Strategic decisions for sustainable competitive advanatage

Introduction – Competitive Advantage

According to Daft, “ strategy” is the plan of action that allocates resources and activities and aims at dealing with the environment, achieving a competitive advantage and attaining the organisation’s goals. ‘ Competitive advantage refers to what sets the organisation apart from others and provides it with a distinctive edge for meeting customer needs in the marketplace’ (Daft 2006, p. 274). The choice that will make the organisation different is the essence of formulating strategy (Porter 1996). In order to remain competitive, companies need to focus on core competencies, develop synergy and create value.

According to Kotler, competitive advantage is ‘ a company’s ability to perform in one or more ways that competitors cannot or will not match’ (Kotler 2006, p. 150). A competitive advantage is said to be sustainable when it has the means to edge out rivals when competing for the favours of customers (Porter 1980). Although sustainability is the ideal case for advantages, the most common competitive advantages are leverageable, which means that a company can use them as a catalyst to new ones. The competitive advantages that companies develop will fail if the costumers do not value them as important. Therefore companies must focus on building customer advantages.

Porter argues that ‘ competitive advantage results from a organisation’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 organisations to command a premium price' (Porter 1991, p. 102).

This report will try to investigate the strategic decisions to achieve sustainable competitive advantage. Four different theories will be examined: The SCP paradigm, Porter's ' generic strategies', the resource-based approach and the core competences model. These theories, along with the " the compliance and choice paradox" will be tested through application in practice at the industry of gaming consoles.

The SCP framework

In the ' structure – conduct – performance' (SCP) framework (Anonymous 2007), the way in which the organisation acts is determined by external forces in the industry (market or industrial structure). This school of thought argues that the structure of an industry will determine the strategies (conduct) and that this in turn will determine performance.

- Market structure: the degree of market concentration, product differentiation, barriers to entry and exit, vertical integration and diversification.
- Conduct: goals of the organisations, strategies, anti-competitive practices, research and innovation, advertising etc.
- Performance: a number of performance indicators, output growth, sales revenue growth, profitability, technical progress, employment, efficiency, added shareholder value, added economic value.

Therefore, the structure of the industry is the key parameter in the formation of strategy. Not all strategies are appropriate for all industries, Successful

strategies may fail (not produce the intended outcome) if applied as-is in a different environment.

However, this linear paradigm proves itself too deterministic. When strategic managers apply this approach, they take the industrial structure as a given. In this way, their job is to respond to the external forces and plan their strategies in an automated way by analysing the competitive environment. However in many industries the environment follows turbulence change. Strategists tend to change the environment by designing strategies that will shape it to their needs and their advantage, instead of being spectators to the change. In these cases, the industry structure is being shaped by the strategies, and not the other way round as the SCP paradigm argues.

Five Forces and Generic Strategies

Michael Porter's (Porter 1980) work is organisationally rooted in the SCP paradigm. According to his approach, two factors underlie the choice of competitive strategy.

1. Industry attractiveness and the factors that determine it.
2. The determinants of relative competitive position within an industry.

In order to analyse the industry attractiveness, Porter developed the Five Forces model. According to that, in any industry competition is mutually influenced by five forces: The entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers and the rivalry amongst the competitors.

Although the Five forces model roots within the SCP approach, Porter differentiates in that he argues that an organisation is not a prisoner of its

industry structure. Through their strategies, organisations can shape industry by influencing the competitive forces. For example, industry leaders can influence buyers, suppliers and other competitors, and subsequently shape the underlying industry structure.

Competitive strategy is also influenced by the specific relative position within the industry. Through positioning, organisations can possess two basic types of competitive advantage: low cost and differentiation. These types of competitive advantage result from the ability to cope with the industrial forces better than the competitors. Porter introduces three ‘ generic competitive strategies’ for achieving above-average performance in an industry.

1. Cost leadership, when the organisation tries to become the low-cost producer or operator of the industry.

Risks associated with cost leadership include:

- Changes in technology allow new entrants to become themselves the cost leaders. This risk is minimised by constant research and development, but obviously such investments require rise of costs.
- Margins fall when costs rise (by internal or external factors). In such scenarios, the differentiation advantage may overcome the cost leadership one.

2. Differentiation, when the organisation seeks to be unique within the industry along some dimensions that are valued by buyers (higher quality, more functions etc). If it succeeds, it is then

rewarded for its uniqueness with a premium price. However, when choosing to differentiate, companies should seek appropriate ways that lead to a price premium greater than the cost of differentiating.

