs operation in China. Furthermore, as we have learned, the LEGO Company do no directly localize their products, but the way they communicate them to their customers is however specialized, namely through a customized 360° marketing approach. As the CCP have a direct influence on all broadcasting platforms and heavily censors the media, the LEGO Company is required to have a positive relationship to them in order to communicate their value proposition to the Chinese market, where the LEGO brand is much less know as it is in the West.

Lastly, as we have seen, China is not only the largest e-commerce market, but its customers also increasingly demand products presenting digital opportunities or features. As the LEGO Company is notoriously weak in the digital sphere as opposed to their competitor Mattel, the company is required to leverage digitalisation in order to create synergies through their brand and LEGO products with new and exciting, digital features.

As we can see, however, the LEGO Company's strong brand and their unique, consistent value proposition build around the LEGO brick and its system of play, is therefore one of the company's biggest strengths and thus constitute their CoG together with their effective operational-systems supporting the development and production of their products. Their bricks might be easy to duplicate, but the LEGO brand, the company's critical capabilities and dual value propositions are, however, difficult to imitate.

The LEGO Company's strength can, however, be turned into their weakness. If the tides thus should move against them, their first critical vulnerability could stem from their product portfolio, which is tighter than that of their competitors, and notoriously weak in the digital sphere. This could e.g. happen, if there is a general, significant fall in demand for construction toys, which naturally will have an enormous and disproportionate impact on the company as apposed to e.g. Mattel that has a much broader product portfolio. It thus also follows, that the LEGO Company is vulnerable if they fail to reinvent themselves in an appropriate way that is true the their brand, or if other general changes in the PESTI structures significantly transform the competitive environment to their disadvantage.

The second systemic vulnerability thus lies in a failure of the protection and communication of the LEGO brand and its associated values. As we have seen, the deficient legal framework often fails to protect brands and trademarks, which then disproportionally can affect the company, as LEGO copies in China are rampant. Secondly, LEGO might be the most powerful brand worldwide, but China is a new competitive battlefield, and as opposed to the West, where generations have grown up playing with the iconic, colourful plastic bricks, LEGO is still a relatively new phenomenon in China, unknown by the vast majority of their possible customers.

The LEGO Company's success therefore rests on their ability to differentiate themselves from their competitors through the communication of their brand and their associated value proposition. If they, however, succeed in this, they have the strategic opportunity to cater to the critical demand in a way that the competitors cannot. In the following, we will therefore explore the COA possible for the LEGO Company and their competitor Mattel Inc. in the Chinese market.

### 7.5. Opposing COAs

Now we have reached the phase for developing opposing COAs. However, before developing the LEGO Company's OCOAs, we must first estimate Mattel Inc.'s assumed CCOAs<sup>46</sup> in order to formulate a strategy that not only addresses the critical demand in the market, but also pre-empts the competitors' anticipated strategies. This is done by revisiting the interim conclusions in order to decide which COA the competitor is most likely to take, based on his assumed ES. Naturally, there should be an emphasis on the COA that is most threatening for the achievement of the LEGO Company's ES.

As for Mattel Inc.'s CCOA, three assumed ways ahead can be identified:

- (1) CCOA: Seek to adjust current product and brand portfolio to better target the Chinese customers' CoG
- (2) CCOA: Merger with Hasbro to expand current product and brand portfolio and capture greater market share
- (3) CCOA: Continue without adjusting current product and brand portfolio to the Chinese customers' CoG

As for the 3<sup>rd</sup> COA, this can be rejected on the basis of sustainability, i.e. it will not allow Mattel to accomplish their assumed ES. This is based on the findings in the CoG analysis that clearly show, that it is a critical requirement that Mattel adjusts and customizes their offerings to cater the demand, in order to be able to stay in the strategically important Chinese market.

Let us start by exploring CCOA (1), namely a reconfiguration and expansion of Mattel's offerings, seeking a better fit between Mattel's value proposition and the critical demand. As we have seen, the company offers a very broad product and brand portfolio. The majority of the products, however, represent 'fashion toys' e.g. through the company's broad use of licencing toys, leading sales to be influenced by a relatively fast change in consumer trends, rather than inherent classic, features in the individual products. Despite the fact that licencing products are vastly popular, the company still lacks the ability to create relevant, classic toys targeting Chinese preferences, that still are inspiring and fun,

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<sup>46</sup> Remember that the most likely and most threatening COA for each opposing system should also be included in fully developed, elaborated strategy. Due to the scope of the paper, this is however, not done here.



and above all, do not require vast financial resources to reconfigure the value chain every season, as fleeting preferences change. In order to create a value proposition that better addresses the critical demand, Mattel must thus deploy dynamic capabilities in order to upgrade their portfolio along with the capabilities required to reach this end. Mattel is assumed to draw on their inherent strengths to reach this end, i.e. through the synergies arising from their successful and broad use of licensing, along with and a focus on digital features, platforms and services, where Mattel is relatively strong as opposed to the LEGO Company.

Mattel will assumedly try to reach their goal by launching new customized products from brands that already are popular in China, e.g. Barbie and Fisher-Price. Furthermore, the company has declared that it in line with its usual strategy, intends to launch several new brands all through 2016, hoping to gain a larger market share in China (Global Times, 2016). Additionally, Mattel is assumed to boost the LEGO brands direct competitor i.e. MEGA Bloks commercially via. marketing campaigns etc., as construction toys are the most popular segment in the toy industry in China.

