

# Chapter 06

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## Building Competitive Advantage

# Success and Strategy

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- Within an industry some companies outperform others.
  - **What** is the basis of their competitive advantage?
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# Competitive Advantage

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- Occurs when a company's profitability is **greater** than the **industry's average** profitability
  - Competitive advantage over several years is considered ***Sustained***
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# Company Profitability

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Two basic conditions:

- Amount of Value that customers place on a good or service
    - Value creation is at the heart of competitive advantage
    - The greater the value customers place on a product, the more the company can charge.
    - A product's price is usually less than the value placed on it by the average customer. Why? Impossible to segment market to the degree that one captures each consumers reservation price
    - This causes customers to capture consumer surplus.
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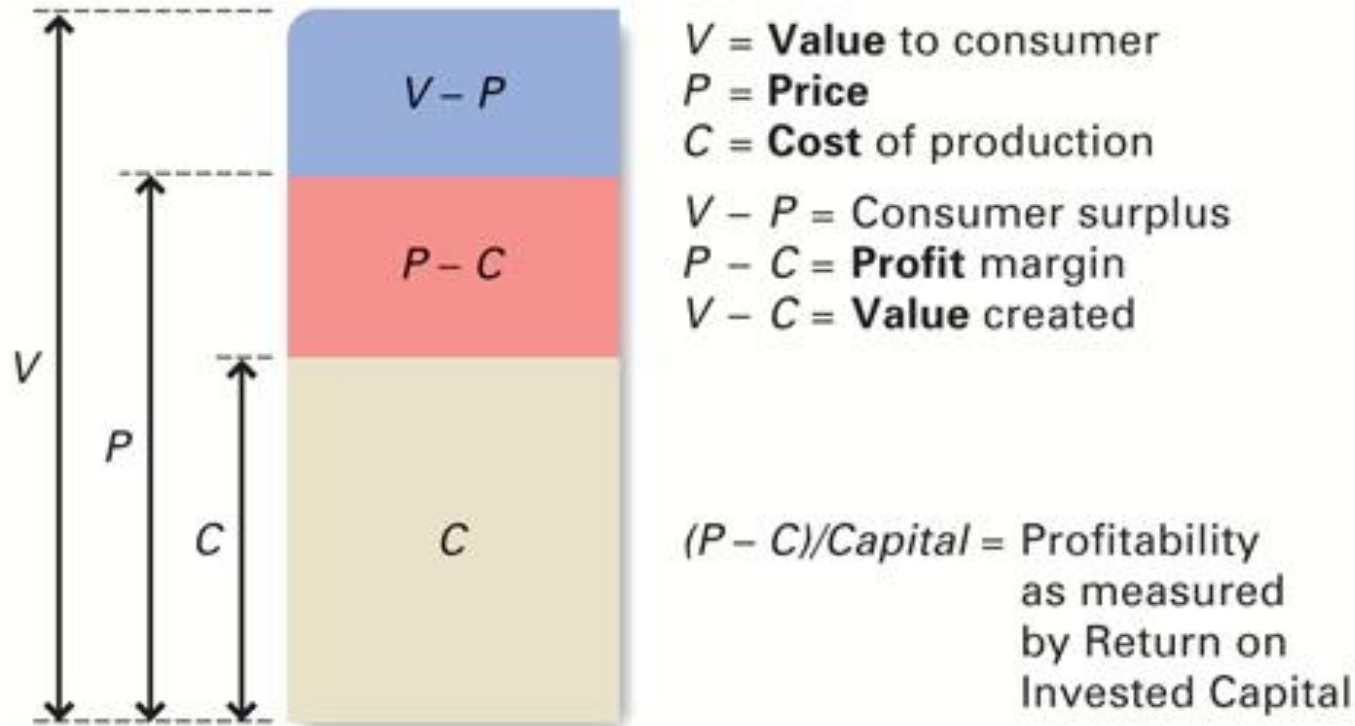
# Company Profitability (cont'd)

