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STRATEGIC MANAGEMENT IN THE DIGITAL ECONOMY

Sources of Competitive Advantage

Competitive advantage - Strategic positioning and capabilities

Competitive advantage refers to a firm's ability to outperform its rivals or, in other terms, «*a firm's potential to earn a higher rate of profit than its direct competitors*.» (Grant, 2019)

Creation of a unique and valuable market position

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Capabilities to occupy and defend market position

Competitive advantage - Resources

Tangible Resources

- Physical (Plants, land, equipement, etc.)
- Financial (Cash, Credit)

TESLA

Intangible Resources

- Technology (Patents, Copyrights, Trade Secrets)
- Reputation (Brand)
- Culture

GORE Creative Technologies Worldwide

Human Resources

- Skills and Know-How
- Motivation
- Intercultural skills
- Leadership

McKinsey&Company

Competitive advantage – From resources to organizational capabilities

- List of resources is insufficient to diagnose sources of competitive advantage
- We need to understand **how resources enable firms to perform value creating activities**
- Value creating activities respond to key success factors in a particular industry

Organizational Capability	"the capacity to deploy resources, usually in combination, using organizational processes, to effect a desired end" (Amit & Shoemaker, 1993, p. 35)

Competitive advantage – From resources to organizational capabilities

From **Penrose** to **Barney**

Resource-based view of the firm

The emphasis on **resources and capabilities as the foundation of firm strategy** was popularized by C. K. Prahalad and Gary Hamel in their 1990 landmark paper "The Core Competence of the Corporation. The potential for capabilities to be the roots of competitiveness"

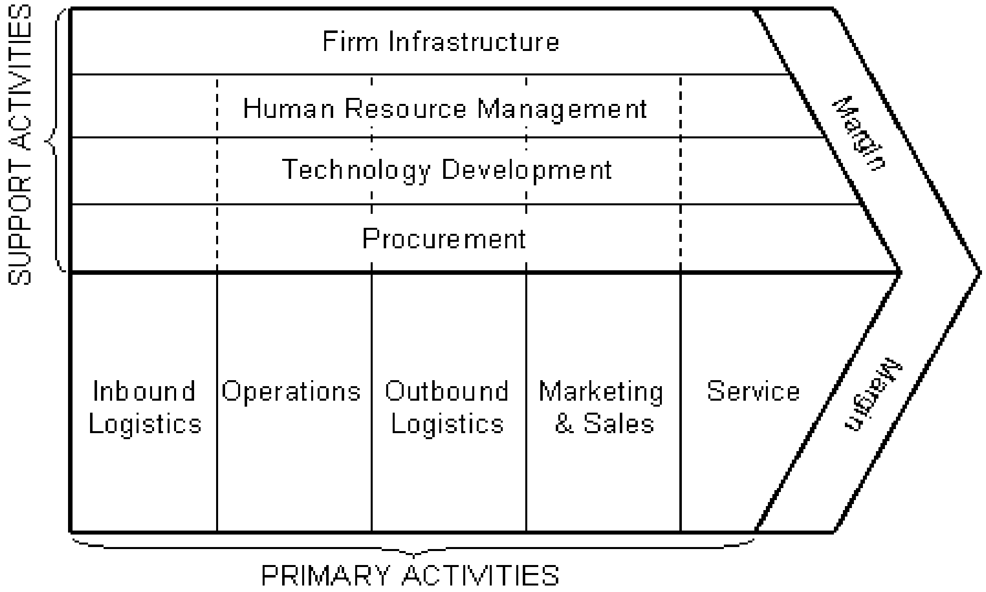
NEC

GTE

Three characteristics of core competences:

- A core competence provides **potential access to a wide variety of markets**
- A core competence should make a **significant contribution to the perceived customer benefits** of the end product
- A core competence should be **difficult for competitors to im**itate. And it will be difficult if it is a complex **harmonization of individual technologies and production skills**

In order to evaluate **capabilities** and sources of **competitive advantage** we need to understand **what firms actually do**



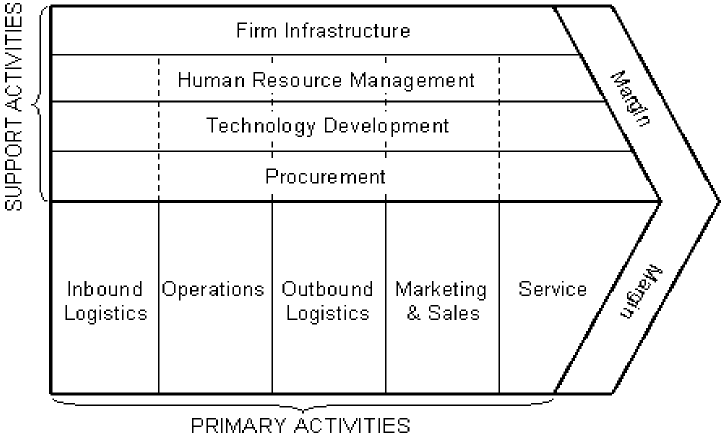
A linked series of value generating activities that create competitive advantage (differentiation/ cost leadership)

- Value Chain Analysis:
  - organizes all activities a company performs in
  - bringing products or services to the market

