COMPETITIVE ADVANTAGE – EVOLUTION AND CHALLENGES

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Competitive advantage is the result of a firm's planned strategy. The strategic direction is realised through the ability of producing greater profits than the competitors. Many factors are equally important in producing a position of success. Some of these are industrial factors, others are resources and competencies of the single firm. The sum of all these forces results in creating and sustaining a successful position, in other words a competitive advantage. This study focuses on the evolution of the concept of competitive advantage from the study of the industrial environment to the analysis of inner resources such as knowledge and specific competencies embedded in firms.

Competitive advantage, Portr's diamond, value chain, resources, firm strategy

Introduction

Moving from the study of competitive advantage theory, the work tries to define this concept identifying its constitutive factors. The study of the mechanisms responsible of creating a sustainable competitive advantage is useful for the management itself and provides many interesting opportunities to investigate the causes of the firm's competitive success. When studying the concept of competitive advantage, the first question we need to answer is: what is the nature of competitive advantage?

Competitive advantage is the result of a strategy capable of helping a firm to maintain and sustain a favourable market position. This position is translated into higher profits compared to those obtained by competitors operating in the same industry. From the definition proposed two issues emerge: the existence of a strategy which is intentionally planned and realized through investments and resource deployment programs (we are therefore interested in strategic planning results and their implications on investment decisions); the implementation of a firm's strategy as result of a long-term competitive advantage, that is, a competitive advantage not immediately destroyable by competitors. These two issues limit the analysis to the study of competitive environments characterized by informative asymmetries and imperfect resource markets. In the absence of these conditions, we could not have sustainable competitive advantages, because the realization of a new competitive advantage would be immediately destroyed by the imitative strategies of competitors.

Therefore, the firm's success is the result of the firm's ability to respond to threats and opportunities existing in the specific industrial environment in which it operates. The strategic decisional processes and the profit-results that firms obtain are heavily influenced by external market conditions. The relationship between the firm and the industrial environment in which it operates is responsible for realising a successful market position and develops along three dimensions. First of all, the firm develops a consistent system of strategic objectives, adopting a complex of coherent functional policies. Second, the system of objectives and policies must be kept consistent with the external conditions of the market; that is, the strengths and weaknesses of the industry which the firm must consider in deciding strategies and policies. Nevertheless, the firm's adaptation to industrial environment requirements has to be seen in a dynamic form, in which the firm constantly adapts its action to external and internal changes, in a continually changing pattern.

The most important milestone in competitive advantage studies is related to Porter's idea of 'value chain' proposed in the 1980s. According to his approach, the study of strategy must rely on three elements: the external environment, the firm's behaviour, and the market results that the firm obtains in implementing its strategy. The successful market position that firms can gain is the result of two factors: the industrial environment and the position assumed by the firm inside the market. Industry attraction depends on the mutual influence of five competitive forces: competitors, new entrants, substitute producers, demand, and suppliers. The two-way interaction of these forces influences the profit leverage available to firms operating in the same industry. Firm

profits are also influenced by the specific position that the firm occupies in the industrial environment. Firms operating in the same industry can decide to adopt different strategies, choosing between three so-called 'generic competitive strategies': cost leadership, when the firm offers the same product at a lower price than its competitors; differentiation, when the firm offers a different product (higher quality and more functions) at a higher price. In this case, the firm must fix the price at a level sufficient to cover the greater costs sustained to differentiate the product. If this is not done, the differentiation strategy will result in greater costs not covered by higher income; focus, when the firm follows one of the two previous strategies, but focusing on a restricted segment of the market. We shall have a cost focus if the firm decides to pursue a cost leadership strategy in a restricted segment of the market, and a differentiation focus if it acts according to a differentiation strategy. Positions not consistent with the three proposed options result in what Porter calls 'stack in the middle' and do not enable the firm to gain average market profits. In explaining the process of gaining competitive advantage, Porter introduces the further concept of 'value chain' claiming that: 'competitive advantage results from a firm's ability to perform the required activities at a collectively lower cost than rivals, or perform some activities in unique ways that create buyer value and hence allow the firm to command a premium price'. In other words, the firm's strategy arises 'from the way in which it configures and links the many activities in its value chain relative to competitors'.