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- The company's cost of production
    - A company will look for ways to increase productivity of capital and labor through:
      - Economies of Scale
      - Spread fixed cost over large product volume
      - Greater division of labor and specialization
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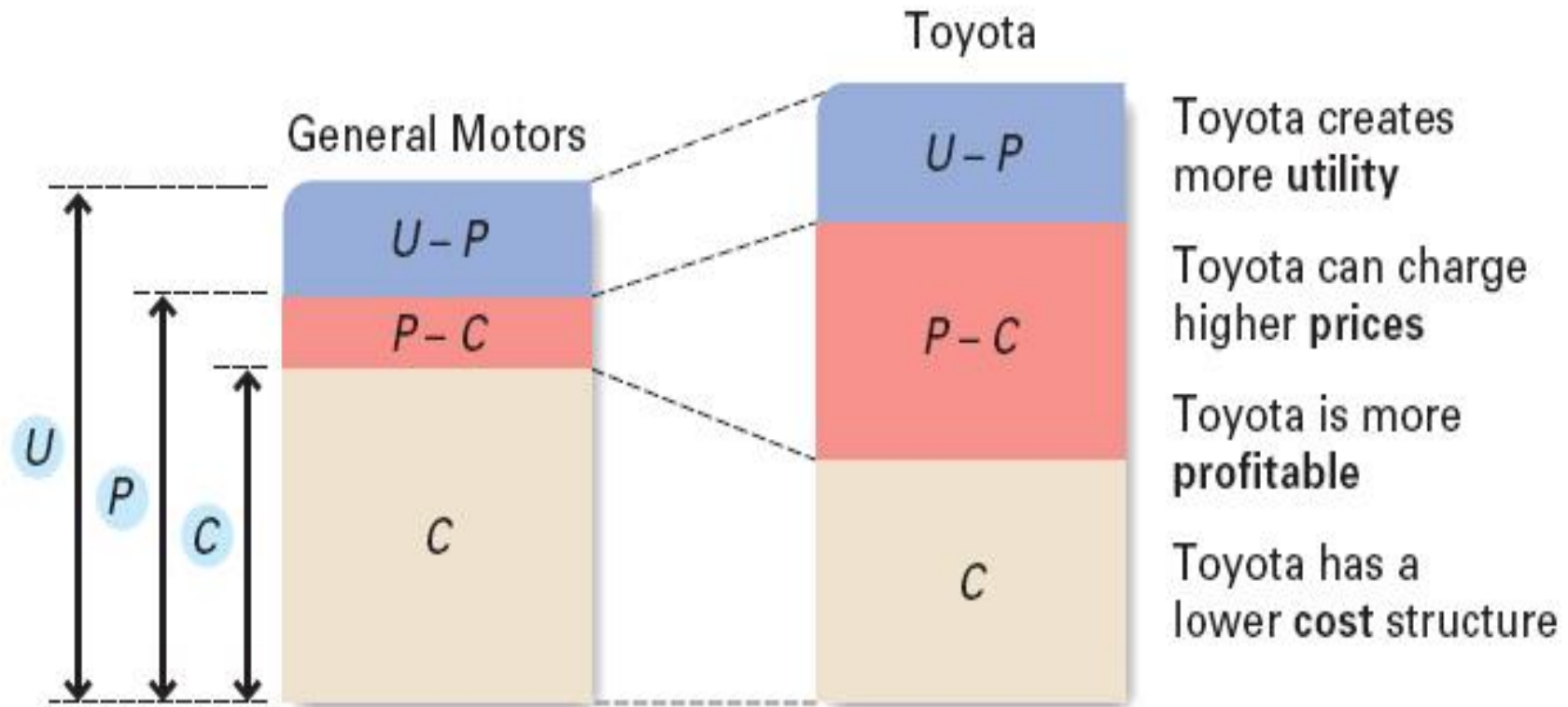
# Figure. Value Creation

**What 2 ways exist to create more value for the customer?**



- **A company that has high profitability = competitive advantage, when it creates more value for its customers than do rivals**
- **How do you create value?**

# ... Comparing Toyota and General Motors



# Two Basic Strategies for Creating Value

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- Low Cost- Drive down cost structure
  - Differentiation- Consumers value the product and are willing to pay a premium price
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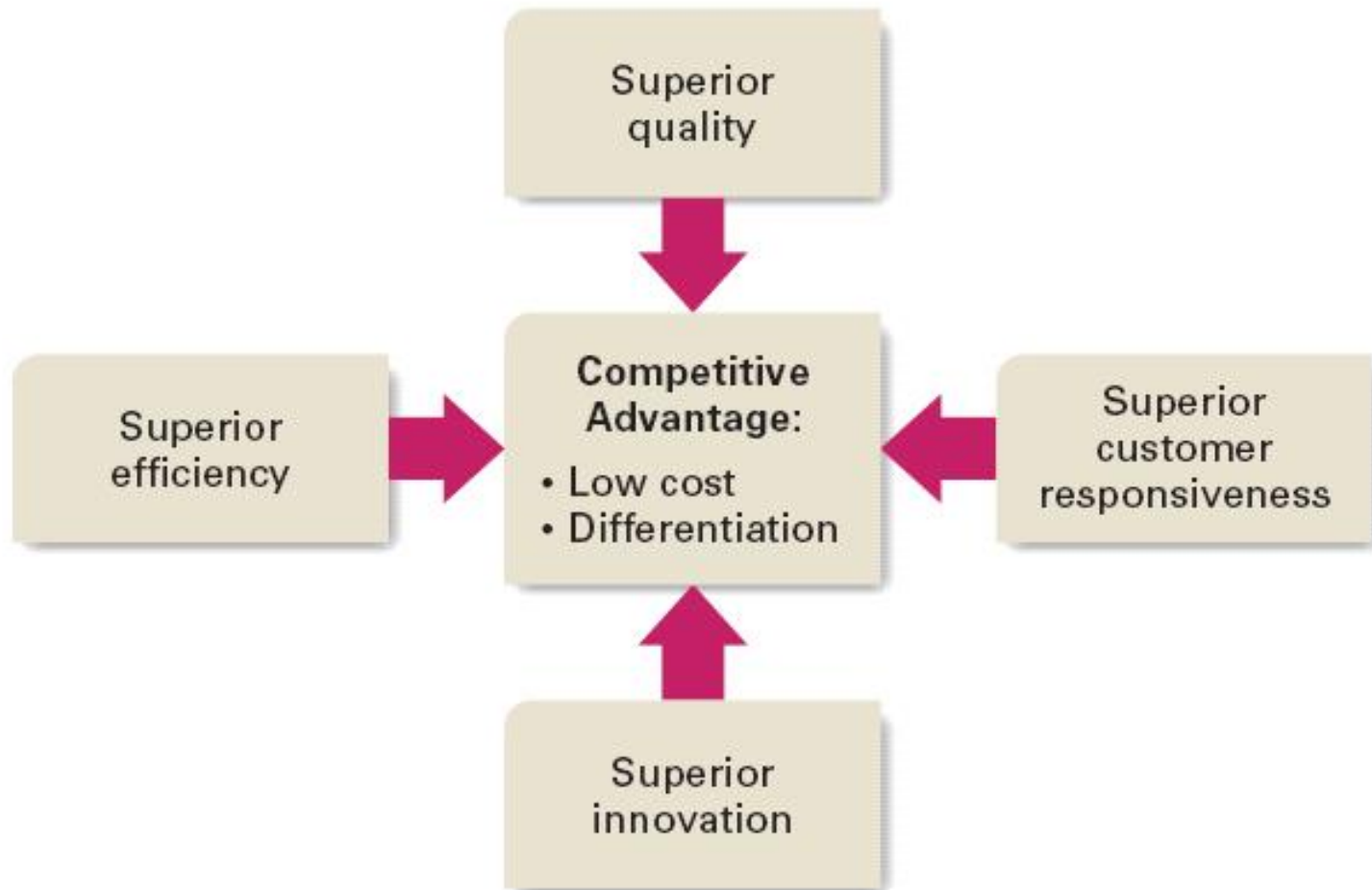
# Building Competitive Advantage

