

# BRANCH-WISE AND REGIONAL ECONOMY

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## The competitive status of the mining company: mechanisms of formation and management

*The essence of the competitive status of the company is considered, the specificity of influence of the basic external and internal economy factors on formation of the competitive status of the mining company is established, the factors of institutional regulation, investment attractiveness of the industry, the structure of the industry and the markets, the degrees of integration and diversification, the type and efficiency of the company's strategy are studied. The methodical approach to formation, estimation and management of the competitive status of the mining companies is offered.*

*Mining company, competitive status, institutional regulation, investment attractiveness of the industry, industry and market structure, investment strategy.*



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One of the unsolved problems and one of the least grounded and well-established terms of modern theory and practice of competition is the definition of the competitive status of the company. The complexity of this concept is due to the reflection in it of both static characteristics (subject's condition in the

competitive environment) and dynamic ones (subject's behavior, which is realized in the competitive strategy). The static component of competitive status is determined by the structure and the concentration degree of industry and market, the presence and the formation of competencies and specific strategic assets

and resources of the company. The dynamic component depends on the company's strategic and investment activity, the specifics of its competitive behavior, the efficiency of use of assets and resources.

The competitive status of the company refers to its position in the business system, integrally reflecting the set of strategic and competitive positions, formed in each field of activity and a set of strategic competitive behavior stereotypes. In this sense, the competitive status of the business subjects serves as an integrated status of a set of the strategic competitive positions of these subjects, defended by them in the process of implementing their strategic target aims, creating additional value to the company [1, p. 314].

It is known that the founder of the approach to the study of the competitive status of the company is I. Ansoff [2], who treats the concept of competitive status as a competitive position (a specific index) of the company's position in the market. He proposed a method for assessing the competitive status, which reflects the profitability of strategic investments, corrected for the degree of "optimal" strategy and the extent to which the company's capacity corresponding to its optimum value. This method of calculation reflects statics and dynamics of the competitive status assessment.

Inadequate methodological elaboration of the concepts and the method of determination of the competitive status in relation to mining companies rises the need to clarify the characteristics of the competitive status taking into account the specifics of its operation, the application of the typology of competitive status to the companies of mineral and raw complex (MRC), the development of assessment methodologies, and the methodological approach to the formation and managing of the competitive status of the mining company.

Formation of a competitive status of the company includes the definition of the very

concept, its structuring, classification of species, establishment of influencing factors, the analysis of the competitive environment and competitive markets, as well as industry structure, assessment of the company's competitive status.

Managing the competitive status of the company includes the assessment and selection of strategic directions for development, taking into account the potential reserves and opportunities, ensuring the creation or increase of competitive advantages and maximizing the value of the company; feasibility study of the effectiveness of financial and investment strategy as creating or breaking the company's value; assessment of competitive status, taking into account the implementation of the chosen strategy.

To clarify the definition of competitive status we should set the specifics of impact of major external and internal economic factors on the company (in MRC). The main external factors of the company's competitive status include: institutional regulation, investment attractiveness of the industry, industry and markets structure. Internal factors of competitive status are: the degree of integration and diversification of the company, the type and effectiveness of the company's strategy. We consider the main factors determining the level of competitive status, the degree of their manifestation in the MRC markets and the possibility of their estimates.

**The institutional regulation's significance and the degree of its influence** vary depending on the economic activities and the industries. The institutional environment is one of the main factors determining the dynamics and development character of national economy and industry sectors. The degree of influence of institutional constraints is, first of all, determined by the strategic importance of the industry to the national economy at present and in the future, the systemic character of the industry and other strategic factors.

Contemporary strategy of efficient subsoil management cannot be based solely on market opportunities. The market mechanism, even in developed countries does not provide the strategic objectives of subsoil use, environmental protection, sustainable development and economic security. In Russia it is necessary to implement such a principle of rational subsoil use as an organic combination of market mechanisms of self-regulation and government support for sustainable consumption and saving of mineral resources.

Subsoil use is a scope of interweaving and collision of interests of the federal, regional and mining companies, local governments, public organizations and population. These interests are quite different, sometimes even opposite, so the institutional system of subsoil use is to provide search and balancing of the multifaceted interests of all parties. Its most important “elements” are: legislative and regulatory framework, strategy and policy of mineral wealth development, the mechanism of granting rights to subsoil use, where the balance of interests is established by competition between mining companies, exploration program on new subsoil areas to be placed on auctions and contests.