As we saw, however, a thorough reconfiguration and expansion of Mattel's offerings will require a vast amount of resources, and will possibly take a considerable amount of time.

As for CCOA (2) i.e. a possible merger between Mattel and Hasbro to expand current product and brand portfolio, it almost certainly allows the LEGO Company's competitor to become the largest company in the highly fragmented industry, as measured in sales and brand share. If the two MNCs were to merger, they would, based on their combined brand share in 2015, become the larges player in China with a combined brand share of 2,9%, which is just over LEGO's 2,8% (Euromonitor, 2016d). Furthermore, a merger between the two companies would generally complement both parties, as Mattel generally is stronger in the girls segment, whereas Hasbro's force lies within the boy's segment. Additionally, both MNCs are stronger in the digital sphere as compared to the LEGO Company. The merger, however, would not be without challenges. Indeed, in addition to the usual issues related to mergers, the challenges discussed in CCOA (1), would still be present. That is the combined product and brand portfolio would still have to be adjusted to better target the Chinese market's CoG, as Hasbro's brands also lack a direct fit to the critical demand, and therefore do not challenge the LEGO Company's existence or justification in the market.

In both CCOA Mattel thus needs to make considerable adjustments in order to target the critical demand better. This will require a significant amount of time and resources, which ceteris paribus,

provides the LEGO Company with a chance to entrench itself deeper in the Chinese market, while Mattel seeks to catch up with them. CCOA (1) is viewed as the most likely due to the costs and general challenges related to the merger. Nevertheless, the subsequent formulation of the LEGO Company's OCOA is aimed to be able to address the threat of both CCOA.

#### 7.6. The LEGO Company's Operational Design and Initial Strategy Formulation

Now we arrive at the LEGO Company's operational design, or initial strategy formulation that represents the link between ends, means and ways. It is expressed through the various lines of operations, i.e. operational, organizational and commercial, and their related, individual OBJ, addressing each of the represented key system's CoG; here the main competitor, Mattel Inc., and the Chinese customers.

As for the overall strategy it should support a positioning in the Chinese market's strategic sweet spot, meaning that it by the exploitation of the company's competitive advantage and critical capabilities should enable it to target the customers' critical demand in a way that Mattel cannot. Furthermore, it should seek to exploit Mattel's systemic critical vulnerabilities as it can provide the LEGO Company with an opportunity to further strengthen their competitive position in the market. Finally, the competitive position taken in the market should seek to protect the sustainability of the LEGO Company's CoG, which is done by both enforcing their critical capabilities and by outmanoeuvring CCOA trying to pre-empt the achievement of own strategic OBJ.

As we saw earlier, conditions in the engagement space along with the various CoGs, can be affected through the application of the various instruments of power, whose synergies determine how the value created in the market is divided. Consequently, the combination and deployment of the LEGO company's instruments of power should be a conscious decision, naturally determining the formulation of both possible OCOA.

As a combination of both destructive and conductive power is the most beneficial in the long run, the LEGO Company's strategy should thus be build on both. The first leg of the strategy, which both OCOA should contain, should thus be built on value acquisition. Operationally then, the company should therefore continuously seek to deploy and strengthen their critical capabilities related to their effective logistics system and their value chain leading to cost advantages, in order to be able to create more value at a comparable lower cost, and thus subdue their competitors. The first OBJ is

thus operational and tied to the establishment of the Jiaying factory, that should be fully operational in 2017, and supply 70-80% of products delivered to the Asian market.

As for the second leg of the strategy, i.e. the deployment of conductive power, the company should seek to assume a unique, sustainable value position by effectively creating and sustaining a new frontier or value segment, from which they can differentiate themselves from their competitors. In this endeavour as well, the company is already well underway with their development of skills-based toys creating value for parents and children alike. Through their persistent interaction and co-creation with their customers, the company has thus managed to create a movement with continuous innovation, not just of products but of an entire system of play (Robertson, 2013: 110) launching new initiatives that look and feel like the iconic LEGO, but still are contemporary and above all, fun and relevant for their customers (Robertson, 2013: 125).

The chosen OCOA should thus embody a continuation of the deployment of both sources of power, and should be designed to achieve the operational OBJ mentioned above. In the following, two possible yet clearly distinguishable OCOA for the LEGO Company will be developed based on the interim conclusions made throughout the eclectic directive, namely:

(1) OCOA – Expand product portfolio to match competitor

(2) OCOA – Remain tight focus on the LEGO System while leveraging digitalization

#### 7.6.1. OCOA – Expand Product Portfolio to Match Competitor

As we have seen Mattel Inc. has a very broad portfolio of subsidiaries with globally popular brands that offer an enormous range of differentiated products, which provide Mattel with an opportunity to cater to a wider range of customers through a broader value proposition. Furthermore, in the unlikely event that Mattel Inc. should merge with Hasbro, their combined product portfolio would amount to the world's largest, effectively catering customer demand that LEGO does not satisfy.

In order to cater to this demand the LEGO Company could therefore chose to maintain their current activities with LEGO centered products from which they derive their power, while they also expand their product portfolio further into other product niches occupied by their competitors, in order to gain further market share from Mattel and their other competitors.

