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Business Strategies for Sustainable Growth

Application of Competitive Advantage Tool of Porter.

ABSTRACT

In this era of globalisatin, liberalisation an privatisation formulating stategies for growth has been the main focus area of top management of the firms; not only growth but sustainable of Porter propounded, "Competitive Advantage grows out of the value of a firm is able to create for its buyers that exceeds the firm's cost of creating it. There are two basic types of competitive advantage - cost leadership and differentiation". A firm may choose to emphasize one of three 'value disciplines'-- Product leadership, Operational excellence, and Customer intimacy. an essential lesson for the corporates is that competencies are the roots of competitive advantage, and therefore business should be organised as a portfolio of competencies rather than a portfolio of business.

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1. INTRODUCTION

A firm's relative position within an industry is given by its choice of *competitive advantage* (cost leadership vs. differentiation) and its choice of *competitive scope*. Competitive scope distinguishes between firms targeting broad industry segments and firms focusing on a narrow segment. Generic strategies are useful because they characterize strategic positions at *the simplest and broadest level*. There are different risks inherent in each generic strategy, but being "all things to all people" is a sure recipe for mediocrity - getting "stuck in the middle". Basically, strategy is about two things: deciding where you want your business to go, and deciding how to get there. A concrete definition of competitive advantage as given by Michael Porter, "*Competitive advantage grows out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price. There are two basic types of competitive advantage: cost leadership and differentiation."*

Treacy and Wiersema (1995) offer another popular generic framework for gaining competitive advantage. In their framework, a firm typically will choose to emphasize one of three "value disciplines"*: product leadership, operational excellence, and customer intimacy*.

COMPETITIVE SCOPE	COMPETITIVE ADVANTAGE: Lower Cost	COMPETITIVE ADVANTAGE: Differentiation
Lower Cost	**1. Cost Leadership**	**2. Differentiation**
Narrow Target	**3. Cost Focus**	**4. Differentiation Focus**

2. CONCEPTUAL STRATEGY FRAMEWORKS

Frameworks *vs.* Models

We distinguish here between strategy frameworks and strategy models. Strategy models have been used in theory building in economics to underst and industrial organization. However, the models are difficult to apply to specific company situations. Instead, qualitative frameworks have been developed with the specific goal of better informing business practice. In another sense, we may also talk about "frameworks" as referring to the guiding analytical approach you take to your project (*i.e.,* decision analysis, economics, & finance).

Some Perspective on Strategy Frameworks: Internal and External Framing for Strategic Decisions

It may be helpful to think of strategy frameworks as having two components - internal and external analysis.

The *external* analysis builds on an economics perspective of industry structure, and how a firm can make the most of competing in that structure. It emphasizes *where* a company should compete, and what's important when it does compete there. Porter's 5 Forces and Value Chain concepts comprise the main externally-based framework. The external view helps inform strategic investments and decisions.

The *Internal* analysis, like core competence for example, is less based on industry structure and more in specific business operations and decisions. It emphasizes *how* a company should compete. The internal view is more appropriate for strategic organization and goal setting for the firm.

Porter's focus on industry structure is a powerful means of analyzing competitive advantage in itself, but it has been criticized for being too static in an increasingly fast changing world. The internal analysis emphasizes building competencies, resources, and decision-making into a firm such that it continues to thrive in a changing environment. Though some frameworks rely more on one type of analysis than another, both are important. However, neither framework in itself is sufficient to set the strategy of a firm.

The internal and external views mostly frame and inform the problem. The actual firm strategy will have to take into account the particular challenges facing a company, and would address issues of financing, product and market, and people and organization. Some of these strategic decisions are event driven (particular projects or reorgs responding to the environment and opportunity), while others are the subject of periodic strategic reviews.

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3. COMPETITIVE ADVANTAGES

What is the basis for competitive advantage?

Industry structure and *positioning within the industry* are the basis for models of competitive strategy promoted by Michael Porter. The "Five Forces" diagram captures the main idea of Porter's theory of competitive advantage. The Five Forces define the rules of competition in any industry. Competitive strategy must grow out of a sophisticated understanding of the rules of competition that determine an industry's attractiveness. Porter claims, "The ultimate aim of competitive strategy is to cope with and,

