CHAPTER 6
THE NATURE AND SOURCES 
OF COMPETITIVE ADVANTAGE

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

• identify the circumstances in which a company can create a competitive advantage and understand the contribution of responsiveness and innovation

• describe the variation of competitive advantage in different market settings

• recognise the different stages of industry development and understand the factors that drive the process of industry evolution

• distinguish between slow-, standard- and fast-cycle market characteristics that promote temporal responses to competitive attacks based on unique capabilities and competencies

• analyse various levels of strategy and describe how strategic advantage can be sustained at each level

• identify and explain how different kinds of strategies create competitive advantage.
Central Retail Corporation (CRC) is Thailand’s largest retail group and one of the country’s largest conglomerates, with total sales in 2011 of $139.6 billion Baht. However, the company’s retail interests within Thailand tell only half the story. The company is an extremely large multinational in its own right with sales in excess of $188 billion Baht or US$5.97 billion in 2012, representing a 17 per cent year-on-year growth. This dramatic growth has been built on the back of a diversified portfolio of related businesses such as department stores, specialty shops and supermarkets. While the group is largely known for its retailing expertise, it is a conglomerate of unrelated businesses that comprise five core business units including retail, real estate development, trading and marketing, hotels and restaurants.

To create competitive advantage, CRC believes in strong risk management underpinned by excellent management and staff relations. Further, the group’s strategies are a mixture of business-level and corporate-level strategies. As this chapter will later explain, although developing new products is one way to expand competitive advantage, a faster means is through acquisition and mergers as well as joint ventures. CRC’s growth has been achieved by intensive distribution: taking existing products into existing markets (see also chapter 8) and maximising opportunities within Thailand, and also taking existing and new products into new markets. Accordingly, innovation is a key competence for the group. For instance, through its Central Marketing Group, the company has leveraged its core competencies in the fields of retailing, distribution and manufacturing by exporting various house brands to overseas markets through its extensive chain of distribution channels. The company continues to build and enhance its reputation by developing iconic retail landmarks such as its ‘Central Embassy’ project with 8 floors of retail and 29 floors of luxury hotel accommodation. The recent acquisition of La Rinascente, Italy’s number one luxury department store, with 11 locations nationwide, is an example of growth through acquisition. In a conglomerate, competitive advantage is achieved by adding value to existing businesses, so any new acquisition or diversification needs to build on an existing set of capabilities and core competencies. The company’s business policy — that is, to ‘renovate, improve, seek allies for mergers, enhance value, add new branches, develop new distribution channels and expand business internationally’ — appears to fit this philosophy. Consequently, as well as buying up other retail chains, a CRC looks for mergers and acquisitions within their hotel strategic business unit — for example, the securing of contracts for management services for 23 hotels. At the same time, it continues to expand into hotel chains in other countries (e.g. Vietnam). In a recent interview, the group’s executive chairman, Sudhitham Chirathivat, suggested that the company is developing expansion plans into China and Malaysia.

In its retail business, the group is highly differentiated in product depth and width. This includes both luxury brands at the high end (i.e. their own plus imported brands) and goods that cater for the low end of the market — this approach is often called a two-way product stretch. The company has continued also to expand nationally by building on its retail chain of stores and at the same time enhancing its corporate social responsibility master plan of making heavy investments in art and culture, social equity, the environment and sufficiency economy. In terms of competitive advantage, CRC uses the ideas of corporate parenting (see chapter 8 for more detail) by building value into its existing set of business portfolios while adding layers of competitive advantage through its acquisitions and mergers. When a company becomes large, or is in a position to acquire other businesses, then this is competitive advantage at its peak.
INTRODUCTION

A company can achieve superior profitability either by locating in an attractive industry or by establishing a competitive advantage over its rivals. Of these two options, competitive advantage offers the more important competitive edge because an attractive industry will likely draw more competitors and the advantage will very soon vanish. As competition has intensified across almost all industries, very few industry environments can guarantee stable returns; hence, the primary goal of a corporate-level strategy is to establish a position of sustainable competitive advantage for the company. The scene setter illustrates the point about sustainable advantage in new markets. It also provokes other questions about how large companies in highly competitive markets (e.g. retail) actually create competitive advantage when costs are high and demand is variable. If we were to examine Central Retail Corporation in far more detail, we would see that an increasing practice of working closely with suppliers in emerging and developing countries yields many rewards. When companies are large and, by definition have more purchasing power, they are able to drive down costs by working with dozens and sometimes hundreds of smaller suppliers. As we shall see in this chapter, this tends to create competitive advantage through low-cost differentiation, which allows organisations to expand not only through exports but through supplier relationships in developing countries.

There are three big questions that concern competitive advantage: 4
1. Where do competitive advantages come from, and how are they sustained?
2. Why do some companies consistently outperform their competitors?
3. Why do some companies succeed in the same industry environments where others fail?

Competitive advantage can be approached from two perspectives. From a longitudinal perspective, strategy formulation and implementation can be analysed in relation to competitive advantages at various stages of the industry life cycle (which includes introduction, growth, mature and declining stages). From a hierarchical perspective, three basic levels of strategies within an organisation (namely corporate, business, and functional levels) can be examined. In addition, how a company can obtain competitive advantage at the network and global levels will be addressed, as these are both very important factors for the consideration of market competition in this modern, boundaryless world.

THE EMERGENCE OF COMPETITIVE ADVANTAGE

What is the meaning of competitive advantage? Why is it important? How does competitive advantage emerge? To understand how competitive advantage emerges, it is first necessary to understand what competitive advantage is. Competitive advantage is often easily recognised: Microsoft has a competitive advantage in the supply of computer operating software, Toyota has a competitive advantage in making cars, BHP Billiton has a competitive advantage in mining. Defining competitive advantage precisely is not easy. However, at a basic level it can be defined as follows: When two or more companies compete within the same market, competitive advantage is a condition that enables a company to operate in a more efficient or responsive manner than its competitors, and which results in higher potential to earn a persistently higher rate of profit.

It should be noted that competitive advantage may not be necessarily revealed immediately in higher profitability — a company may forgo current profit in favour of investment in market share, technology, customer loyalty or executive perks. 5 It is, therefore, important to have a long perspective on strategy formulation and implementation.
How competitive advantage emerges from external sources of change

Companies that do not compete effectively will be eliminated from the market eventually. Competitive advantage is the key success factor of a company’s survival. However, the competitive advantage of a company cannot last forever. When the market changes, the competitive advantage possessed by companies may also change. For example, the introduction of digital camera technology has caused significant damage to the traditional film camera market. No matter how effective or efficient a film camera producer is, most consumers are no longer interested in its products.

Various types of competitive advantages emerge when change occurs. The source of the change may be external or internal to the industry (see figure 6.1). For an external change to create competitive advantage, the change must have differential effects on companies because of their different resources and capabilities or strategic positioning. When will external change create competitive advantage and disadvantage? It depends on the magnitude of the change and the extent of companies’ strategic differences. The more turbulent an industry’s environment, the greater the number of sources of change. The greater the differences in companies’ resources and capabilities, the greater the dispersion of profitability within the industry.

In the world tobacco industry, the external environment is comparatively stable and the leading companies pursue similar strategies with similar resources and capabilities. The result is that competitive advantages, as reflected in inter-company profit differentials, tend to be small. The toy industry, on the other hand, experiences rapid and unpredictable changes in demand, technology and fashion. The leading companies pursue different strategies and have different resources and capabilities. As a result, profitability differences are wide and variable over time.

Competitive advantage from responsiveness to change

The impact of external change on competitive advantage depends on a company’s ability to respond to change. Any external change creates opportunities for the organisation. The ability to identify and respond to opportunity lies in the core management capability of
entrepreneurship.\textsuperscript{6} To the extent that external opportunities are fleeting or subject to first-mover advantage, speed of response is critical to exploiting business opportunity. An unexpected rain shower creates an upsurge in the demand for umbrellas. Those street vendors who are quickest to position themselves outside a busy railway station will benefit most.

As markets become increasingly turbulent, so responsiveness to external change has become increasingly important as a source of competitive advantage. For example, in response to market changes, supermarket chain Woolworths re-packaged itself in 2008 as ‘The Fresh Food People’. Its dominance in the food and grocery market in Australia has gained substantial competitive advantage and effectively formed an entry barrier to new entrants.

Responsiveness to the opportunities provided by external change requires one key resource (information) and one key capability (flexibility). Information is necessary to identify and anticipate external changes. This requires environmental scanning.

As the pace of change has accelerated, companies are less dependent on conventional analysis of economic and market research data and more dependent on ‘early warning systems’ through direct relationships with customers, suppliers and competitors. The faster a company can respond in real time to changing market circumstances, the less it needs to forecast the future. Short cycle times have become a key requirement for fast response capability.

Emphasis on speed as a source of competitive advantage is central to the Boston Consulting Group’s concept of time-based competition.\textsuperscript{7} In the car industry, speed of new product development has been a major advantage of Japanese companies (see table 6.1).\textsuperscript{8} However, only with the advent of the internet, real-time electronic data exchange, and business process re-engineering have companies been able to reduce cycle times drastically through radical changes in operations, strategy, and organisation.

