

Strategic Management

Competitive Advantage

Lecture 2-3

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Agenda

- **Competitive advantage: superior performance**
- **Sources of competitive advantage**
 - Value creation
 - Value appropriation
- **Measuring competitive advantage**
 - Economic value
 - Shareholder value

What is Strategy?

- Goal of strategy *Competitive advantage*
- Where we are
- What we have
- What to do
- Corporate level

Competitive Advantage

$$\text{Profits} = Q * (R - C) * \text{Time}$$

- Above normal returns
- Create *added value*
- Sustain overtime

Willingness to Buy

Q

Quantity

- Market share
- Economies of scale

Willingness to Pay

R Price/Revenue

- Total value created for customers
- Quality
- Monopoly
- Customer loyalty
- Etc...

Cost Minimization

C **Costs**

- Scales
- Scope
- Location
- Experience
- Productivity
- Etc...

Value Creation

Willingness to Pay
-- Customers



Total costs



*The Total
Value
Created*

=

My Profit

Value Appropriation

Willingness to Pay =
Upper Bound on Prices



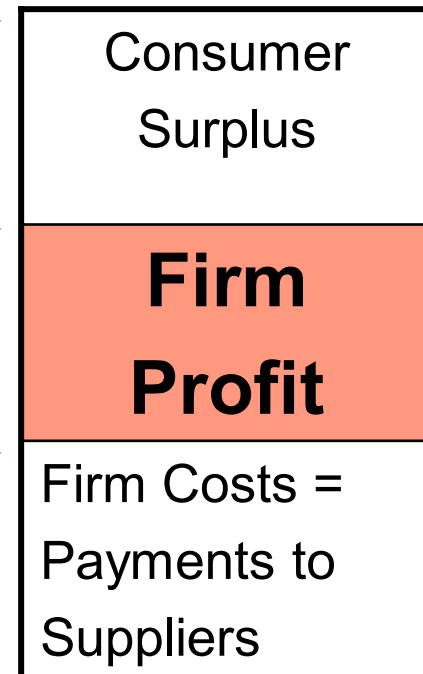
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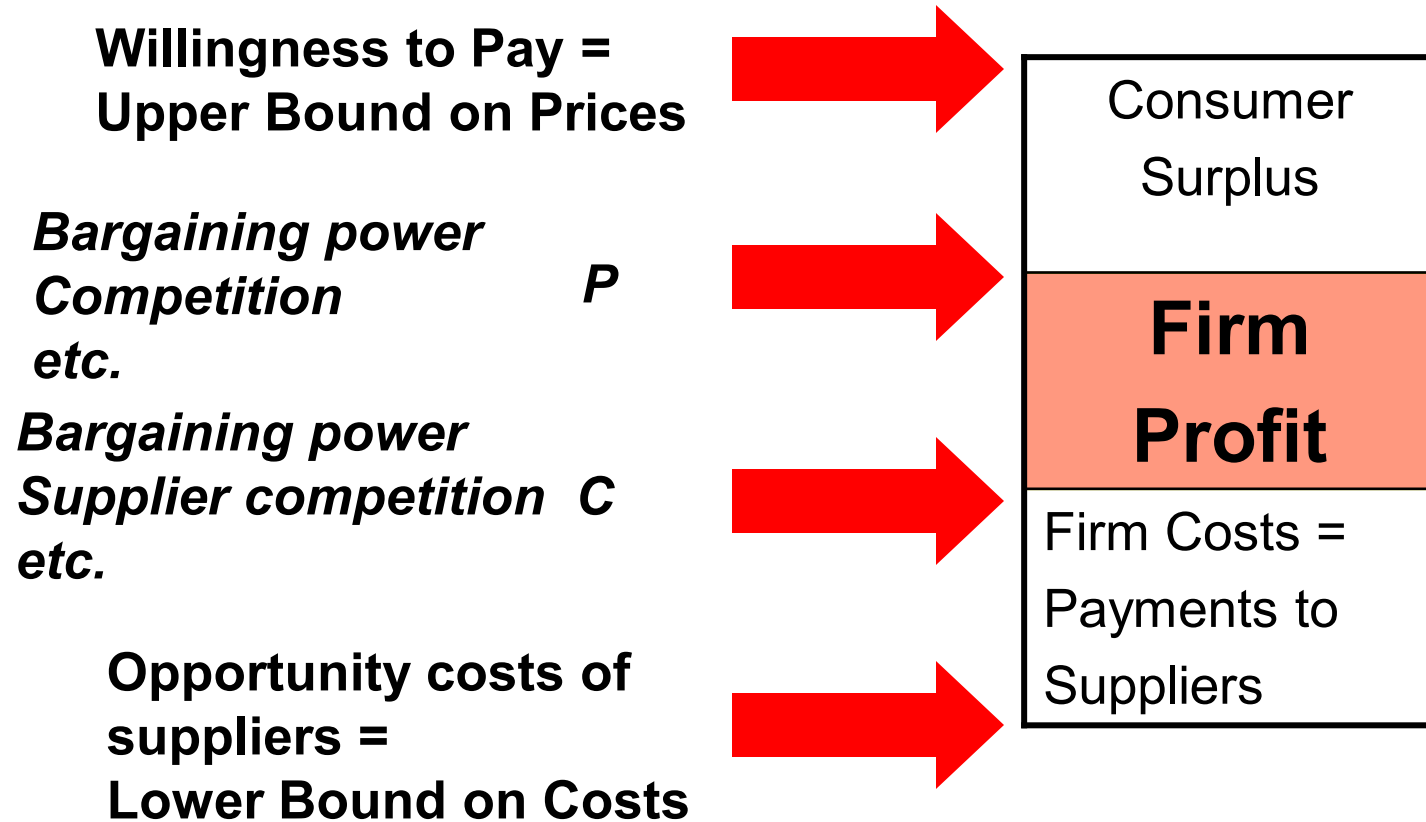
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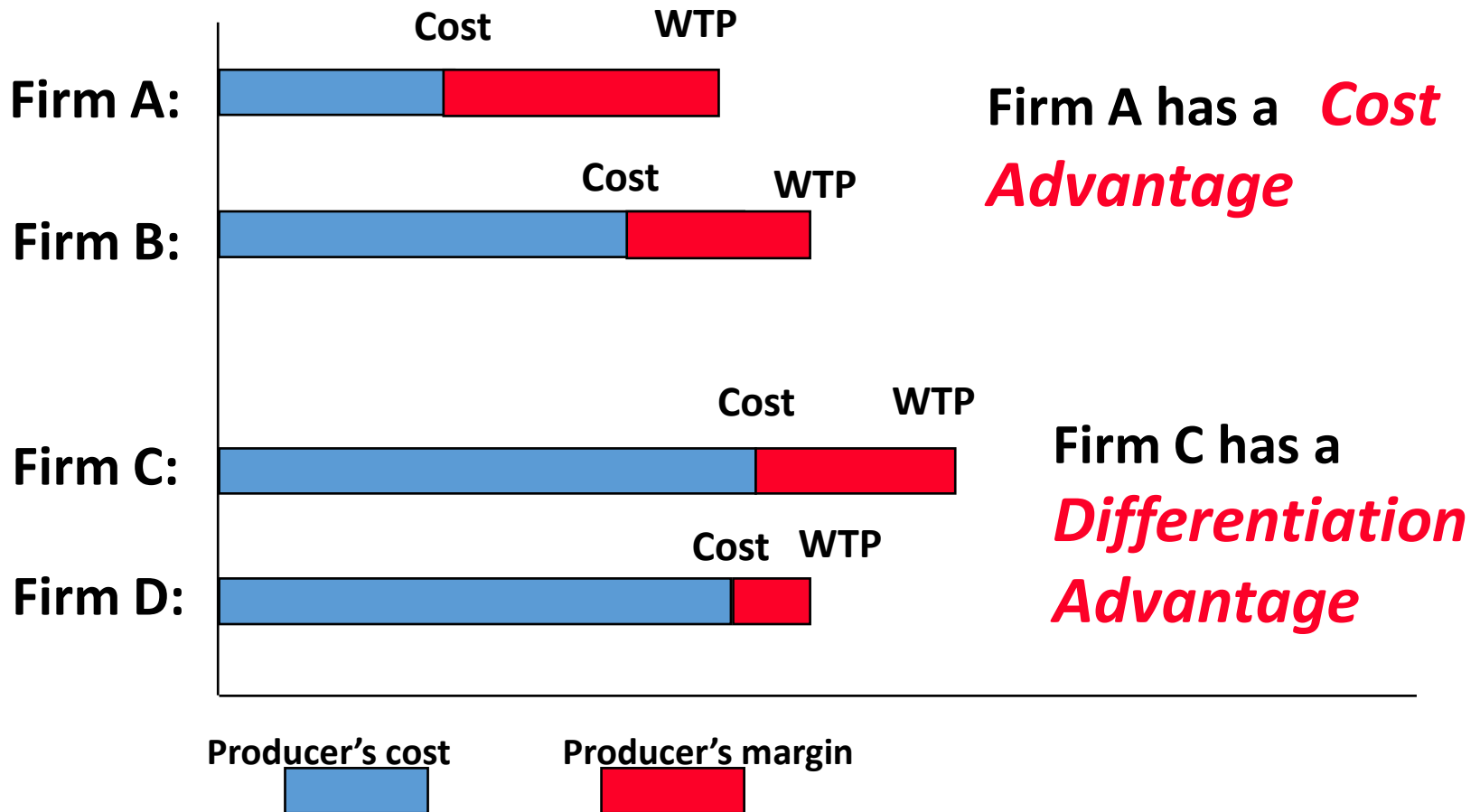
Opportunity costs of
suppliers =
Lower Bound on Costs



