Module II: Competitive Advantage

SECTIONS B & C

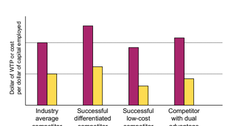
RC STRATEGY

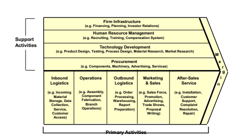
ASHISH NANDA

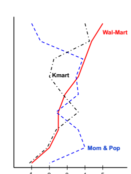
FALL 2025

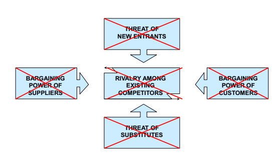
Course Structure

- Introduction
- Industry attractiveness
- **Competitive advantage**
  - Walmart
  - Royal Opera House
  - Hurtigruten
  - Hilti
- Competitive interaction
- Crafting strategy
- Corporate strategy
- Strategy across the S-curve
- Conclusion









What Is Strategy?

Internal consistency
Job 2: configure all of a firm's choices to attain an advantage within its environment

Strategy is an **integrated set of choices**
that positions a firm **in its industry**
to create and capture superior value
over the long run

External consistency
Job 1: size up the external environment of a firm in its entirety

Dynamic Consistency
Job 3: sustain a firm's advantage over time in the face of competition

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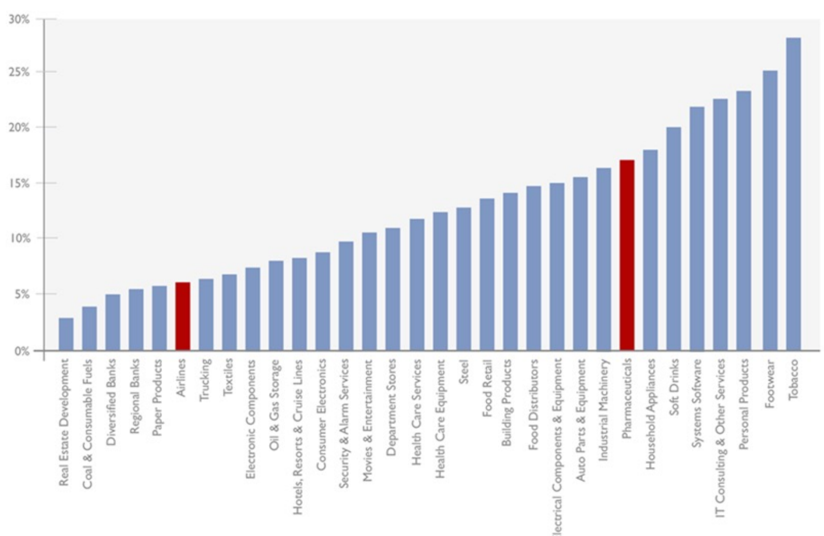
Module I: Heterogeneity in Performance Across Industries



2010-2021, US Compustat)

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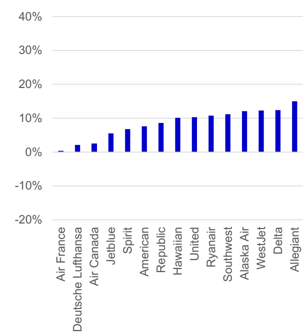
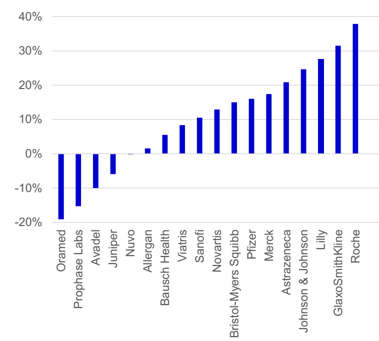
Module II: Competitive Advantage
Differences in Profitability within Markets

Return on Invested Capital, 2005-2021, of Selected Airlines



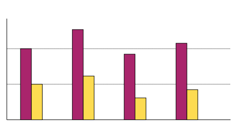
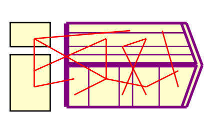
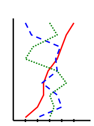
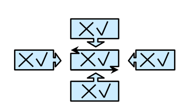
Return on Invested Capital, 2005-2021, of Selected Pharmaceutical Companies