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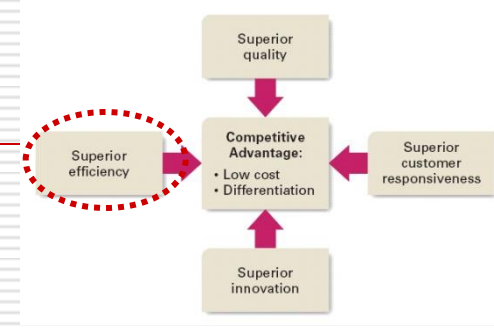
- **4 Factors** – building blocks of **competitive advantage**:
    - Efficiency
    - Quality
    - Innovation
    - Customer Responsiveness
  
  - These are the generic building blocks of competitive advantage that any company in any industry can adopt.
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# Building Blocks of Competitive Advantage

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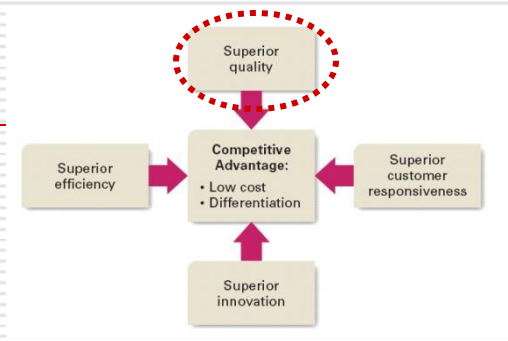
# Efficiency



- **Efficiency** = outputs/inputs
- **2** of the most important component of efficiency are:
  - **Employee Productivity**: output per employee
  - **Capital Productivity**: Output per unit of investment capital
- The concept of productivity is not limited to employee and capital productivity, **what are types of productivity exist?**
- High Productivity = greater efficiency and low costs

# Quality as Excellence

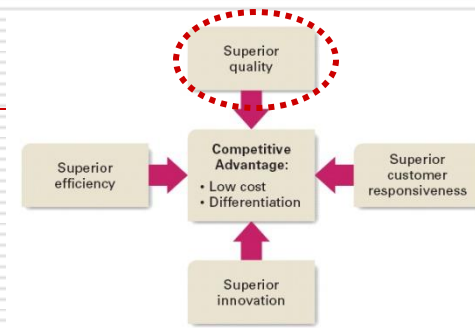
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- Superior Quality: customers perceive attributes of a product to be better than rival's attributes
  
  - 1° type of quality: Excellence: when excellence is built into product offering, consumers have to pay more to own or consume the product
    - Design
    - Style
    - Aesthetic appeal
    - Features and functions
    - Level of service that comes with the product
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# Quality as Reliability

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□ 2° type of quality: reliability

□ A product is reliable if it:

