# CHAPTER 16

# STRATEGIC ELEMENTS OF COMPETITIVE ADVANTAGE

# SUMMARY

In this chapter we focus on factors that help industries and countries achieve **competitive advantage**. According to Porter's **five forces model**, industry competition is a function of the threat of new entrants, the threat of substitutes, the bargaining power of suppliers and buyers, and rivalry among existing competitors. Porter's **generic strategies** model can be used by managers to conceptualize possible sources of competitive advantage. A company can pursue broad market strategies of **low cost** and **differentiation** or the more targeted approaches of **cost focus** and **focused differentiation**. Rugman and D'Cruz have developed a framework known as the **flagship model** to explain how networked business systems have achieved success in global industries. Hamel and Prahalad have proposed an alternative framework for pursuing competitive advantage, growing out of a firm's **strategic intent** and use of competitive innovation. A firm can build *layers of advantage*, search for *loose bricks* in a competitor's defensive walls, *change the rules of engagement,* or *collaborate with competitors* and utilize their technology and know-how.

Today, **global competition** is a reality in many industry sectors. Thus, competitive analysis must also be carried out on a global scale. Global marketers must also have an understanding of national sources of competitive advantage. Porter has described four determinants of *national advantage*. **Factor conditions** include human, physical, knowledge, capital, and infrastructure resources. **Demand conditions** include the composition, size, and growth pattern of home demand. The rate of home market growth and the means by which a nation's products are pulled into foreign markets also affect demand conditions. The final two determinants are the presence of **related and supporting industries** and the **nature of firm strategy, structure, and rivalry**. Porter notes that chance and government also influence a nation's competitive advantage. Porter's work has been the catalyst for promising new research into strategy issues, including D'Aveni's work on **hypercompetition** and Rugman's recent **double-diamond framework** for national competitive advantage.

**OVERVIEW**

The first few years of the twenty-first century were difficult for IKEA, the $ 31 billion global furniture powerhouse based in Sweden. The euro's strength dampened financial results, as did an economic downturn in Central Europe. The company faces increasing competition from hypermarkets, "do-it-yourself" retailers such as Wal-Mart, and supermarkets that are expanding into home furnishings. Looking to the future, CEO Anders Dahlvig stresses three areas for improvement: product assortment, customer service, and product availability. With stores in 38 countries, the company's success reflects founder Ingvar Kamprad's "social ambition" of selling a wide range of stylish, functional home furnishings at prices so low that the majority of people can afford to buy them.

The essence of marketing strategy is successfully relating the strengths of an organization to its environment. As the horizons of marketers have expanded from domestic to regional and global, so too have the horizons of competitors. The reality in almost every industry today—including home furnishings—is global competition. This fact of life puts an organization under increasing pressure to master techniques for conducting industry analysis and competitor analysis, and understanding competitive advantage at both the industry and national levels. These topics are covered in detail in this chapter.

**ANNOTATED LECTURE/OUTLINE**

### INDUSTRY ANALYSIS: FORCES INFLUENCING COMPETITION

A useful way of gaining insight into competitors is through industry analysis. As a working definition, an industry can be defined as a group of firms that produce products that are close substitutes for each other.

In an industry, competition drives down the rate of return on invested capital toward the rate earned in a "perfectly competitive" industry.

Rates of return greater than the "competitive" rate stimulate an inflow of capital while those below the "competitive" rate force a withdrawal from the industry and a decline in competition.

* **What are Porter’s “Five Forces”?**

Michael E. Porter identifies five forces that influence industry competition:

1. the threat of new entrants,
2. the threat of substitute products or services,
3. the bargaining power of buyers,
4. the bargaining power of suppliers, and
5. competitive rivalry.

## Threat of New Entrants

New entrants to an industry bring new capacity, a desire to gain market share and position, and, quite often, new approaches to serving customer needs.

The decision to become a new entrant in an industry if often accompanied by a major commitment of resources.

New players mean prices will be pushed downward and margins squeezed, resulting in reduced industry profitability in the long run.

Porter describes **eight** major sources of barriers to entry, the presence or absence of which determines the extent of threat of new industry entrants.

* **What are the eight major barriers to entry?**
1. *Economies of Scale* refers to the decline in per-unit product costs as the absolute volume of production per period increases.
2. *Product differentiation*is the extent of a product's perceived uniqueness; in other words, whether or not it is a commodity. Differentiation can be achieved as a result of unique product attributes or effective marketing communications, or both.
3. *Capital requirements.* Capital is required not only for manufacturing facilities (fixed capital) but also for financing R&D, advertising, field sales and service, customer credit, and inventories (working capital).
4. *Switching costs* are those costs caused by the need to change suppliers and products.
5. *Access to distribution channels.* If channels are full, or unavailable, the cost of entry is substantially increased because a new entrant must invest a time and money to gain access to existing channels or to establish new channels.
6. *Government policy* is frequently a major entry barrier. In some cases, the government will restrict competitive entry.
7. *Cost advantages independent of scale economies*that may present barriers to entry. Access to raw materials, a large pool of low-cost labor, favorable locations, and government subsidies are several examples.
8. *Competitor response* can be a major entry barrier. If new entrants expect existing competitors to respond strongly to entry, their expectations about the rewards of entry will certainly be affected.

The digital revolution appears to have altered the entry barriers in many industries.

Technology has lowered the cost for new entrants. (Amazon.com is an example).

## Threat of Substitute Products

The availability of substitute products places limits on the prices market leaders can charge in an industry; high prices may induce buyers to switch to the substitute.