Institutional constraints are based on a particular resource mode, and can be analyzed from the perspective of institutional-evolutionary theory, including the theory of property rights, transaction costs theory, and others. Property rights to natural resources always include limitations on their use by the owners, and under present conditions there is a definite tendency to increase such limits [3]. For the world practice it is characteristic the transition from the guidelines of direct action in the regulation of subsoil use to generalization and dissemination of the cases of “best practices”. Thus the “regulatory space” (or resource mode) evolves not only as the characteristics of assets changes (especially in connection with the transition of the resource extraction regions to the stage of maturity as far as mineral resources exhaust, their

characteristics deteriorate, human impact is strengthening), but also as they gain experience and form the stable “specific organization knowledge”.

The most significant elements of the institutional environment are the following: subsoil use mode, tax system (including its specific rental component) and organizational structure. These elements of the institutional environment are closely interrelated and mutually conditioning, the state and dynamics of their change is largely dependent on the state policy in respect of MRC, and they are actually a part of the state regulatory system. However, the current regime of subsoil use in Russia does not provide for adequate monitoring and control stiffness during the development of mineral resources [3].

Active regulation in the institutional sphere of subsoil use should include a range of measures. The effectiveness of the licensing process, which is a key institution in the subsoil use, is largely determined by the completeness and consistency of laws and other legal acts of the federal and regional levels. However, the monitoring of the subsoil use conditions compliance is insufficient, that is why it is necessary to increase the responsibility of subsoil users up to the license withdrawal. In modern Russian conditions in MRC and FEC there are the specific features of the rent existence as a result of regulation incompleteness in the institutional sphere, besides a significant and economically reasonable portion of the added value of (quasi-rent) must be withdrawn by the owner of resources (assets) – the state. Improving the taxation based on the differentiation of tax rates should be based on differential accounting and monitoring of production operations and economic performance at the level of certain licensed objects. Operation of integrated companies in the MRC is focused on the widespread use of transfer pricing in intra-circulation of goods and services that does not provide an objective assessment of the effectiveness of mineral resources development and makes the transition to a flexible taxation

problematic. Therefore, regulation of transfer prices should stimulate competition in the MRC in the domestic market and prevent non-market pricing.

**Investment attractiveness of the industry** is uniquely determined. Exploring different points of view on the investment attractiveness of companies and industries revealed that in the current understanding there is no single approach to the nature of this economic category. The most common understanding of the investment attractiveness is as appropriate investment in the objects which are interesting for investors, which depends on several factors. More precisely, the economic substance of the investment attractiveness can be defined [4] as a set of objective features, properties, assets and opportunities that determine the potential effective demand for investments. This definition is broader and allows taking into account the interests of any member of the investment process. Accounting and analytical interpretations of investment attractiveness (including those of L. Gilyarovskiy, V. Vlasova and E. Krylova and others) are based on an assessment of the structure, efficiency of own and loan capital use, analysis of solvency and liquidity. In assessing the investment attractiveness in terms of income and risk, it can be argued that it is the presence of income (economic impact) on investments with minimal risk.

Thus, it becomes apparent that regardless of the approach used by expert or analyst to determining, more often, the term “investment attractiveness” is used to assess the feasibility of investment in this or that object, selection of the options and determination of the efficiency of resources allocation on the basis of objective purposeful information for making investment decision. Formation of a methodology for assessing the companies’ and industries’ investment attractiveness in Russia is at an early stage. This is evidenced not only by a small number of publications on the subject, but also by the almost total absence of specific working practices.

A generally accepted is an approach to assessing the investment attractiveness of industries based on the theory of competitive advantage theory of M. Porter and the positioning theory which have been dominating in strategic management for a long time. In this interpretation the competitive advantages are stated as conditions ensuring company’s profit exceeding the industry average, mainly due to market power and monopoly rent. Factors of formation of competitive advantages are determined by the external environment of the company: the structure of industries and markets, entry barriers, product portfolio, the share of the company, etc. Management of competitive advantage is understood as positioning of business in a stable industrial structure, so the strategy should provide the best match of the company with specific external environment and can be defined as reactive [5, c. 336] or adaptive. This approach has the following disadvantages: exaggeration of the role of external factors of competitive advantage, impossibility of use in unstable environments and dynamic change of the competitive environment and industry structure, orientation to suppress competitors, strategy lagging.