- Consistently does the job it was designed for

- Does the job well

- Rarely, if ever, breaks down

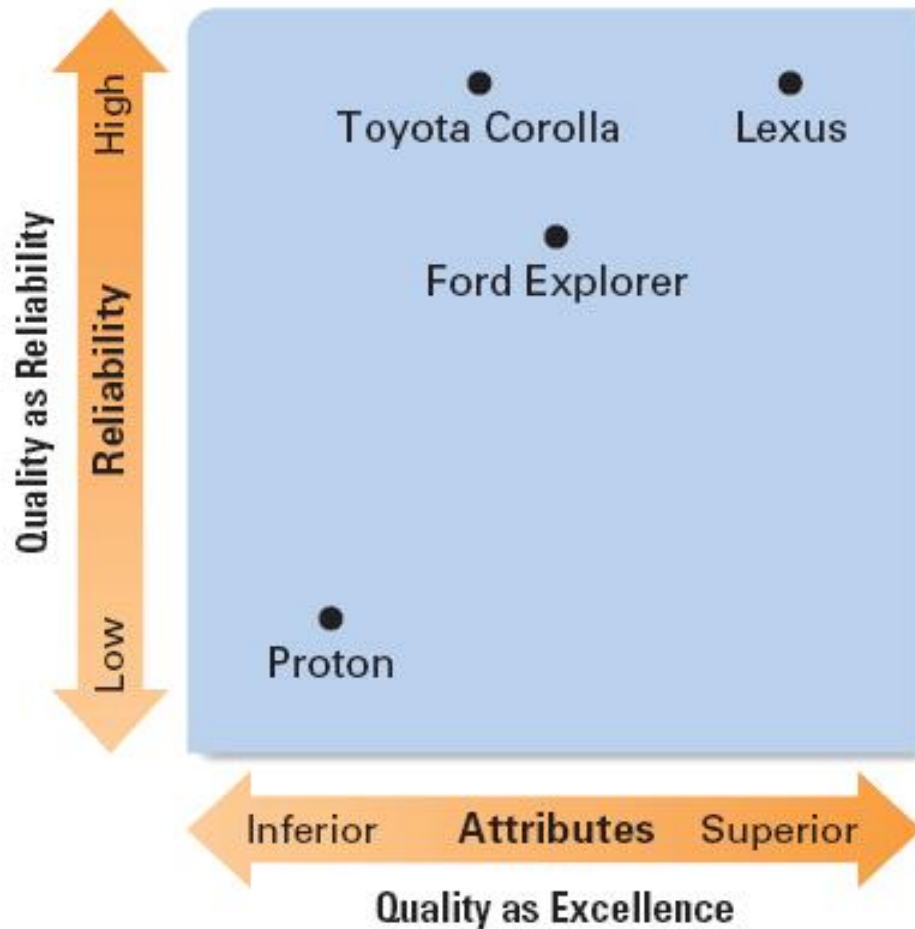
□ Less time is spent of defective products and fixing mistakes

□ Reliability increases the value a consumer gets from the product and increases the price that the company can charge

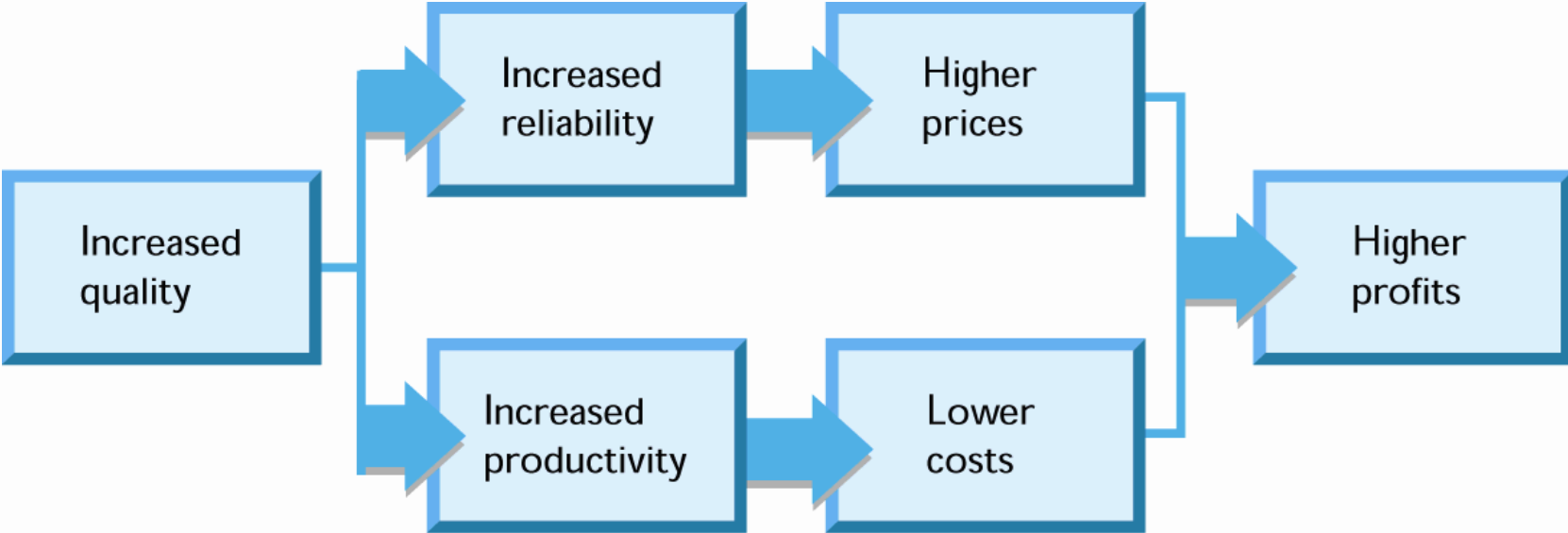
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# A Quality Map for Automobiles