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<thead>
<tr>
<th>TABLE 6.1</th>
<th>New product development performance by Japanese, United States and European automotive products</th>
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<tbody>
<tr>
<td></td>
<td>Japanese volume producer</td>
</tr>
<tr>
<td>Average lead time (months)</td>
<td>42.6</td>
</tr>
<tr>
<td>Engineering hours (in millions)</td>
<td>1.2</td>
</tr>
<tr>
<td>Total product quality index</td>
<td>58</td>
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**Competitive advantage from innovation:**

‘new game’ strategies

The changes that create competitive advantage may be internal as well as external. Internal change is generated through innovation. Innovation not only is a source of competitive advantage, it provides a basis for overturning the competitive advantage of other companies. Innovation is typically thought of in its technical sense: the new products or processes that embody new ideas and new knowledge. In a business, however, innovation includes new approaches to doing business.

What does ‘strategic innovation’ involve? Most commonly it involves creating value for customers from novel experiences, products, or product delivery or bundling. For example, the competition in the retail sector is driven by a constant quest for new retail concepts and formats. This may take the form of bigger stores with greater variety (Woolworths and Metcash) or novel approaches to display and store layout (Coles).
Strategic innovation may also be based on redesigned processes and novel organisational designs:

- Costco operates an international chain of membership warehouses, under the ‘Costco Wholesale’ name, that carry quality, brand-name merchandise at substantially lower prices than are typically found at conventional wholesale or retail sources. The company uses an intensive distribution strategy of its highly successful brand name into different regional areas to promote its unique form of competitive advantage.

- Nike built its large and successful businesses on a business system that totally reconfigured the traditional shoe-manufacturing value chain. To begin with, Nike does not manufacture shoes — indeed, it manufactures little of anything. It designs, markets and distributes shoes, but its primary activity is the coordination of a vast and complex global network involving design and market research (primarily in the United States), the production (under contract) of components (primarily in Korea and Taiwan), and the contract assembly of shoes (in China, the Philippines, India, Thailand and other low-wage countries).

- Apple’s resurgence between 2003 and 2006 is the result of its reinvention of the recorded music business by combining an iconic MP3 player, iPod, with its iTunes music download service. In 2007, Apple Computer Inc. changed its name to Apple Inc. to reflect that it no longer considers itself strictly a computer manufacturer. This shift was evidenced by the development of the highly innovative, multifunctional iPad which, in 2013, continued to dominate the global tablet market.

Formulating innovative strategies

How do organisations go about formulating innovative strategies? Are new approaches to competing and delivering superior value the result of pure creativity, or are there analyses and ways of thinking that can lead an organisation in the right direction? The management literature suggests several approaches:

- Expert advice is one of the primary sources of innovative ideas for most companies. For instance, Dairy Innovation Australia is the innovation centre for dairy manufacturing research and development, bringing together a critical mass of skills and expertise. Through seeking advice from these experts, dairy companies can obtain information that helps them be innovative in operations and the marketing of their products.  

- Hamel argues that strategic innovation extends beyond new products, new markets and new technologies. Innovations in management — Procter & Gamble’s invention of brand management, General Electric’s unique approach to management development, Toyota’s lean production system — are the strongest foundation for competitive advantage.

- Kim and Mauborgne’s blue ocean strategy emphasises the attractions of creating new markets. Blue oceans may comprise entirely new industries (e.g. Apple’s pioneering of the personal computer industry) or the re-creation of existing industries (e.g. Cirque du Soleil in the circus business).

- McKinsey & Company’s concept of new game strategy involves reconfiguring the industry value chain in order to change the ‘rules of the game’.

Sustaining competitive advantage

A company cannot live on its current competitive advantage forever. Once established, competitive advantage is subject to erosion by competition. The speed with which competitive advantage is undermined depends on the ability of competitors to challenge by imitation or innovation. Imitation is the most direct form of competition; thus, for competitive advantage to be sustained over time, barriers to imitation must exist. In most industries the erosion of the competitive advantage of industry leaders is a slow process.
To identify the sources of isolating mechanisms, the process of competitive imitation needs to be examined. For one company to imitate the strategy of another, it must meet four conditions:

- **Identification.** The company must be able to identify that a rival possesses a competitive advantage.
- **Incentive for imitation.** There must be a profit incentive. If a company can persuade rivals that imitation will be unprofitable, it may be able to avoid competitive challenges. A company can also deter imitation by pre-emption — occupying existing and potential strategic niches to reduce the range of investment opportunities open to the challenger.
- **Diagnosis.** If a company is to imitate the competitive advantage of another, it must understand the basis of its rival’s success. In most industries, there is a serious identification problem in linking superior performance to the resources and capabilities that generate that performance.
- **Resource acquisition.** A company can acquire resources and capabilities in two ways: it can buy them or it can build them. The period over which a competitive advantage can be sustained depends critically on the time it takes to acquire and mobilise the resources and capabilities needed to mount a competitive challenge.

Figure 6.2 illustrates these stages and the types of isolating mechanism that exist at each stage. In addition, a company can develop inimitable competitive advantage through continuous innovation. For instance, Apple Inc., the American company that produces iMac, iPod, iPhone and iPad, adopts a strategy of continuous innovation to build up its competitive advantage in the market.

<table>
<thead>
<tr>
<th>Requirement for imitation</th>
<th>Isolating mechanism</th>
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<tbody>
<tr>
<td>Identification</td>
<td>Obscure superior performance</td>
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<tr>
<td>Incentives for imitation</td>
<td>Deterrence: signal aggressive intentions to imitators</td>
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<td></td>
<td>Pre-emption: exploit all available investment opportunities</td>
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<tr>
<td>Diagnosis</td>
<td>Rely on multiple sources of competitive advantage to create ‘causal ambiguity’</td>
</tr>
<tr>
<td>Resource acquisition</td>
<td>Base competitive advantage on resources and capabilities that are immobile and difficult to replicate</td>
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**First-mover advantage**

A company’s ability to challenge an incumbent depends on the extent and the sources of **first-mover advantage** in the market. The idea of first-mover advantage is that the initial occupant of a strategic position or niche gains access to resources and capabilities that a follower cannot match. The simplest form of first-mover advantage is a patent or copyright.
First movers can also gain preferential access to scarce resources, such as a prime retail location. First movers may also be able to use the profit streams from their early entry to build resources and capabilities more rapidly than latecomers. While figure 6.2 illustrates ways to maintain first-mover advantage and thus sustained performance over time, there are many examples where innovators have more recently benefited by greater knowledge spillovers. For example, when Intel established superior advantage by developing sophisticated microprocessor capabilities, companies such as AMD benefited from this knowledge as it became available. The natural tendency for firms is to prevent spillovers and to protect proprietary assets such as investment-rich resources in technologies and capital investments. This belief is based on a classical view that knowledge spillovers (e.g. detailed technical specifications, process techniques) commonly shared over time with competitors are highly beneficial to imitators but detrimental to innovators. More recent research suggests that deliberately withholding knowledge may force imitators to speed up innovative attempts to replicate the innovator’s first-mover advantage. However, rather than maintaining isolating mechanisms (outlined in figure 6.2), the practice of ‘free revealing’ — that is, the provision of a minimal level of spillover knowledge to rivals — may prove more beneficial for the innovator, in that it encourages followers to adopt an imitative development strategy rather than a concurrent one. This means that innovators or leaders with first-mover advantage can slow down their own development activities and reduce development costs.

COMPETITIVE ADVANTAGE IN DIFFERENT MARKET SETTINGS

Profiting from competitive advantage requires that the company first establishes a competitive advantage, and then sustains its advantage for long enough to reap the rewards. To identify opportunities for establishing and sustaining competitive advantage requires an understanding of the competitive process in the specific market. For competitive advantage to exist, there must be some imperfection of competition. To understand these imperfections in the competitive process, it is necessary to identify the types of resources and capabilities necessary to compete and the circumstances of their availability.

There are two types of value-creating activity: trading and production. Trading involves arbitrage across space (trade) and time (speculation). Production involves the physical transformation of inputs into outputs. These different types of business activity correspond to different market types: trading markets and production markets (see figure 6.3). But first, a special type of trading market — an efficient market — is discussed.

Efficient markets: the absence of competitive advantage

Economic theories state that perfect competition exists where there are many buyers and sellers, no product differentiation, no barriers to entry or exit, and free flow of information. The closest real-world examples of perfect competition are financial and commodity markets (e.g. the markets for securities, foreign exchange, and grain futures). These markets are sometimes described as efficient. An efficient market is one in which prices reflect all available information. Because prices adjust instantaneously to newly available information, no market trader can expect to earn more than any other. Any differences in profit reflect either different levels of risk selected by different traders or just pure luck. Because all available information is reflected in current prices, no trading rules based on historical price data or any other available information can offer excess return. In other words, competitive advantage is absent.
The absence of competitive advantage in efficient markets can be linked to resource availability. If financial markets are efficient, it is because only two types of resource are required to participate — finance and information. If both are equally available to all traders, there is no basis for one to gain competitive advantage over another.

**Competitive advantage in trading markets**

For competitive advantage to emerge, there must be some imperfections that exist in the competitive process. Using trading markets as an example, the following introduces different sources of imperfection to the competitive process, showing how these imperfections create opportunities for competitive advantage.