This will naturally require a vast amount of resources. However, the company could draw on critical capabilities from their highly effective logistic and product innovation systems in order to create a broader value proposition, and further exploit synergies created by associating their world famous brand to the new products.

An application of this OCOA, which to some extent is similar to the assumed CCOAs, will quite possibly enable the LEGO Company to become the largest toy company in the world. The question is, however, whether it would also allow the company to be “the best”?

The LEGO Company has previously experimented with a thorough expansion and reconfiguration of its product portfolio, which according to many, was one of the reasons for the company’s near bankruptcy (Robertson, 2013). Now the company is, however, financially and organizationally strong. Furthermore, the company has through its expansion gained new resources and capabilities, which could allow for a broader experimentation and expansion of products. However, based on the same arguments that apply to Mattel’s reconfiguration, the best COA is evaluated to be to remain a tight focus on the LEGO system, while strengthening the position through the deployment of dynamic capabilities.

#### 7.6.2. OCOA – Remain Tight Focus on the LEGO System While Leveraging Digitalization

As the LEGO Company’s goal is to become the strongest and most successful company within the niche of high-end traditional toys, the strongest OCOA is to remain a tight focus on the core business, i.e. the LEGO system of play and the value it brings to the Chinese customers. Instead of looking to compete with others on intense battlefields, the LEGO Company should continuously seek to reinvent and maintain their unique value proposition, thereby making competitors less relevant for their core customers. With a clear focus on their critical capabilities and value proposition, they should thus seek to make the LEGO system of play even more attractive and exciting for the Chinese customers, leading to several commercial OBJ. First of all, the company should continue to integrate licensing in some of the product lines, thereby keeping the classic features of the LEGO sets, while giving them the relevant and modern feel demanded by their customers. Secondly, the company should focus on digitalization<sup>47</sup> – an initiative directly targeting the Chinese market’s CoG, and further, a capability that

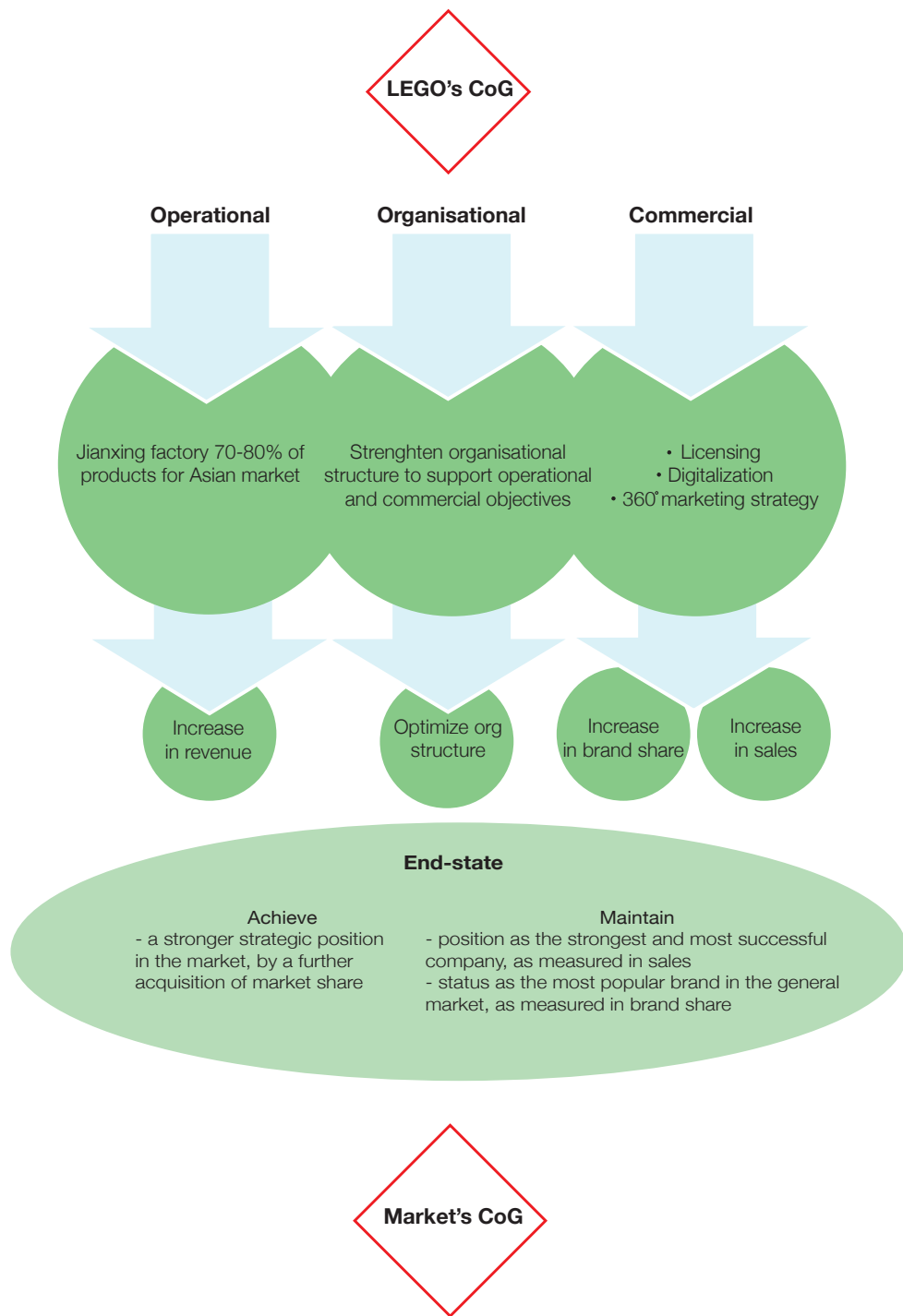
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<sup>47</sup> ‘Leveraging digitalisation’ is also one of the four main pillars the LEGO Strategy is build on (the LEGO Company, 2016).