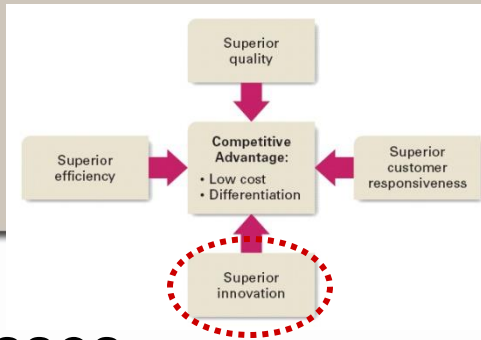
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# The Impact of Quality on Profits

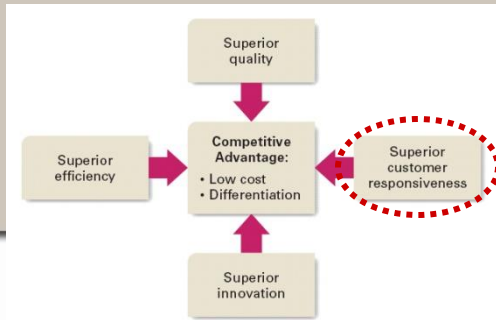


# Innovation



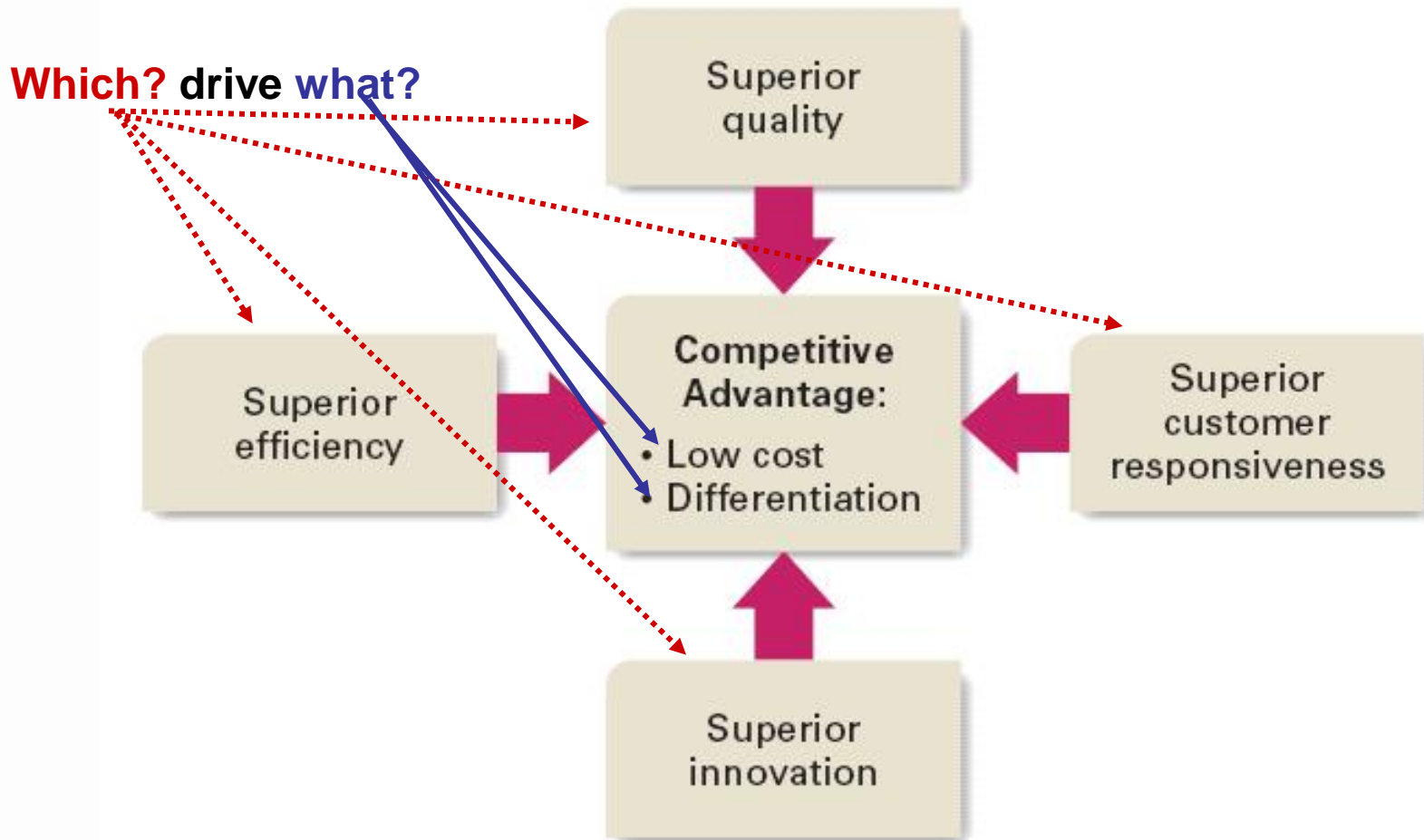
- The act of creating new products or processes
- Product Innovation- The development of products that are new to the world or have superior attributes to existing products.
- Process Innovation-The development of a new process for producing products and delivering them. **Example:** *Toyota lean production system: JIT inventory systems, self-managing teams, reduced set-up times for complex equipment)*
- Competition can be seen as a process driven by innovation
  - Innovations give a company something *unique* that their competitors lack : diving either differentiation or cost advantage