**Superior access to information**

In financial markets (and most other trading markets), competitive advantage depends on superior access to information. The most likely source of superior information is privileged access to private information. Trading on the basis of such information normally falls within the restrictions on ‘insider trading’. Though insider information creates advantage, such competitive advantage tends to be of short duration. Once a market participant begins acting on the basis of insider information, other operators are alerted to the existence of the information. Even though they may not know its content, they are able to imitate the behaviour of the market leader.

**Transaction costs**

In stock markets, low transaction costs are attained by traders who economise on research and market analysis and achieve efficient portfolio diversification. Studies of mutual fund performance show that, on average, managed funds underperform index funds and the amount of that underperformance is roughly equal to the additional expenses incurred by the managed funds.
Systematic behavioural trends

In general, there is evidence that prices in financial markets follow systematic patterns that are the result of ‘market psychology’, which is reflected in the trends, the turning points of which can be established from past data. Chart analysis uses hypotheses concerning the relationship between past and future price movements for forecasting. Despite mixed evidence on the success of chart analysis in financial markets, systematic behavioural trends do occur in most markets, which implies that competitive advantage is gained by traders with superior skill in diagnosing such behaviour.

Overshooting

One well-documented behavioural aberration is the propensity of market participants to overreact to new information, with the result that prices overshoot. Such overreaction is typically the result of imitative behaviour resulting in the creation of bandwagon effects. On the assumption that overshooting is temporary and is eventually offset by an opposite movement back to equilibrium, then advantage can be gained through a contrarian strategy: doing the opposite of the mass-market participants.

Competitive advantage in production markets

The transitory nature of competitive advantage in trading markets is a result of the characteristics of the resources required to compete: finance and information. Production markets are quite different. Production activities require complex combinations of resources and capabilities, and these resources and capabilities are highly differentiated. The result is that each producer possesses a unique combination of resources and capabilities.

In the airline industry, the growing diversity of companies has expanded opportunities for competitive advantage and widened the profit differentials between them. For instance, Qantas (Australia’s leading airline) operates a fleet of over 200 aircraft and, at the same time, has diversified its airline operations to include regional carrier, QantasLink, as well as a low-fare carrier, Jetstar Airways, both of which operate in Australia and elsewhere in the Asia-Pacific region.

Differences in resources of companies have an important impact on the process by which competitive advantage is eroded. Where companies possess very similar bundles of resources and capabilities, imitation of the competitive advantage of the incumbent company is most likely. Where resource bundles are highly differentiated, competition is likely to be less direct. Using different resources and capabilities, a company may substitute a rival’s competitive advantage. It is misleading, however, to suggest that resources and capabilities are the main source of competitive advantage — the integrative effects of strength and weakness sets on relative performance also need to be considered. That is, if resources are influenced by both strengths and weaknesses of a given organisation, then we need to think about the combined effect of capabilities/weaknesses on competitive advantage. Research indicates that it is not just resources that lead to sustained competitive advantage because this misrepresents the power of strategic liabilities. While resource-based theory (RBV) suggests that valuable and rare resources create a competitive advantage, this is relative to competitors — meaning that organisations cannot rely on the absolute quality of capabilities. Consequently, strengths and weaknesses create a dynamic interdependence between multiple rivals competing in the same marketplace.

Hence, the durability of competitive advantage over time depends on the environment and organisation-specific factors, and this is limited because strengths and weakness sets change significantly. Research confirms that there is a negative outcome on relative
organisation performance from weakness sets, which probably accounts for temporary advantage rather than sustained competitive advantage. Many factors lead to attacks on an organisation’s competitive advantage including, but not limited to, organisational inefficiencies (what Dorothy Leonard-Barton calls rigidities) and inability to exploit opportunities. When an organisation has many weaknesses, the number and intensity of attacks upon it are likely to be higher and stronger. Figure 6.4 illustrates that relative high or low weaknesses need to be offset with high or low strengths.

Quadrant II in figure 6.4 indicates that a set of strengths will overwhelm a set of weaknesses, leading to a robust advantage. This fits RBV logic that more capabilities from resources than weaknesses create competitive advantage. Quadrant III, however, indicates that a low strength set coupled with a high weakness set will have a negative effect on relative performance because the weaknesses undermine the strengths set’s positive contribution. In quadrant I, there is little to differentiate between competitors since strengths and weaknesses offset each other. Lastly, in quadrant IV, the strength and weakness sets neutralise each other. Precarious advantage in quadrant IV is less durable because a high level of weaknesses makes an organisation more vulnerable to rivals’ attacks and there is greater performance variation than with robust advantage (quadrant II). Notice that in quadrant III, organisations possess an overall competitive disadvantage while in quadrant I, at best, competitors achieve parity but the absence of any real capabilities does not create competitive advantage in production markets. The overall logic of figure 6.4 is that organisations are more likely to achieve temporary advantage because of constant changes to organisation-specific resources and shifting environments. In such circumstances, organisations need to develop a differentiated stock of capabilities in dynamic markets that are constantly shifting. To achieve sustained competitive advantage, organisations will need to constantly develop their capabilities and not stay static after recent successes.

Note the following examples of firms constantly developing capabilities:

- Canon, a Japanese company, substituted for Xerox’s technical service capability in copiers by developing high reliability copiers that needed little service.
- Lenovo, the Chinese company that purchased IBM’s PC business, is now moving the focus back to the Chinese PC market which provides a sustainable home-based competitive advantage. Strategy capsule 6.1 outlines the new home-based strategy of Lenovo.

Since substitute competition can come from many directions — alternative resources, technological innovations or new business models — it is difficult to counter. The key is to persuade potential competitors that substitution is unlikely to be profitable. This can be achieved through committing the company to continuous improvement, locking in customers and suppliers, and market deterrence.
Lenovo’s new strategy to build up its competitive advantage at emerging markets

Lenovo, the Chinese computer maker that bought IBM’s personal computer business for US$1.25 billion in 2004, decided to change its focus by returning to its home market — where it remains a market leader (although not without steep competition). As the fourth largest computer producer in the world, Lenovo’s original intention was to compete in the American and European markets using IBM’s brand name. However, as the global financial crisis deepened, Lenovo realised that its competitiveness in developed markets had been eroded by a decline in the purchasing power of buyers.

Lenovo currently holds over 35 per cent of its home market, China, which is one of the fastest growing economies in the world. The company decided to launch a restructuring plan by cutting the number of its global staff outside China by 11 per cent. Its strategy is to keep only its important customers in the United States and Europe and, at the same time, expand its business in China. Lenovo merged its China and Asia-Pacific divisions and also set up a plan to actively explore emerging markets such as Russia and India. These changes include developing products for individual users and small to medium-sized enterprises.

The company also announced a new ‘channel partners’ organisation with the sole objective of being the channel’s vendor of choice. The company has defined a new framework that enhances the way it approaches its partners and brings significant business growth benefits.

Industry conditions conducive to the emergence of sustained competitive advantage

The opportunities for establishing competitive advantage in production markets depend on the number and diversity of the sources of change in the business environment. Consider the wireless telecommunication services industry. The industry is subject to a vast array of dynamic forces — regulatory change, technological change, changing customer preferences, to mention but a few. All of these forces offer opportunities for competitive advantage. The complexity of the industry also determines the variety of opportunities for competitive advantage. The extent to which competitive advantage is eroded through imitation will also depend on the characteristics of the industry. For example:

- **Information complexity.** Industries where competitive advantage is based on complex, multilayered capabilities tend to have more sustainable competitive advantages. In movie production, the long-established leadership of studios such as Paramount, Columbia (Sony), Universal, Fox and Disney reflects the difficult-to-diagnose secrets of producing ‘blockbuster’ movies, even though the individual resources (scripts, actors, technicians and directors) can be hired from the market.
• **Opportunities for deterrence and pre-emption.** Industries in which the market is small (relative to the minimum efficient scale of production), essential resources are scarce or tightly held, or economies of learning are important, allow first movers to establish and sustain competitive advantage by pre-emption and deterrence. The local market dominance of Australian banks such as the Commonwealth Bank and National Australia Bank (NAB) ensure that foreign banks are relatively uncompetitive in their development of effective local business networks and efficient customer services.

• **Difficulties of resource acquisition.** Industries differ according to the availability of strategically important resources. The securities underwriting business (whether for initial public offerings or corporate bond issues) offers more sustainable advantages because the key resources and capabilities (market expertise, reputation, relationships, retail distribution links and massive financial reserves) are difficult to assemble.

### INDUSTRY EVOLUTION AND STRATEGIC ADVANTAGE

Everything is in a state of constant change — the business environment especially. The greatest challenge of management is to ensure that adaptation of the enterprise matches the changes occurring within the business environment, while upholding the company’s strategic advantage.

Change in the industry environment is driven by a number of forces — technology, consumer preferences, economic growth and a host of other influences. In some cases, these forces for change may combine to create massive, unpredictable changes. For example, in telecommunications, new digital and wireless technologies combined with regulatory changes have resulted in the telecommunications industry in the twenty-first century being almost unrecognisable from that which existed 20 years previously. In other industries — food processing, car production and wedding services — change is more gradual and more predictable. Change is the result both of external forces and the competitive strategies of the companies within the industry.

### Industry life cycle

One of the best-known and most enduring marketing concepts is the product life cycle. Products are born, their sales grow, they reach maturity, they go into decline, and they ultimately die. If products have life cycles, so too do the industries that produce them.