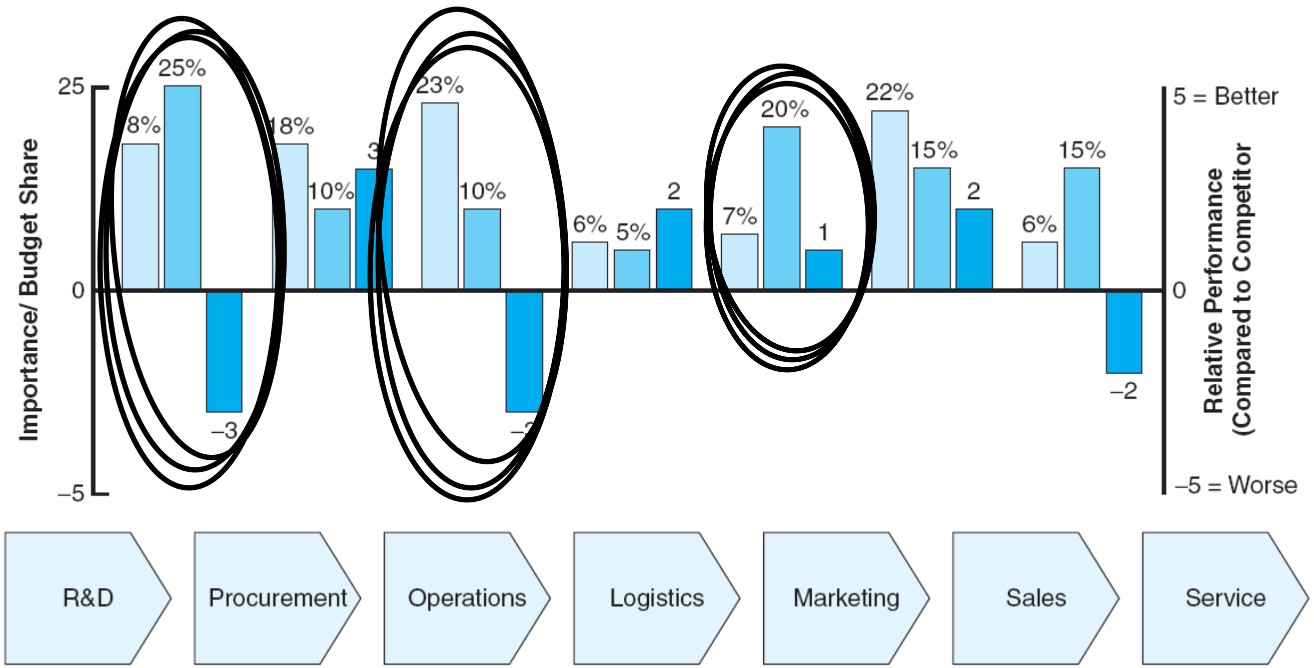
- The benefits of the Value Chain Analysis:
  - Distinguish strategically relevant activities, that can lead to
    - Costs
    - Quality advantages
  - Identify what influences the product’s margin
  - Identify what activities lead to competitive advantage

Value chain analyses should answer the following questions:

- What are the activities of a company's value chain?
- Which of them are **strategically important** in the industry/strategic group?
- How well does the company perform on the activities?
- Which are the activities that **generate profits and which cause losses**?
- Which are the activities that **generate competitive advantages or core competences**?
- Which are the activities that **should be outsourced**?



Competitive advantage – Value chain analysis



- Cooperation with Research Institutions
- 2 Research Lab
- 7 New Products/ Year

- Global Sourcing
- Centralized Sourcing
- Just-in-time Delivery
- 60 Suppliers

- 25 Plants
- Decentralized Production
- Low Economies of Scale
- Effective Quality Management

- Own Distribution Network
- High Flexibility and Reliability
- Good Coordination with Logistics Partners

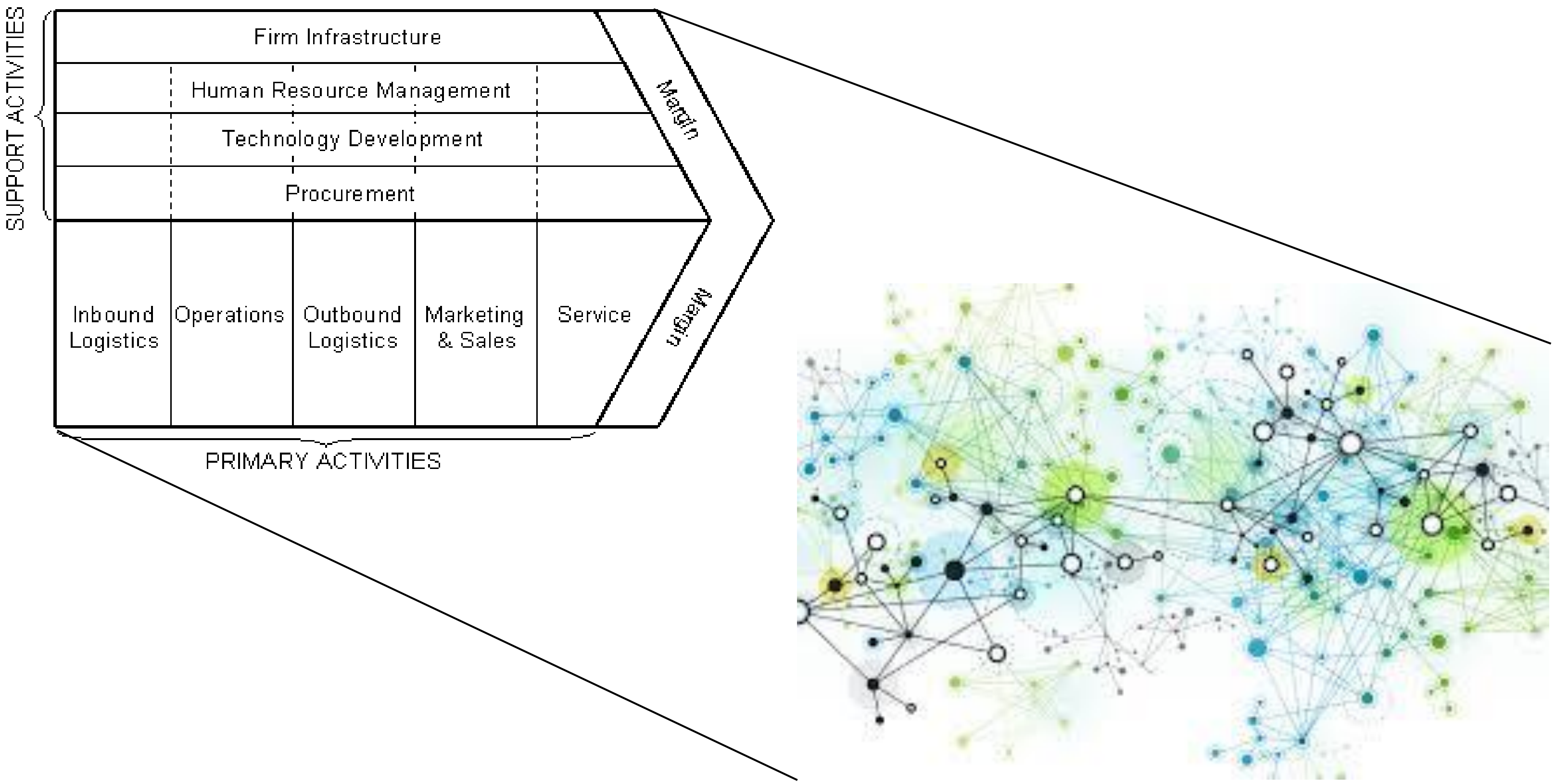
- Strong Brand
- Focus on Direct Marketing