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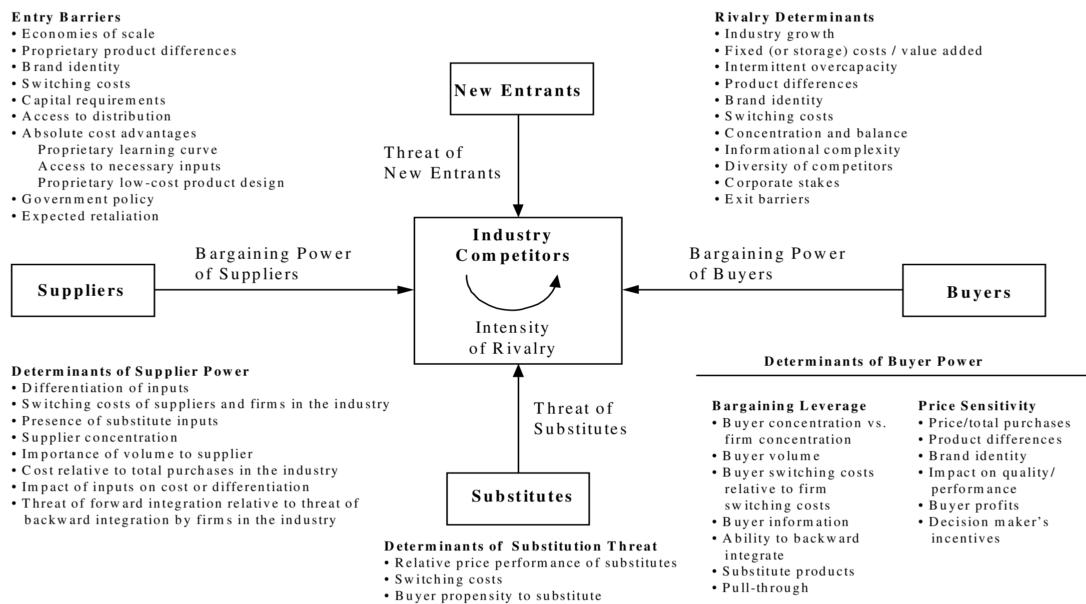
ideally, to change those rules in the firm's behavior." The five forces determine industry profitability, and some industries may be more attractive than others. The crucial question in determining profitability is how much value firms can create for their buyers, and how much of this value will be captured or competed away.

Industry structure determines who will capture the value. But a firm is not a complete prisoner of industry structure - firms can influence the five forces through their own strategies. The five-force framework highlights what is important, and directs manager's towards those aspects most important to long-term advantage.

Be careful in using this tool: just composing a long list of forces in the competitive environment will not get you very far – it's up to you to do the analysis and identify the few driving factors that really define the industry. Think of the Five Forces framework as sort of a checklist for getting started, and as a reminder of the many possible sources for what those few driving forces could be.

PORTER'S FORCES- ELEMENTS OF INDUSTRY STRUCTURE



How is competitive advantage created ?

At the most fundamental level, firms create competitive advantage by perceiving or discovering new and better ways to compete in an industry and bringing them to market, which is ultimately an act of innovation. Innovations shift competitive advantage when rivals either fail to perceive the new way of competing or are unwilling or unable to respond. There can be significant advantages to early movers responding to innovations, particularly in industries with significant economies of scale or when customers are more concerned about switching suppliers.

The most typical causes of innovations that shift competitive advantage are the following:

- new technologies
- new or shifting buyer needs

- the emergence of a new industry segment
- shifting input costs or availability
- changes in government regulations

How is competitive advantage implemented?

But besides watching industry trends, what can the firm do? At the level of strategy implementation, competitive advantage grows out of the way firms perform discrete activities - conceiving new ways to conduct activities, employing new procedures, new technologies, or different inputs. The "fit" of different strategic activities is also vital to lock out imitators. Porters "Value Chain" and "Activity Mapping" concepts help us think about how activities build competitive advantage.

The *value chain* is a systematic way of examining all the activities a firm performs and how they interact. It scrutinizes each of the activities of the firm (e.g. development, marketing, sales, operations, etc.) as a potential source of advantage. The value chain maps a firm into its strategically relevant activities in order to understand the behavior of *costs* and the existing and potential sources of *differentiation*. Differentiation results, fundamentally, from the way a firm's product, associated services, and other activities affect its buyer's activities. All the activities in the value chain contribute to buyer value, and the cumulative costs in the chain will determine the difference between the buyer value and producer cost.

A firm gains competitive advantage by performing these strategically important activities more cheaply or better than its competitors. One of the reasons the value chain framework is helpful is because it emphasizes that competitive advantage can come not just from great products or services, but from anywhere along the value chain. It's also important to understand how a firm fits into the overall *value system*, which includes the value chains of its suppliers, channels, and buyers.