the LEGO Company has not fully developed yet. Both of these initiatives should be supported by an organizational OBJ to continue and strengthen local knowledge gathering and implementing through the local main office in Shanghai, supported by innovation activities and product upgrades from activities in the company's HQ in Denmark.

The organizational structure should also support the next commercial OBJ related to marketing, where the company needs to tailor, execute and later update their 360° marketing strategy to the Chinese market. As we explored previously, marketing is an extremely important part of the company's strategy, as the LEGO brand as opposed to the Western markets, is relatively unknown in the new Chinese market. Further, the company must try to create the same customer loyalty the brand enjoys in the established Western markets. The company thus has to communicate their value proposition through various platforms, ranging from TV to extensive campaigns on the strategically important Internet, where the company should also seek to expand its e-commerce platform, in order to cater to Chinese shopper preferences (McKinsey, 2012: 27). A further initiative the company has taken and should continue to develop is the establishment of the world's largest LEGO mega store in Shanghai. Extensive studies show that one of families' favorite pastimes is to spend time shopping (McKinsey, 2016), and the LEGO Mega Store thus gives the company a unique commercial platform to sell and promote their brand.

For the convenience of the reader the operational design supporting this OCOA is illustrated in the model below:



As the reader can appreciate, this OCOA effectively exploits the LEGO Company's critical capabilities and competitive advantage by not only targeting the Chinese customers' CoG in a way that Mattel cannot, thereby exploiting the competitor's systemic vulnerability - it also essentially entrenches the company's competitive position, as it allows for the creation of a whole new segment or battlefield, where the LEGO Company is the only player.

The philosophy behind the chosen OCOA then appropriately leads us back to where we started - back to the thousand years old Chinese philosophy stating that:

The supreme art of war consists in breaking the enemy's resistance without engaging him

Sun Tzu, The Art of War

## 8. Discussion and Contributions

The eclectic framework has now been formulated and tested through the analysis of the case study. Furthermore, the formulated concepts have been discussed throughout the framework in order to better evaluate them in the context of the phenomena they address. What now remains is a summarising discussion of the framework's foundation<sup>48</sup>, contributions and value.

The framework's primary theoretical foundation and approach is derived from a military paradigm as proposed in NATO's COPD. The paradigm seeks to assist decision-makers on all levels to formulate and execute appropriate strategic courses of actions through a systemic approach to analysis and an effects-based approach to operations. The paradigm understands and analyses challenges as complex dynamics in an international, multi-faceted environment, and through its comprehensive approach and related paradigm, it purposes a framework to combine strategic ends, means and ways, that can be of general use to stakeholders outside the military community. Furthermore, as discussed in the theory review in the beginning of the thesis, additional relevant theories from academia are also used throughout the formulation of the framework, in order to strengthen the paradigm and support the eclectic framework's applicability to international business.

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<sup>48</sup> For a discussion of the scientific foundations of the thesis, i.e. the theoretical foundation, the research method and the processed and included data, see paragraph 2. 'Delimitation of the Research Area' and 3. 'Methodology, Research Strategy and Data'

As we have seen, the dialectic approach as proposed by the eclectic framework, thus essentially integrates strategy formulation as a logical process of planning and design, with strategy as an emerging, incremental activity. As we have discussed earlier, the scope of the thesis along with the nature of the case study, however, promotes a primary focus on the first element or quality of the paradigm, namely strategy as design and systemic analysis. This does, however, not reflect an inherent weakness in the eclectic framework, but is rather a product of the scale and the scope of the thesis, along with the nature of the case study<sup>49</sup>.

The eclectic framework thus presents several contributions to strategy formulation in international business. First of all, in opposition to most approaches that uses a combination of individual, separated models - e.g. PEST, Porter's Five Forces and SWOT - the eclectic framework instead presents an integrated whole. Here the interim conclusions drawn at each phase directly feed into the next, thus adding additional value starting at the task analysis, through the analysis of the competitive terrain, the CoG, purposed COA, and then, the reassessment and reconfiguration of strategy through the continuous, rotating movement through the relevant phases.

The second contribution of the eclectic framework is to be found in its generalizability. The framework thus suggests guidance and suggestions for strategic COA that are industry independent, which allows for the incorporation of additional features relevant for the specific task, making the formulation of the framework of general value.

The third contribution is that the eclectic framework explicitly considers and integrates the competitors' assumed COA in strategy. Other frameworks thus consider factors as e.g. the intenseness of rivalry etc. (see e.g. Porter, 2008), but the eclectic framework additionally explicitly focuses on the analysis of the competitors' strategic intent and capabilities and further incorporates this in strategy formulation.