- Effective and Well-Trained Sales Force

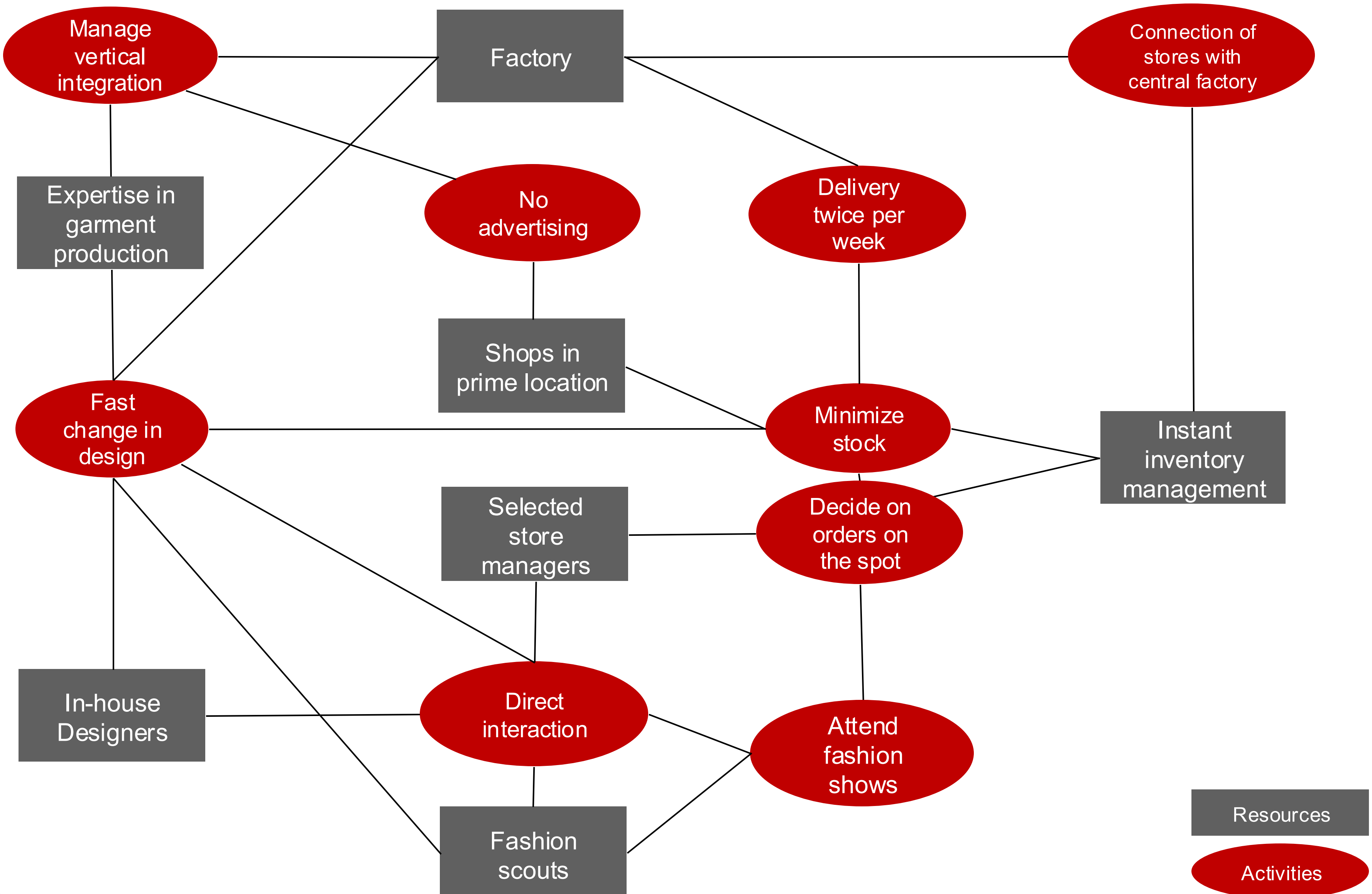
- IT-based Feedback System
- Effective Call Center

Budget Share
Strategic Importance
Relative Performance (Compared to Strongest Competitor)