## Bargaining Power of Buyers

* **What does the “bargaining power of the buyer” mean?**

"Buyers" refers to manufacturers and retailers, rather than consumers. The ultimate aim of such buyers is to pay the lowest possible price to obtain the products or services that they require.

Usually, buyers drive down profitability in the supplier industry.

Buyers must gain leverage over vendors in order to accomplish this. Following are ways this may happen:

* Buyers may purchase in such large quantities that supplier firms are highly dependent on the buyers' business.
* When the suppliers' products are viewed as commodities, buyers are likely to bargain hard for low prices, because many firms can meet their needs.
* Buyers will bargain hard when the supplier industry's products or services represent a significant portion of the buying firm's costs.
* Another source of buyer power is the willingness and ability to achieve backward integration.

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## Bargaining Power of Suppliers

Supplier power in an industry is the converse of buyer power.

If suppliers have enough leverage over industry firms, they can raise prices high enough to significantly influence the profitability of their organizational customers.

* **What are some of the factors that influence a supplier’s ability to gain leverage over industry firms?**

Suppliers' ability to gain leverage over industry firms is determined by several factors.

* If they are large and relatively few in number.
* When the suppliers' products or services are important inputs to user firms, are highly differentiated, or carry switching costs.
* If their business is not threatened by alternative products.
* The willingness and ability of suppliers to develop their own products and brand names if they are unable to get satisfactory terms from industry buyers.

**Rivalry among Competitors**

Rivalry among firms refers to all the actions taken by firms in the industry to improve their positions and gain advantage over each other.

Rivalry manifests itself in price competition, advertising battles, product positioning, and attempts at differentiation.

To the extent that rivalry among firms forces companies to rationalize costs, it is a positive force.

To the extent that it drives down prices, and therefore profitability, and creates instability in the industry, it is a negative factor.

Several factors can create intense rivalry.

* When an industry becomes mature, firms focus on market share and how it can be gained at the expense of others.
* Once the industry accumulates excess capacity, the drive to fill capacity will push prices—and profitability—down.
* Lack of differentiation or an absence of switching costs encourages buyers to treat the products or services as commodities and shop for the best prices.
* Firms with high stakes in achieving success in an industry generally are willing to accept below-average profit margins to establish themselves, hold position, or expand.

# COMPETITIVE ADVANTAGE

**Competitive advantage** exists when there is a match between a firm's distinctive competencies and the factors critical for success within its industry.

* **What are the two ways of achieving competitive advantage?**

There are two ways to achieve competitive advantage.

1. A firm can pursue a low-cost strategy that enables it to offer products at lower prices than competitors.
2. A firm can pursue a strategy of differentiating products so that customers perceive unique benefits, often accompanied by a premium price.

The greater the perceived consumer value, the better the strategy.

A firm may market a better mousetrap, but the ultimate success of the product depends on customers deciding for themselves whether or not to buy it.

Two different models of competitive advantage exist.

## Generic Strategies for Creating Competitive Advantage

Michael Porter has developed a framework of generic business strategies based on the two sources of competitive advantage: *low-cost* and *differentiation*.

These sources combined with the scope of the target market (narrow or broad) for product mix width (narrow or wide) yields four **generic strategies**: *cost leadership*, *product differentiation*, *cost focus*, and *focused differentiation*.

Achieving competitive advantage or superior marketing strategy demands that the firm makes choices.

Firms decide the type of competitive advantage (based on cost or differentiation) and the market scope or product mix width.

By choosing a given generic strategy, a firm always risks making the wrong choice.

### Broad Market Strategies: Cost Leadership and Differentiation

**Cost leadership advantage** is based on a position as a low-cost producer, in broadly defined markets or across a wide mix of products.

The firm must obtain largest market share so its cost per unit is the lowest in the industry.

These advantages give the producer a lead in terms of experience, which leads to refinements of production, delivery, and service, which leads to cost reductions.

Cost leadership is sustainable only if barriers prevent competitors from achieving the same low costs (IBM had an advantage in printers; then the Japanese gained the low-cost advantage).

* **What is differentiation advantage?**

When a product has perceived uniqueness, in a broad market, it is said to have achieved competitive advantage by **differentiation**.

This can be effective for defending market position and obtaining above-average financial returns (e.g., Maytag in large home appliances).

### Narrow Target Strategies: Cost Focus and Focused Differentiation

Strategies to achieve a narrow focus advantage target a narrowly defined market/customer.

This advantage is based on an ability to create more customer value for a narrowly targeted segment and results from a better understanding of customer needs and wants.

* **What does cost focus mean?**

A narrow-focus strategy can be combined with either a cost- or differentiation – advantage strategies. In other words, while a *cost focus* means offering a narrow target market low prices, a firm pursing *focused differentiation* will offer a narrow target market the perception of product uniqueness at a premium price.

German’s *Mittlestand* companies have been extremely successful pursing **focused differentiation** strategies backed by strong export effort. The world of “high-end” audio equipment offers another example of focused differentiation.

The final strategy is **cost focus,** when a firm’s lower cost position enables it ot offer a narrow target market and lower prices than the competition.

The issue of sustainability is central to this strategy concept. As noted, cost leadership is a sustainable source of competitive advantage only if barriers exist that prevent competitors from achieving the same low costs.

Sustained differentiation depends on continued perceived value and the absence of imitation by competitors.

Several factors determine whether or not focus can be sustained as a source of competitive advantage.

* A cost focus is sustainable if a firm's competitors are defining their target markets more broadly.
* A firm's differentiation focus advantage is only sustainable if competitors cannot define the segment even more narrowly.