Under current conditions of the MRC markets development, the investment attractiveness of the industry is affected by market structure and power of companies, as well as institutional management and development of artificial competitive advantages.

**The industry and market structure** determines the behavior and performance of the company to a large extent. The nature of competition and the emerging types of markets in the modern economy has changed fundamentally due to the concentration of capital and production, leading to economy corporativization and formation of oligopolistic market. At that the relationships in the markets change fundamentally, as a result free competition is substantially restricted, such specific factors of ineffectiveness as technical (failure costs), X-inefficiency, allocative inefficiency, the net loss of society’s welfare become apparent.

The main institutional problem which is closely linked to the regulation of competition is state regulation of corporate economy, which requires the development of appropriate mechanisms in terms of the new paradigm of economic development – the state-corporate.

Factors that reflect the character of changes in the state of competition include both subjective factors: the behavior of competitors, the availability of institutional regulation of the market participants' behavior, and objective factors: the types of market, concentration, technology, the dynamic characteristics of their changes, etc.

When diagnosing the state of competition the crucial point is the analysis conducted on the coefficients and indices. The most common in the scientific, practical and normative literature on the analysis of the markets structure are the indices of concentration, Herfindahl-Hirschman index, ranking concentration index (Hall-Tydeman index, Rosenbluth index), the coefficients of Lerner, Linda, Gini, entropy, the maximum share, reciprocal share, variations in market shares, etc. In this case different indices and coefficients may show different levels of market concentration, the degree of market power and indicate the existence of different market structures. In addition, in the dynamics each of the applied indices and coefficients may show different directions of changes in the state of the market being diagnosed.

Assessment of the state of competition in the Russian market [6] reflects the following indicators of the commodity market: product and geographic boundaries, subject composition, size, proportion of businesses entities (BE) on the market, the level of product market concentration, entry barriers, assessment of the competitive environment state, potential BE. However, this list of indicators, in our opinion, is not exhaustive.

In general, the methodologies for assessing the state of competition prevailing today are in many ways behind the modern requirements for the reliability of estimates. First of all, it concerns the evaluation of dynamic characteristics, which

often use expert (intuitive) assessment, giving only a fragmentary and approximate idea of the conditions of competition and not allowing to predict the direction of their changes. The conclusion about the ambiguity of approaches in the definition of the company's dominant position in the market is associated with a lack of common evaluation criteria against which it is possible to conduct research directly related to the definition of the market share. Practice has shown the possibility of using both qualitative and quantitative characteristics related to the assessment of the competitive environment and the level of monopoly in the domestic economy [7].

Internationally accepted institutional framework for the protection of equal conditions of competition include the legal basis for competition protection, principles of state regulation of cartels, natural monopolies, the application of antimonopoly regulation and its impact on international exchange. In Russia, the European principle of control and regulation was laid into antimonopoly regulation foundation [8]. Further development of the regulatory framework for the protection and development of competition was associated with the new Constitution and the Civil Code of the RF; then the appropriate changes and additions in almost every article of the first edition of the Law "On Competition..." were made. Modern institutional framework of competition policy in Russia is defined [9], where a special object of legal regulation is the monopolistic activity and the business entity's abuse of dominant position. With a dominant position a business entity gets a possibility to exert a decisive influence on the general conditions of commodity circulation in the relevant market and (or) to eliminate, and (or) obstruct the access to this commodity market to other participants.

Competition policy can be defined in different ways. Russian law defines competition policy as a set of consistent measures implemented by the state in order to ensure conditions for the competitiveness of

business entities, to improve efficiency and competitiveness of the Russian economy, modernization of enterprises and creating conditions for cost-effective way to citizens' needs for goods and services [9]. According to the OECD definition (1984), competition policy aims to support and promote the competitive process that ensures efficient production and distribution of goods and services over time through exposure to innovative development and adaptation to technological change. That is, the aim of competition policy is to support and promote the dynamic process of sustainable economic growth.