Competitive advantage – Diagnosing organizational capabilities – Activity

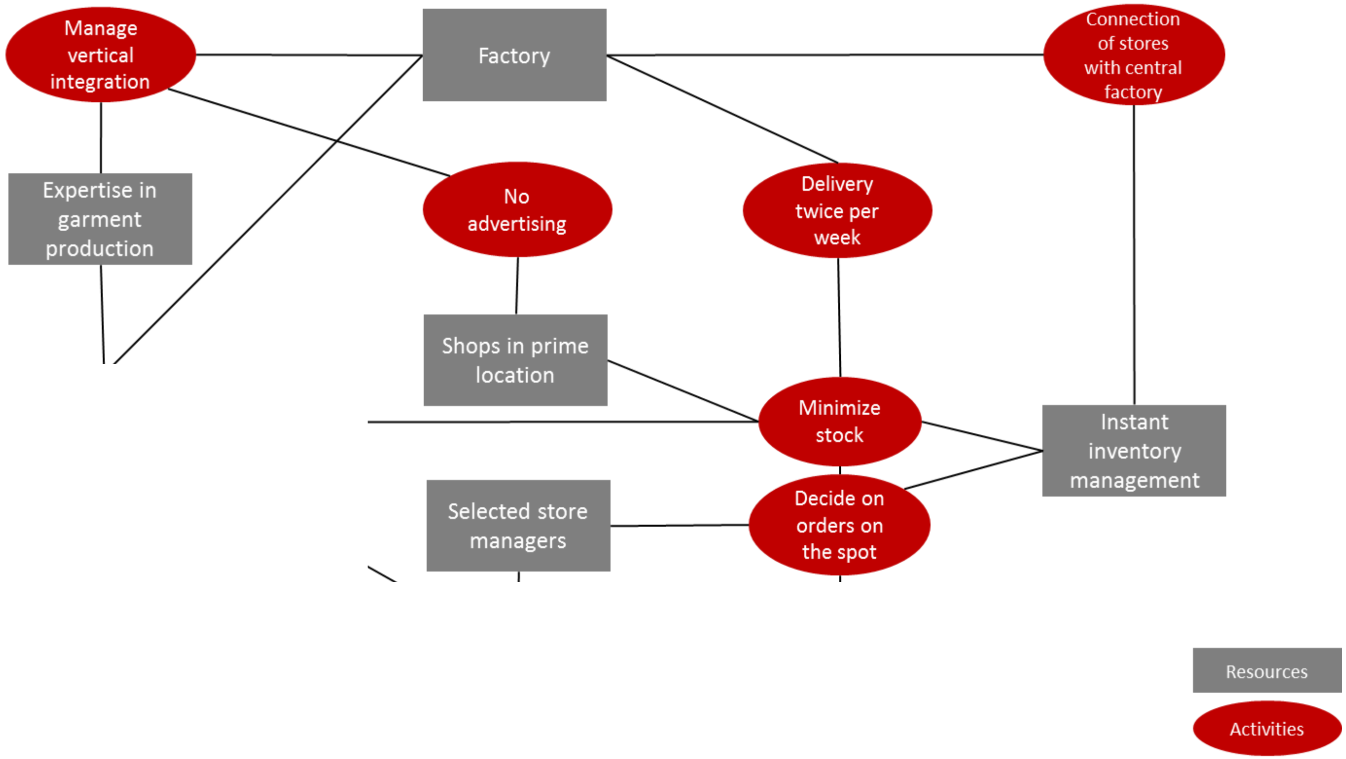


Example: Zara - Diagnosing organizational capabilities – Activity systems



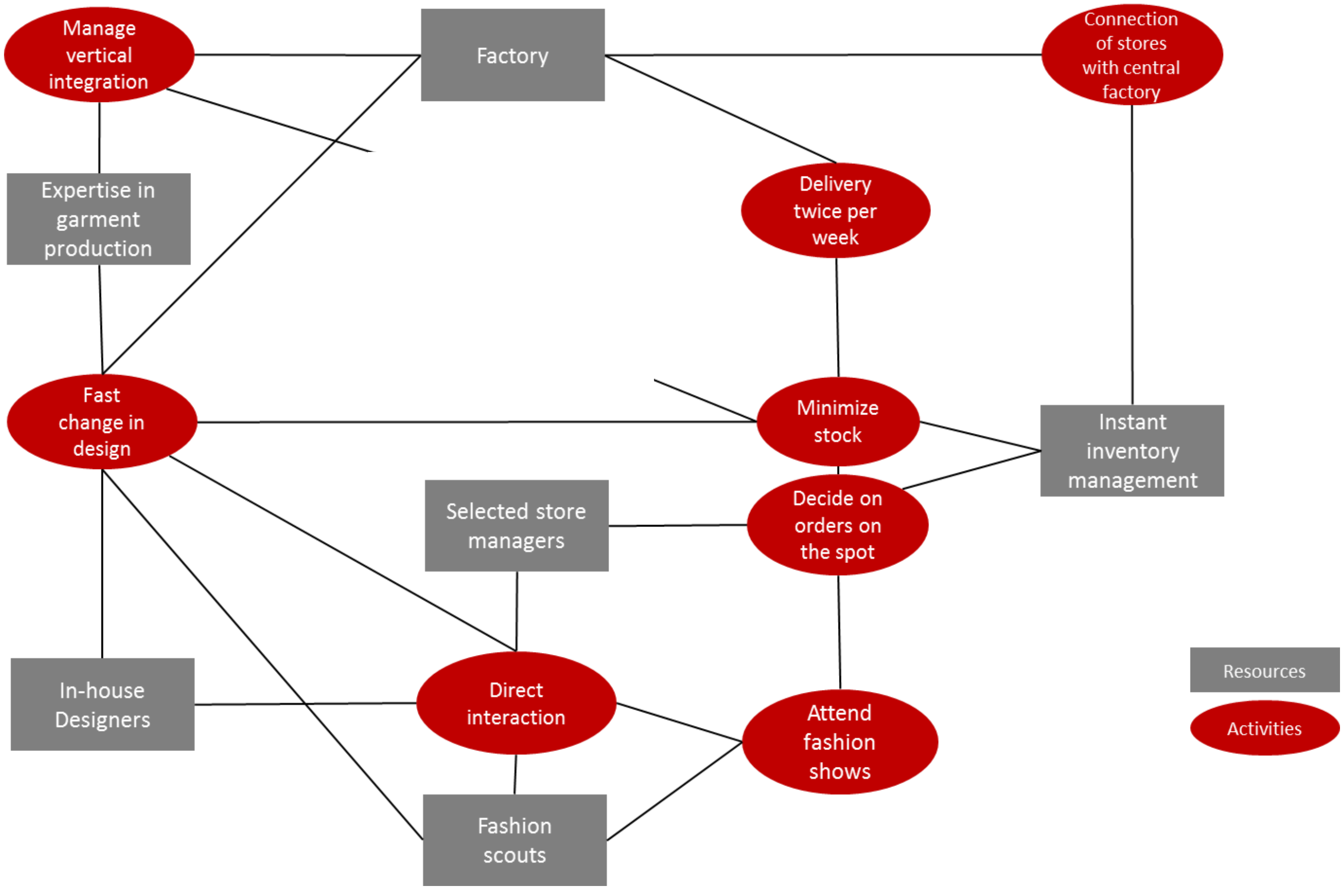
Example: Zara - Diagnosing organizational capabilities – Activity systems

Capability 1: Managing cost efficient production



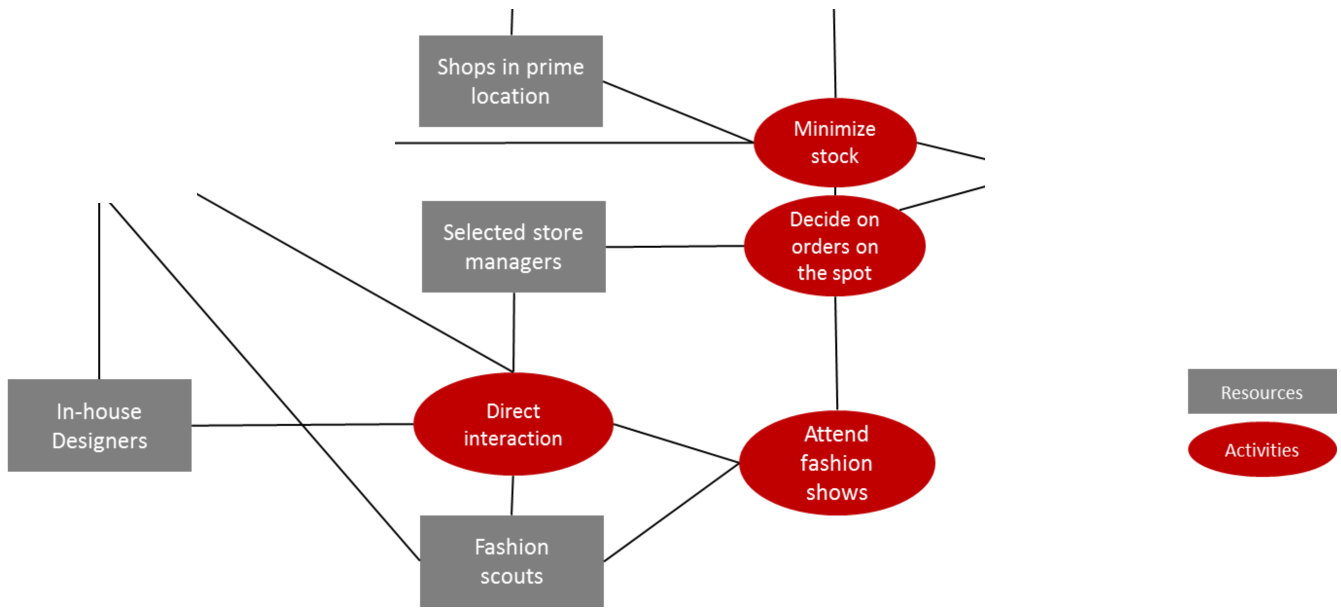
Example: Zara - Diagnosing organizational capabilities – Activity systems