Risks of this strategy include:

- Costumers may choose another differentiated product which they value more, or their needs change over time.
- Costumers may choose the low-cost products, especially when the price difference tends to be high.
- Other competitors may imitate the chosen differentiation.

2. Focus, which rests on the choice of a narrow competitive scope within an industry and the optimisation of the strategy for the target segment. In cost focus an organisation seeks a cost advantage in the target segment. In differentiation focus, the organisation seeks differentiation in the narrow segment.

Risks associated with focus are:

- The focus strategy is imitated. In order for this to be avoided, entry barriers are required (e. g. assets valued by the costumers such as customer care services, reputation, etc).
- The target segment becomes unattractive.
- Broadly targeted competitors dominate the segment. Again, entry barriers will sustain the competitive advantage experienced.

Organisations that try to position on more than one generic strategy but fail to achieve any of them are “ stuck in the middle”. Not only they do not possess a competitive advantage, but they are in a disadvantage situation, since the cost-leader, the differentiators or the focusers are already better positioned.

Although Porter’s positioning framework is an industry standard for more than twenty years, Mintzberg (1998) argues that it constrains creative thought. Strategists do not think outside the box and the given options (cost leadership, differentiation and focus) tend to minimise the process of strategic thinking.

Resource-based view

According to Barney (1991), the environmental models of competitive advantage have assumed that organisations within an industry are identical in terms of the resources they control and the strategy they pursue. Further, they assume that if resource heterogeneity develops within an industry, it will not last long since strategic resources are highly mobile (they can be bought and sold). The proposed resource-based view substitutes these assumptions. The model assumes that strategic resources can be heterogeneous and that these resources may not be perfectly mobile. Organisation’s resources include all assets, capabilities, processes, attributes, information, knowledge, etc, controlled by an organisation that enable it to implement strategies that promote efficiency.

In order for a resource to hold the potential of sustained competitive advantage, it must have four attributes.

- It must be valuable, exploiting opportunities and neutralising threats.
- It must be rare among existing and potential competitors. A valuable resource cannot be considered as a source of competitive advantage if it is shared amongst a large number of organisations, because all organisations will have the capability to exploit it and will be lead to a common strategy
- It must be imperfectly imitable. Valuable and rare resources can only be sources of sustained competitive advantage if competitors that do not possess them cannot obtain them.
- There cannot be strategically equivalent substitutes. Organisation resources are strategically equivalent when they can be exploited separately to implement the same strategy. That is, an organisation may be able to substitute a similar resource that enables it to conceive and implement the same strategy. Further, very different resources may also be strategic substitutes.

The proposed framework reasons that resources heterogeneity and immobility within an industry allow organisation resources to be valuable, rare, imperfectly imitable and not easily substitutable. Such resources will then lead to exploiting opportunities and neutralising threats, in order for sustained competitive advantage to be achieved.

It should be noted that a distinction is drawn in the literature between resources (tangible) and capabilities (less tangible) (Anonymous 2007). The framework of Barney unites both resources and capabilities under the umbrella of “ resources”.

Core competences

There are some capabilities that are much less visible and they are more difficult to imitate and establish competitive advantage. These are referred to as core competences (Anonymous 2007). Phahalad and Hamel (1990) take the resource-based approach one step further, through the notion of core competencies. They argue that in the long run, competitive advantage depends on the ability to build core competencies at lower cost and more speedily. Management should consolidate corporate-wide technologies and production skills into competencies that empower individual businesses to adapt promptly to environmental changes.

Three criteria are being used in order to categorise a capability as a core competence. A core competence should provide potential access to a wide variety of markets. It should make a significant contribution to the perceived customer benefits of the end-product. Finally, it should be difficult for competitors to imitate. Examples of core competencies include Apple’s ability to create from scratch and innovate and Sony’s ability to miniature.

According to this framework, the common mistake that companies do is to outsource and finally lose their core competences, led to this by the strict perception of competitiveness in terms of price/performance. Although a more competitive product may result, competitiveness cannot be sustained as core competences will be surrendered. Another common mistake is that companies often miss opportunities to establish competences that are evolving in existing business. At the Strategic Business Unit level, existing core competencies are often being sabotaged by underinvestment and improper allocation, which may result in atrophy and missing opportunities.