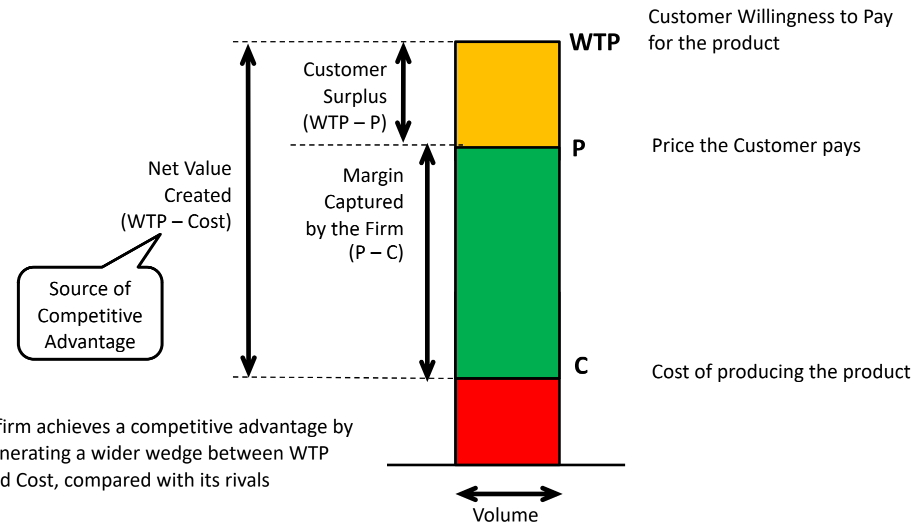
- Differences in profitability within industries are typically even larger than differences across industries
- It is essential to have a systematic way to think through the roots of those differences
- In this module, we have focused on four patterns among companies with advantage

Competitive Advantage:
Patterns among Firms with Advantage

1. Wider wedge between customer willingness to pay (WTP) and costs
2. Reinforcing choices of advantage, scope, and activities throughout the value chain (internal consistency)
3. Distinctive value proposition
4. Effective response to competitive forces (external consistency)

Value Bar: A Pictorial Representation of How a Firm Achieves Competitive Advantage



A firm achieves a competitive advantage by generating a wider wedge between WTP and Cost, compared with its rivals

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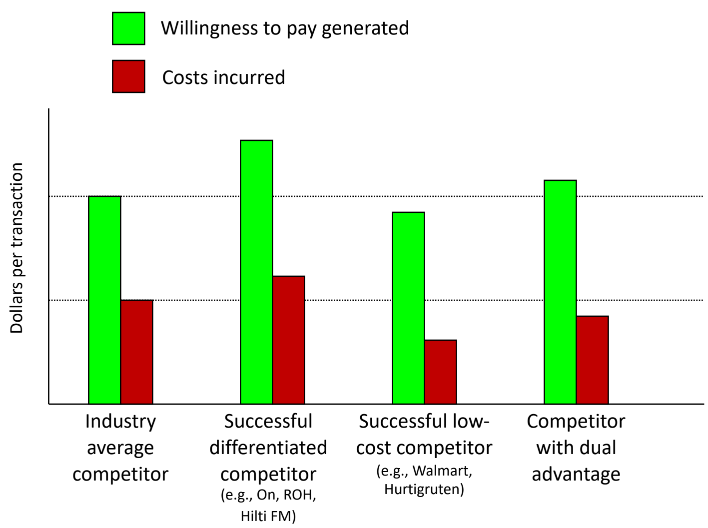
Competitive Advantage:
1. Wider Wedge between WTP and Costs…Types of Advantage