The **industry life cycle** is the supply-side equivalent of the product life cycle and is likely to be of longer duration than that of a single product. The life cycle comprises four phases: introduction (or emergence), growth, maturity, and decline (see figure 6.5). The characteristic profile of such a life cycle is an S-shaped growth curve.

- **In the introduction stage**, sales are small and the rate of market penetration is low because the industry’s products are little known and customers are few. Customers for new products tend to be affluent, innovation-oriented and risk-tolerant.
- **The growth stage** is characterised by accelerating market penetration as product technology becomes more standardised and prices fall. Ownership spreads from higher income customers to the mass market.
- **Increasing market saturation causes the onset of the maturity stage** and slowing growth as new demand gives way to replacement demand. Once saturation is reached, demand is wholly for replacement, either by customers replacing old products with new products or by new customers replacing old customers.
- **Lastly, as the industry becomes challenged by new industries that produce technologically superior substitute products, the industry enters its decline stage.**
Driving forces of an industry life cycle

The industry life cycle is driven by two forces:

- The life cycle and the stages within it are defined primarily by changes in an industry's growth rate over time.
- The second driving force of the industry life cycle is knowledge. New knowledge in the form of product innovation is responsible for an industry's birth, and the dual processes of knowledge creation and knowledge diffusion exert a major influence on industry evolution.

The life cycle model is a useful approach to exploring the impact of temporal processes of market saturation and technology development and dissemination and their impact on industry structure and the basis of competitive advantage. Classifying industries according to their stage of development can in itself be an insightful exercise:

- It acts as a shortcut in strategy analysis. Categorising an industry according to its stage of development can suggest the type of competition likely to emerge and the kinds of strategy likely to be effective.
- Classifying an industry encourages comparison with other industries. By highlighting similarities and differences with other industries, such comparisons can provide a deeper understanding of the strategic characteristics of an industry.
- It directs attention to the forces of change and direction of industry evolution, thereby helping anticipate and manage change.

Industry life cycle can also explain how international migration of production started to prevail in the 1980s. Strategy capsule 6.2 discusses how this migration process can explain the shift of production from developed countries to developing ones.

International migration of production

The industry life cycle involves the international migration of production. The life cycle theory of trade and direct investment is based on two assumptions. First, that demand for new products emerges in the advanced industrialised countries of North America, Western Europe and Japan and then diffuses internationally. Second, that with maturity, products require fewer inputs of technology and sophisticated skills.

The result is the following development pattern:
1. New industries begin in high-income countries because of the presence of a market and the availability of technical and scientific resources.
2. As demand grows in other countries, they are serviced initially by exports.
3. Continued growth of overseas markets and reduced need for inputs of technology and sophisticated labour skills make production attractive in newly industrialised countries. The advanced industrialised countries begin to import.

4. With maturity, commoditisation and de-skilling of production processes, production shifts to developing countries where labour costs are lowest.

For example, consumer electronics were initially dominated by the United States and Germany. During the early 1960s, production shifted towards Japan. The 1980s saw the rise of Korea, Hong Kong and Taiwan as leading exporters. By the mid 1990s, assembly had moved to lower-wage countries such as China, the Philippines, Thailand, Mexico and Brazil. These shifts in production and commoditisation of products and innovations are similar to slow-, standard- and fast-cycle markets. In many countries — such as Malaysia and China — large car firms (e.g. General Motors) are involved in standard-cycle markets with the goal of sustaining competitive advantage with strategic investments in new designs and/or modified designs for supplying cars to the mass market. However, fast-cycle competition is evident in the motorcycle industry (as outlined in Strategy capsule 6.3), since competitive advantage can erode rapidly.

While various management consultants and commentators advocate radical and continuous change among established companies, there is little evidence that most companies have the capacity to manage such change. Certain tools and techniques — scenario analysis, in particular — may help managers understand and cope with change in the external environment. Nevertheless, the fundamental truth is that, so long as developing new capabilities is slow and risky, a company’s capacity to successfully undergo radical change is inherently uncertain.

**Industry life cycle and cycle markets**

As we discussed earlier, market growth-to-saturation and technology development and dissemination have a significant impact on industry structure and the basis of competitive advantage. However, industry life cycle cannot be defined or highlighted in such discrete terms. This is because the pace of change or the competitive dynamics within a particular industry and market dictate the life of products and innovations at each stage of the life cycle. So, it is often useful to think of industry life cycles in terms of cycle markets: slow, fast and standard. **Slow-cycle markets** are defined here as products and innovations that have high barriers to competitive imitation protecting an organisation’s strategic advantage over time. An example is B. Braun in Malaysia, which manufactures high precision surgical equipment where each product is patented and protected. While companies may imitate over time, the capability and production related to ‘high precision’ are more difficult to copy. For instance, B. Braun has a unique set of competencies and capabilities that are hard to replicate, and the company possesses many unique in-house innovations.

**Standard-cycle markets** by comparison are defined as products and innovations that have measured barriers to competitive imitation protecting a firm’s strategic advantage over time.
time. Here, firms compete in high-volume markets that experience severe competition. However, as outlined in figure 6.4 earlier, continuing investments in resources and capability strengths create robust advantage over time, allowing companies to stay ahead of their competitors. Continuous investments in people through skill equipping, process technology investments, and general organisational know-how assist these companies to sustain their advantage over time. Rather than seeking to understand product and industry life cycles with discrete starts and ends, viewing markets as a compilation of capabilities that are earnestly defended makes equal sense. In many ways, precarious advantage (see figure 6.4) aptly fits standard-cycle organisations when imitators achieve parity in design and innovation. Here, precarious advantage suggests an equal number of strengths and weaknesses for a time when competitors have roughly the same quality of resources. However, standard-cycle organisations make strategic investments in new and related products and processes, enabling them to maintain advantages longer and thus make performance gains relative to competitors.30

Fast-cycle markets are different because of the pace of disruption. Fast-cycle markets are defined as products and innovations that cannot be protected because of intense and rapid competitive moves that erode and destroy competitive advantage.31 An example here is the fast imitation by Samsung of Apple’s iPhone patents and designs in their Android 4.0 platform.32 Similarly, Motorola, who own patents to key wireless technologies, are seeking separate payments for Apple’s use of Qualcomm chips that incorporate Motorola patents.33 What is noticeable here are the barriers to innovation and imitation that were discussed previously in figure 6.3. Rapid competition creates temporary advantage because of the volatility of hyper-competition and the influence this has on organisation-level competitive behaviour.34 The nature of imitation and counterattack to an organisation’s innovation(s) in fast-cycle markets is illustrated in figure 6.6.35

**Competitive advantage at the introduction and growth stages**

In emerging industries at the introduction and growth stages, nurturing and exploiting innovation is the fundamental source of competitive advantage. This means that the practices of effective strategic management are fundamentally different in emerging industries from other types of business environments.
A common problem in emerging industries is the speed of change and the difficulty of forecasting change. It means that traditional approaches to strategy formulation based on forecasting must be abandoned in favour of strategic management approaches that combine a clear sense of direction based on vision and mission, with the flexibility to respond to and take advantage of the unexpected.

Despite this turbulence and uncertainty, the principles of strategic analysis are critical in guiding the quest for competitive advantage in emerging industries. Key issues include:

- whether an innovation has the potential to confer sustainable competitive advantage
- the relative merits of alternative strategies for exploiting an innovation
- the factors that determine the comparative advantages of being a leader or a follower in innovation.

The key to successful innovation is not resource allocation decisions, but creating the structure, integration mechanisms and organisational climate conducive to innovation. Strategies aimed at the exploitation of innovation, choices of whether to be a leader or a follower and the management of risk must take careful account of organisational characteristics.

Emerging industries also reveal some of the dilemmas that are a critical feature of strategic management in complex organisations and complex business environments. For example, emerging industries are difficult to predict, yet some investments in technology have time horizons of a decade or more, for example, LCD televisions. Successful strategies must be responsive to changing market conditions, but successful strategies also require long-term commitment. The fundamental dilemma is that innovation is an unpredictable process that requires creating a nurturing organisational context, whereas strategy is about resource-allocation decisions.

The increasing pace of technological change and intensifying international competition suggest that the advanced, industrialised countries will be forced to rely increasingly on their technological capabilities as the basis for international competitiveness. Strategies for promoting innovation and managing technology will become more important in the future.

**Strategic innovation at the growth stage**

Innovation is not easy, and it is often expensive. Although in some heavy industries — steel, textiles, food processing, insurance and hotels — research and development (R&D) expenditure is below 1 per cent of sales revenue, in manufacturing as a whole just three sectors — computers and electronics, pharmaceuticals, and aerospace – account for more than half of research and development spending.36

At the early growth stage of a company, the pressure of competition and the opportunities for technology-based advantage create impetus for innovation in competitive strategy. While product and process innovation is definitely important, it is possible that there is another phase of innovation — **strategic innovation** — which becomes most prominent once product and process innovation have begun to develop.

Imagine what will happen when most competitors have started to explore similar technologies — the initial competitive advantage enjoyed by a company at the introduction stage will be eroded later when it intends to grow further. Strategic innovation will then become important for competition.