With the idea of *activity mapping*, Porter (1996) builds on his ideas of generic strategy and the value chain to describe strategy implementation in more detail. Competitive advantage requires that the firm's value chain be managed as a system rather than a collection of separate parts. Positioning choices determine not only which activities a company will perform and how it will configure individual activities, but also how they relate to one another. This is crucial, since the essence of implementing strategy is in the activities - choosing to perform activities differently or to perform different activities than rivals. A firm is more than the sum of its activities. A firm's value chain is an interdependent system or network of activities, connected by linkages. Linkages occur when the way in which one activity is performed affects the cost or effectiveness of other activities. Linkages create tradeoffs requiring optimization and coordination.

Porter describes three choices of strategic position that influence the configuration of a firm's activities:

- *Variety-based positioning* - based on producing a subset of an industry's products or services; involves choice of product or service varieties rather than customer segments. Makes economic sense when a company can produce particular products or services using distinctive sets of activities. (i.e. Jiffy Lube for auto lubricants only)

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The activities are tightly linked to each other, as shown by a relevance diagram of sorts.

- *Needs-based positioning* - similar to traditional targeting of customer segments. Arises when there are groups of customers with differing needs, and when a tailored set of activities can serve those needs best. (i.e. Ikea to meet all the home furnishing needs of a certain segment of customers)
- *Access-based positioning* - segmenting by customers who have the same needs, but the best configuration of activities to reach them is different. (i.e. Carmike Cinemas for theaters in small towns)

Porter's major contribution with "activity mapping" is to help explain how different strategies, or positions, can be *implemented* in practice. The key to successful implementation of strategy, he says, is in *combining* activities into a consistent fit with each other. A company's strategic position, then, is contained within a set of tailored activities designed to deliver it. The activities are tightly linked to each other, as shown by a relevance diagram of sorts. Fit locks out competitors by creating a "chain that is as strong as its strongest link." If competitive advantage grows out of the entire system of activities, then competitors must match each activity to get the benefit of the whole system.

Porter defines three types of fit:

- simple consistency - first order fit between each activity and the overall strategy.
- reinforcing - second order fit in which distinct activities reinforce each other.
- Optimization of effort - coordination and information exchange across activities to eliminate redundancy and wasted effort.

How is competitive advantage sustained?

Porter (1990) outlines three conditions for the sustainability of competitive advantage:

- *Hierarchy of source (durability and imitability)* - lower-order advantages such as low labor cost may be easily imitated, while higher order advantages like proprietary technology, brand reputation, or customer relationships require sustained and cumulative investment and are more difficult to imitate.
- *Number of distinct sources* - many are harder to imitate than few.
- *Constant improvement and upgrading* - a firm must be "running scared," creating new advantages at least as fast as competitors replicate old ones.

4. IMPLICATIONS FOR STRATEGY

Portfolio of competencies

An essential lesson of this framework is that competencies are the roots of competitive advantage, and therefore businesses should be organized as a portfolio of competencies (or capabilities) rather than a portfolio of businesses.

Organization of a company into autonomous strategic business units, based on markets or products, can cripple the ability to exploit and develop competencies - it unnecessarily restricts the returns to scale across the organization.

Core competence is communication, involvement, and a deep commitment to working across organizational boundaries.

Products based on competencies

Product portfolios (at least in technology-based companies) should be based on core competencies, with core products being the physical embodiment of one or more core competencies.

Thus, core competence allows both focus (on a few competencies) and diversification (to whichever markets firm's capabilities can add value). To sustain leadership in their chosen core competence areas, companies should seek to maximize their world manufacturing share in core products. This partly determines the pace at which competencies can be enhanced and extended (through a learning-by-doing sort of improvement).

Continuous investment in core competencies or capabilities

The costs of losing a core competence can be only partly calculated in advance - since the embedded skills are built through a process of continuous improvement, it is not something that can be simply bought back or "rented in" by outsourcing. Wal-mart, for example, has invested heavily in its logistics infrastructure, even if the individual investments could not be justified by ROR analysis.

They were strategic investments that enabled the company's relentless focus on customer needs. While Wal-mart was building up its competencies, K-mart was outsourcing whenever it was cheapest.

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Caution: core competencies as core rigidities

Bowen *et al*. talk about the limitations to restricting product development to areas in which core competencies already exist, or core rigidities. Good companies may try to incrementally improve their competencies by bringing in one or two new core competencies with each new major development project they pursue.

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