Capability 2: Fast response to fashion trends



Example: Zara - Diagnosing organizational capabilities – Activity systems

Capability 3: Top fashion and brand recognition



The importance of routines

- Organizational capability is based upon **organizational routines**: “regular and predictable behavioral patterns [comprising] repetitive patterns of activity” that determine
  - what firms do
  - who they are
  - how they develop

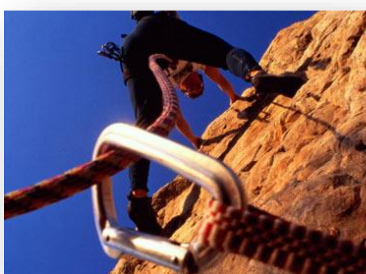
- Like individual skills, organizational routines develop through **learning by doing**—and, if not used, they wither

- There is a **trade-off between efficiency and flexibility**. A limited repertoire of routines can be performed highly efficiently with near-perfect coordination. The same organization may find it difficult to respond to novel situations

Are these resources and capabilities sources of **sustainable competitive advantage**?

Resources, Capabilities, and Sustainable Competitive Advantage

V	R	I	O
Value	Rarity	Imitability	Org'l support




Barney, J. (1995). Looking Inside for Competitive Advantage. *Academy of Management Executive*, 9, 49-61

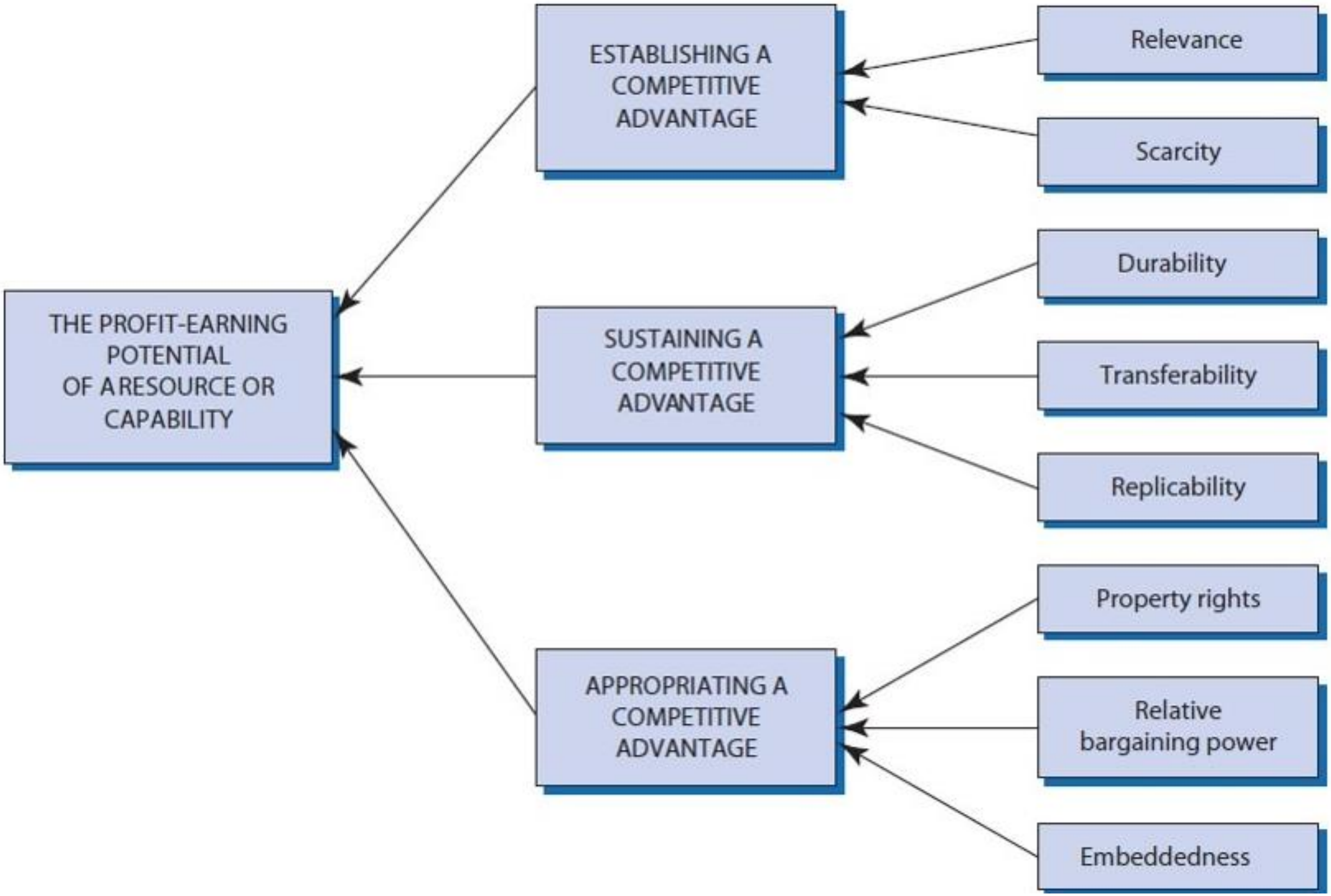
Sustainable competitive advantage

	Valuable?	Rare?	Inimitable?	Organizational support?	Competitive advantage?
Capability 1: Managing cost efficient production	?	?	?	?	?
Capability 2: Fast response to fashion trends	?	?	?	?	?
Capability 3: Top fashion and brand recognition	?	?	?	?	?