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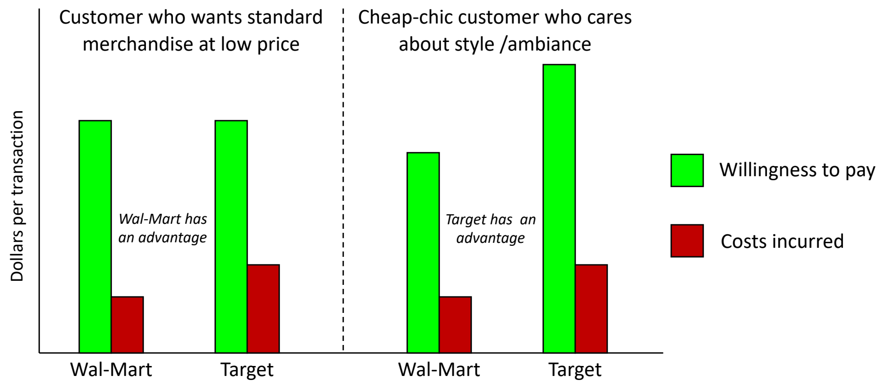
Competitive Advantage:
1. Wider Wedge between WTP and Cost…by Customer Segment



Advantage is defined with respect to a specific customer segment
Different companies can have an advantage for different segments

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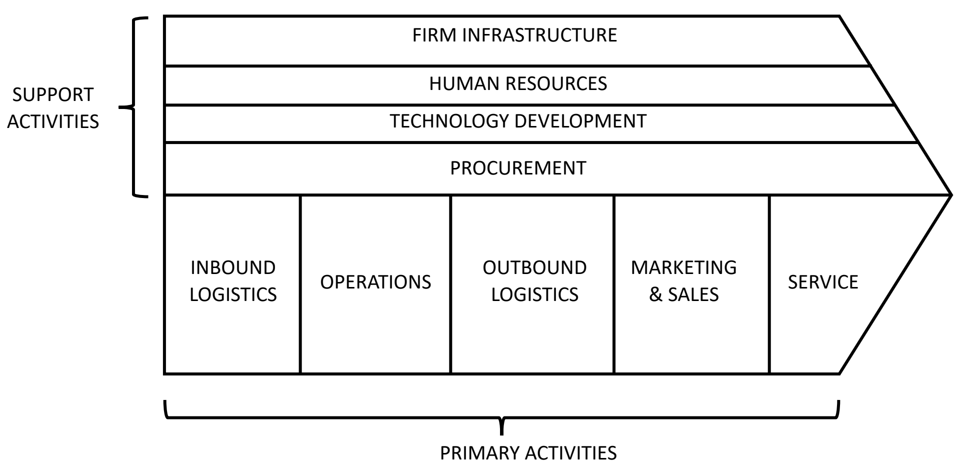
Value Chain: Establishing Competitive Advantage by Engaging in Distinctive and Reinforcing Activities

What are the critical activities and are they properly aligned and mutually reinforcing?



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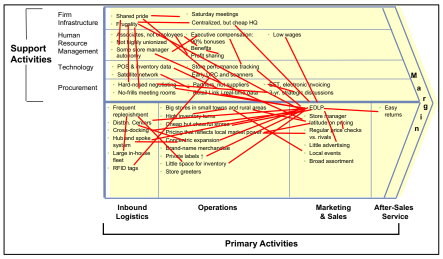
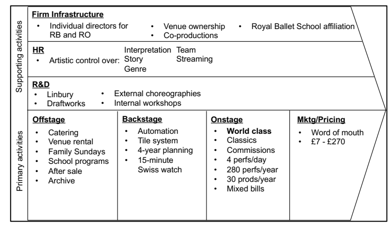
Competitive Advantage:
2. Distinctive & Reinforcing Activities (as Represented on Value Chain)

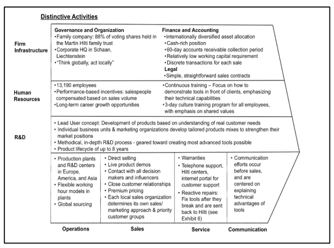
Classic Walmart



ROH



Hilti



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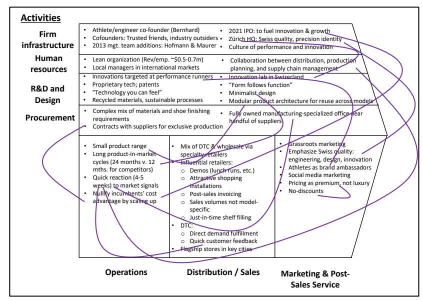