The eclectic framework's biggest contribution is, however, that it through its systemic approach to analysis and its effects-based approach to operations, effectively incorporates strategy as a designed, planned and logical procedure, with strategy as an emerging and learning activity. In this way, the

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<sup>49</sup> This is meant in the sense that the LEGO Company is still in the initial phases of its strategy in China, which is why an illustration with a primary focus on the first element of the paradigm, i.e. strategy as a logical and planned design, is appropriate.



formulated framework thus incorporates approaches from various schools of thought in a tested and pragmatic way.

## 9. Conclusion

The thesis has sought to explore how military strategic paradigms can be used to formulate a new eclectic framework that informs strategy formulation in international business.

As we have just discussed, this is done by introducing the NATO paradigm's main phases to the eclectic framework: namely the task analysis, the analysis of the competitive terrain, the CoG analysis, and the formulation of strategic COA. In order to further support strategy formulation, the military paradigm's dialectic and systemic approach to analysis along with its effects-based approach to operations, is further applied to the eclectic framework. This supports strategy formulation as a design based on analysis and planning, and strategy as an emerging learning process, effectively supporting formulation of strategic courses of action in an international business environment.

The foundation of the eclectic framework thus rests on a thoroughly tested strategic paradigm, building on hundreds of years of experience from the military community. Furthermore, it is strengthened with the support of landmark theories from international business studies, reinforcing the framework through its eclectic nature, effectively drawing of strengths from both fields. Finally, the eclectic framework has been tested and illustrated in its appropriate context by the use of the case study of the LEGO Company in China.

As we have seen, one of the strengths of the eclectic framework is its generalizability and flexibility. The framework can thus be adjusted to include additional, relevant variables in accordance with the analytical needs. Moreover, the depth of the various phases of the analysis along with the prioritized focus on the various phenomena and variables, can further be adjusted to meet the specific requirements of the unique, strategic challenge.

The primary purpose of the case study has therefore been to illustrate the eclectic framework and test its applicability and use in an international business setting. The primary value of the thesis is therefore predominantly related to the formulation of the eclectic framework, and the illustrations and findings derived through the case study is therefore of a general value, surpassing the characteristics of the unique case study.

## 10. Suggestions for Further Research

As we have just discussed, the scope of the thesis along with the nature of the case study promotes a primary focus on the first element or quality of the paradigm, namely strategy as design and systemic analysis. The first suggestion for further research is therefore, additional data collection and field studies to further test the eclectic framework's viability in an international business context as related to the dialectic, emerging strategy formulation as proposed by the paradigm.

The next suggestion is related to a proposition for a further elaboration of the eclectic framework. One of the strengths of the framework is as mentioned its generalizability, however, a further expansion through additional or interchangeable models could assist the framework to be adjusted to explicitly address or engage volatile developing markets and/or non-conventional competitors. Indeed, this feeds into the current debate in military communities, where the discussion, however, rather is concerned with irregular warfare and the engagement of non-state actors and failed states. The dynamic and challenges discussed here are, however, remarkably similar.

Let us explore this notion a bit further. When the paradigm analyses the competitive terrain, it utilises the presented acronym to study the key macro systems, i.e. the political system, the economic, and so on. When the engaged terrain is a functional state or a developed market, all of these systems will be present and mature, with many of them possessing tangible infrastructure, institutions etc., that are easy to identify and target through precise action (Arnold, 2006). As we have seen, however, these systems may function in a fundamentally different way in emerging markets, which is why the strategist must be able to identify and mitigate the inherent risks created by the presence of institutional voids<sup>50</sup> (Khanna and Palepu, 2010).

The second issue is thus that of engaging non-conventional actors (Arnold, 2006) or competitors, who are organized and function in completely different ways, and therefore must be analysed and addressed accordingly. An additional suggestion for further research is therefore, to formulate an additional acronym as a corollary to the PESTI construct<sup>51</sup>, which could support the analysis and engagement of non-conventional competitors, which e.g. would be interesting when analysing actors representing the piracy industry in China.

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<sup>50</sup> Which is why 'infrastructure' has been included in PESTI, so that it allows the consideration of institutional voids, while remaining market and industry independent.

<sup>51</sup> Here inspiration could be found in Arnold (2006), who proposes an additional acronym based on critical requirements to supplement the PMESII construct.

## 11. Appendix

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## 11.2. China, Facts & Figures