Sustainable competitive advantage

	Valuable?	Rare?	Inimitable?	Organizational support?	Competitive advantage?
Case 1	No				Competitive Disadvantage
Case 2	Yes	No			Competitive Parity
Case 3	Yes	Yes	No		Temporary Competitive Advantage
Case 4	Yes	Yes	Yes	No	Unused Competitive Advantage
Case 5	Yes	Yes	Yes	Yes	Sustainable Competitive Advantage

Sustainable competitive advantage: A different perspective



Grant, R. (2022). *Contemporary Strategy Analysis*. Wiley (11th Edition), p. 109

Sustainable competitive advantage: A different perspective

- **Durability** is accounted as a key characteristic of resources and capabilities **determining the pace of erosion of competitive advantage**.

- The more durable a resource, the greater its ability to support a competitive advantage over time:
  - For many resources, such as capital equipment and proprietary technology, **the pace of technological innovation is shortening their life spans**
  - **Brands instead can be remarkably resilient**

GRANT: Strategic Importance Framework	BARNEY: VRIO Framework	Comparison
Establishing competitive advantage		
• Relevance	• Valuable	Similar: both are concerned with creating value for customers
• Scarcity	• Rare	Identical: scarcity = rareness
Sustaining competitive advantage		
• Durability	—	No equivalent criterion in VRIO
• Transferability	• Imitable	Similar: imitating a resource or capability requires either buying it (i.e., transferring it) or replicating it
• Replicability		
Appropriating competitive advantage		
• Appropriability	• Organization	Similar: being organized to capture value implies the ability to appropriate value

Grant, R. (2022). *Contemporary Strategy Analysis*. Wiley (11th Edition), p. 109

- Considering the analysis you have done, **define the sources of competitive advantage by analyzing a firm's resources and competences (VRIO)**.

- Download or draw the template, work on the model and **upload a PDF** with the analysis applied to a firm you know and like

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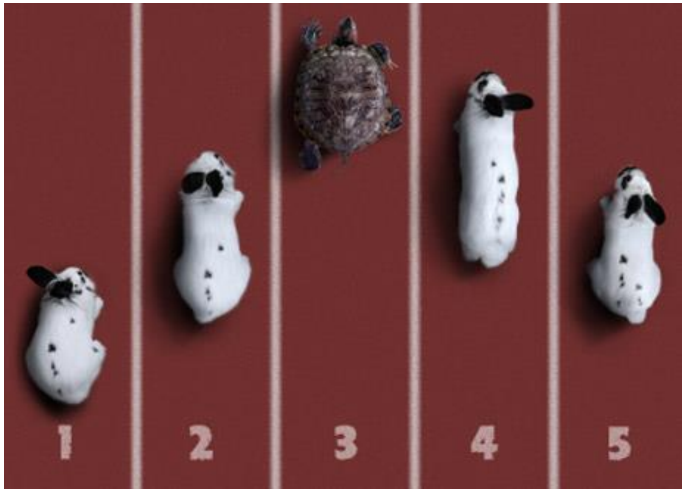
- Managers ‘label’ activities in abstract terms
- Masking the activities that underpin bases of competitive advantage
- In the absence of identifying those activities managers will focus on activities that matter to them

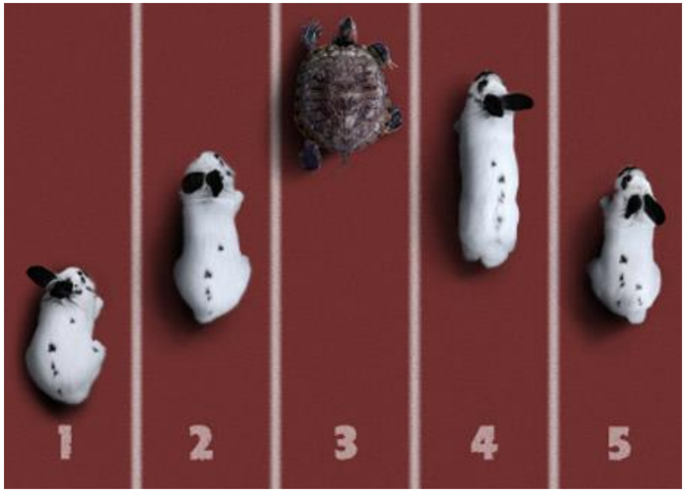
Sustainable competitive advantage - Challenges



Capability / Rigidity Paradox

Hypercompetition / Disruptive Innovation

Differentiation / Conformity Paradox

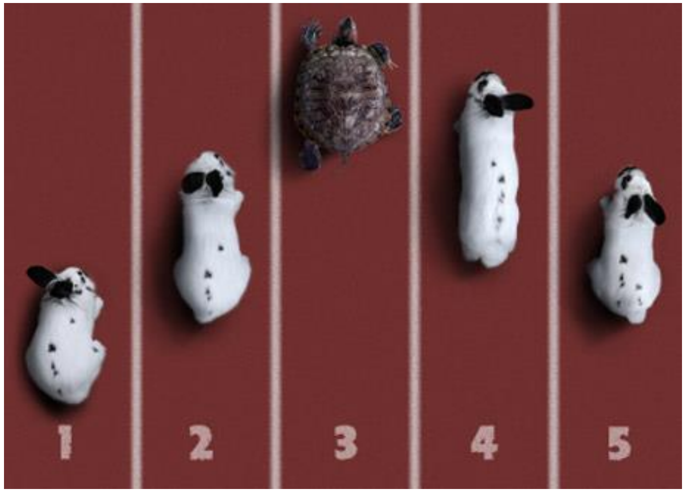


Capability / Rigidity Paradox

Hypercompetition / Disruptive Innovation

Differentiation / Conformity Paradox

- Capabilities require **constant investment and learning**
- Companies would like to benefit from existing capabilities (efficiency oriented, ‘**exploitative**’ learning)
- Internal **budget allocation** mechanisms often favor existing capabilities and crowed out new initiatives
- Over time organizational capabilities potentially become **core rigidities**



