Chapter 7

The Nature and Sources of Competitive Advantage

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The Nature and Sources of Competitive Advantage

OUTLINE

- How competitive advantage emerges and is sustained
- Types of competitive advantage: cost and differentiation
- Cost analysis
- Differentiation analysis
- Implementing cost and differentiation strategies

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How Competitive Advantage Emerges and is Sustained

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The Emergence of Competitive Advantages

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Competitive Advantage from Internally-Generated Change: Strategic Innovation

- **Strategic innovation** – Creating customer value from new products, experiences or modes of product delivery
- Innovatory strategies may include:
  - **Creating whole new markets/industries**: My Space & Facebook in social networking
  - **Creating new customer segments**: AirAsia in low-cost air travel in SE Asia; Nintendo's Wii games console
  - **New sources of competitive advantage**
    - **Reconfiguring the value chain**: Zara in fashion clothing, IKEA in furniture
    - **Reconceptualizing the product**: Cirque de Soleil in circuses, Apple in computers (iPad)
    - **New performance combinations**: Low prices and style (Primark, H&M)

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Sustaining Competitive Advantage Against Imitation

Requirement for Imitation	Isolating Mechanism
Identification	Obscure superior performance
Incentives for imitation	**Deterrence**: Signal aggressive intentions to imitators **Pre-emption**: Exploit all available investment opportunities
Diagnosis	Rely upon multiple sources of competitive advantages to create "*casual ambiguity*"
Resource acquisition	Base competitive advantage upon resources and capabilities that are immobile and difficult to replicate

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Types of Competitive Advantage

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Cost Analysis

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Drivers of Cost Advantage

ECONOMIES OF SCALE	• Indivisibilities • Specialization and division of labor
ECONOMIES OF LEARNING	• Increased dexterity • Improved organizational routines
PRODUCTION TECHNIQUES	• Process innovation • Reengineering business processes
PRODUCT DESIGN	• Standardized designs & components • Design for manufacture
INPUT COSTS	• Location advantages • Ownership of low-cost inputs • Non-union labor • Bargaining power
CAPABILITY UTLIZATION	• Ratio of fixed to variable costs • Speed of capacity adjustment
RESIDUAL EFFICIENCY	• Organizational slack • Motivation and culture • Managerial efficiency

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Economies of Scale: The Long-Term Cost Curve for a Plant

Sources of scale economies
Technical input/output relationships
Indivisibilities
specialization

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Scale Economies in Advertising: US Soft Drinks

Despite the massive advertising budgets of brand leaders Coke and Pepsi, their main brands incur lower advertising costs per unit of sales than their smaller rivals

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The Experience Curve

The "Law of Experience"

The unit cost of value added for a standard product declines by a constant proportion (typically 20-30%) each time cumulative output doubles.

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Examples of Experience Curves

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The Importance of Market Share

If all firms in an industry have the same experience curve, then:

Change in relative costs over time = f(market share)

This implies that market share is linked to profitability. This is confirmed by PIMS data:

BUT:

- **Association** does not imply **causation**
- Costs of acquiring market share offset the returns to market share

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Using the Value Chain for Cost Analysis: Automobile Manufacture

Stages of the analysis:

1. Identify the main value chain activities
2. Allocate total costs between value chain activities
3. Identify the cost drivers at each stage of the value chain
4. Identify linkage between activities
5. Identify opportunities for cost reduction

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Differentiation Analysis

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The Nature of Differentiation

DEFINITION: *"Providing something unique that is valuable to the buyer beyond simply offering a low price"*

(M. Porter)

KEY ISSUE: Creating value for the customer

TANGIBLE DIFFERENTIATION

Observable, product characteristics:

- Size, color, materials, etc.
- Performance
- Packaging
- Complementary services

INTANGIBLE DIFFERENTIATION

Unobservable and subjective characteristics that appeal to the customer's image, status, identity and desire for exclusivity

TOTAL CUSTOMER RESPONSIVENESS

Differentiation not just about the *product*, it embraces the whole *relationship* between the supplier and the customer.

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The Nature of Differentiation: Differentiation and Segmentation

- **Differentiation:** Concerns choices of how a firm distinguishes its offerings from those of its competitors (i.e. **How** the firm competes)
- **Segmentation**: Concerns choices of which customers, needs, localities a firm targets (i.e. **Where** the firm competes
- **Does differentiation imply segmentation?**
  - Not necessarily, depends upon the differentiation strategy
  - **Broad Scope Differentiation** – Appealing to **what is common** between different customers (McDonalds, Honda, Gillette)
  - **Focused Differentiation** – Appealing to **what distinguishes** different customer groups (MTV, Harley-Davison, Armani

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The Nature of Differentiation: Differentiation and Segmentation

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Techniques for Analyzing Product Attributes and Positioning

- **Multidimensional Scaling**: Maps consumer perceptions of competing products along key differentiating variables
- **Conjunct Analysis**: Uses estimates of consumer preferences for particular product attributes to forecast demand for new products that comprise different bundles of product attributes
- **Hedonic Price Analysis**: Estimates the price that consumers will pay for particular product attributes
- **Value Curve Analysis**: Maps competing products according to bundles of attributers in order to identify opportunities for new products with a different combination of attributes

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Differentiation in Pain Relievers: Multidimensional Scaling of Competing Products

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Analyzing Differentiation on the Supply Side

- Sources of uniqueness:
  - Product features and product performance
  - Complementary services (such as credit, delivery, repair)
  - Intensity of marketing activities (advertising; promotion)
  - Technology embodied in design and manufacture
  - Quality of purchased inputs
  - Procedures that impact the customer experience (e.g. the, rigor of quality control, service procedures, frequency of sales visits)
  - Skill and experience of employees
  - Location (for example, with retail stores)
  - Degree of vertical integration (allow control over inputs and intermediate processes)

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Product Integrity

- Key to differentiation is consistency of all aspects of the firm's relationship with its customers
- **Product integrity**: The total balance of product features
  - **Internal integrity** – Consistency between the function and structure
  - **External integrity** – Fit between the product and consumers' objectives, values and lifestyle
- Key to successful differentiation strategy: Consistency of internal and external integrity (e.g. Harley-Davidson, Apple)

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Value Chain Model for Differentiation Analysis

CASE STUDIES

- Adapt Value Chain model (Differentiation advantage) to these two big companies.

Features of Cost Leadership & Differentiation Strategies

Generic Strategy	Key Strategy Elements	Resource and Organizational Requirements
Cost Leadership	• Scale-efficient plants • Design for manufacture • Control of overheads and R&D • Process innovation • Outsourcing/offshoring • Avoiding marginal customers	• Access to capital • Process engineering skills • Frequent reports • Tight cost control • Specialization of jobs and functions • Incentives linked to quantitative targets accounts
Differentiation	• Emphasis on branding advertising, design, service, quality, and new product development	• Marketing abilities • Product engineering skills • Cross-functional coordination • Creativity • Research capability • Incentives linked to qualitative performance targets

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