Strategic innovation may also result from redefining markets and market segments.37 This may involve:

- **Embracing new customer groups.** The ability to break away from conventional wisdom and establish a unique positioning or novel form of differentiation may be critical in mature industries. This is particularly important in finding new customers. For example, Sony, through its product, the PlayStation 3 console, has extended video gaming from teenage boys to girls, adults and retirees.
• Adding products and services that perform new but related functions. Many of the innovative forms of differentiation involve the creation of entirely new customer experiences. Some companies go beyond providing a product or service that meets a clearly defined customer need and involve their customers in a process that engages them at the emotional, intellectual, or even spiritual, level.\(^38\)

Embracing new customer groups and adding new products and services can be done by adopting a blue ocean strategy.\(^39\) However, Strategy capsule 6.3 considers whether developing new markets — either at the growth or mature stage — primarily to prolong a product’s life cycle on the basis of low cost will be enough. Simply taking advantage of low-cost developing countries’ resources in an effort to harvest the fruits of innovation and home country R&D efforts might backfire on multinational companies.\(^40\) While we have discussed the importance of strategic innovation, particularly with regard to technological innovation to promote sustained competitive advantage, this may have a blowback effect in developing countries. Innovation blowback describes the unintended consequences of Western incursions into emerging markets, where an event — such as taking advantage of low-cost labour — backfires on its maker.\(^41\) Ultimately, attackers might become defenders where emerging markets generate a wave of disruptive product and process innovations that assist established companies and entrepreneurs to develop a new playing field for a range of globally traded goods and services. In such circumstances, companies from emerging nations may capture significant market share in the developed countries from which products where originally sourced.

### Outsourcing innovation

Strategic innovation is not just about clever innovation at home; emerging countries are rapidly catching on. China and Malaysia and other emerging countries are targets for multi-national organisation offshore investments. The factor conditions in these countries such as low labour costs and easy access to labour supply have long been a source of advantage for multinationals. However, switched-on large corporations are starting to build distinctive capabilities in low-income segments of developing countries before other companies. How do they do this and why is it important? Two ways to do this is through production-driven modularity and process-driven networks.

Production-driven modularity — also known as localised modularisation — is a ‘loosely controlled, supplier-driven approach that speeds up a company’s time to market, cuts its costs, and enhances the quality of its products’.\(^42\) Chinese manufacturers have adapted the tightly integrated product architecture of Japanese motorcycle manufacturers by outsourcing to local suppliers and taking a more flexible and modular approach. In prescribing to suppliers only the design blueprints and specifying broad parameters, this left local innovators and manufacturers to design their own components and subsystems. Through improvisation, local manufacturers then used ‘process networks’ to mobilise dozens of specialised companies to modularise
production in parallel. As such, detailed design drawings of components and subsystems are therefore irrelevant. Rather, suppliers improvise within broad constraints, take collective responsibility for the detailed design of components and subsystems and rapidly cut costs and improve quality.

This has enabled China to make rapid gains in export markets, where they now account for half of global motorcycle production. The ‘blowback’ for Japanese manufacturers has been immense — for example, in Vietnam, Honda’s share of exports fell from 90 per cent to 30 per cent against the popularity of Chinese motorcycle products. What Chinese manufacturers have done through production modularity is change the rules of the game as Gary Hamel and CK Prahalad talked about in their article ‘Strategic Intent’ HBR (1989).43 While an advanced country such as Japan might complain about Chinese manufacturers copying their designs, this approach to strategic innovation is about encouraging local innovation at the component and subsystem level at a fraction of the cost of the resource allocations used in traditional designs. Similarly, in the apparel industry in Hong Kong, the experiences of Li & Fung testify to the importance of the second aspect of strategic innovation: process networks. Li & Fung have developed a network of 7500 specialised businesses as partners who create customised supply for each new apparel line. These ‘process orchestrators’ decide which companies will participate in the network, what the party’s role will be, and guarantee performance for a fair price.44 From a strategic innovation perspective, mobilised process networks require unique performance parameters, access to reliable suppliers, and ways to reduce the cost of interaction among network participants. So, why are production-driven modularity and process-driven networks important? The answer is because they potentially disintegrate vertically by outsourcing the innovation entirely, effectively turning traditionally-designed resource components on their head. In turn, emerging economies can take advantage of these dispersed aspects of production and networks by developing their own products and exporting them to developed countries (the blowback effect).

**Competitive advantage in mature industries**

An analysis of the industry life cycle suggests that maturity has two principal implications for competitive advantage: first, it tends to reduce the number of opportunities for establishing competitive advantage; second, it shifts these opportunities from differentiation-based factors to cost-based factors.

Diminishing opportunities for sustainable competitive advantage in mature industries stem from:

- less scope for differentiation advantage resulting from increased buyer knowledge, product standardisation and less product innovation
- diffusion of process technology, which means that cost advantages based on superior processes or more advanced capital equipment methods are difficult to obtain and sustain; once a cost advantage is established, it is vulnerable to exchange rate movements and the emergence of low-cost overseas competitors
- a highly developed industry infrastructure together with the presence of powerful distributors, which makes it easier to attack established companies that occupy particular strategic niches.

This trend towards deteriorating industry profitability is a constant threat in mature industries. As rivalry encourages overinvestment in capacity, international competition increases and differentiation is undermined by commoditisation, attaining a competitive advantage becomes essential to achieving positive economic profits.
Cost advantage

Cost is the overwhelmingly important key success factor in most mature industries. What are the primary sources of low cost? Three cost factors tend to be especially important:

1. Economies of scale. In capital-intensive industries, or where advertising, distribution or new product development is an important element of total cost, economies of scale are important sources of intercompany cost differences. The significance of scale economies in mature industries is indicated by the fact that the association between profitability and market share is stronger in mature industries than in emerging industries.\(^4\)

2. Low-cost inputs. Where small competitors are successful in undercutting the prices of market leaders in mature industries, it is frequently through their access to low-cost inputs. Established companies can become locked into high salaries and benefits, inefficient working practices, and bloated overheads inherited from more prosperous times. New entrants into mature industries may gain cost advantages by acquiring plant and equipment at bargain-basement levels and by cutting labour costs. The acquisition of retailers, hotels, hospital groups and chemical companies by private equity funds has been motivated in part by the attractions of substituting low-cost debt for high-cost equity.\(^4\)

3. Low overheads. Some of the most profitable companies in mature industries tend to be those that have achieved the most substantial reductions in overhead costs. In retailing, the Coles Group in Australia is persistent in its parsimonious approach to lowering overhead costs.

Segment and customer selection

Sluggish demand growth, lack of product differentiation, and international competition tend to depress the profitability of mature industries. Yet, even unattractive industries may offer attractive niche markets with strong growth of demand, few competitors, and abundant potential for differentiation. As a result, segment selection can be a key determinant of differences in the performance of companies within the same industry.

In the car industry, there is a constant quest to escape competition by creating new market segments with ‘crossover’ vehicles that span existing segments. Opportunities for establishing new segments can arise from the strategies of market leaders. The more that incumbents focus on the mass market, the more likely it is that new entrants can carve out new market niches by supplying under-served customer needs.\(^4\)

The logic of segment focus implies further disaggregation of markets — down to the level of the individual customer. Information technology permits new approaches to customer relationship management (CRM), making it possible to analyse individual characteristics and preferences, identify individual customers’ profit contribution to the company, and organise marketing around individualised, integrated approaches to customers. Banks, supermarkets, credit card companies and hotels increasingly use transaction data to identify their most attractive customers and those that are a drag on profitability. The next possible step in this process is to go beyond customer selection to actively target more attractive customers and transform less valuable customers into more valuable customers.

The quest for differentiation

Cost leadership is difficult to sustain, particularly in the face of international competition. Hence, differentiating to attain some insulation from the rigours of price competition is particularly attractive in mature industries. The problem is that the trend toward
commoditisation narrows the scope for differentiation and reduces customer willingness to pay a premium for differentiation. For example:

- In the domestic appliances industry, companies’ investments in differentiation through product innovation, quality and brand reputation have generated disappointing returns. Vigorous competition, price-sensitive customers and strong, aggressive retailers have limited the price premium that differentiation will support.

- Attempts by airlines to gain competitive advantage through offering more legroom, providing superior in-flight entertainment and achieving superior punctuality have met little market response from consumers. The only effective differentiators appear to be frequent flyer programs and services offered to first- and business-class travellers.

Standardisation of the physical attributes of a product and convergence of consumer preferences constrain, but do not eliminate, opportunities for meaningful and profitable differentiation. In consumer goods, maturity often means a shift from physical differentiation to image differentiation. Entrenched consumer loyalties to specific brands of cola or cigarettes are a tribute to the capacity of brand promotion over long periods of time to create distinct images among near-identical products.

Rejuvenation represents a formidable challenge to a mature enterprise. Resistance to innovation and renewal arises not just from entrenched structures and systems but also from the propensity for managers to be trapped within their industry’s conventional thinking about key success factors and business practices. Some companies are able to adapt better than others.

**Strategy implementation in mature industries: structure, systems and style**

If the key to success in mature industries is achieving operational efficiency and reconciling this with innovation and customer responsiveness, achieving competitive advantage in mature businesses requires implementing structures, systems and management styles that can mesh these multiple performance goals.

If maturity implies greater environmental stability, slower technological change and an emphasis on cost efficiency, what types of organisation and management approaches are called for? The conventional prescription for stable environments was ‘mechanistic’ organisations characterised by centralisation, well-defined roles and predominantly vertical communication.