# Customer Responsiveness

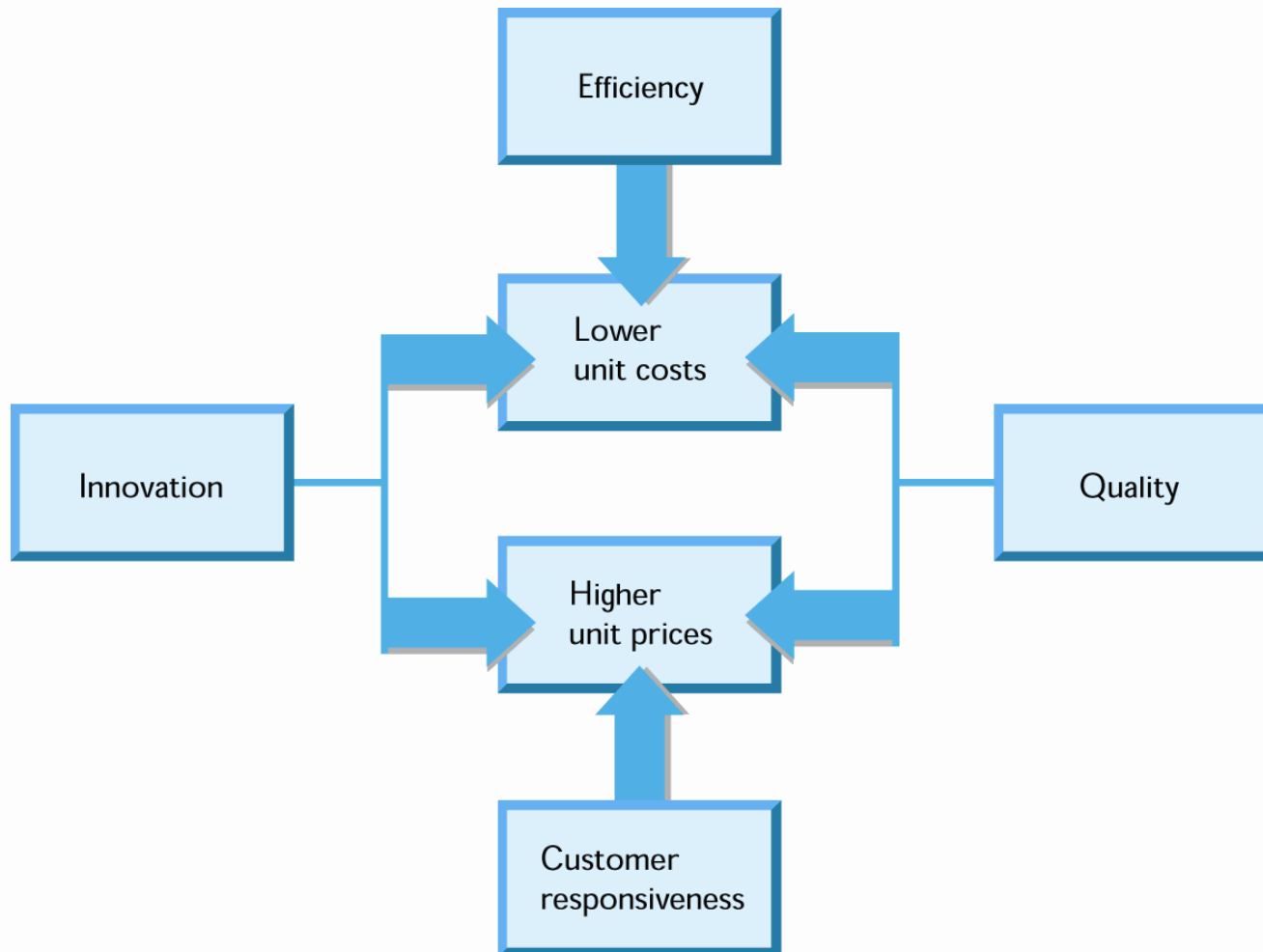


- Superior customer responsiveness implies being better than competitors at identifying and satisfying customers' needs, **thus**;
- If a customer's need is satisfied better by a certain product, the customer will attribute more value to the product. **therefore**:
- More value creates a differentiation and ultimately a competitive advantage
- **Why is this not the same as innovation and superior quality?**
- Other issues: customization, customer response times