**The Flagship Firm: The Business Network with Five Partners**

Rugman and D'Cruz have developed a framework based on business networks that they call the flagship model. (See Figure 15-1)

Japanese vertical *keiretsu* and Korean *chaebol* have succeeded by adopting strategies that are mutually reinforcing within a business system and by fostering a collective long-term outlook among partners in the system.

Moreover, the authors note, “long-term competitiveness in global industries is less a matter of rivalry between firms and more a question of competition between business systems.”

A major difference between their model and Porter's is that Porter's is based on the notion of corporate individualism and individual business transactions.

The flagship model is evident in the strategies of Ford, Volkswagen, and other global automakers; Sweden's IKEA and Italy's Benetton are additional examples.

* The flagship firm is at the center of a collection of five partners; together, they form a business system that consists of two types of relationships.

## The flagship firm provides the leadership, vision, and resources.

## Key suppliers are those that perform value-creating activities better than the flagship.

## Other suppliers are kept at "arm's length."

## The flagship has network relationships with key customers and more traditional, arm's length commercial relationships with key consumers.

## In the case of Volkswagen, dealers are its key customers while individual car buyers are key consumers.

## Key competitors are companies with which the flagship develops alliances such as those described at the end of Chapter 9.

## The fifth partner is the non-business infrastructure (NBI), comprised of universities, governments, trade unions, and other entities that can supply the network with intangible inputs such as intellectual property and technology.

Benetton’s success in the global fashion industry illustrates the flagship model.

## Creating Competitive Advantage via Strategic Intent

An alternative framework for understanding competitive advantage focuses on competitiveness as a function of the pace at which a company implants new advantages within its organization.

This framework identifies **strategic intent** as the means for achieving competitive advantage.

This approach is founded on the principles of W. E. Deming, who stressed that a company must commit itself to continuing improvement in order to be a winner in a competitive struggle.

Many firms have gained competitive advantage by *disadvantaging* rivals through "competitive innovation."

Hamel and Prahalad define *competitive innovation* is "the art of containing competitive risks within manageable proportions." and identify four successful approached used by Japanese competitors. These are building *layers of advantage, searching for loose bricks, changing the rules of engagement, and collaborating.*

1. **Layers of Advantage.** A company faces less risk in competitive encounters if it has a wide portfolio of advantages.

Successful companies steadily build portfolios by establishing layers of advantage on top of one another.

Because cost advantage could be temporary, the Japanese also added additional layers of advantage:

* *Quality and reliability*: building pants large enough to serve world markets.
* *Global brand franchise.*: invested heavily in marketing channels and Japanese brand names creating a *global brand franchise.*
* *Regional manufacturing.*
1. **Loose Bricks.** This approach takes advantage of the "loose bricks" left in the defensive walls of competitors whose attention is narrowly focused on a market segment or a geographic area to the exclusion of others. Intel’s focus on microprocessors provided opportunities for other manufactures for non-PC consumer electronics products.
2. **Changing the Rules*.*** This approach involves changing the "rules of engagement" and refusing to play by the rules set by industry leaders. Canon wrote a new rulebook in the copier market with a copier with “connectivity”.
3. **Collaborating.** This source of competitive advantage is using know-how developed by other companies.

Such c*ollaboration* may take the form of licensing agreements, joint ventures, or partnerships.

History has shown that Japanese companies excel at using collaborating strategies to achieve industry leadership.

# GLOBAL COMPETITION AND NATIONAL COMPETITIVE ADVANTAGE

An inevitable consequence of the expansion of global marketing activity is the growth of competition on a global basis.

**Global competition** occurs when a firm takes a global view of competition and sets about maximizing profits worldwide, rather than on a country-by-country basis.

If, when expanding abroad, a company encounters the same rival in market after market, then it is engaged in global competition.

The effect of global competition has been highly beneficial to consumers around the world.

In the two examples cited, detergents and automobiles, consumers have benefited. In Central America, detergent prices have fallen as a result of global competition. In the United States, foreign companies have provided consumers with the automobile products, performance, and price characteristics they wanted.

Global competition expands the range of products and increases the likelihood that consumers will get what they want.

In the United States, foreign companies have provided consumers with products with performances and prices they wanted.

The downside of global competition is its impact on the producers of goods and services.

Global competition creates value for consumers, but it also has the potential to destroy jobs and profits.

This section addresses the following issue: Why is a particular nation a good home base for specific industries?

According to Porter, the presence or absence of particular attributes in individual countries influences industry development, not just the ability of individual firms to create core competences and competitive advantage.

Porter describes these attributes—*factor conditions, demand conditions, related and supporting industries,* and *firm strategy, structure, and rivalry*—in terms of a national "diamond" (Figure 15-2).

Activity in any one of the four points of the diamond impacts on all the others and vice versa.

## Factor Conditions

* **What are factor conditions?**

**Factor** **conditions**refer to a country's endowment with resources.

*Basic factors* may be inherited or created without much difficulty; because they can be replicated in other nations, they are not sustainable sources of national advantage.

*Specialized factors*are more advanced and provide a more sustainable source for advantage.

* **What are the five categories of factor conditions, as described by Porter?**

Porter describes five categories of factor conditions**: *human, physical, knowledge, capital,* and *infrastructure*.**

* ***Human Resources.***The quantity of workers available, the skills possessed by these workers, the wage levels, and the overall work ethic of the workforce together constitute a nation's human resource factor.
* ***Physical Resources****.* The availability, quantity, quality, and cost of land, water, minerals, and other natural resources determine a country's physical resources.
* ***Knowledge Resources.***The availability within a nation of a significant population having scientific, technical, and market-related knowledge means that the nation is endowed with knowledge resources.
* ***Capital Resources.***Countries vary in the availability, amount, cost, and types of capital available to the country's industries.
* ***Infrastructure Resources.*** Infrastructure includes a nation's banking system, healthcare system, transportation system, communications system, as well as the availability and cost of using these systems.