Capability / Rigidity Paradox

Hypercompetition / Disruptive Innovation

Differentiation / Conformity Paradox

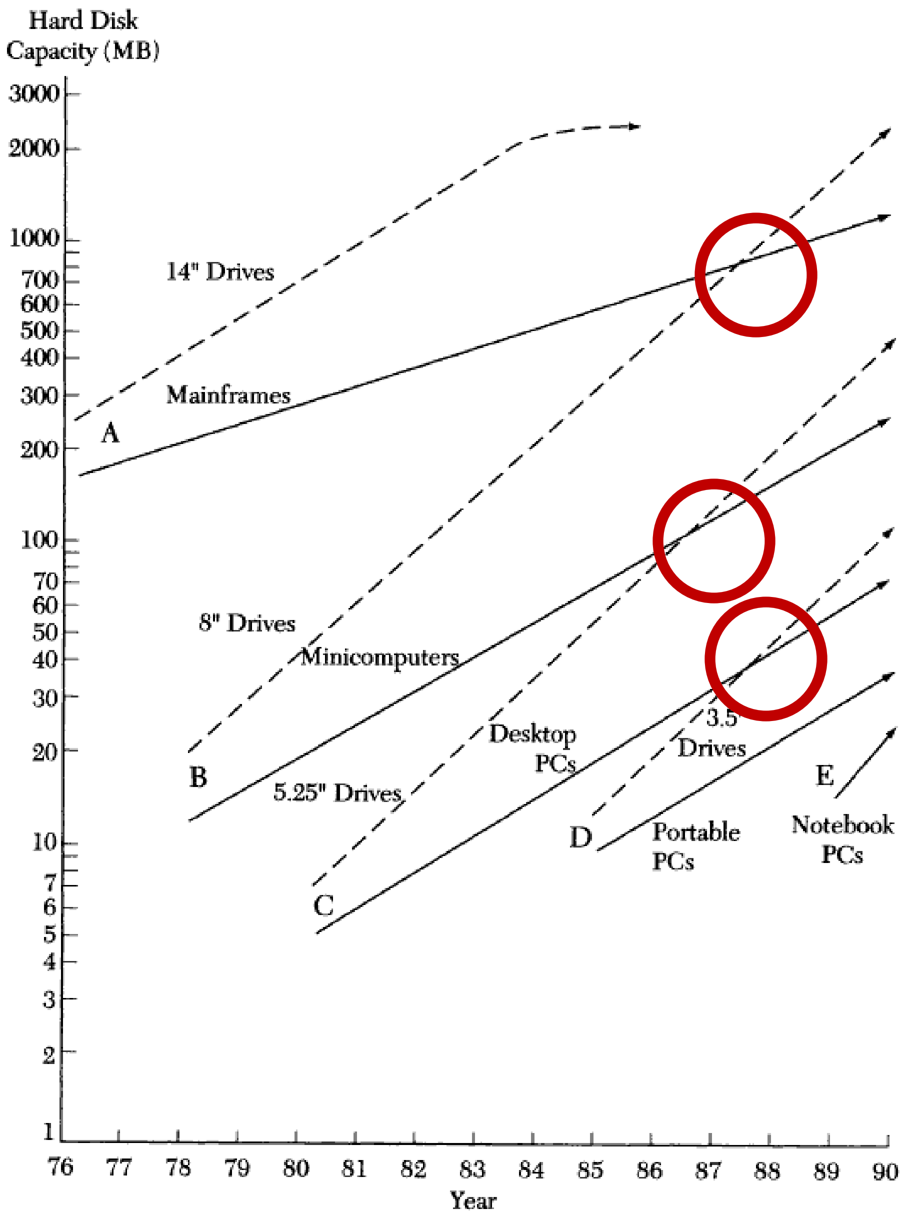
Characteristics

- Markets with **little scope for differentiation**
- **Fast cycles of innovation** that quickly erode advantage
- **Large number of players**
- Extensive **price competition**

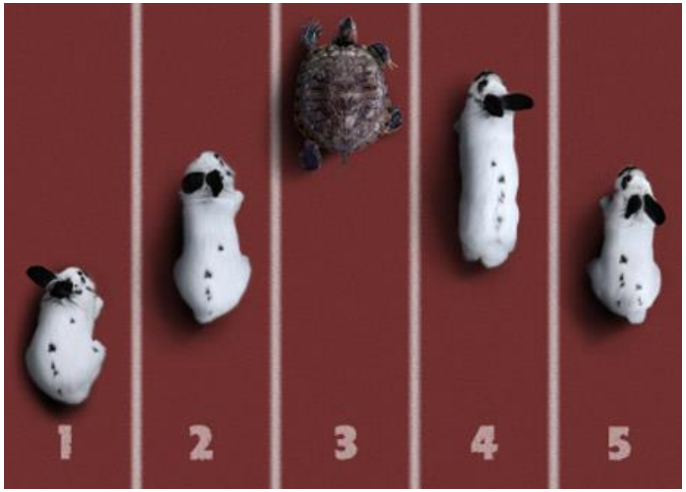
Implications

- Challenges to achieving sustainable competitive advantage
- Advantage in **ability to change**
- ‘**Dynamic Capabilities**’: capabilities that allow the modification and adaptation of lower-level operational and functional capabilities

Example: disc drive industry - Hypercompetition



(Source: Christensen, C. (1993) The rigid disk drive industry: A history of commercial and technological turbulence, Business History Review 67, 4, 559)



Capability / Rigidity Paradox

Hypercompetition / Disruptive Innovation

Differentiation / Conformity Paradox

Resource and Capability Based View of the Firm

Firms perform well if they have distinctive resources and capabilities that are a source of competitive advantage

'Distinctiveness Premium'

Institutional Theory

Firms perform well if they operate on similar and recognizable routines and processes

Ability to categorize

'Distinctiveness Discount'