Furthermore, the value chain of each firm will interact with the value chain of any other firm placed along the production chain. The industrial environment defines opportunities, risks, resources, and costs firms must take into account. The external environment maintains a central role, influencing with more or less strength the company's strategy and its ability to gain a successful position in the market. Porter's analysis underscores the firm's opportunity to decide its strategy freely, implementing a cost-based, a differentiation-based, or a focused approach. The market maintains its importance but firms seem to be given higher levels of freedom. Porter's contribution makes the model less rigid, giving the firm the opportunity to move in the market freely, developing one of the three (or rather four) strategy options identified.

The resource based view: a firm focused approach.

The resource based view chooses the single firm, its strategy, its resources, its strengths and weak points as the objects of analysis. In examining the construction of solid and durable competitive advantages, an internal focus becomes the only accepted perspective, and the process of resource accumulation appears to be the only possible one. The resource based view removes the two fundamental assumptions on which the environmental models are based: homogeneity of resources and opportunities among firms operating in the same industry; perfect resource mobility. These assumptions provided the conceptual basis on which environmental models could choose to study the industrial environment in place of the single firm. Each firm that operates in the same industry can gain the same profit (industry leverage profit) because of the structural conditions of the market. No room is left for single firm strategy; uniform strategy behaviour becomes the necessary condition for firms operating in the same market. The only choice the firm can make is which industrial market to operate in, based on the analysis of market opportunities. In contrast, the resource view gives the firm freedom to decide which strategy to adopt, in relation to the specific resources and competencies acquired and developed by the firm itself during its activity. The importance of industry analysis decreases in relation to the growing strength of the firm, now capable of influencing and modifying the environment with its decisions.

Resources and capabilities: what makes the difference?

Declaring the central role of the firm in deciding which strategy to adopt to fit better with its internal characteristics, the resource view defines some fundamental distinctions necessary for a better understanding of the process of creation of competitive advantage. A general distinction is made between resources and competencies. Furthermore, in each of the two groups, we can identify different types of resources and competencies. Resources are all those physical, human, and financial assets contributing in different ways to the input-output production process realized by the firm. These resources are employed, separately or as a complex, and their employment allows the firm to develop a sum of knowledge and operative capabilities, resulting in greater competencies. The distinction between resources and competencies is important because of the way firms can acquire or develop them. Firms can acquire the necessary resources in the markets and can produce their own specific competencies using them. Thus, competencies result from the way the firm uses its resources to create knowledge and skills. Resources are freely acquired in the market, while competencies are internally developed by the firm in its day-by-day activity and use of acquired resources. Competencies are therefore accumulated following firm-specific knowledge patterns. Once developed, they affect the resources from which they have been

generated, transforming the same resources into something different from what the firm bought originally. The result is that resources and competencies change continually, under the effect of normal organisational activity.

Based on this general distinction, we can classify resources into two types: tangible resources, which are physical assets (land, buildings, raw materials, facilities, etc.) that can be easily accounted for in financial plans; and intangible resources, which are, among others, know-how, brand name, and the firm's reputation. These elements cannot be accounted for in the balance sheet. Intangible resources are particularly critical in strategy implementation because of the importance of knowledge and reputation creation and the difficulty of acquiring them.

Competencies are classified into two main groups, too: tacit competencies are the result of personal and tacit learning processes developed in daily work, such as the 'learning by doing' process. These competencies are embodied in workers and cannot be translated into explicit rules and behavioural norms; whereas explicit competencies are embodied in organisational rules, behavioural codes, and other knowledge sources available in written form. These competencies are more easily recognised, acquired and widespread among workers, because of their availability in explicit rules and procedures. The process of competence development is both explicit and implicit. It is explicit because workers learn from the explicit rules developed by management. It is implicit, because workers, in their daily activity, become aware of new patterns of competence deployment, modifying by themselves (naturally) the codified rules of the organisation. The transferability of resources and competencies: barriers to mobility, causal ambiguity and other considerations. According to the resource based approach, the most important knowledge is that which concerns the methods that the firm uses in building and developing its resource and competence assets. How can the firm create a strong and distinctive asset of specific resources and competencies? How can the firm protect itself from imitation strategies implemented by its competitors? Is it possible easily to transfer resources to different contexts? Which resources are available in the market? These are some of the most important questions, sometimes answered, sometimes not, emerging from the resource based view. In answering these questions, we encounter new concepts and face with new problems. Indeed, the resource based view, removing the main assumption on which environmental models were based, introduces two key issues, responsible for the different results that firms can obtain in implementing their strategy: imperfect resource mobility and barriers to imitation of competitive advantage.