Competition support policy includes [10]: policy of regulation of monopolistic activities, policy of control over the restrictions of competition (vertical restraints), policy in the area of mergers and acquisitions, providing direct or indirect assistance to companies by the state and its bodies. The legislation is designed to monitor the compliance with three conditions: the independence of consumers' decisions in the market, freedom of choice of producers' competitive behavior strategy and the absence of artificially created barriers to market access.

In MRC most industries have the following characteristics: first, they are capital intensive, and therefore the concentration regulation of the internal market may be directed to the formation of large production units, with the formal characteristics of a monopoly. Second, many MRC industries are export-oriented, so the measures are needed for direct and indirect state regulation to encourage the development of the domestic market. Third, in MRC industries there is a high proportion of specialized investment and companies need to invest heavily in specific assets (firm-specific assets), which are the basis for the establishment of permanent competitive advantage. The concept of specific assets determines their special properties as rare, non-traded, impossible for the simulation and irreplaceable [11]. Government regulation can promote and protect specific investment and lead to long-term contracts.

Finally, the risks of different nature, the irreversibility of investment and considerable dynamism of the environment determine the complexity of the current and forecast assessment of competition. Investing in specific assets in order to acquire permanent competitive advantage by certain companies and the leveling of the competitive advantages of competitors means that the company takes on considerably more risk than in traditional investment strategies, which determines the need for the state's involvement in the distribution of risks, such as through public-private partnerships, etc.

Thus, the institutional regulation of competition includes: the regulation of state-corporate economy, modernization and implementation of competition policy, assessment and forecast of the competition dynamic state, protection of specific investments and stimulation of long-term contracts, lowering barriers to market entry.

**The degree of the companies' integration** and diversification forming the organizational, structural and operational characteristics and determining the degree of influence on the market, largely determines the competitive status of the company. A study of integrated mining companies has been done and the following characteristics are established:

- a high degree of interdependence with the state over the ownership and use of mineral resources;
- a direct interest of the region and the state to improve operational efficiency due to limited resources;
- integrated mining companies are the city main budget forming and socially-significant landmarks;
- the legal framework of vertically integrated companies (VICs) is a holding type public company;
- the core of VICs is a set of enterprises, which are successive stages of a production cycle and interconnected technologically with necessary production constraints;
- mineral resources are specific assets;

- integrated companies include supporting and service production ensuring the development of the specialization and their own needs;
- production and cash flow management is provided by the parent company;
- a high degree of risk, declining with the increasing degree of integration and diversification;
- diversification of production.

To assess the degree of diversification and integration there are no reliable methods developed, the following can be recommended as key indicators: the number of industries in which the company operates, the modified Herfindahl-Hirschman index, an index of entropy. Gathering the required information is quite difficult for Russian companies, as the requirements for presentation and disclosure of relevant information in Russian standards are not available.

**The type and effectiveness of the strategy** influences the type of competitive status. It is appropriate to implement the determination of the types of competitive status of business entities focusing on two parameters – the type of the implemented strategies of competitive behavior and the assessment of its implementation success degree through the use of the character of actually acquired strategic and competitive positions.

The priority for MRC is the analysis of the types of strong competitive status [1]: monopoly and dominant.

Monopoly status is manifested in two forms:

- common (absolute) monopoly, with monopoly positions in all the selected sectors and market segments,
- differential (relative) monopoly – the status corresponding to the firm with monopoly positions in some sectors of the market, at least one.

The dominant status is manifested in the following ways:

- common (absolute) dominant is successfully engaged in widely diversified business, as evidenced by the presence of a dominant position (25% and higher) in all selected market sectors;

- differential (relative) dominant – succeeded in at least one of the sectors of the market;

- specialized dominant – a company operating in a very limited number of market sectors and having achieved dominant positions there;

- highly specialized dominant – a company operating in a single sector of the market and having achieved dominant positions there;

- partial dominant – a company that has no dominant positions in any sector of the local market, but with the ability to influence and really impacting on weaker opponents, with a share of 7 – 25% of the respective market sectors;

- pseudodominant – an entrepreneurial firm that seeks to be similar to the original owners of the dominant positions in the nature of the competitive action, but having no dominant positions anywhere.