Value Appropriation



Potential Margin Comparison



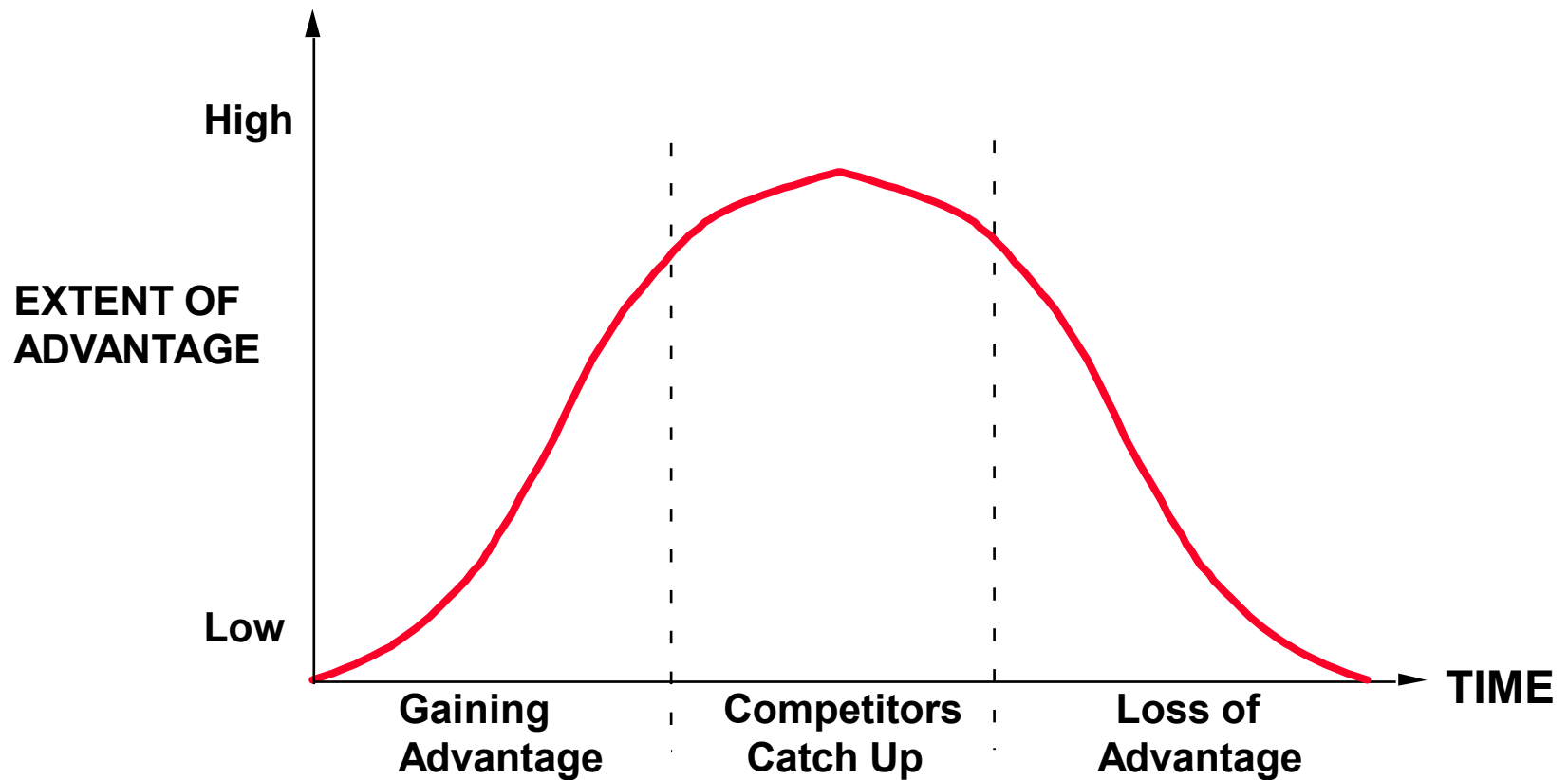
Measures: Accounting Profitability

- Common metrics
 - ROA: profit/total assets
 - ROE: profit/total equity
 - ROR: profit/revenue
 - ROIC: profit/invested capital
- Critiques
 - depends on financial models
 - reports tangible resources rather than intangibles
 - listed companies only

Measures: Shareholder Value

- Total return to shareholders
- Assumption
 - Stock price fully captures the net present value of a company
- Criticism
 - short term volatility
 - macroeconomic factors overestimated
 - bounded rationality