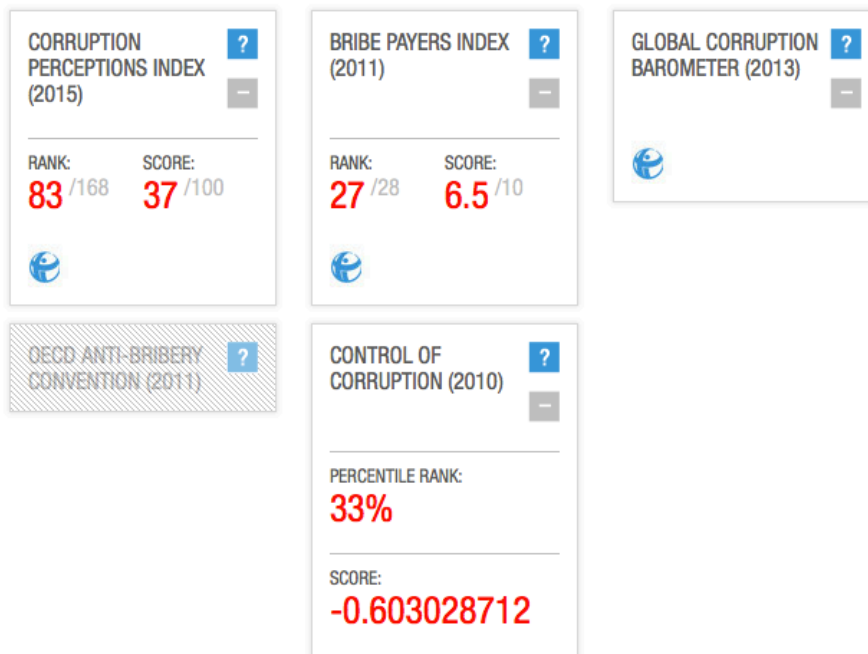
Source: The World Bank (2016) 'China' and Transparency International (2016) 'Corruption by Country, China'.



### FACTS & FIGURES

- \* POPULATION (2010):  
**1.3 BILLION**
  - \* GDP (2010):  
**\$5.93 TRILLION**
  - \* INFANT MORTALITY RATE (PER 1,000 LIVE BIRTHS - 2010):  
**15.8**
  - \* LIFE EXPECTANCY (2009)  
**73.06 YEARS**
  - \* LITERACY RATE (2009)  
**94%**
- (\* World Bank data)

### CORRUPTION MEASUREMENT TOOLS





### 11.3. Data Graphics of the Toy Industry in China

Source: Euromonitor International (2015)

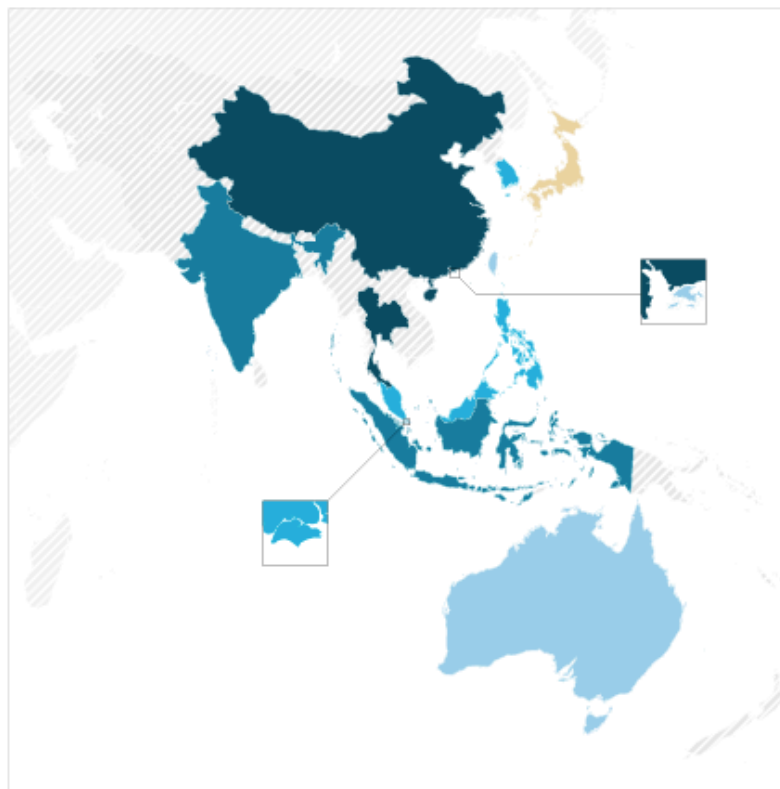
## Strong Growth Expected to Continue in Asia Pacific

Datagraphic | 16 Sep 2015



DATAGRAPHIC TOYS AND GAMES

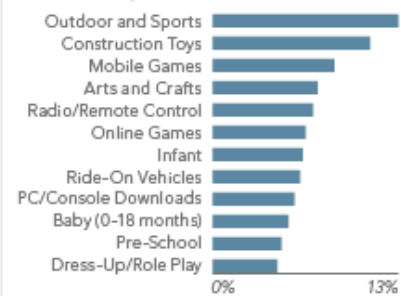
### Strong Growth Expected To Continue in Asia Pacific



#### Growth Drivers in APAC

##### Fastest Growing Categories

2014-19 CAGR, US\$ fixed 2014 rates



#### ABSOLUTE REGION GROWTH

**24%**

is expected between 2014-2019

#### Toys and Games Growth

2014-19 CAGR, US\$ fixed 2014 rates

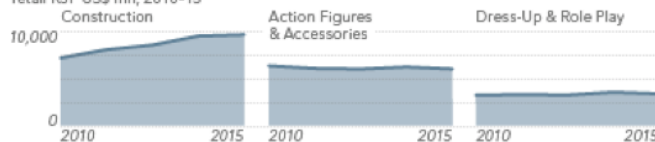


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#### Fastest Growing Categories