Some resources do not flow freely among firms and between firms and the market. These resources, and the competencies created in using them, have been called 'sticky'. Once purchased or internally created, they remain bound to the firm, developing a higher value than if they were used outside. As Peteraf points out: 'because immobile or imperfectly mobile resources are nontradable or less valuable to other users, they cannot bid away readily from their employer'. The construction of solid competitive advantages relies on these firm-specific and not easily transferable resources. A firm's competitive advantage is tightly related to its strategy and not only to its operational effectiveness. He defines the last one as 'performing activities *better* than rivals perform them'. In other words, the operational effectiveness 'refers to any number of practices that allow a company to better utilise its inputs by […] reducing defects in products or developing better products faster.' On the other hand strategic positioning 'means performing *different* activities from rivals' or performing similar activities in *different ways*.' The difference between the two concepts is relevant because in the first case a firm can try to imitate the other companies' strategy, only improving efficiency or developing products faster than competitors do, but moving towards the same direction, whit the same combination of activities. In the second case, when we talk of strategy, we should consider the sum of activities performed by the firm. These activities are completely different from the other firms' or they are performed in a different way with completely different results. The message to customers is different and the firm must choose among different strategies.

Given the difference between the two concepts, the competitive advantage of the firm can only be the result of strategic positioning. Only performing different activities or performing them differently from competitors, the firm can gain a competitive advantage establishing a difference from the other firms and maintaining it over time. Again, as in his older works, Porter underlines the existence of trade-offs which firms must consider and cannot remove. Managers are continually faced with trade-offs among (for example) costs, differentiation, flexibility, or quality and trade-offs are required to give the opportunity to choose among different opportunities and to gain success. Nevertheless, respect to other Porter's works we find a new idea, the one of fit among different activities. Fitness is about how the activities relate to each other, because strategy is not only a problem of what individual activities to choose but, particularly, a problem of how to put activities together, of how to fit them. The fitting activities make the firm successful and let it gain competitive advantage. It 'grows out of the *entire system* of

activities. The fit among activities substantially reduces cost or increase differentiation. Beyond that, the competitive value of individual activities – or the associated skills, competencies, or resources – cannot be de-coupled form the system or the strategy. Thus in competitive companies it can be misleading to explain success by specifying individual strengths, core competencies, or critical resources. The list of strengths cuts across many functions and one strength blends into others. It is more useful to think in terms of themes that pervade many activities, such as low cost, a particular conception of the value delivered. These themes are embodied in nests of tightly linked activities.

Conclusion

The Porter's work can be resumed in some points: He emphasises the importance of considering what the strategy is and how it differs from operational effectiveness. Many managers are now unable distinguish the difference. They are confused between the strategy's implementation through tools such as time-based competition, total quality management, reengineering and so on. These are only mechanisms to implement strategy, improve it and obtain better results. Strategy is something more and something different. It concerns the way how the many activities implemented by the firm can be tied together in different and specific ways. Strategy makes the difference among firms and strategy lets the firm gain a competitive advantage position not easily imitated. Given the difference between the two, a successful strategy implies fitting among activities, so that the result is coherent and the direction is the same. Once more, the sum of activities is more important than the single one. Strategy is something pervading the whole system of activities and all the activities must be reinforcing each other. In Porter's words, 'It is more useful to think in terms of themes that pervade many activities, such as low cost, a particular notion of customer service, or a particular conception of the value delivered. These themes are embodied in nests of tightly linked activities.' Furthermore, the fitting among activities makes them not easy to replicate. Rivals could easily imitate one single activity or some technique, or improve practices, but they could hardly replicate the entire system of activities, performing them in exactly the same way as competitors. This explains how to make the competitive advantage sustainable and durable over time. Trade-offs are important for strategy. Without trade-offs there would be no choice among different strategies and all the firms could obtain the same results with no extra-profits. Also if great improvements have been obtained in getting better results, the trade-off between cost and differentiation continues to be important and real. Firms must choose among different ways to win the markets. Sustainability of competitive advantage and strategy as fitting among activities include the concept of commitment. Strategy has long-range horizons and this means investments and commitment of the firm.

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