 - investors' strategy

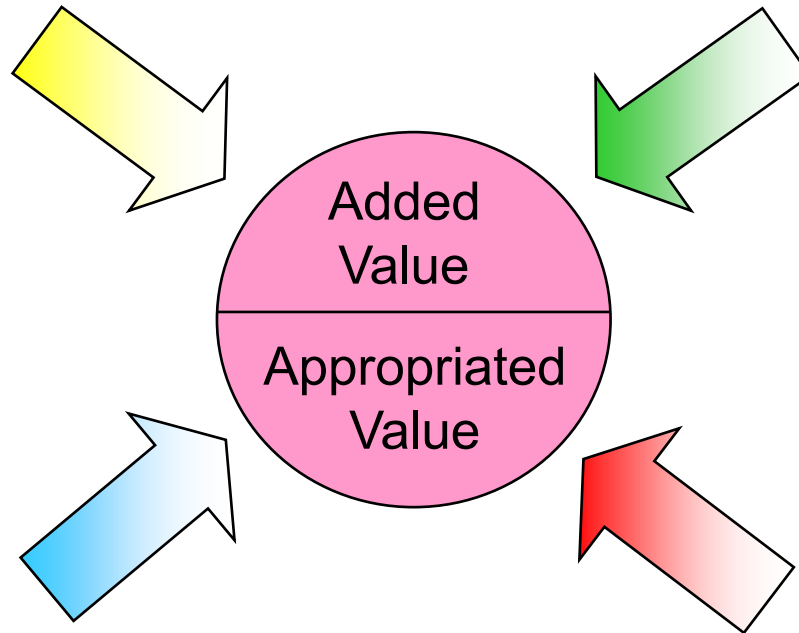
Time: Duration of Advantage



Four Threats to Sustainability

Imitation

Substitution



Slack

Holdup

Goal of Strategy Sustained Competitive Advantage

CREATE/CAPTURE, EXPLOIT, DEFEND

- search for **new sources** of profit margin (CREATE/CAPTURE)
- increase the **volume** which these margins are earned (EXPLOIT)
- **extend the period** over which margins can be sustained (DEFEND)

Take-away Points

- Competitive advantage stems from the total value creation, and value appropriation
- The duration of advantage is threatened by imitation, substitution, slack, and holdup