Efficiency of a mature company can be achieved through standardised routines, division of labour and close management control based on bureaucratic principles. Division of labour extends to management as well as operatives — high levels of vertical and horizontal specialisation are typical among managers. Vertical specialisation is evident in the concentration of strategy formulation at the apex of the hierarchy, while middle and junior management supervise and administer through the application of standardised rules and procedures. Horizontal specialisation takes the form of functional structures.

**Strategies for declining industries**

The transition from maturity to decline can be a result of technological substitution (e.g. typewriters and railways), changes in consumer preferences (men’s suits), demographic shifts (baby products in Australia where the birth rate is declining) or foreign competition (computers from Japan and the United States). Shrinking market demand gives rise to acute strategic issues. Among the key features of declining industries are:

- excess capacity
- lack of technical change (reflected in a lack of new product introduction and stability of process technology)
a declining number of competitors, but some entry as new companies acquire the assets of exiting companies cheaply
• high average age of both physical and human resources
• aggressive price competition.

Some declining industries can still earn surprisingly high profits. These include electronic vacuum tubes, cigars and leather tanning. However, elsewhere — notably in prepared baby foods, rayon and meat processing — decline has been accompanied by aggressive price competition, company failures and instability.49

What determines whether or not a declining industry becomes a competitive blood-bath? Two factors are critical: the balance between capacity and output; and the nature of the demand for the product.

Adjusting capacity to declining demand
The smooth adjustment of industry capacity to declining demand is the key to stability and profitability during the decline phase. In industries where capacity exits from the industry in an orderly fashion, decline can occur without trauma. Where substantial excess capacity persists, as has already occurred in some industries in Asia–Pacific economies, such as shipbuilding in Japan and Korea, and the clothing and footwear industry in Australia, the potential exists for destructive competition. The ease with which capacity adjusts to declining demand depends on the following factors:

• The predictability of decline. If decline can be forecast, it is more likely that companies can plan for it. The decline of traditional photography with the advent of digital imaging was anticipated and planned for by most companies. The more cyclical and volatile the demand, the more difficult it is for companies to perceive the trend of demand even after the onset of decline.

• Barriers to exit. Barriers to exit impede the exit of capacity from an industry. The major barriers are:
  – Durable and specialised assets. Just as capital requirements impose a barrier to entry into an industry, those same investments also discourage exit. The longer they last and the fewer the opportunities for using those assets in another industry, the more companies are tied to that particular industry.
  – Costs incurred in plant closure. Apart from the accounting costs of writing off assets, substantial cash costs may be incurred in redundancy payments to employees, compensation for broken contacts with customers and suppliers, dismantling the plant, and environmental clean-up.
  – Managerial commitment. In addition to financial considerations, companies may be reluctant to close plants for a variety of emotional and moral reasons. Resistance to plant closure and divestment arises from pride in company traditions and reputation, managers’ unwillingness to accept failure, and loyalties to employees and the local community.

• The strategies of the surviving companies. The sooner companies recognise and address the problem of the decline, the more likely it is that independent and collective action can achieve capacity reduction. Stronger companies in the industry can facilitate the exit of weaker companies by offering to acquire their plants and take over their after-sales service commitments.

The nature of declining demand
Where a market is segmented, the general pattern of decline can obscure the existence of pockets of demand that are not only comparatively resilient, but also price inelastic. For example, despite the obsolescence of vacuum tubes after the adoption of transistors,
GTE Sylvania and General Electric earned excellent profits supplying vacuum tubes to the replacement and military markets.\(^5\) In fountain pens, survivors in the quality pen segment such as Cross and Mont Blanc have achieved steady sales and high margins through appealing to high-income professionals and executives. Despite overall decline of the cigar market, quality cigars have benefited from strong demand and attractive margins.

Choosing the most appropriate strategy requires a careful assessment of the profit potential of the industry and the competitive position of the company. Harrigan and Porter\(^5\) pose four key questions:

1. Can the structure of the industry support a hospitable, potentially profitable decline phase?
2. What are the exit barriers that each significant competitor faces?
3. Do your company strengths fit the remaining pockets of demand?
4. What are your competitors’ strengths in these pockets? How can their exit barriers be overcome?

Selecting an appropriate strategy requires matching the opportunities remaining in the industry to the company’s competitive position.

**Beyond bureaucracy in mature and declining industries**

The past two decades have seen growing unpopularity of bureaucratic approaches to management, especially in mature and declining industries. Factors contributing to this trend include:

- **Increased environmental turbulence.** Bureaucracy is conducive to efficiency in stable environments. However, the centralised, structured organisation cannot readily adapt to change. Achieving flexibility to respond to external change requires greater decentralisation, less specialisation and looser controls.
- **Increased emphasis on innovation.** The organisational structure, control systems, management style and interpersonal relationships conducive to efficiency are likely to hinder innovation. As mature enterprises sought new opportunities for competitive advantage, so the disadvantages of formalised, efficiency-oriented organisations became increasingly apparent.
- **New process technology.** The efficiency advantages of bureaucratised organisations arise from the technical virtues of highly specialised, systematised production methods. As automation displaces labour-intensive, assembly-line manufacturing techniques, there is less need for an elaborate division of labour and greater need for job flexibility. At the same time, the electronic revolution in the office is displacing the administrative bureaucracy that control and information systems once required.

Companies in mature industries have undergone substantial adjustment over the past decade. Among large, long-established corporations management hierarchies have been pruned, decision making decentralised and accelerated, and more open communication and flexible collaboration fostered. The trend began in North America, spread to continental Europe, and is now evident in Australia, Japan and Korea. The changes are apparent in:

- strategic decision processes that increase the role of business-level managers and reduce the role of corporate management; an emphasis on the strategy formulation process as more important than strategic plans per se
- a shifting of decision-making power to the business level accompanied by shrinking corporate staffs
- less emphasis on economies of large-scale production and increased responsiveness to customer requirements together with greater flexibility in responding to changes in the marketplace.
• increased emphasis on teamwork as a basis for organising separate activities to improve interfunctional cooperation and responsiveness to external requirements
• wider use of profit incentives to motivate employees and less emphasis on controls and supervision.

Despite the changes, the primary emphasis on cost efficiency remains. However, the conditions for cost efficiency have changed. The most powerful force for organisational change in mature industries has been the inability of highly structured, centralised organisations to maintain their cost efficiency in an increasingly turbulent business environment. By relying more on performance targets and less on approvals and committees, the old corporate empires need to become more flexible and responsive while maintaining a strong focus on efficiency.

COMPETITIVE ADVANTAGE AT VARIOUS LEVELS OF A COMPANY

Competitive advantage is considered the basis for superior company performance. A company has to nurture an evolving system of competitive advantages to carry it through competition and over time. What are the various possible types of such advantages at various levels of strategy? How can a company systematically analyse the multiple advantages it could possess and use them to achieve and maintain superior performance?

Answers to these questions can contribute to managers’ knowledge about the nature and content of competitive advantage at different levels of organisations. Such knowledge can help managers nurture, sustain and renew their company’s advantages more effectively through time.

In general, there are several levels of strategy associated with the strategic advantage of business organisations (as shown in figure 6.7):
• A corporate-level strategy defines the organisation’s purpose and the type of businesses in which it plans to operate, providing the overarching direction for the organisation. It also considers the structure of the organisation.
• A business-level strategy is the blueprint that should enable an organisation to leverage its resources in order to differentiate itself from the competition within a particular line of business. If an organisation only operates in one line of business, its corporate-level strategy and business-level strategy are effectively one and the same.
• A functional-level strategy serves to support the organisation’s business-level strategy by providing direction for the appropriate short-term activities required by each functional area to meet the goals established in the business-level strategy.
• A network-level strategy helps the organisation to form alliances with other companies for seeking valuable resources and information.
• A global-level strategy provides an opportunity for the company to develop overseas markets, especially when local markets have matured.

Consequently, having properly aligned strategies at corporate, business, functional, network and global levels aids an organisation in its efforts to accomplish its goals, thereby strategically positioning itself to successfully compete within the marketplace. An organisation must view strategies for developing and managing its employees as a part of its overarching corporate-level strategy if it desires to have highly differentiated and efficient human capital in today’s competitive, global environment.

Competitive advantage will always be established through one or more business-level strategies as well. Here, business-level strategies such as low cost or low-cost differentiation are required because, as discussed earlier, firms produce capabilities that attack cherished company positions. Other firms will always want to take market share away from those
who possess it. They do this through different combinations of business-level strategy inputs such as low cost/high quality or more product differentiation by including and designing more features. As much as firms build in competitive advantage, this is frequently counter-attacked (as shown in figure 6.6). For example, the innovator might respond with another dose of business-level strategy by either adjusting prices, adding new features, lowering costs in production cycles and, if the innovator is a smaller business, perhaps focusing on a niche market to capture new business. In chapter 7, we describe how these strategies unfold in different ways and how the value chain is one way of developing various responses to competitive attacks to existing products and services.

**Competitive advantage at the network level**

Companies cannot survive by themselves. They need at least suppliers and customers. Sometimes companies work together with other organisations to develop and enhance their competitive advantage. This type of inter-organisational cooperation is often done in the form of inter-organisational networks, which are informal collaborations that provide
A network strategy is a cooperative strategy used by several companies to form multiple partnerships based on shared objectives. A network strategy can provide access to greater resources than the member organisations could access on their own. Network strategies are an alternative to vertical integration and diversification, and have become central to competitive success in fast-changing global markets.