# Figure 4.3: Building Blocks of Competitive Advantage



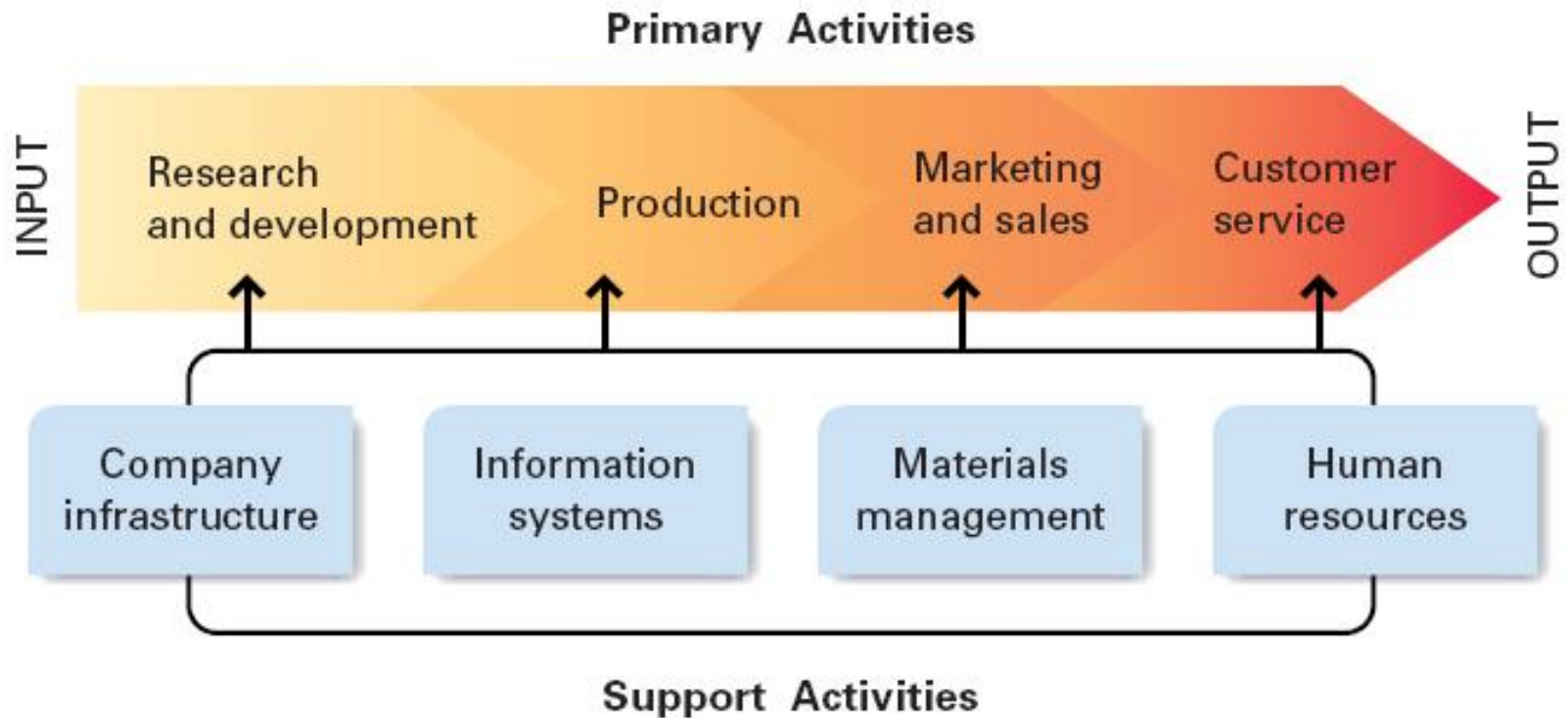
# The Impact of Efficiency, Quality, Innovation, and Customer Responsiveness on Unit Costs and Prices



# The Value Chain

- Idea that a company is a chain of activities for transforming inputs into outputs that customers value
- Composed of functional groups, each of which contribute to either driving down cost and/or increasing the perception of value through differentiation
- Consists of *primary* and *support* activities

# The Value Chain



# Primary Activities

- Research and Development
- Production
- Marketing and Sales
- Customer Service

# Support Activities

- Provide inputs for primary activities
  - a. Material Management (logistics)
  - b. Human Resources
  - c. Information Systems
  - d. Company Infrastructure
- **Why do we need to understand the Value Chain?** Because it is somewhere there that we will be able to create competitive advantage!

# Functional Level Strategies

- Managers pursue improvement in business functions by:
  - a. Increasing efficiency
  - b. Increasing quality
  - c. Increasing innovation
  - d. Achieving superior customer responsiveness

# Functional Level Strategies

- Increasing efficiency
  - a. R&D
  - b. Production (EOS, learning effects, flexible manufacturing technology / lean production, mass customization)
  - c. Marketing (customer defection rate)
  - d. Materials management
  - e. H&R (self managing teams)
  - f. IT
  - g. Infrastructure (structure, culture, style of strategic leadership and control system)

# Functional Level Strategies

- Increasing quality
  - a. Attaining superior reliability (Quality improvement methodology – six sigma (TQM))
  - b. Improving quality as Excellence (deciding where to put emphasis)

# Functional Level Strategies

- Increasing innovation
  - a. High failure rate of innovation
  - b. Reducing innovation failures
- Achieving superior customer responsiveness
  - a. Customer focus
  - b. Satisfying customer needs (customization)

# Distinctive Competencies

- A **unique firm-specific strength** that allows a company to better *differentiate* or achieve *lower cost* than rivals
- Arise from Resources and Capabilities

# Resources

- Financial, physical, social or human, technological, and organizational factors that create value to customers.
- Can be ***Tangible*** or ***Intangible***  
Example:  
Tangible = land, building, equipment  
Intangible = brand names, reputations, knowledge
- The more firm specific and difficult to imitate a resource is, the more likely it is to constitute grounds for a distinctive competency
- Obviously needs to be valuable!