Most companies, given their specificity, integration and diversification in the MRC markets have a status of specialized and highly specialized dominant.

There are few methods for determining the competitive status of the companies being developed; all of them are built on a unified methodological basis – I. Ansoff's approach [2].

In the classical version the indicator of competition status of a firm (CSF) is given by the formula:

$$CSF = \frac{(I_F - I_k)}{(I_O - I_k)} \times \frac{S_F}{S_O} \times \frac{C_F}{C_O},$$

where  $I_F$  is the value of strategic capital investments;

$I_k$  is the critical value of capital investments, which shows that capital expenditures below this value do not result in revenue;

$I_O$  is the optimum value of investments;

$S_F, S_O$  is acting and the “optimal” strategy of the firm, respectively;

$C_F, C_O$  are the best available capacities of the firm, respectively.

I. Ansoff's interpretation in its economic content is similar to the concept of competitive advantage in the treatment of Porter, as both treatments operate on the ratio of actual and basic productivity of companies' resource use. Competitive status of the company characterizes the prerequisites for achieving by a company a high-level competitive advantage, for which the availability of resources of all kinds of the firm's "capacities" to capture a leading position in the industry (the world market); favorability and the possibility of using by the firm of the environmental conditions to create and maintain a high level competitive advantage are determined.

The practical significance of I. Ansoff's approach is in the agreement of common and competitive strategy with the investment strategy of the company, the formalization and evaluation of the latter. The evaluation of future competitive status of the company is based on the determination of the relative investment positions in perspective: strategic investments provided and planned by the company, the critical point and the point of optimal volume in the future.

For each element of the strategic potential there should be identified the resources that can provide achieving of the company's goals. Comparing the values of actual and desired resource parameters we can determine the compliance of actual parameters required for each element of the strategic potential taking into account the adequacy extent of the external environment. I. Ansoff evaluates the performances  $S_F$ ,  $S_0$  and  $C_F$ ,  $C_0$  as the arithmetic mean scorings (on a scale from 0 to 1) to the extent of factors correspondence to the current strategy (or potential available) to the factors optimal strategy (or optimal potential). If  $CSF = 1$ , the firm will be able to secure an exceptionally strong competitive status and become one of the most profitable, if one of the indicators that make up the competitive status of the firm is zero, it will not gain profit.

This situation can occur if the firm lacks a strategy, a resource potential, or the firm's strategic investment comply with the critical point. Further, I. Ansoff suggests the following gradation of competitive status of the company:  $0 < CSF < 0.4$  – weak,  $0.5 < CSF < 0.7$  – average,  $0.8 < CSF < 1.0$  – strong competitive position.

In our opinion, the main problem in determining the competitive status of the company is the complexity of assessing the adequacy of the strategic potential and environmental conditions to create and maintain a high level of competitive advantage. Other problems in the practical application of I. Ansoff's model include the absence of generally accepted quantitative methods of strategic investments level calculating, and the disadvantages of expert methods application for scoring optimal strategy (strategic standard) and the optimal capacity (capacity standard). There are no well-established methods of calculating the necessary, critical and optimal values of strategic investments, which makes it difficult to assess the competitive status of the company both at the current time, and in the future. Understanding the importance of the level of strategic investment has developed relatively recently, so satisfactory methods of assessment of this indicator have not yet been developed, although research in this area continues [1, 12].

Analysis of the ability to assess the competitive status of a company in crisis and post-crisis [13] shows that the solution of the problem of determining the optimal value of investments and the best opportunities is complicated under the conditions of high uncertainty and market volatility impeding the development of long-term strategies. Therefore, the formula for assessing the competitive status of the company is simplified and is based on expert assessments:

$$KC\Phi = (I_\Phi/I_K - K_0) \times I_{CT} \times K_{cy},$$

where  $I_\Phi$  and  $I_K$  are respectively  $I_F$  and  $I_K$  (see above);



$K_0$  is the coefficient (average value on the basis of international practice) of the ratio of the optimal and critical value of capital investment, typical for the industry and being in the range 2.5 – 5;

$I_{cr}$  is the coefficient of production stability, determined by the ratio of the index of output growth and inflation rate;

$K_{cy}$  is the estimate of the optimality of the applied methods of strategic management, provided by expert or scoring method.