Case study: Seventh Generation of video gaming consoles

The seventh generation of video gaming consoles is a competition between Sony's Playstation 3, Microsoft's Xbox 360 and Nintendo's Wii and started on November 2005 with the release of Xbox 360. Although gaming is the main characteristic and attribute of these products, the war of High-Definition (HD) video formats between Blu-Ray and HD-DVD, two incompatible formats that tried to improve and replace the DVD standard, affected the industry (ref: wikipedia HD war).

Microsoft and Sony approached the market with cutting-edge graphics and expensive technology as well as HD video capabilities. Both consoles target hard-core and casual gamers. Microsoft, being a member of the HD-DVD alliance chose to offer the HD-DVD option as a peripheral for its device, while Sony, a founding member of the Bly-ray alliance chose to integrate the Blu-ray player within PS3.

On the other hand, Nintendo chose to differentiate. Nintendo did not take any sides at the format war. Wii targets a broader demographic than that of Microsoft's Xbox 360 and Sony's PlayStation 3, as Nintendo planned to attract current hard-core and casual gamers, non-gamers, and lapsed gamers by focusing on new gameplay experiences and new forms of interaction with games. The differentiating feature of the console is its wireless controller, the Wii Remote, which can be used as a handheld pointing device and can detect acceleration and orientation in three dimensions.

Positioning of the rivals

Competitive Scope: As analysed before, Microsoft and Sony both targeted the hard-core and the casual gamers. Nintendo on the other hand targeted broader demographic including non-gamers and lapsed gamers. According to Porter's framework, the generic strategies can be divided into two categories in terms of the competitive scope: Broad Target and Narrow Target. Therefore, in the console industry Nintendo can be positioned within the Broad Target while Microsoft and Sony are positioned within the Narrow Target.

Cost: The choices of the competitors regarding their hardware shaped their manufacturing costs to a great extent. Indeed, Sony chose to compete using a new cpu processor (Cell) with a high production cost as well as by integrating the newly arrived Blu-Ray technology. Thus, Sony became the high-cost producer of the industry, with each console costing around $800 to produce (ref: Joystiq). Microsoft utilised industry standard high-end CPUs and GPUs and although they strongly supported the success of the HD-DVD format, they decided to offer the HD-Dvd option as a peripheral component. This resulted in Microsoft being the low-cost producer of the Narrow Market (Cost Focus). Nintendo managed to keep the manufacturing costs very low by not following the path of high-end graphics. Wii (ref: Kotaku) is not only the console with the less production cost, but it is the only one that has an actual profit from every unit sold (Cost leadership).

Differentiation: In the Narrow Target, Sony is the company that differentiates its products with the integration of the Blu-Ray drive, which enables the consumers to enter the High Definition video era (Differentiation Focus). In the Broad Target, Nintendo differentiates the whole idea of gaming

experience and fun by installing the Wii Remote (Broad Differentiation). The success on the Nintendo's case is that the company differentiated the attributes but the costs did not rise.

What is clear from this table in combination with the actual sales numbers is that Nintendo managed well in positioning in more than one generic strategy. That of course was a risk, as Porter (1985) claims that achieving cost leadership and differentiation is usually inconsistent, and may lead to " stuck in the middle" situations.

Also, it should be pointed out that the type of Differentiation that Sony chose (Blu-Ray integration) involved high risks. At the time of the launch the battle for the domination of a new HD format had just started. In the case of a possible win of the HD DVD format, it is obvious that Sony would lose that differentiation competitive advantage and would need to re-plan its strategy. On February 2008 Toshiba, HD DVD's creator, announced plans to cease development, manufacturing and marketing of HD DVD players and recorders, giving an end to this war and announcing Blu-Ray as the winner (ref: wikipedia HD war). It's obvious that Sony's differentiation policy will start to pay-off from now on, but until Toshiba's announcement the differentiation policy was not valued highly by the consumers, thus not constituting a competitive advantage.

Compliance and Choice: The Nintendo case

A question is raised on whether or not an organisation should attempt to shape its industry. If an organisation can lead industry developments, the results will be attractive. If the industry norms that are being questioned

prove themselves immutable, the attempt might prove suicidal. When the structure of the industry cannot be influenced, compliance to the industry norms is the strategic rule and managers should adapt the organisations to the industry context. On the other hand, when they have the ability to influence the industry structure they should break industry norms by exercising their freedom of choice. In this case managers' efforts should be on the direction of changing the terms of competition on their own advantage (De Wit 2004).

