MG3212 Strategy

Competitive Advantage

Overview of the Session

- Review
  - Competitive Advantage
- Learning Activities
  - Assignment–Problem Set (Conceptual Questions)
- Wrap-up

Review

Competitive Advantage

Reminder

Reminder: To propose/evaluate an Strategy we need to

– Evaluate the opportunities and threats that are present in a firm's environment (*Positioning*)

- *Competitive analysis*: Understand how competitors interact.
- *Strategic Positioning:* Understand how to develop a sustainable competitive advantage.

Main Insight #1:

"Ex-post competition crowds out ex-ante competition"

– Evaluate the strengths and weaknesses of the firm's internal environment (*Capabilities*).

- Internal Organization: What are the challenges to get members of the organization to devise/execute?
- Boundaries of the Firm: Would I be more effective if I integrate with my competitor/supplier?

Next topics on strategic positioning (differentiation and focus strategies)

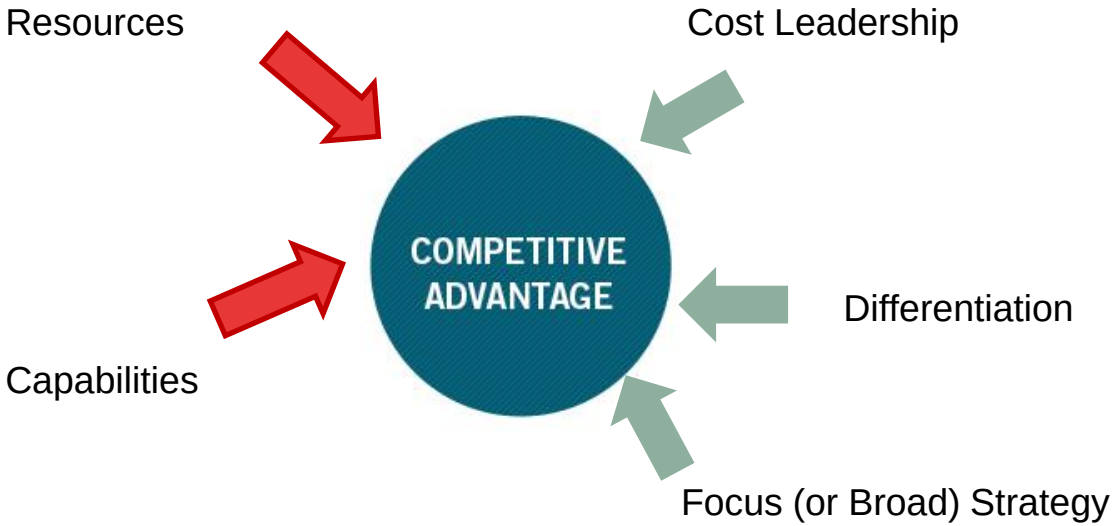
From Industry-Level to Firm-Level Analysis

Industry-level analysis (intensity of rivalry)
How does rivalry threaten profitability? What are the sources of inter-industry variability on average profits?

Quantitative Analysis (Economic Models) on product-market competition

Qualitative framework: *Five Forces Analysis* (channels through which rivalry threatens profitability other than product-market competition)

Intra-industry analysis: *Why are some firms within an industry more profitable than the average firm? What are the sources of competitive advantage?*



Resource-based View of the firm

Strategic Positioning

Competitive Advantage

- **Competitive Advantage**: Ability of a firm to be consistently more profitable than the average competitor in the same market or industry.

- Profits that arise from the following sources do not signify competitive advantage:
  - Luck, randomness, or a windfall
  - Cyclical fluctuations or fads that favour one firm
  - Temporary market imperfections

- **Persistent performance** differences are typically a result of firms enjoying a competitive advantage

Measuring Competitive Advantage

- **Does Competitive Advantage exist?**
  - We need a measure for competitive advantage: **productivity**
- **Productivity** is the ratio of output obtained (units/£) to inputs used (units/£).
- We can measure the productivity of each input (capital, labour, raw materials).
  - The main challenge when comparing productivity across firms: firms operate at different scales
- Researchers focus on **total factor productivity (TFP)**: the ratio of outputs under the hypothetical scenario that both firms were using the same inputs.
- Not talking about profitability, but rather productive efficiency; the relationship is not perfect, but highly productive firms are typically very profitable.

Total Factor Productivity

- Total Factor Productivity typically defined by

$$Y_t = A_t K_t^{\alpha_K} \, L_t^{\alpha_L} \, M_t^{\alpha_M}$$

  - K_t , L_t , M_t are capital, labor and intermediate materials in period t.
  - **A_t is TFP in period t**.
    - TFP scales output for fixed inputs.
    - **TFP is a residual**: whatever affects output and is not accounted for in K_t , L_t , M_t .
    - TFP is the intercept in a log regression of capital, labor and raw materials.