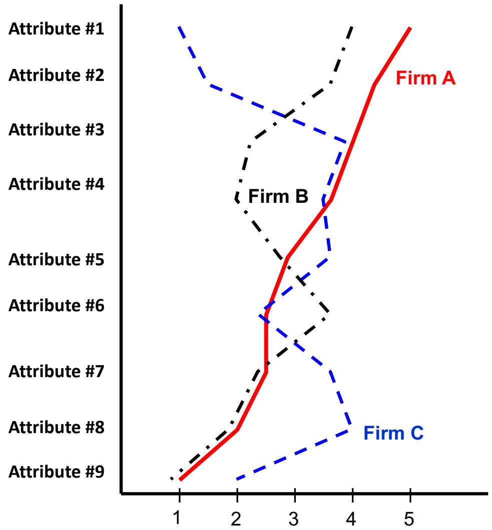
Competitive Advantage:
3. Distinctive Value Proposition

- It is rare that a company can be everything to everyone
  - Different customers are willing to pay for different attributes, or they put different weights on the same attributes (Walmart, ROH)
  - Different segments of the market often require…
    - …different employees with different HRM approaches (ROH – Opera v. Ballet, Hurtigruten –warm water v. cold water)
    - …different systems of activities (Walmart – physical stores v. online, Hurtigruten – warm water v. cold water, Hilti – tools sales v. fleet management)
  - Companies that try to be too broad risk getting picked apart by specialists who choose segments and tailor themselves to those segments (Hurtigruten?)

- Companies with strong competitive advantages typically make tradeoffs
  - They forego being the best on some attributes so that they can excel on targeted attributes ⇒ distinctive value proposition (Walmart, Hurtigruten, ROH)
  - What you choose not to do is essential (Walmart, ROH)
  - Look especially for choices that make it difficult for competitors to straddle positions

Value Map: Establishing Competitive Advantage in the Eyes of the Target Customer Segment

Customer segment: xxx



Steps in value map analysis:

1. Identify the target customer segment that you wish to serve
2. List out product attributes
3. Prioritize attributes from "most important" to "least important" (in the eyes of the customer)
4. Put yourself in the customer's shoes and rate your performance and your rivals' performance on each attribute
5. Identify areas for improvement
6. What are you willing to give up to be able to be good at attributes that are important to your target market segment?

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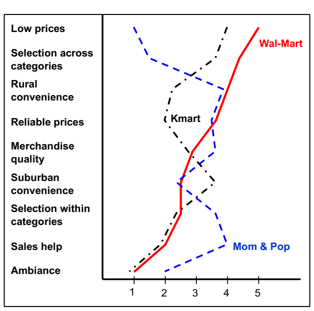
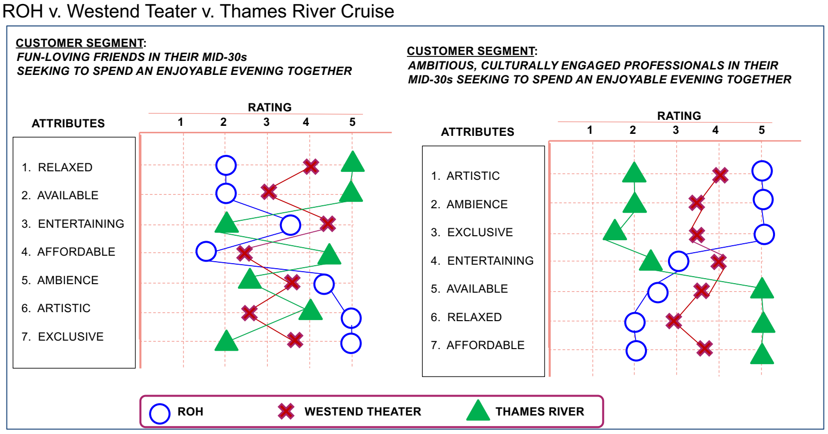
Value Map Examples: Walmart, ROH