##### in Traditional Toys and Games

retail RSP US\$ mn, 2010-15



# China Remains The Biggest Growth Driver in Traditional Toys

Datagraphic | 25 Jun 2015

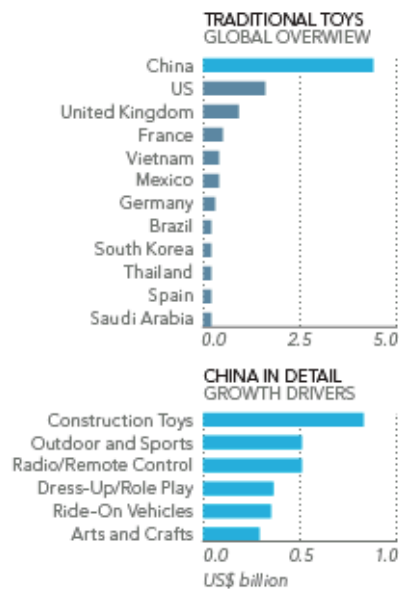


DATAGRAPHIC TOYS AND GAMES

## China Remains The Biggest Growth Driver in Traditional Toys

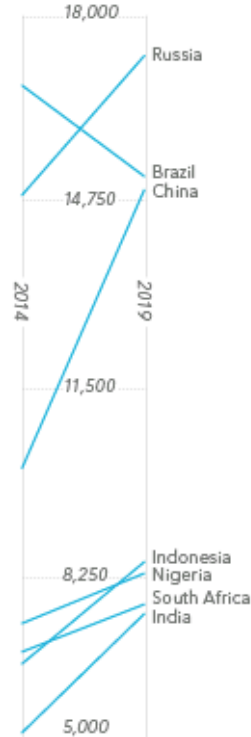
### Growth Leaders

Expected Absolute Growth: 2014-2019  
US\$, constant 2014 prices



### China Surges Upward

Income in Key Emerging Markets  
median income per household (US\$)



POPULATION UNDER 14

**211**  
million persons in 2014

CHILDREN PER HOUSEHOLD

**0.6**  
well below most emerging markets

RETAIL VALUE SALES

**13.8**  
US\$ billion expected in China in 2019

© 2015 Euromonitor International

#### 11.4. Brand Shares in the Toy Industry in China

Source: Euromonitor International (2015)

**Brand Shares (Global - Historical Owner) | Historical | Retail Value RSP | %  
breakdown**

Brand	Company name (GBO)	2010	2011	2012	2013	2014	2015
<b>China</b>							
<b>Traditional Toys and Games</b>							
Yaoji Poker	Shanghai Yaoji Playing Cards Co Ltd	3,6	3,4	3,1	3,2	3,1	3,0
Lego	LEGO Group	0,7	0,7	1,0	1,5	2,2	2,8
Fisher-Price	Mattel Inc	0,6	0,6	0,5	0,8	1,0	1,2
AAA-Poker	Ningbo Three A Group Co Ltd	1,5	1,4	1,3	1,3	1,2	1,1
VTech	VTech Holdings Ltd	0,7	0,6	0,6	0,6	0,7	1,1
Rastar	Rastar Group	-	-	-	-	1,0	0,9
BanBao	BanBao Co Ltd	0,7	0,9	1,0	0,9	0,8	0,9
Race Tin Flash & Dash	Guangdong Alpha Animation & Culture Co Ltd	0,8	0,9	0,9	0,8	0,9	0,9
Armor Hero	Guangdong Alpha Animation & Culture Co Ltd	1,5	1,5	0,7	0,7	0,8	0,8
Wanshengda	Zhejiang Wanshengda Industry Co Ltd	1,1	1,1	1,1	1,0	0,9	0,8
Auby	Guangdong Alpha Animation & Culture Co Ltd	0,6	0,8	0,9	1,0	1,0	0,8
Battle of King	Guangdong Alpha Animation & Culture Co Ltd	-	-	0,5	0,6	0,7	0,8
QunXing	Guangdong Qunxing Toys Joint-Stock Co Ltd	1,3	1,2	1,1	1,1	1,0	0,7
Bin Wang	Zhejiang Binwang Playing Cards Co Ltd	0,9	0,9	0,8	0,8	0,7	0,7
Toyroyal	Toyroyal Co Ltd	0,5	0,5	0,5	0,6	0,6	0,6
Blazing Teens	Guangdong Alpha Animation & Culture Co Ltd	1,0	1,0	0,7	0,5	0,6	0,5
Transformers	Hasbro Inc	0,5	0,5	0,5	0,5	0,5	0,5
Belens	Belens (Shenzhen) Technology Co Ltd	-	-	-	0,1	0,3	0,5
Chicco	Artsana, Gruppo	0,5	0,5	0,5	0,5	0,5	0,4
Crayola	Hallmark Cards Inc	0,3	0,4	0,4	0,4	0,4	0,4
Muma Smart	Beijing Smart Toy Co Ltd	0,4	0,4	0,4	0,4	0,4	0,4
Mobile Suit Gundam	BANDAI NAMCO Group	0,4	0,4	0,4	0,4	0,4	0,4
Thomas & Friends	Mattel Inc	-	0,0	0,1	0,1	0,2	0,4
Superwings	Guangdong Alpha Animation & Culture Co Ltd	-	-	-	-	-	0,3
Better Life	Better Life Commercial Chain Share Co Ltd	0,4	0,4	0,4	0,4	0,4	0,3
Smart	Beijing Smart Toy Co Ltd	0,3	0,3	0,3	0,3	0,3	0,3