Competitive advantage accrues to a nation's industry if the mix of factors available to the industry is such that it facilitates pursuit of a generic strategy.

Nations that have selective factor *disadvantages* may also indirectly create competitive advantage.

## Demand Conditions

The nature of home demand conditions for the firm's products and services is important because it determines the rate and nature of improvement and innovation by the firms in the nation.

**Demand conditions** are the factors that either train firms for world-class competition or that fail to adequately prepare them to compete in the global marketplace.

Three characteristics of home demand are important to creation of competitive advantage:

1. ***Composition of Home Demand.*** This demand element determines how firms perceive, interpret, and respond to buyer needs.

Competitive advantage occurs when home demand sets the quality standard and defines buyer needs. This information is not available to foreign rivals.

This advantage is enhanced when home buyers pressure firms to innovate quickly and frequently; the advantage is in staying ahead of the market.

1. ***Size and Pattern of Growth of Home Demand.*** These are important only if the composition of the home demand is sophisticated and anticipates foreign demand.

Large home markets offer economies of scale and learning while dealing with familiar, comfortable markets.

If home demand reflects or anticipates foreign demand, large-scale facilities and programs will be an advantage in global competition.

1. ***Rapid home market growth.*** This is an incentive to invest in and adopt new technologies faster, and to build large, efficient facilities.

*Early home demand* gives local firms the advantage of getting established in an industry sooner than foreign rivals.

*Early market saturation* puts pressure on a company to expand into international markets and innovate.

**Means by Which a Nation's Products and Services Are Pushed or Pulled into Foreign Countries*.*** The issue is whether a nation's people and businesses go abroad and then demand the nation's products and services in those second countries.

A related issue is that of a nation's people going abroad for training, pleasure, business, or research. After returning home, they are likely to demand the products and services with which they became familiar while abroad.

## Related and Supporting Industries

## A nation has an advantage when it is home to globally competitive companies in business sectors that comprise related and supporting industries.

## Globally-competitive supplier industries provide inputs to downstream industries.

They are globally competitive in terms of price and quality and gain competitive advantage.

Downstream industries have easier access to inputs and technology, and to the managerial and organizational structures that made them competitive.

Access is a function of proximity in terms of physical distance and cultural similarity.

It is the *contact and coordination* with the suppliers optimize linkages; these opportunities are not available to foreign firms (e.g., sharing between hardware manufacturers and software developers).

Similar advantages are present when there are globally competitive, related industries in a nation. Opportunities are available for coordinating and sharing value chain activities.

## Firm Strategy, Structure, and Rivalry

The **nature of firm strategy, structure, and rivalry** is the final determinant of a nation’s diamond.

Domestic rivalry in a single national market is a powerful influence on competitive advantage.

The PC industry in the U.S. shows how a strong domestic rivalry keeps an industry dynamic and creates pressure to innovate and improve.

It is not the number of domestic rivals that is important; rather, it is the intensity of the competition and the quality of the competitors that make the difference.

Differences in management styles, organizational skills, and strategic perspectives create advantages and disadvantages, as do differences in domestic rivalry.

For example, German company structure is hierarchical while Italian firms run like small family businesses.

There are two final external variables to consider in the evaluation of national competitive advantage—chance and government.

## Chance

Chance events play a role in shaping the competitive environment.

Chance events are occurrences that are beyond the control of firms, industries, and usually governments.

Included are wars and their aftermaths, major technological breakthroughs, dramatic shifts in factor or input cost, like the oil crises, and swings in exchange rates.

Chance events are important because they create major discontinuities in technologies that allow nations and firms that were not competitive to leapfrog over old competitors and become competitive, even leaders, in the changed industry.

For example, the development of microelectronics allowed Japanese firms to overtake U.S. and German firms.

From a systemic perspective, chance events alter conditions in the diamond.

The nation with the most favorable "diamond," will convert these events into a competitive advantage.

## Government

Although it is often argued that government is a major determinant of national competitive advantage, government is not a determinant, but rather an influence on determinants.

Government influences determinants by virtue of its role as a buyer of products and services, and by its role as a maker of policies on labor, education, capital formation, natural resources, and product standards.

It also influences determinants by its role as a regulator of commerce, for example, by telling banks and telephone companies what they can and cannot do.

By reinforcing determinants in industries where a nation has competitive advantage, government improves the competitive position of the nation’s firm.

Governments devise legal systems that influence competitive advantage by means of tariffs and nontariffs barriers and laws requiring local content and labor.

# CURRENT ISSUES IN COMPETITIVE ADVANTAGE

Porter's work on national competitive advantage has stimulated a great deal of further research.

The Geneva-based World Economic Forum issues an annual report ranking countries in terms of their competitiveness.

Morgan Stanley used the Porter framework to identify 238 companies with a sustainable competitive advantage worldwide.

"National advantage" was then assessed by analyzing how many of these companies were headquartered in a particular country.

The United States ranked first, with 125 companies identified as world leaders.

**Hypercompetitive Industries**

Richard D'Aveni suggests that the Porter strategy frameworks fail to adequately address the dynamics of competition in the 1990s and beyond.

He notes that, in today’s business environment, short product life cycles, short product life cycles, short product design cycles, new technologies, and globalization undermine market stability.

The result is an escalation and acceleration of competitive forces.