The main advantages of the improved approaches are the account of the company life cycle influence, the variability of external factors in a crisis on its competitive status. This account is especially important for mining companies, as their life cycle is largely determined by the system-specific features of commodity assets, the companies have high operating leverage, and mineral markets are inertial and sensitive to the price situation. The main disadvantages of these approaches are the subjective evaluations, the impossibility of adequate considering the company's industry sector, the lack of statistical basis for calculations, thus the reliability of the calculations will be very low.

In our view, the competitive status of the mining company is affected by a wider range of factors whose influence must be taken into account by the index method:

1. Competitive intensity, the company's competitive behavior and the type of market competition in the industry markets at present and in the future.

2. Financial and investment strategy of the company, taking into account the irreversibility of investment and high barriers to entry into the industry.

3. The influence of the synergistic effect associated with the company's participation in integrated and especially holding companies.

4. The level of financial dependence on the creditor and the price of capital, significantly affecting the efficiency of strategies implementation.

5. Investment attractiveness of companies, industries and markets.

6. Corporate ownership structure, as with the company's participation in large corporate associations, the interest in performance is reduced, since the market transactions mechanism is replaced by their intra-firm organization.

The choice of the company's development strategy and investment policy depends on several factors: size, financial capability, performance, credibility, financial stability, solvency, competition level, barriers to entry and the extent of its influence on the market, the maturity of the company and the market, the development of external and internal capital markets; specific and institutional regulation of sectors and markets, and others.

The company carries out a strategic choice among the three groups of investment market objects: the objects of real investment (tangible long-term assets, including, mineral assets), financial assets, objects of intellectual capital. Making investment decisions aimed at creating, maintaining and developing of competitive advantage must be based on strategic management in view of predicting changes in the environment, adaptation of management decisions to them and flexible response.

In Russian companies one can meet the following types of investment policy [14, p. 195]: narrowed reproduction, simple reproduction, partial modernization of assets, complete modernization of the core assets, dynamic assets allocation, portfolio strategic investment.

The first three types of investment policy are implemented by about 30% of companies, especially by those with a high degree of public participation. In this case the key factors for project choice are to maintain solvency and profit growth, the traditional criteria for evaluating projects are the payback period and internal rate of return. Approximately 40% of companies are choosing a policy of full modernization of the core assets, the others focus on dynamic assets allocation and portfolio strategic investment (few companies).

Integrated mining companies are characterized by the more developed (the last three) forms of investment policy determined by the target-oriented strategies, shaped by the results and the scale. When there is complete redesign of core assets, investment is mainly in specific assets related to innovations, that provides keeping competitive advantage in the industry and increase company value. In a dynamic investment policy of asset allocation there are direct and portfolio investments, the projects are characterized by both investment and financial flexibility, a wide variety of sources is used including domestic capital market, as a result new competitive advantages in specific sectors and additional company's value are created. Strategic portfolio investment (investment in strategic assets) is aimed at developing strategic abilities (competencies) and resources (assets), taking into account the financial strategy, resulting in the creation and retention of long-term competitive advantages and sustainable growth of the company's value. The fundamental difference of such investment policy from the other species is the possibility of changes in the environment due to the formation of new needs, technologies and competencies.

To assess the effectiveness of the strategy implemented by the company, one should [2]:

- 1) analyze the competition factors and competitive advantages;
- 2) determine the significance of factors for the company's strategy;
- 3) make models of several competitive strategies;
- 4) define a model of competitive strategy, which may be an optimal strategy in the future;
- 5) compare each factor of the optimal model with the relevant factors of particular substrategies within the current strategy based on the scoring method in order to determine whether the current strategy is optimal.

It should be noted that the assessment of the competitive status is relative, as it is determined in comparison with the industry average values, or with the performances of the leading competitors. The quality and efficiency of the chosen strategy determines the company's behavior leading to the formation of the result – an increase of competitive status. Therefore the choice of the company's development strategy should take into account the generally accepted indices of economic efficiency of investment projects, the projected growth of the company's value and its competitive status increase.

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