Evidence of Productivity Differences

- Researchers have found **large productivity differences across firms**, even within **narrowly defined industries**.
  - Reported in every country, industry, and time period explored
  - Question: How narrow is “narrowly defined”?

- Large productivity differences: The typical **90–10 percentile** of TFP in narrowly defined industries is at least two-to-one.
  - Line up industry producers according to TFP; the 90th-percentile producer obtains twice as much output from the same measured inputs as the 10th-percentile producer
  - In China, the ratio is more like three-to-one
  - In India, the ratio is more like five-to-one

Sources of Competitive Advantage

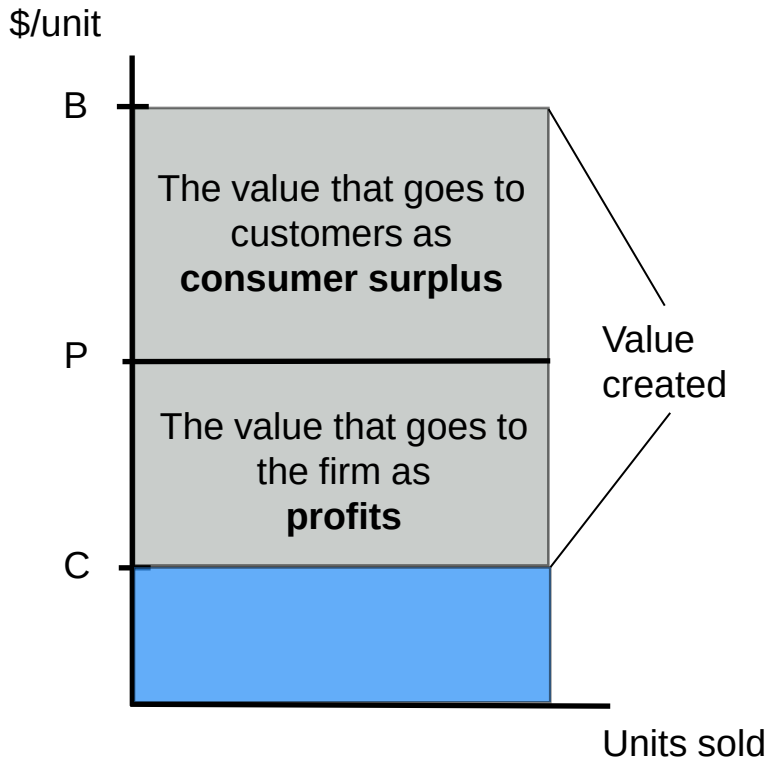
- *What are the sources of competitive advantage?* Two (complementarity) views:
  - **Resource-Based View** (RBV) of the firm: competitive advantage is the result of the presence of certain resources that allow a firm to develop superior capabilities
    - Resources that support a sustainable competitive advantage must be Valuable, Imperfect Imitable, its returns are appropriable and confer an early-mover advantage.
  - **Strategic Positioning:** competitive advantage is the result of the adequate positioning with respect to rivals to exploit the firm's capabilities.
    - Strategic positioning reflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals.
    - To exploit its competitive advantage, a firm can follow a *cost-leadership* strategy, a benefit strategy through *differentiation*, or a *focus strategy* (by focusing on a niche market).

The Resource-Based View of the Firm

- **Characteristics of Sustainable Advantage:** strategies that will generate sustainable C.A. are often developed around resources and capabilities that exhibit four characteristics
  1. **Heterogeneity**
     - Something different from what competitors are doing
  2. **Imperfect imitability**
     - Something competitors and entrants cannot perfectly replicate
  3. **Appropriability**
     - Something from which the firm can capture value
  4. **Early-mover advantage**
     - Something whose value the firm recognised before competitors or potential entrants did

Strategic Positioning

- Competitive advantage arises from focusing the use of assets in activities that better create and/or capture value relative to the rivals.