Walmart v. K-Mart v. Mom-n-Pop



ROH v. Westend Teater v. Thames River Cruise



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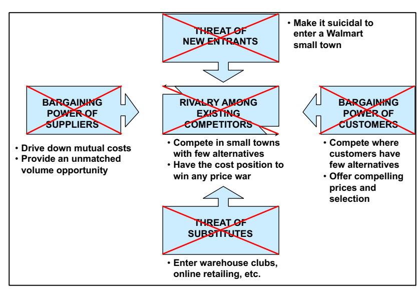
Competitive Advantage:
4. Effective Response to Competitive Forces

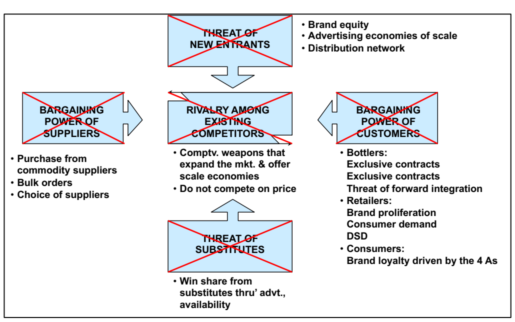
- The Five +1 Forces encompass the factors that can drive profit out of an industry
- Companies that outperform their rivals in an industry find some way to deal better with the Five Forces than do the rivals
  - They find segments that are less exposed to the Five Forces
    - Segments that are served by few others, that have high entry barriers, that find substitutes unattractive, that have high customer loyalty, etc. (On)
  - They configure themselves to neutralize the Forces. For instance, they…
    - Focus on segments not targeted by rivals (Hurtigruten, Pepsi v. Coke, On v. Nike/ Adidas)
    - Build customer switching costs and barriers to entry (Walmart in small towns, Hilti fleet management)
    - Find alternative sources of supply (Walmart)
    - Offer attributes not available from substitutes (Coke & Pepsi, Walmart, Hilti)
    - Lock in customers by serving them uniquely well or appealing to customers' customers (Coke, Hilti, On)
  - This is the essence of external consistency

Responding to External Forces: Examples

WALMART



COKE & PEPSI



Relative Cost Analysis

- **Relative cost analysis** is a common and useful tool of strategic analyses
  - Helpful when figuring out how to establish, attack, or defend an advantage
- Typical process:
  - Start with a company to which you have access (the source)
  - Catalog the economically distinct activities of the source
  - Build up the cost structure for the source
  - Identify cost drivers
  - Pinpoint how the target company differs on cost drivers
  - Estimate costs for the target, activity by activity
  - Determine, or make a judgment, whether the activity costs are fixed or variable
  - Compare final cost estimates to aggregates; refine
  - Use estimates to conduct sensitivity analysis and explore "what if…"
- Examples: Walmart v. K-Mart, Hurtigruten

Some Good Habits for Relative Cost Analysis

- The analysis should be done at the level of a transaction
  - Typically, this is in terms of what the customer actually buys
  - It should not be done simply as a percent of revenue

    The latter approach does not provide insight into the cause of advantage: is it cost-leadership or differentiation?
- Use aggregate financial statements with caution
  - Aggregate financials mix together lots of products, can be manipulated, and are often not comparable across companies
  - If that's all the information you have, then make the best of it
  - But when you can, build up from finer-grained information
  - And use the aggregate financials to triangulate and confirm analysis
- Focus your analytical effort on activities…
  - That account for a large portion of total costs
  - That are configured differently across firms
  - Whose costs you do not understand well
- Try to distinguish between fixed and variable costs
- Remember that analysis of relative cost is only half of an analysis of competitive advantage

  Don't forget willingness to pay

Estimating Willingness to Pay

- WTP is not just an abstract idea
  - In B2C contexts, WTP can be estimated through a combination of approaches: research methods (e.g., survey interviews, conjoint analysis, Van Westendorp price sensitivity meter), behavioral data (e.g., market data, competitor benchmarking), experiments (e.g., A/B testing, tiered pricing tests), and indirect signals (e.g., purchase intent v. drop-off rates, secondary market behavior)
  - In some B2B contexts, it can even be calculated
    - Begin with the best alternative for the target customer
    - Add to the price for that alternative all the additional costs, direct and hidden, that the customer incurs in using the product/ service
    - Subtract from this amount the customer cost (direct and hidden) of using the focal product/ service
    - This provides the WTP for the focal product/ service
- Conceptually, WTP provides the ceiling up to which a company can charge its price for a product/ service
  - However, customers may not be aware of hidden costs
    Thus, if if hidden costs of the alternative are relatively high, a company has lower pricing power with a moderately informed customer than what the WTP of a well-informed customer might indicate
    The company may push up its pricing by educating customers about their hidden costs
- Example: Hilti