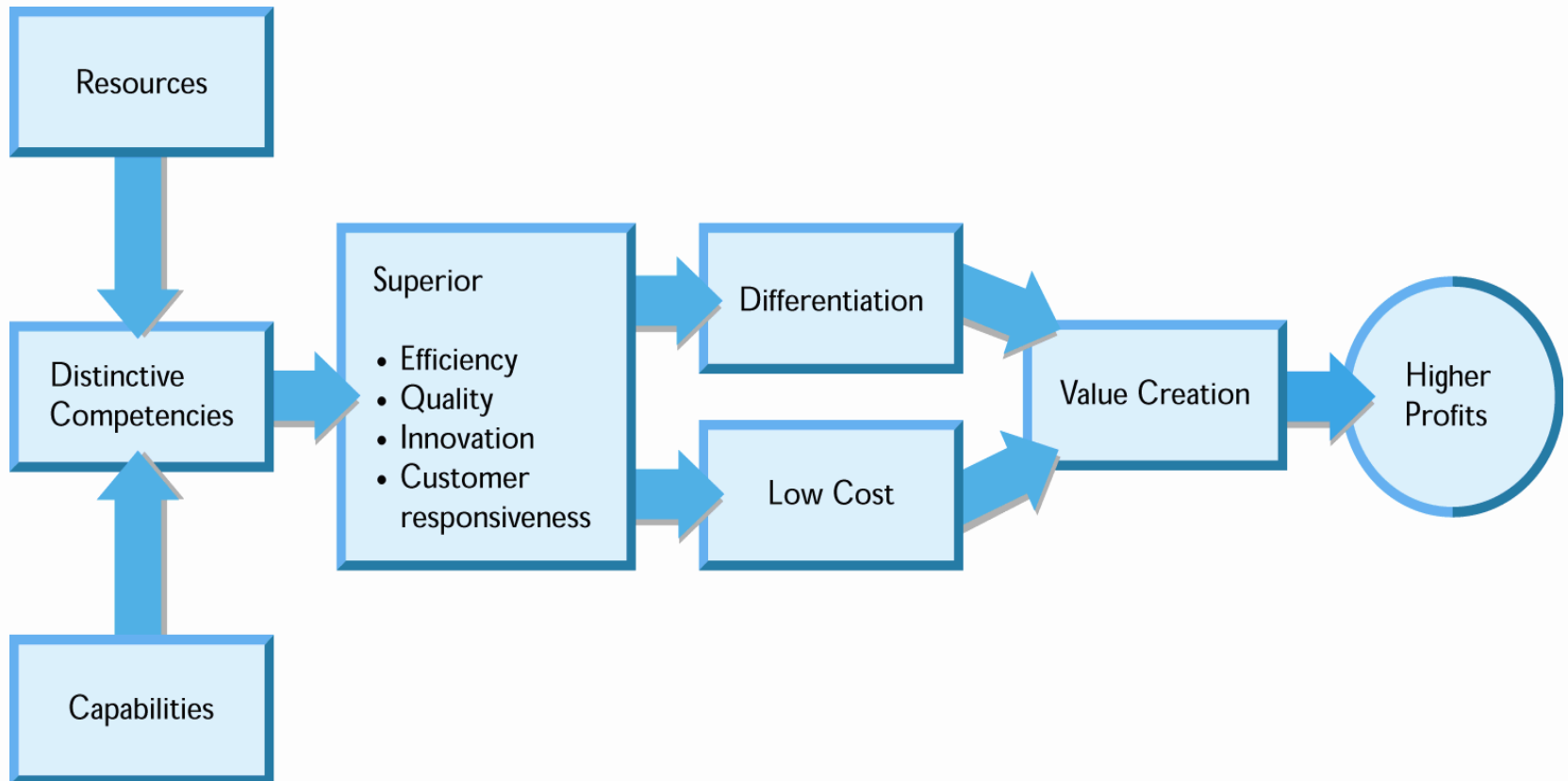
# Capabilities

- A company's skills at coordinating its resources and putting them into productive use.
- **Where are they?**
- To have a distinctive competency, a company must at least have:
  - a. A firm-specific and valuable resource and the capabilities (skills) necessary to take advantage of that resource, or
  - b. A firm specific capability to manage resources

***A company's distinctive competency is strongest when it has both!***

# Distinctive Competencies, Resources, and Capabilities

- The roots of competitive advantage:



# Durability

- When a company has superior profitability, other companies are inclined to imitate the successful strategy.
- Durability of competitive advantage depends on the ease or difficulty to copy distinctive competencies.  
**Which are easiest to copy?**
- Barriers of Imitation are the factors that make copying difficult for competitors.
- Even if a company's distinctive competencies are protected by higher barriers to imitation, it should act as if rivals are continually trying to nullify its source of advantage

***“Only the paranoid survive”***