Resource exchange relationships are regarded as critical requirements of business organisations. The control and distribution of valuable resources is a major role played by inter-organisational networks, which facilitate the provision of valuable resources for the embryonic development of the new organisation up to its maturity. These networks can act as a resource to facilitate organisational development. It is viewed as a strategic mechanism to improve a company’s competitive advantage through cost minimisation while maintaining flexibility, thus allowing companies to economise on information costs and accelerate technological innovation.

Types of network relationships

The relationships within a business network can be very complex and multilayered. In general, there are four basic types of network relationship:

- **Upstream vertical (supplier) relationships.** These are the relationships of a company with its suppliers that provide raw materials, parts, machinery and services to the company.
- **Downstream vertical (buyer) relationships.** These are the relationships of a company with its buyers that purchase its products and services.
- **Direct horizontal (industry insider) relationships.** These represent the relationships of a company with its competitors in the same industry.
- **Indirect horizontal (industry outsider) relationships.** These are the company’s relationships with companies outside its industry.

Leadership strategy in networks

A typical business network comprises one or a few leading participants, with most of the rest being smaller companies. There are two leadership strategies in networks:

- **Keystone strategy.** Keystone leaders typically exercise a system-wide role in the networks by setting the rules and standards of the business operations. However, a keystone leader tends not to become overly dominant and leaves room for other network participants to operate their businesses. Microsoft is a good example of the keystone profile. While it remains the most influential player in software provision, its market capitalisation as a percentage of this domain has never gone above 40 per cent of the whole industry.
- **Dominator strategy.** A dominator is a leading company in a network, which tends to use its powerful position to extract as much value as possible from the network. Other smaller participants will eventually find the network unattractive. As a result of such domination, it will very likely diminish the attractiveness of the network to new entrants. Examples can be found in the microprocessor (Intel) and operating system (Microsoft) markets.

Companies that are not the leaders in their inter-organisational networks usually play the role of followers by participating in the majority of the network’s activities in terms of the provision of differentiated products and services. However, they must be careful not to become too tightly linked to the network and limit their opportunities of further development in other business networks.
Success at the network level

The biggest challenge of a successful network-level strategy is the combination of the internal and external competencies of the company in order to maximise the value gained from the business network. Participating companies will need to carefully consider the effective design and management of the complex marketplaces in the networks.

Inter-organisational networks can also promote social learning of adaptive responses, rather than other less productive forms of inter-organisational imitation. Inter-organisational networking involves a select, persistent, intertwined, yet structured set of autonomous companies engaged in offering products or services. 56

From networks to business ecosystem

Many companies develop and expand their operations and distribution through building up their own business networks. A business ecosystem is a well-developed network of suppliers and support organisations operating within a particular business environment, which collaborate in an economic web of relationships with a powerful company as the centre of the network. 57 Such a system is very effective because it can attract a diverse set of specialised participants with a wide range of capabilities willing to make their own specific investments in the business network to further enhance its value.

When there is a well-established business ecosystem in an industry, new competitors will find difficulties in entering the market. A company's choice of ecosystem strategy is governed primarily by the nature of its business as well as the business environment in which it operates (the general level of turbulence and the complexity of its relationships with others in the ecosystem). Strategy capsule 6.4 describes the various ways of creating strategic advantage in such a business ecosystem.

Business ecosystems and competitive advantage

Microsoft's and BHP Billiton's dominance in modern business has been attributed to many factors, ranging from the vision and drive of their founders to the companies' aggressive competitive practices. The performance of these two powerful companies derives from the success of their respective business ecosystems. These include networks of suppliers, distributors, outsourcing companies, makers of related products or services, technology providers, and a host of other organisations that are related to the company.

If a company faces rapid and constant change, a niche strategy by focusing on a narrowly and clearly defined business segment may be most appropriate. The company can develop its own specialised expertise, which will differentiate itself from
competitors and, because of its simple focus, foster the unique capabilities and expertise it needs to weather the turbulence of its environment.

If a company operates in a turbulent environment and is at the centre of a complex network of asset-sharing relationships, a keystone strategy may be the most effective. By carefully managing the widely distributed assets the company relies on, it can capitalise on the entire ecosystem’s ability to generate, because of its diversity, innovative responses to disruptions in the environment.

If a company relies on a complex network of external assets but operates in a mature industry, it may choose a physical dominator strategy. Because the environment is relatively stable and the innovation that comes with diversity is not a high priority, the company can move to directly control the assets it needs, by acquiring its partners or otherwise taking over their functions.

A physical dominator eventually becomes its own ecosystem, absorbing the complex network of interdependencies that existed between distinct organisations, and is able to extract maximum short-term value from the assets it controls. When it reaches this end point and has a commodity business in a mature and stable environment and operates relatively independently of other organisations, an ecosystem strategy is irrelevant — although that may change sooner than imagined.

If, however, a business chooses to extract maximum value from a network of assets that it does not control — the value dominator strategy — the business may end up starving and ultimately destroying the ecosystem of which it is a part. This makes the approach a fundamentally flawed strategy.58

Discrete and embedded organisations

While business networks obviously can help a company build up their competitive advantage, not every company chooses to be part of extended networks. There are organisational leaders who believe that companies should be primarily competitive in their relationships to all outside forces and they should remain independent and interact with other companies under market conditions. This view is described as the discrete organisation perspective.

Other organisational leaders believe that companies should build up more cooperative relationships with key organisations in their environment. They argue that companies can reap significant benefits by surrendering a part of their independence and developing close collaborative arrangements with a group of other organisations. This view is referred to as the embedded organisation perspective.

Remember that these two views are only extreme cases and most business organisations are between these two extremes. Sometimes businesses like to work with other companies in the form of networks, for instance, supplier cooperatives; at other times, they prefer to work alone. Therefore, the choice of perspective is a matter of strategic decision. Network strategies are further considered in chapter 9.

Competitive advantage from a global perspective

During the second half of the twentieth century, most barriers to international trade were removed and many companies began pursuing global-level strategies to gain a competitive advantage. However, some industries benefit more from globalisation than do others, and some nations have some comparative advantages over other nations in certain industries.
To create a successful global-level strategy, managers first must understand the nature of global industries and the dynamics of global competition.

**Sources of competitive advantage from a global-level strategy**

A well-designed global-level strategy can help a company to gain a competitive advantage. This advantage is based on the following objectives of a global-level strategy:

- **Extended customer base.** A company’s customer base is limited by the population and production capacity of industries in its home country. By exploring the global market, a company can significantly extend its customer base.

- **Innovation and learning.** A company can enhance first-mover advantage and become the only provider of a new product to a foreign market. It can also broaden learning opportunities due to the diversity of operating environments in other countries.

- **Efficiency in operations.** A global strategy can be built on the economies of scale from access to more customers and markets. A company can take advantage of another country’s resources, including labour, raw materials and expertise.

- **Flexibility.** A company can enhance its operational flexibility by shifting production or markets to another country. It can also extend the product life cycle so that older products can be sold in less-developed countries.

In order to achieve these objectives, a company pursuing an international strategy can build on the following sources of competitive advantage:

- **National differences.** Expanding into overseas markets can allow a company to exploit factor cost differences between countries. There are also learning and development opportunities arising from differences in management and organisation in different countries.

- **Scale economies.** The expansion into overseas markets provides an opportunity to achieve a more efficient production scale. Cost reduction is thus possible and the company can become even more competitive in offering cheaper products with equivalent quality in the home market.

- **Scope economies.** A company can enhance product diversification in the global market and, therefore, can share investment and costs among its overseas operations and develop shared learning across different activities.

**Types of global-level strategies**

In this era of globalisation, all companies have to be aware of global competition, even if they are not planning to expand their operation outside their home market. Even a local company has to understand global-level strategies used by multinational corporations whose penetration of a local market will change the competitive dynamics and capture a market share from local companies.

Nippon Express (see Strategy capsule 6.5) is an example of a global company that adapts its procurement and logistics strategies to each market. In both chapter 8 and chapter 11, we expand upon specific global strategies and how different company structures are often necessary for the implementation. So, a standardisation strategy of taking a homegrown product(s) in design, engineering and manufacturing to mass markets (e.g. Honda cars) is different from a global adaptation strategy of adapting products to suit the particular characteristics of different markets. For this chapter, our key focus has been on how competitive advantage is achieved in different markets. Another point is that global standardisation may require a global matrix structure and global adaptation of a multinational networked structure (see also chapter 10 for an explanation).
Nippon Express — competitive advantage through adaptation

Nippon Express operates a global network that covers the five key regions of Japan, the Americas and Europe, East Asia and South Asia/Oceania, and there is further potential for growth. Drawing on the integration of land, sea and air transportation, the company operates as a one-stop logistics consultant, connecting companies across national and regional boundaries through its procurement and distribution logistics services. Spread over its various business units — including rail, truck, marine, warehousing, air, heavy haulage and construction and incidental operations — the group’s total sales reach ¥1 billion annually. As a global company, with over 36,700 employees, Nippon Express has business units covering emerging economies as well as five main regions if does business in. Interestingly, Nippon divide their market into various emerging, growth, and mature markets in order to obtain competitive advantage within an industry with highly competitive product life cycles.