In light of these changes, D'Aveni believes the goal of strategy has shifted from sustaining to disrupting advantages.

* **What does term hypercompetition mean?**

D'Aveni uses the term **hypercompetition**to describe a dynamic competitive world in which no action or advantage can be sustained for long. (See Table 15-2)

According to D’Aveni’s model, competition unfolds in a series of dynamic strategic interaction in four arena’s: cost/quality, timing and know-how, entry barriers, and deep pockets.

According to D’Aveni, the only source of a truly sustainable competitive advantage is a company’s ability to manage its dynamic strategic interactions with competitors by means of frequent movements and counter-movements that maintain a relative position of strength in each of the four arenas. (Table 16-2).

**Cost Quality**

Competition in the first arena, cost/quality, occurs via seven dynamic strategic interactions: price wars, quality and price positioning, “the middle path”, “cover all niches”, outflanking and niching, the move toward an ultimate value marketplace, and escaping from the ultimate value marketplace by restarting the cycle. (See Table 15-2)

The global watch industry is cited as an example of hypercompetitive behavior in the cost/quality arena.

**Timing and Know-how**

The second arena for hypercompetition is based on organizational advantages derived from timing and know-how.

A firm that has the skills to be a "first mover" and arrive first in a market has achieved a *timing advantage*.

A *know-how advantage* is the technological knowledge—or other knowledge of a new method of doing business—that allows the firm to create an entirely new product or market.

D’Aveni identifies six dynamic strategic interactions that drive competition in this arena: capturing first-mover advantages, imitation and improvement by followers, creating impediments to imitation, overcoming the impediments, transformation or leapfrogging, and downstream vertical integration.

**ENTRY BARRIERS**

Industries in which barriers to entry have been built up comprise the third arena in which hypercompetitive behavior is exhibited.

These barriers include economies of scale, product differentiation, capital investments, switching costs, access to distribution channels, cost advantages other than scale, and government policies.

The first dynamic strategic interaction comes as a company builds a geographic “stronghold” by creating and reinforcing barriers. After securing a market—especially the home-country market—competitors begin to seek markets outside the stronghold.

Thus, the second dynamic strategic interaction takes place when companies target the product market strongholds of competitors in other countries.

The third dynamic strategic interaction comes when incumbents make short-term counter-responses to the guerrilla attacks. Strong incumbents may try to turn back the invader with price wars, factory investment, or product introductions, or they may adopt a wait-and-see attitude before responding.

The fourth dynamic strategic interaction occurs when the incumbent realizes it must respond fully to the invader by making strategic responses to create new hurdles. U.S. automakers, for example, waged a PR campaign urging U.S. citizens to “Buy American.”

The fifth dynamic strategic interaction takes place when competitors react to these new hurdles. In an effort to circumvent import quotas as well as co-opt the “Buy American” campaign, the Japanese automakers built plants in the United States.

The sixth dynamic strategic interaction consists of long-run counter-responses to the attack via defensive moves or offensive moves. GM’s 1990 introduction of Saturn is a good illustration of a well-formulated and executed defensive move. As the first decade of the twenty-first century continues, GM is launching another defensive move; in an effort to defend its Cadillac nameplate from Lexus, Acura, and Infiniti, GM is developing a global strategy for Cadillac. Competition in the third arena continues to escalate; in the seventh dynamic strategic interaction, competition between the incumbent and entrant is exported to the entrant’s home turf.

The eighth and final dynamic strategic interaction in this arena consists of an unstable standoff between the competitors. Over time, the stronghold erodes as entry barriers are overcome, leading competitors to the fourth arena.

As the preceding discussion shows, the irony and paradox of the hypercompetition

framework is that, in order to achieve a sustainable advantage, companies must seek a series of *unsustainable* advantages!

D’Aveni is in agreement with the late Peter Drucker, who long counseled that the role of marketing is innovation and the creation of new markets.

Innovation begins with abandonment of the old and obsolete. The age of strategic planning is fast evolving into the era or organizational learning.

Likewise, D’Aveni urges managers to reconsider and reevaluate the use of what he believes are old strategic tools and maxims. He warns of the dangers of commitment to a given strategy or course of action. The flexible, unpredictable player may have an advantage over the inflexible, committed opponent. D’Aveni notes that, in hypercompetition, pursuit of generic strategies results in short-term advantage at best. The winning companies are the ones that successfully move up the ladder of escalating competition, not the ones that lock into a fixed position.

D’Aveni is also critical of the five forces model. The best entry barrier, he argues, is maintaining the initiative, not mounting a defensive attempt to exclude new entrants.

**Additional Research on Comparative Advantage**

Other researchers have challenged Porter’s thesis that a firm’s home-base country is the main source of core competencies and innovation.

For example, Indiana University Professor Alan Rugman argues that the success of companies based in small economies such as Canada and New Zealand stems from the “diamonds” found in a particular set or combination of home and related countries. For example, a company based in an EU nation may rely on the national “diamond” of one of the 26 other EU members.

Similarly, one impact of NAFTA on Canadian firms is to make the U.S. “diamond” relevant to competency creation. Rugman argues that, in such cases, the distinction between the home nation and the host nation becomes blurred.

He proposes that Canadian managers must look to a “double diamond” and assess the attributes of both Canada and the United States when formulating corporate strategy.

D’Aveni urges managers to reconsider and reevaluate the use of what he believes are

old strategic tools and maxims. He warns of the dangers of commitment to a given strategy or course of action. The flexible, unpredictable player may have an advantage over the inflexible, committed opponent.