Optimal Distinctiveness

Example: Businesses in the Sharing Economy – Differentiation/Conformity paradox

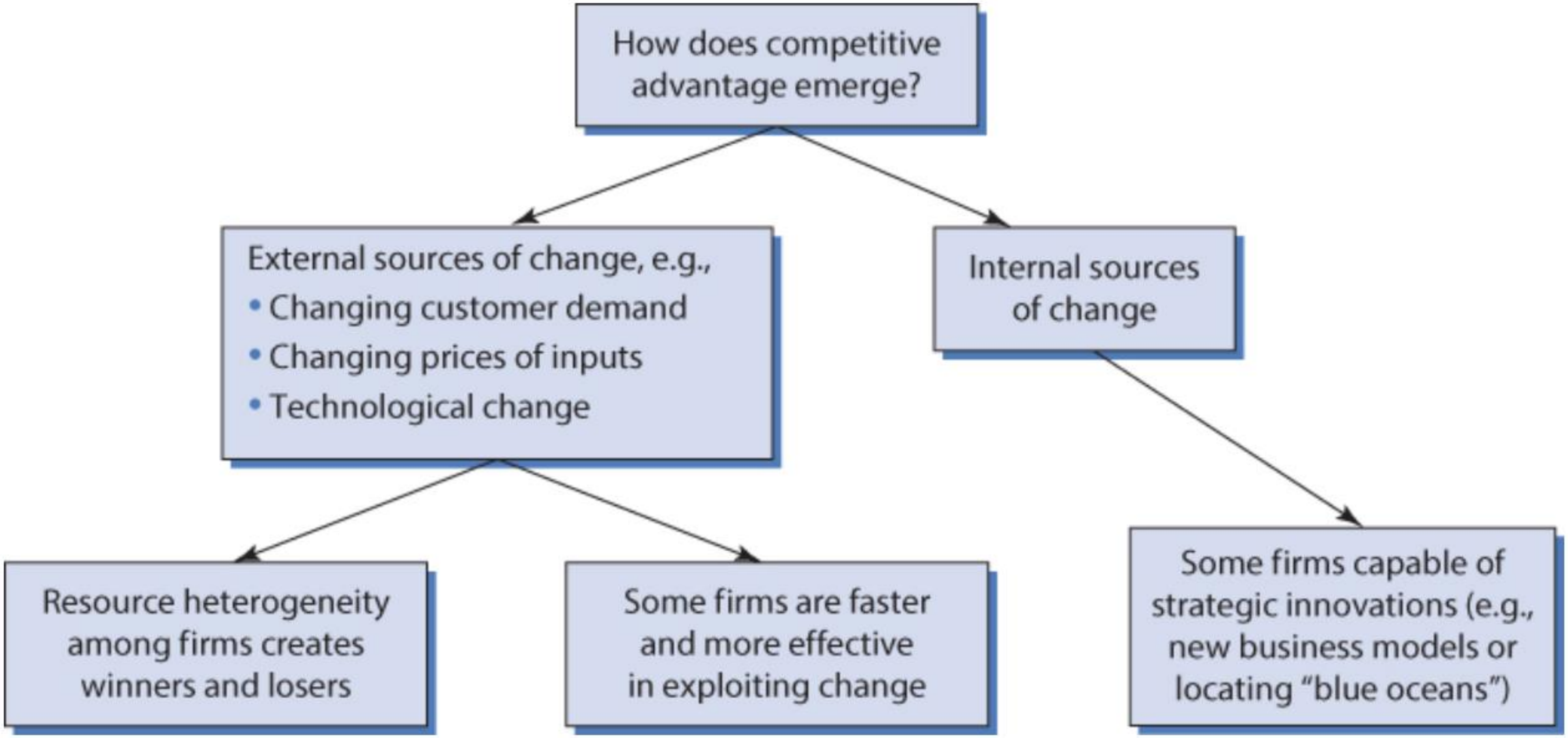
- Stakeholders (competitors, customers, investors) evaluate the **‘type’ of firm**
- Unfamiliarity with a business propositions increases **perception of risk**
- Research shows that conformity with established ‘categories’ positively affects investment decisions share price performance

airbnb

UBER

Source: Zhao et al. (2017) Optimal distinctiveness: Broadening the interface between institutional theory and strategic management. Strategic Management Journal, 38, 93-113.

The emergence of competitive advantage



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The emergence of competitive advantage

- The competitive advantage that arises from external change depends on firm' **ability to respond to change**.

- Any external change creates **entrepreneurial opportunities** that will accrue to the firms that exploit these opportunities most effectively.

- Entrepreneurial **responsiveness** involves one of two key capabilities:
  - **Anticipation**
  - **Agility**

- Competitive advantage may also be generated **internally through innovation** which creates competitive advantage for the innovator while undermining previously established competitive advantages

- **Business model innovation** has been used to describe the introduction of novel approaches to creating and/or capturing value within an industry
  – <u>New industry models</u>—**reconfigurations of the conventional industry value chain** such as Dell's direct sales model for PCs or Zara's vertically integrated fast-fashion model

  – <u>New revenue models</u>—**changing the value proposition**, the **target audience** or **pricing strategy**. For example, Virgin America introduced a novel customer offering comprising low airfares and a differentiated in-flight experience

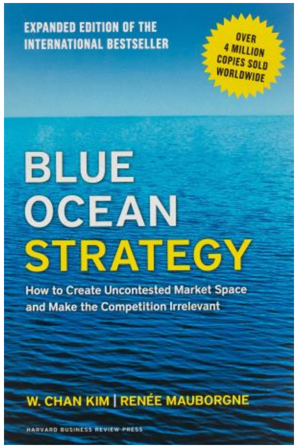
  – <u>New enterprise models</u>—involve **reconfiguring enterprise boundaries and partner relationships**. Apple's iPhone with outsourced manufacture and network of application providers created a new model of the smartphone business

- **Blue Ocean Strategy** is an alternative approach to identifying the potential for strategic innovation is that developed by Insead's Kim Chan and Renee Mauborgne.

- Their blue ocean strategy involves a quest for “uncontested market space”

- Creating untapped market space doesn’t necessarily require finding new market opportunities well beyond existing industry boundaries, blue oceans can be **created also within existing markets**

- The challenge is “to create new rules of the game by breaking the existing value/cost trade-off”



These “blue oceans” may be **entirely new industries** created by technological innovation (such as artificial intelligence and nanotechnology), but are more likely to be the **creation of new market space within existing industries** using existing technologies. This may involve:

- **New customer segments** for existing products, for example, Tesla's Powerwall battery for electrical storage in the home
- **Reconceptualization of existing products**, for example, Mark Zuckerberg's reconceptualization of a printed Facebook of class members as an online, interactive, and social platform
- **Novel combinations of product attributes and reconfigurations of established value chains** that establish new positions of competitive advantage, for example, Dell's integrated system for ordering, assembling, and distributing PCs, which permitted unprecedented customer choice and speed of fulfillment

- The **strategy canvas** is a framework for also developing blue ocean strategies.
  - The horizontal axis shows the different product characteristics along which the firms in the industry compete
  - The vertical axis shows the amount of each characteristic a firm offers its customers

- There are four types of choice:
  - **Raise**: What factors should be raised well above the industry's standard?
  - **Eliminate**: Which factors that the industry has long competed on should be eliminated?
  - **Reduce**: Which factors should be reduced well below the industry's standard?
  - **Create**: Which factors should be created that the industry has never offered?

- The **strategy canvas** is a framework for developing blue ocean strategies.