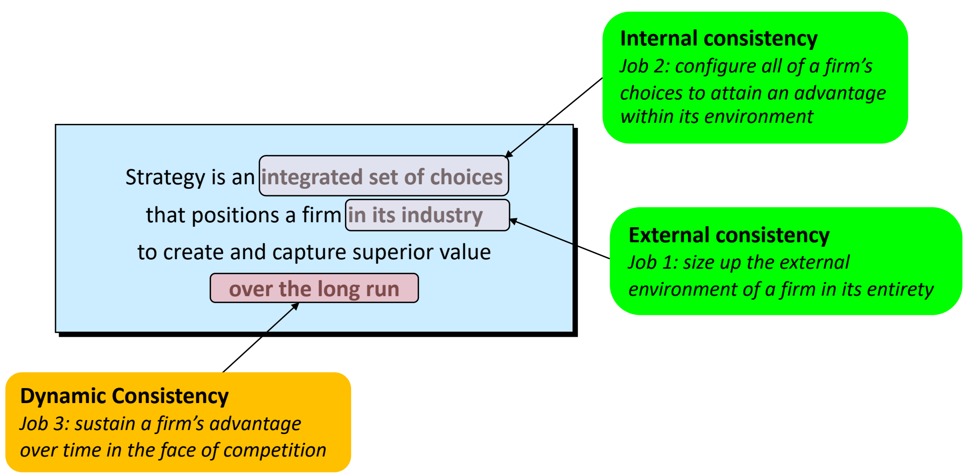
Business Model Innovation: Opportunity and Challenges

- Business model innovation is an attempt to build an innovative business model that anticipates and meets latent customer needs
- In practice…
  - It is hard to discover and satisfy latent needs
  - The customer isn't aware of the needs
  - Members of your organization may also doubt they exist
  - And your company might lack the capabilities needed for the innovation
- Thus, business model innovations face the four-fold challenge of:
  - Innovation: What does the customer need (not just want)?
  - Customer education: Does the customer appreciate the value of the new offering?
  - Internal persuasion: Are my constituents prepared to make the changes to deliver the new offering?
  - Capability development: Does my company have the resources to deliver the new offering in an effective manner?
- There is no magic formula, but a few things help in implementing business model innovation:
  - A powerful story of why the status quo is dangerous
  - A compelling vision of a brighter future
  - A set of restless leaders
  - Ownership that is supportive of management
  - Resources to invest in the short term to achieve returns in the long term
  - A sandbox in which to try out new ideas
  - A track record within the organization of scaling up sandbox ideas and celebrating innovations

Strategy and Non-Profits

- Why do non-profits exist?
  - In some situations (externalities, public goods, institutional voids), market solutions based on private ownership and personal motives fail to meet societal needs
  - In such situations, individuals may group together to achieve the desired goals without assigning preeminence to personal economic returns
- How are non-profits different from for-profits?
  - Non-profit goals are not targeted toward maximizing economic returns
  - Often, non-profits have a multiplicity of goals
  - This has implications for funding sources, how they are governed, stakeholders to whom they are responsible, transparency requirements, and type of people who are attracted to them
- Is strategy relevant to non-profits?
  - Yes! Perhaps, even more than in for-profits.
    Given multiple objectives and multiple stakeholders, there is a real risk of diffusion of effort in the absence of a clear strategy.
  - Other elements of strategic thinking are also very relevant: think of the ecosystem, compare yourself with other alternatives, ensure activities are integrated, create value over the long term
  - Two tweaks are needed, however, in thinking about strategy:
    - Think of value in broader terms, beyond economic value accruable to the principal
    - Rather than "create and capture value," aim to "create value and distribute it among relevant constituencies"

Competitive Interaction: On to Job 3



What's Next?

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  - Ryanair
  - Fiber Optics
  - Keroche
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