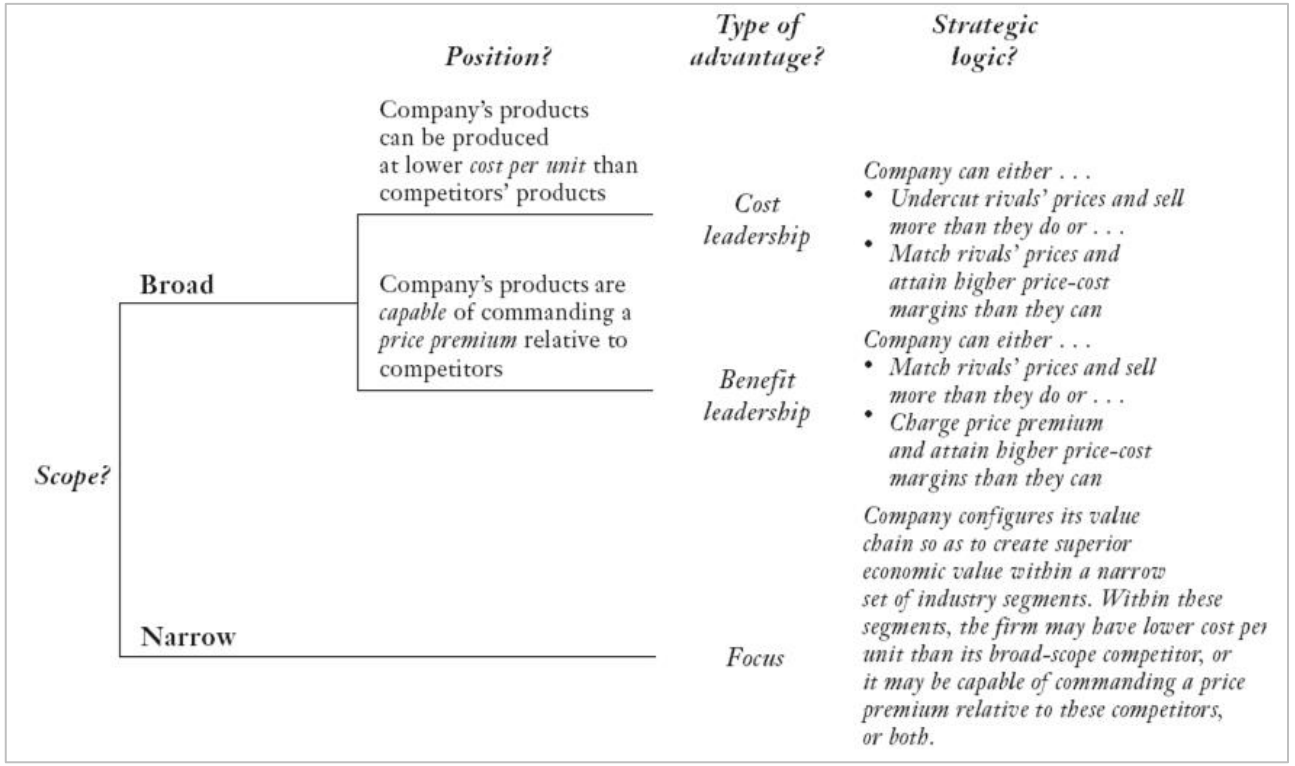


A firm could focus on activities that:

- decrease costs,
  → ***Cost-based advantage***
- increase benefits, or
  → ***Benefit-based advantage***
- cater to a particular group.
  → ***Focus-based advantage***

Porter's Generic Strategies

- A firm's **generic strategy** describes how it positions itself to achieve a competitive advantage.
- A competitive environment also shapes the competitive respond of rivals to a firms choice of strategy.



Zara - Fast Fashion Pioneer

Zara, part of the Inditex group, is a globally renowned fast-fashion retailer. Unlike many competitors, Zara focuses on speed and responsiveness in its supply chain. It designs, produces, and distributes new collections in as little as two weeks, allowing it to react quickly to changing fashion trends. Zara produces most of its goods in-house or through closely managed suppliers, which is uncommon in an industry where outsourcing is the norm.

The company employs a resource-based view to leverage its unique resources and capabilities, such as its vertically integrated supply chain and advanced information systems. Zara also positions itself as a provider of trendy yet affordable clothing, appealing to a broad customer base.

Zara - Fast Fashion Pioneer

Resource-Based Strategy

Identification of Resources and Capabilities:

1. What key resources and capabilities give Zara a competitive advantage?
2. How do Zara's resources meet the VRIO criteria (Valuable, Rare, Inimitable, and Organized)?

Analysis of Value Creation:

1. How does Zara's vertically integrated supply chain contribute to its competitive advantage?
2. Why is Zara’s ability to produce and deliver new trends quickly critical in the fast fashion industry?

Zara - Fast Fashion Pioneer

Strategic Positioning

Positioning in the Industry

1. How does Zara's strategic positioning differ from competitors like H&M and Gap?
2. Does Zara compete on cost, differentiation, or both? Justify your answer.

Trade-offs:

1. What trade-offs has Zara made to achieve its strategic positioning?
2. How might these trade-offs affect Zara’s long-term competitiveness?

Zara - Fast Fashion Pioneer

Sustainable Competitive Advantage

Sustainability of Advantage

1. To what extent is Zara’s competitive advantage sustainable in the long term?
2. What external factors (e.g., competition, changing consumer preferences, technological advancements) could threaten Zara’s competitive advantage?