It has been argued that, for smaller countries, the nation is not the relevant unit of analysis in formulating strategy. Rather, corporate strategists must look beyond the nation to the region or to sets of closely linked countries.

Porter explains, “‘Choice’ arises from doing things differently from the rival. And strategy is about trade-offs, where you decide to do this and not that. Strategy is the deliberate choice not to respond to some customers, or choosing which customer needs you are going to respond to.”

Porter is not convinced of the validity of competitive advantage models based on core competency or hypercompetitive industries. A nation has an advantage when it is home to globally competitive companies in business sectors that are related and supporting industries.

**DISCUSSION QUESTIONS**

1. How can a company measure its competitive advantage? How does a firm know if it is gaining or losing competitive advantage? Cite a global company and its source of competitive advantage?

Competitive advantage is defined as arising from “a match between a firm’s distinctive competencies and the factors critical for success within its industry.” When a company achieves this match, it will deliver superior perceived value relative to competitors. This definition suggests that, first; a company must have a clear understanding in which it competes, and the overall business environment. If a firm’s distinctive competencies allow it to attain the low-cost position in its industry, it cannot afford to lose ground to rivals seeking to leapfrog it. If a company competes via differentiation, it must be continually innovative to maintain or enhance the perceived uniqueness of its products. Beyond this, it is necessary for a company to assess customer perceptions.

Sony has an enviable history of first-mover achievements based on its know-how in audio technology: first pocket-sized transistor radio, first consumer VCR, first portable personal stereo, and first compact disc player. Sony entered the video game industry in 1994, but its 64-bit Playstation outsold a competitive product from Sega. After Sony launched the Playstation 2 in 2000, Sega halted production of its Dreamcast game player; the company will now concentrate on developing game software.

2. Outline Porter's five forces model of industry competition. How are the various barriers to entry relevant to global marketing?

The five forces model is shown in Figure 15-1. The first force, the *threat of new entrants,* depends on the presence or absence of barriers to entry. As industries globalize, the threat on new entrants into national markets increases. The issue of *government policies* is at the heart of the trade dispute between Kodak and Fuji. Similarly as the experience of Toys “R” Us in Japan shows, *access to distribution channels,* may be blocked to deter would-be entrants. Strong global brands may also constitute a barrier to entry by providing product differentiation.

The second force, the *threat of substitute products,* limits a company’s ability to raise prices. Global competitive pressures often compel companies to search for manufacturing sources low-wage countries.

*Bargaining power of buyers* is the third force. The discussion of *keiretsu* in Chapter 9 shows how Japanese firms impose discipline and obtain low prices in various industries.

*Bargaining power of suppliers,* the extent to which a company is the “900 pound gorilla” in its industry, can be very high in a global industry.For example, Microsoft’s Windows operating system and Intel’s Pentium processor have become de facto worldwide standards. This allows the two companies to drive very hard bargains with computer manufacturers and others that depend on their products.

Finally, *rivalry among competitors* can be especially intense in global industries such as automobiles, consumer electronics, and pharmaceuticals.

3. How does the five partners or flagship model developed by Rugman and D'Cruz differ from Porter's five forces model?

According to Professors Alan Rugman and Joseph D'Cruz, Porter's model is too simplistic given the complexity of today's global environment. Rugman and D'Cruz have developed an alternative framework based on business networks that they call the flagship model (see Figure 10-3). The success of Japanese vertical *keiretsu* and Korean *chaebol*, Rugman and D'Cruz argue, is that they adopt strategies that are mutually reinforcing within a business system and foster a collective long-term outlook among the partners. Moreover, the authors note, "long-term competitiveness in global industries is less a matter of rivalry between firms and more a question of competition between business systems."

A major difference between their model and Porter's is that Porter's is based on the notion of corporate individualism and individual business transactions. For example, Microsoft's tremendous supplier power allows it to dictate to, and even prosper at the expense of, the computer manufacturers it supplies with operating systems and applications. The flagship model is evident in the strategies of Ford, Volkswagen, and other global automakers; Sweden's Ikea and Italy's Benetton are additional examples.

4. Give an example of a company that illustrates each of the four generic strategies that can lead to competitive advantage: overall cost leadership, cost focus, differentiation, and differentiation focus.

 Overall cost leadership: Bic, Wal-Mart

 Cost focus: IKEA, Kia

 Differentiation: Kodak, Gillette, Swatch, Nike

 Differentiation focus: Harley-Davidson, Germany’s *Mittelstand*

5. Briefly describe Hamel and Prahalad's framework for competitive advantage.

Hamel and Prahalad argue that, while Western companies have been preoccupied with outdated concepts such as generic strategies, competitors in Japan have developed a true vision. Strategic intent, in essence, represents an obsession with winning. At the core of the concept are core competencies that link related products. A case in point is Honda’s expertise at engine design. Competitive advantage is achieved when a company develops layers of competencies.

It should be noted that some industry observers have found fault with Hamel and Prahalad’s work. For example, how, exactly, does a company go about identifying its core competence? Does the mere obsession with winning lead to success? What if a company is obsessed with winning, but it has joined the wrong battle?

6. How can a nation achieve competitive advantage?

Porter identifies four determinants of national competitive advantage:

* Factor conditions
* Demand conditions
* Related and supporting industries
* Firm strategy, structure, and rivalry

In the United States, for example, the patient monitoring equipment industry thrived due to sophisticated demand an active domestic rivalry. The robotics industry in Japan benefited from public policy decisions that led to government support to stimulate domestic demand. In robots, automobiles, consumer electronics, and other industries in Japan, fierce domestic rivalries are the rule. In Italy, the ceramic tile industry thrived thanks to high per capita demand, vigorous domestic rivalry, and abundance of available factors.