From a global perspective, the company uses adaptation (as distinct from standardisation) to pursue business strategies adapted to the special characteristics of each region. This is one form of competitive advantage through adaptation. To be more precise, in emerging economies, the company expands logistic networks and develops new bases, rolls out special projects adapted to each market and captures domestic distribution business in consumer regions. In growth markets such as those in Asia, there is a shift to further establish competitive advantage by expanding sales through specialist staff, enhancing operations in countries such as India and Vietnam, and by putting in place domestic transport networks. In mature markets where business sectors have more of a precarious advantage (see figure 6.4) — perhaps through existing distribution networks — Nippon Express has pushed towards expansion into new markets through the establishment of a Europe-wide sales organisation, directing enhanced efforts towards Russia, Turkey and the middle East, and by enhancing key businesses in logistics and intraregional truck transport businesses.

For Nippon Express — and for any global company — the key is to work out how to establish a competitive advantage in each market with unique characteristics. For example, in Japan where it is headquartered, the company is more likely to focus on business solutions offering quality and cost competitiveness since other companies are equally sophisticated in their ability to match resource inputs. Another interesting point is that competitive advantage is always based on resource units or strategic capabilities that can be realised in specific market circumstances. While Nippon Express has many key capabilities across the different businesses, in rail logistics these relate to energy saving, cost reduction, speed, and storage. In breaking storage down for instance, the company’s specific capabilities relate to its storage of containers at railway stations to enable adjustments of delivery dates and capability to avoid concentration of cargo collection during cargo-handling peak hours. So, global companies work hard at creating capabilities that enable competitive advantage in target markets with unique product/service and cost offerings and this will vary according to a company’s size, breadth of geographic coverage, and actual capability-enhancing advantage.
Creating competitive advantage in global markets is most likely related more to corporate strategy initially, until a firm is established. Nippon Express manages its businesses as related strategic business units (see chapter 8) but this would not be so if they start acquiring or setting up new unrelated businesses. For Nippon Express, strategies used in market development are related since they are not moving away from their core businesses of distribution and procurement. However, unrelated corporate strategies include expansion into new unrelated markets, away from the company’s existing business. Figure 6.8 illustrates some key strategies to create competitive advantage in unrelated industries. For instance, temporary (in some cases, permanent) advantage is gained by transferring existing capabilities to new markets. Organisations can exploit the new market when they are more efficient than those that currently exist in that market. That is, they use their capabilities to exploit the market opportunities. Similarly, they can use a range of product and service capabilities across their product portfolios of existing businesses to fend off rival counterattacks. Most assuredly, when new companies seek to enter a new market, they will receive a counterattack from existing ones since the latter do not want to lose established market share positions.

Drivers for diversifying into new, unrelated markets

- **Economies through scope**
  - By transferring existing skill and capabilities
  - Economies gained

- **Clever and skilled corporate managers**
  - Transferring skill
  - Corporate level competencies

- **Exploitation**
  - More efficient than what the market offers
  - Exploiting what you are good at

- **Market power**
  - Using range of products across portfolio to fend off competitors
  - Can use strengths from one business to another

**FIGURE 6.8** Competitive advantage in unrelated diversification

**Developing global market entry methods**

An important part of a global-level strategy is the method that the company will use to enter the foreign markets. There are four possible methods of global market entry:

- **Exporting.** There are two ways to export: selling products or services directly to an international company or customer, or indirectly by using export agents or intermediaries that include commissioned agents, distributors and export or trading companies.
• **Licensing (includes franchising).** Licensing is a contractual arrangement that gives rights to operate under another’s trade mark name and using their business processes. In return, the trade mark owner receives marketing benefits and earns royalties on the sale of that product or service.

• **Joint venture.** A joint venture with an already established overseas business may be the most effective way to gain entry into a foreign market. These are local businesses that know the market and have a distribution framework in place, meaning less capital is required.

• **Foreign direct investment.** Foreign direct investment requires establishing a company’s own facility under its direct supervision. The cost is high and the company has to bear all the risks of the operations in the overseas subsidiaries.

**SUMMARY**

Making money in business requires establishing and sustaining competitive advantage, which depends critically on the presence of some imperfection in the competitive process. Under perfect competition, profits are transitory. The relationship between strategies and competitive advantage needs to be considered at different levels, such as corporate, business and functional, as well as network and global levels. Competitive advantage can also be considered further in terms of industry life cycle and levels of strategies. Various stages in the industry life cycle — the introduction, growth, mature and declining stages — present challenging environments for the formulation and implementation of business strategies.

To compete in different markets and to pursue different levels of strategies, important and valuable resources and capabilities are required. There is a clear need for accessing resources and information, reducing production and transaction costs, and adopting appropriate strategies. Competitive advantage is the base on which companies can compete in the market.

**PRACTISING STRATEGIC MANAGEMENT**

**SELF-STUDY QUESTIONS**

1. What is competitive advantage? How can a company build its competitive advantage?
2. Describe the different stages of industry development.
3. What are various ways of expanding a company’s business internationally?
4. How would you describe corporate-level competitive advantage?

**DISCUSSION QUESTIONS**

1. Figure 6.1 implies that stable industries in which companies have similar resources and capabilities offer less opportunity for competitive advantage than industries where change is rapid and companies are heterogeneous. Select examples of these two types of industry, and look for any evidence that intercompany profit differences are wider in dynamic, heterogeneous industries than in stable, homogeneous industries.

2. Businesses in fast-cycle markets will have different differentiation features and influences than those in standard-cycle markets. List some of the features in each and discuss the differences.

3. Australian Discount Retail (a discount store), Jusco (a Japanese grocery discount retailer), and Primark (a UK discount clothing chain) have pioneered ‘cheap chic’ — combining discount store prices with fashion appeal. What are the principal challenges of designing...
and implementing a ‘cheap chic’ strategy? Design a ‘cheap chic’ strategy for a company entering another market, for example, restaurants, sports shoes, cosmetics or office supplies.

4. The large German manufacturer of surgical equipment B Braun has been established in Malaysia for quite some time. Given that German engineering represents some of the most advanced processes in the world, why would B Braun be interested in Malaysia? What competitive advantages will the company produce?

5. Consider the changes that have occurred in a comparatively new industry (e.g. wireless communications, video game consoles, medical diagnostic imaging, PDAs, online auctions, bottled water, courier delivery services). To what extent has the evolution of the industry followed the pattern predicted by the industry life cycle model? At what stage of development is the industry today? How is the industry likely to evolve in the future?

6. Department stores (e.g. Anthony Horderns in Sydney, FitzGerald’s Department Stores in Tasmania, Sogo in Japan) are facing increasing competition from specialised chain retailers and discount stores. What innovative strategies might department stores adopt to revitalise their competitiveness?

**EXERCISES**

1. Identify at least five products that you purchased in the past week. Are the companies that produce these products market leaders or followers? At which stages of industry life cycle are these five products? Identify at least two competitors of each of these five products and try to explain how they compete with each other.

2. Imagine that you are the CEO of a commercial bank. Your bank has recently considered expanding its business both locally and internationally. You are required to organise a consultative meeting with the functional managers of various departments such as the loans, marketing and accounting departments. Prepare a short speech with a view to convincing these functional managers to work more efficiently and effectively with you.

3. Form a small group with two or three peers. Select a newspaper or academic article that discusses how a certain company responded to drastic changes in the market. Why and how did this company manage to change its strategies? Identify some of the possible competitive advantages that this company tries to explore or maintain.

4. Perform an online search of some major competitors in a specific industry (e.g. garments, toys or banking).

How do these companies compete in the selected industry? What are the possible competitive advantages each player has?

5. Visit Central Group’s website (www.centralgroup.com) and examine the company’s global-level strategies. List as many competitive advantages you can see related to business-level strategy (such as differentiation and low cost) versus corporate-level strategy competitive advantage (such as new products into new markets). What kind of resource inputs exist in the group? How does the company leverage its capabilities to create new competitive advantage? Draw up a table with two columns — one with existing capabilities, the other with new capabilities — and compare the two. What has this told you about competitive advantage?

6. Explore the website of the National Australia Bank (NAB), www.nab.com.au. What does this website tell about the bank’s business and strategy, especially its personal and business banking operations? Now, compare this site with that of the Commonwealth Bank of Australia, www.commbank.com.au. How do these two banks differ and in what ways are they similar?

7. Go to the website of the World Economic Forum, www.weforum.org, and look for its Global Competitiveness Report. Identify two countries (e.g. Australia and Japan) and compare them based on the 12 pillars of competitiveness as proposed in the report. Based on these 12 pillars, how should each of the countries you’ve selected improve their competitiveness?

**FURTHER READING**


ENDNOTES

2. ibid.
3. ‘Central Group shops for assets overseas,’ CNBC, 8 June 2012.
21. ibid.
22. ibid., p. 1402.
30. op. cit., note 20.
32. ‘When Apple’s Lawsuits get more coverage than Apple’s Products’, Technightowl.com, 14 February 2012.
33. ibid.
41. ibid.
42. ibid, note 40.
43. See CK Prahalad and G Hamel, Strategic Intent. The authors in this article talk about how some companies do not play by the existing rules of the industry. In this case, Chinese motorcycle manufacturers have invented their own system of production which is different to the one imposed on them initially by Japanese producers.
44. ibid, note 26.
58. ibid.