Up to the seventh generation of video gaming consoles, the industry rules dictated that the consoles should compete in a range of different characteristics such as graphics power, cpu power and exclusive game titles. If a company could top these characteristics, their console would dominate the industry. Sony dominated the sixth generation taking advantage of their ability to have a wide variety of anticipated exclusive game titles.

At the seventh generation, Sony and Microsoft compete by following the industry recipe of cutting-edge graphics and exclusive titles. Nintendo tried to shape the rules, by choosing not to compete on the graphics war, but instead pushed the industry to another direction. The Wii Remote controller makes games more fun and gamers experience new forms of interaction (ref: wikipedia 7th generation).

The reception of the console by the press was a great success. The console received many different awards, including an Emmy for Game Controller Innovation by The National Academy of Television Arts and Sciences, a Golden Joystick for Innovation of the Year 2007 at the Golden Joystick Awards

and the award in breakthrough technology by Spike TV's Video Games. The reception by the market was even greater. Wii is the best selling 7th generation console worldwide. It even outsold Microsoft's 360, which launched a year earlier (ref: wikipedia Wii).

Nintendo's choice of not following the industry recipe paid off. This move granted a competitive advantage because consumers valued the industry shift. If Nintendo's estimations regarding the perception of the value were wrong, the company would have failed in this generation. But since they proved correct, they can claim that they are the 7th generation industry leaders.

Microsoft's Resources and Core Competences

Microsoft decided to seek competitive advantage in the industry by utilising their capabilities and competences. One of the main capabilities of Microsoft is " creating operating systems and software". Therefore, they developed the Xbox Live service (ref: wikipedia Xbox Live), a unified online multiplayer gaming and digital media delivery service which integrated many different features that added value to the console, including

- Friends list and Recent player list
- Windows Live messenger integration
- Voice and Video Chat
- Video Chat
- Multiplayer online gameplay
- Parental controls, limiting children's exposure to other users (" Family Settings")

This capability of Microsoft is a core competence because it fits the description:

- It provides potential access to a wide variety of markets (software market, services market, gaming industry).
- It makes a significant contribution to the perceived customer benefits of the end-product.
- Finally, it is difficult for competitors to imitate, since neither Sony nor Nintendo have software expertise. They both developed online services through outsourcing but they still have not managed to make them as unified and full of features as the Xbox Live.

Competing with Sony for the hard-core and casual gamers, Microsoft used its core competences and resources and finally managed to gain competitive advantage. The task was not so easy because the brand name of Playstation was almost a synonym for “ gaming console” in the previous generations. However, the sales numbers indicate that Sony is far behind Microsoft in the 7th generation consoles war.

Conclusion

The search for competitive advantage is of great importance for every organisation. This report investigated the strategic decisions to achieve sustainable competitive advantage through the examination of four different theories.

The SCP framework is a deterministic approach. It is argued that the structure of an industry will determine the strategies and that these in turn will determine performance. Porter, although routed in the SCP framework,

recognises that an organisation is not imprisoned by the structure. He introduces the Five Forces framework to analyse the industry attractiveness which plays an important role, but also argues that an organisation's competitive success depends on the competitive position within the industry through three ' generic strategies': Cost Leadership, Differentiation and Focus. However, Mintzberg criticises in that the given options of generic strategies minimise strategic thinking. The resource-based view and the core competences models argue that sustained competitive advantage resides on the development and usage of resources, capabilities and competences.

In the 7th generation of video gaming consoles the three competitors tried to gain competitive advantage through different ways. Microsoft utilised its core competences (software development) and resources and established an online environment to support its Xbox 360 console. On the other hand, Nintendo achieved competitive advantage by positioning at both Cost Leadership and Differentiation. In addition to that, Nintendo risked by choosing not to comply with the industry norms of high-end graphics but to try to shape the industry towards innovative gameplay experience. As the numbers indicate the competitive strategies chosen by both Nintendo and Microsoft have paid-off. Sony risked by choosing to differentiate with the integration of the Blu-Ray optical drive. If the format war had ended in favour of HD DVD, Sony's differentiation would have been vanished. In addition, the differentiation introduced by Sony was not highly valued by the consumers while the war was in progress, and the numbers indicate that Sony has already fallen behind.

The application of the theories in practice revealed that differentiation strategies involve high risks. However, if successful, the rewards can be enormous. Not following the industry norms is again risky, but managing to finally shape the industry will show the way to the market leader position.

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