7. According to current research on competitive advantage, what are some of the shortcomings of Porter's models?

One criticism of generic strategies is that they are static, rather than dynamic. Porter himself acknowledges this, writing, “The firm competing with a differentiation strategy…must find a stream of new ways to add to its differentiation, or, minimally, improve its effectiveness in differentiating in old ways.”

The five forces model provides a good framework for competitor analysis; however, the model has been criticized for placing too much emphasis on entry barriers. Today’s competitive environment is much more dynamic than it was when the model was introduced in the late 1970s. Another criticism is that the model does not explain why different companies in the same industry facing the same forces perform differently.

8. What is the connection, if any, between *national* competitive advantage and *company* competitive advantage? Explain and discuss.

National competitive advantage is the sum of the company competitive advantages in a country. It is derived from company strategy formulation and implementation. It is not to be confused with national endowments or national natural resources. A country may have, for example, an outstanding educational system or an inferior system. In general, a better system is an advantage, but merely having an outstanding education system does not, per se, lead to competitive advantage. Nor does having a poor system preclude competitive advantage.

National competitive advantage should not be confused with *comparative advantage,* which refers to the economic fact that a country can gain from specialization and trade. Every country can take advantage of the law of comparative advantage, and every country that protects local industry presents an obstacle to the realization of the gains from comparative advantage.

**CASES**

**Case 16-1: IKEA: The Assignment**

**Overview:** IKEA’s unconventional approach to the furniture business has enabled it to rack up impressive growth in a $30 billion industry in which overall sales have been flat. Sourcing furniture from a network of more than 1,600 suppliers in 55 countries helps the

company maintain its low-cost, high-quality position. During the 1990s, IKEA expanded into Central and Eastern Europe. Because consumers in those regions have relatively low purchasing power, the stores offer a smaller selection of goods; some furniture

was designed specifically for the cramped living styles typical in former Soviet bloc countries.

Throughout Europe, IKEA benefits from the perception that Sweden is the source of high-quality products and efficient service. In 2005, IKEA opened two stores near Tokyo; more stores are on the way as the company expands in Asia. IKEA’s first attempt to

develop the Japanese market in the mid-1970s resulted in failure.

1. Review the characteristics of global and transnational companies in Chapter 1. Now consider, as noted in the case, IKEA both sources from the world and markets to the world. Company executives are all Swedish, and the company signals its national origin by using Sweden’s national colors—blue and yellow—in its stores and serving Swedish meatballs with lingonberry sauce in its cafés. Based on this evidence, would IKEA be described as a global firm or a transnational firm?

Per the definition found in Chapter 1: Global firms (transnational firms) demonstrate the following characteristics, all of which apply to IKEA, making it a global firm:

* Views the entire world as a potential market and strives to develop integrated global strategies.
* Serves world markets from a single country or sources globally for the purposes of focusing on select country markets.
* Tend to maintain their association with a particular headquarters country.
* Transnational companies serve global markets and utilize global supply chains.
* Transnational companies both serve global markets and utilize global supply chains and often have a blurring of national identity.
* A key factor that distinguishes global and transnational companies from international or multinational companies is *mind-set:*  At global and transnational companies, decisions regarding extension and adaptation are not based on assumptions but rather on made on the basis of ongoing research into market needs and wants.
* It is a synthesis of ethnocentrism and polycentrism – it is a “world view.”
* Seeks to build a global strategy that is responsive to local needs and wants.

2. At the end of Chapter 11, it was noted that managers of IKEA stores have a great deal of discretion when it comes to setting prices. In terms of the ethnocentric/polycentric/

regiocentric/geocentric (EPRG) framework, which management orientation is in evidence at IKEA?

A company using ethnocentric pricing policy calls for the per-unit price of an item to be the same no matter where in the world the buyer is located. While polycentric pricing, permits subsidiary or affiliate managers or independent distributors to establish whatever price they feel is most appropriate in their market environment. Accordingly, IKEA takes a polycentric approach to pricing.

3. What does it mean to say that, in terms of Porter’s generic strategies, IKEA pursues a strategy of “focused differentiation?”

The definition of *focused differentiation*: a firm pursing *focused differentiation* will offer a narrow target market the perception of product uniqueness at a premium price. With this definition in mind, IKEA ‘s mission of “selling a wide range of stylish, functional home furnishing at prices so low that the majority of people can afford to buy them”, defines a focused differentiation: focus on home furnishing and differentiation being low affordable prices.

**Case 16-2: Kodak in the Twenty-First Century: The Search for the New Sources of Competitive Advantage**

**Overview:** Kodak is a world famous name in a photo industry. Along with a worldwide shift to digital photography, Kodak faces many challenges. The company’s new CEO is trying to find the best way for the company to compete in the global environment.

1. Assess Kodak’s situation in terms of Porter’s five forces model and generic strategies. Which forces are driving competition in the photo industry? What has happened to Kodak’s traditional sources of competitive advantage?

Rivalry among competitors is one of the strongest driving forces in the photo industry. There are a lot of different brands that try to be the best, to take over each other. The threat of substitute products is playing a significant role in photo industry competition. The shift from film to digital means a lot of changes and losses for the companies working on the old theme.

Kodak was the most famous film brand and competed on a low-cost strategy at first. Due to the investment to the new line, Kodak changed the strategy to premium price thus letting such companies as Fuji to set up lower prices and compete on a low-cost strategy. Kodak’s movement to a strategy of differentiating products brought the company many challenges.

2. Do you think the digital photography revolution will spread to China and India more quickly than Kodak’s management expects?