Adaptability and Future Strategy

1. Zara is increasingly being scrutinized for sustainability concerns. How might environmental pressures impact Zara's fast-fashion model?
2. What steps can Zara take to ensure it remains competitive while addressing sustainability concerns?

Zara - Fast Fashion Pioneer

Porter's Generic Strategies

Generic Strategy Analysis

1. Which of Porter’s generic strategies does Zara follow: Cost Leadership, Differentiation, or Focus? Provide evidence to support your analysis.
2. Can Zara successfully maintain its current strategy, or should it shift to a hybrid model?

Competitor Analysis

1. Compare Zara’s strategy with a competitor that follows a different generic strategy (e.g., Primark with cost leadership or Burberry with differentiation).
2. How do these strategies shape their competitive advantages and challenges?

Application: Assignments

Problem Set
(Competitive Advantage)

Questions 1 and 2

Review: Any Questions?

Any Questions before we move on?

Assignment–Problem Set: Competitive Advantage

Questions 1 (a, b, c) and 2 (a, b, c)

Assignment–Problem Set: Competitive Advantage

Question 1

Answer the following questions:

a. What is competitive advantage?

b. What are the four characteristics of strategies that generate a sustainable competitive advantage? Briefly describe each characteristic.

c. What is co-specialization? Explain how it makes it harder for other firms to imitate a firm's sources of competitive advantage. Give a brief example of how co-specialization allowed a particular firm to support a sustainable competitive advantage.

Assignment–Problem Set: Competitive Advantage

Solutions

Q1.a *Competitive advantage* is the ability of a firm to consistently outperform (i.e., obtain higher profits) than the average firm in its industry.

Q1.b *Four Characteristics:* Heterogeneity; Imperfect Imitability; Appropriability; Early-Mover Advantage.

Q1.c *Co-specialization* (i.e., fit or mutual reinforcement) means that a firm cannot obtain the same benefit from replicating a few of the resources on which competitive advantage is based (as it would need to successfully imitate ALL resources).

Example: Apple's devices and services are mutually-reinforcing as the value of a device (like the iPad) is substantially enhanced by on-the-net storage and synchronization services (iCloud), a media entertainment service (iTunes) and productivity apps that work across all apple devices.

Assignment–Problem Set: Competitive Advantage

Question 2

Discuss the following statements:

a. "BP employs many engineers. This fact grants BP a competitive advantange."

b. "It is a stylized fact that there is little variation in the productivity of firms for a given industry, although there is large variation in firms' average productivity across industries, i.e. intra-industry productivity variation is low while inter-industry productivity variation is high" Discuss with reference to available evidence.

c. "Pfizer has good scientists and this fact grant Pfizer a competitive advantage."

Assignment–Problem Set: Competitive Advantage

Solutions

Q2.a *False:* hiring engineers is a necessity for all firms, rather than an element of competitive differentiation between them.

Q2.b *False:* there is empirical evidence that both intra- and inter-industry dispersion is large (see, for example, Syverson, 2011)

Q2.c *False:* any resource that is *necessary* to even be in an industry would not confer a firm with a competitive advantage. This is the case of scientists, as all pharmaceutical companies that develop drugs must rely on scientists to do so.

- Note that a different answer could be given if the statement were “Pfizer has better scientist than the typical company”.

Wrap-up

Wrap up and Main Takeaways

- Competitive Advantage is about consistently outperforming the average firm in the industry

- What Competitive Advantage is NOT
  - *Attractive industry characteristics*
  - *Barrier to entry, few substitutes, commodity suppliers, etc*
  - *Mere differences*

Wrap up and Main Takeaways

- Competitive advantage is not necessary for a firm to be profitable, just required for a firm to be more profitable.
  - It is not true that all firms have a competitive advantage.
    - *It can't be that all firms exhibit consistently above-average profits.*
    - *In an attractive industry, many "average" firms will still be profitable.*
  - Not everything a successful firm does is key to its competitive advantage.

Any Remark/Questions?

Any Remark/Questions?

Next Topic

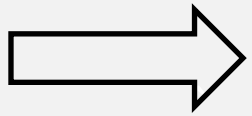
Next Topic: Cost Advantage

- In the next topic,
  - We will start analysing how firms position themselves to compete with their rivals.
  - We will consider strategic positioning based on **cost leadership**. What are the cost drivers? What are the economic implications of cost leadership? What are the conditions needed to exploit a cost advantage?

Next Topic: Cost Advantage

Topic

- Strategic Positioning: Cost Advantage



Assignments

- Assignment–Problem Set: Cost Advantage