Decathlon	Oxylane Group	0,2	0,2	0,2	0,2	0,2	0,3
Barbie	Mattel Inc	0,3	0,3	0,3	0,4	0,3	0,3
Goldlok	Goldlok Toys Holdings Guangdong Co Ltd	0,0	0,1	0,2	0,3	0,2	0,3
PeiPeiLe	Foshan Master Toys Co Ltd	0,2	0,2	0,2	0,3	0,3	0,3
Dun Xin	Dun Xin Paper Co Ltd	0,3	0,3	0,3	0,3	0,3	0,3
Silverlit	Silverlit Toys Manufactory Ltd	0,4	0,3	0,3	0,3	0,3	0,3
Antworld	Antworld (Shantou) Co Ltd	0,4	0,4	0,5	0,6	0,4	0,3
Party Queen	Toyroyal Co Ltd	0,2	0,2	0,2	0,3	0,3	0,3
Goodbaby	Goodbaby International Holdings Ltd	0,2	0,2	0,2	0,2	0,2	0,3
Play-Doh	Hasbro Inc	0,2	0,2	0,2	0,2	0,2	0,3
Readboy	Zhongshan Readboy Electronics Co Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Lelia	Chenghai Lelia Toys Co Ltd	0,3	0,3	0,2	0,2	0,2	0,2
Scence Puzzle	Shanghai Gubu Trading Co Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Xiong Cheng	Chenghai Xiongcheng Plastic Toys Co Ltd	0,3	0,3	0,4	0,4	0,3	0,2
Maisto	May Cheong Group	0,1	0,1	0,1	0,2	0,2	0,2
Uncle Wang	Fuzhou Yawan Stationary Co Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Kurhn	Kurhn Toys Co Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Little Dino	Goodbaby International Holdings Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Aoger	Qingdao Aoger Toys Co Ltd	0,2	0,2	0,2	0,2	0,2	0,2
TOMICA	Takara Tomy Co Ltd	0,1	0,1	0,1	0,1	0,1	0,2
Welly	Welly Die Casting Fty Ltd	0,2	0,2	0,2	0,2	0,2	0,2
Top Bright	Top Bright Group Co Ltd	-	0,1	0,1	0,1	0,1	0,2
RoboWarriors series	Guangzhou Starjet Toys Co Ltd	0,1	0,2	0,2	0,2	0,2	0,2
Disney	Zhongshan 100-Fun Children Articles Co Ltd	0,1	0,1	0,1	0,1	0,1	0,1
Berica	Zhejiang Jiajia Children Carriage Co Ltd	0,1	0,1	0,1	0,1	0,1	0,1
Disney	Walt Disney Co, The	0,1	0,1	0,1	0,1	0,1	0,1
Baby Concert	Toyroyal Co Ltd	0,1	0,1	0,1	0,1	0,1	0,1
Nerf	Hasbro Inc	0,1	0,1	0,1	0,1	0,1	0,1
Playwell	Playwell Ltd	0,1	0,1	0,1	0,1	0,1	0,1
Huawei	Guangdong Huawei Toys Craft Co Ltd	0,1	0,3	0,2	0,2	0,2	0,1
Disney Princess	Walt Disney Co, The	0,2	0,2	0,1	0,1	0,1	0,1
Kayee	Beijing Kayee Toy Co Ltd	0,3	0,3	0,2	0,2	0,1	0,1
Hot Wheels	Mattel Inc	0,1	0,1	0,1	0,1	0,1	0,1
Bestway	Bestway Inflatables & Material Corp	0,0	0,0	0,1	0,1	0,1	0,1
Hongwell	Hongwell Ltd	0,2	0,2	0,2	0,1	0,1	0,1
Plarail	Takara Tomy Co Ltd	0,2	0,2	0,1	0,1	0,1	0,1
Jin Xing	Shantou Chenghai Jinxin Plastic Product Factory	0,1	0,1	0,1	0,1	0,1	0,1
DIFU	DIFU Toys Ltd	0,1	0,1	0,1	0,1	0,1	0,1

Weikesi	Weikesi Children's Toy Co Ltd	0,4	0,3	0,1	0,1	0,1	0,1
Go For Speed Mini 4-way- drive	Guangdong Alpha Animation & Culture Co Ltd	0,5	0,2	0,1	0,1	0,0	0,0
Cars	Mattel Inc	0,1	0,1	0,1	0,1	0,0	0,0
Fruity Attack	Guangdong Alpha Animation & Culture Co Ltd	-	-	0,2	0,2	0,1	-
PP Bears	Shenzheng PP Bears Toys Co Ltd	0,1	0,0	0,2	0,1	0,1	-
MSD	Mesida Electronic Toys Co Ltd	0,1	0,1	0,0	0,0	0,0	-
Rastar	Xinghui Auto Model Co Ltd	0,4	1,0	1,0	1,0	-	-
Others	Others	73,3	72,8	73,3	72,7	72,1	71,6
Total	Total	100,0	100,0	100,0	100,0	100,0	100,0

Research Sources:

Toys and Games: Euromonitor from trade sources/national statistics