I think that digital photography revolution will spread to China and India faster than expected. The consumers’ preference of digital picture taking is a worldwide movement and is not likely to stop unless a new better way is invented. China is a collectivistic society where people trust brand names. If Kodak proves (and it’s already on the way because of its loud name) that its digital products are worth buying, sales will go up tremendously due to the collectivism of the consumers’ mentality.

3. For decades, Kodak has been known as the world’s largest consumer photography company. Today, the company’s strategy calls for a shift towards business-to-business marketing with an emphasis on such products as medical imaging systems and digital printing systems. What risks does this change in strategic direction present?

If Kodak stops paying attention to business-to-customer marketing line, it may well bring troubles for the company. The brand (along with being a well-known industrial brand) is a very well-known consumer brand.

**Case 15-3: LEGO**

**Overview:** LEGO is a world known Danish toy company gaining a great profit from global sales. In past several years the company has been confronted with a Canadian competitor, Mega Blocks, which has tried to copy its products and sell at a lower price. The competition has caused LEGO to experience losses and now faces many challenges.

1. Jorgen Vig Knudstorp became CEO in 2004. Assess the key strategic decisions he has made, including outsourcing, divesting the theme parks, and launching new toys in the Mindstorms line.

Outsourcing for the production with a Singapore company allowed LEGO to reduce costs. Launching new toys is a competitive strategy designed to attract consumer attention back to the company. By creating the exclusive product, LEGO may increase market share and gain valuable profit.

2. In 2004, LEGO continued its entertainment promotional and product tie-ins with new Harry Potter and Spiderman movies. Do you think this is the right strategy?

Surveying the customers might point to the real problem of the Harry Potter line. If the problem is only about the old movie and the expectance for the new one, then the line should be continued, having the same characters in a new setting. If the problem is with the toys themselves (wrong look, wrong color) then the line production should be stopped.

3. Using Porter’s generic strategies framework, compare and contrast LEGO and Mega Blocks in terms of their respective pursuit of competitive advantage.

Mega Blocks is trying to use a cost leadership advantage by providing similar product on a lower price than LEGO. In turn, LEGO tries to be unique and introduce new products, trying to gain a differentiation advantage which is hard because Mega Blocks is continually copying the product.

# SUGGESTED READINGS

## Books

Arnold, David. *The Mirage of Global Markets: How Globalizing Companies Can Succeed as Markets Localize.* Englewoods Cliffs, NJ: Prentice-Hall, 2003.

Abegglen, James C., and George Stalk Jr. *Kaisha: The Japanese Corporation*. New York: Basic Books, 1985.

D'Aveni, Richard. *Hypercompetition: Managing the Dynamics of Strategic Maneuvering*. New York: Free Press, 1994.

Hamel, Gary and C. K. Prahalad. *Competing for the Future.* Boston: Harvard Business School Press, 1994.

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## Articles

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Cravens, David W., H. Kirk Downey and Paul Lauritano. "Global Competition in the Commercial Aircraft Industry: Positioning for Advantage by the Triad Nations," *Columbia Journal of World Business* 26, no. 4 (Winter 1992), pp. 46-58.

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Henzler, Herbert A. "The New Era of Eurocapitalism." *Harvard Business Review* 70, no. 4 (July-August 1992), pp. 57-68.

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Mascarenhas, Briance. "Order of Entry and Performance in International Markets." *Strategic Management Journal* 13, no. 7 (October 1992), pp. 499-510.

Morrison, Allen J., and Kendall Roth. "A Taxonomy of Business-Level Strategies in Global Industries." *Strategic Management Journal* 13, no. 6 (September 1992), pp. 399-417.

Öz, Özlem. "Assessing Porter's Framework for National Advantage: The Case of Turkey." *Journal of Business Research* 55, no. 6 (June 2002), pp. 509-515.

Rugman, Alan M., and Alain Verbeke. "Foreign Subsidiaries and Multinational Strategic Management: An Extension and Correction of Porter's Single Diamond Framework." *Management International Review* 33, no. 2, Special Issue 1993/2, pp. 71-84.

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Generation: Contrasting Porter's Competitive Strategy Framework and the Resource-based Perspective." *Strategic Management Journal* 22, no. 10 (October 2001), pp. 907-934.

WIilliams, Jeffrey R. "How Sustainable is Your Competitive Advantage?" *California Management Review* 34, no. 3 (Spring 1992), pp. 29-51.

**TEACHING TOOLS AND EXERCISES**

**Cases:** Verne Global: Building a Green Data Center in Iceland”. Thomas Steenburgh; Nnamdi Okike. *HBS* 509063.

**Out-of-Class Reading:** Öz, Özlem. "Assessing Porter's Framework for National Advantage: The Case of Turkey." *Journal of Business Research* 55, no. 6 (June 2002), pp. 509-515.

**Activity:** Students should be preparing or presenting their Cultural-Economic Analysis and Marketing Plan for their country and product as outlined in Chapter 1.

**Class Activity:** Students will study a new-car purchasing guide (available at the library, for sale at newsstands or on the Internet). The assignment is to pick a category of new cars (such as luxury or economy) and examine different aspects of the cars (including features, style and image, and price). (a) Identify companies that you think are competing, based on the market point of view. (b) What sort of competitive strategies do you see being used? (c) What different strategic groups can you identify in your chosen segment of the automobile industry? (d) Which groups seem to compete with one another?

**Guest Speaker:** Invite a manager from a local motorcycle dealership to speak to the class. How does this brand (Suzuki or Honda) compete effectively with Harley Davidson to minimize Harley’s competitive advantage?