

## **INNOVATIVE COMPETITIVE ADVANTAGE DETERMINATION MODEL**

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**Abstract.** Nowadays, in the times of globalisation, competitive business environment, market saturation, and the increased consumer power, the client becomes increasingly more definitive in manufacturer's and client's interrelations. Therefore, an efficient satisfaction of client needs becomes increasingly significant in achieving business success. Driven by all these forces, the companies are looking for opportunities to define and develop their competitive advantages. There are developed various methodologies how to determinate competitive advantage. Various scientists have given their input to polish and clarify methodology routes to determinate competitive advantage but the authors of the article challenge achievements still far and propose new input, based on theoretical base, expert surveys, and empirical experience.

The **aim** of the article is to provide effective methodology of company`s competitive advantage determination. The **tasks** of the article are: 1) to inspect various approaches or competitive advantage determination; 2) to evaluate most recognisable opportunities of competitive advantage determination; and 3) to introduce and evaluate new competitive advantage determinant model.

**Research methods:** theoretical observation of existing competitive advantage determinant methods, expert survey of 35 entrepreneurs and representatives of executive management, representing international companies.

**Research object:** competitive advantage determination models.

**Research subjects:** competitive advantage and its constituent components.

**Hypothesis:** existing competitive advantage determination methods are rather too generic or too academically complex to be applied in empirical cases. The empirically useful and effective way to determine competitive advantage is to follow nine logical steps that are defined in the competitive advantage Iceberg model developed by the authors.

**Key words:** marketing, competitive advantage, strategic goals.

**JEL code:** M31

### **Introduction**

The legendary GE CEO Jack Welch has once said: "If you don't have a competitive advantage, you don't compete." The authors of the article could not agree more. Competitive advantage as theoretical subject is considered as a must for successful and efficient company, yet, it is rarely visible in the practice. The authors of the article have identified that Latvian entrepreneurs and executive leaders know generally what is competitive advantage but they have difficulty to identify an understandable way to determinate it, which indicates that the knowledge of competitive advantage is more theoretical, and rarely is implemented in the practice. A theoretical observation shows various methods how to determinate competitive advantage, rather too generic or too academically complicated to implement into

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empirical environment. Lack of effective step by step approach to competitive advantage has made companies to become competitive advantages naturally oriented on internal-functional coordination or on competition driven by short term economic benefits, thus, forgetting other possible directions. Common company practice is to choose one of M. Porter`s defined competitive advantage routes as companies competitive advantage, without deeper investigation where the considered advantage is routed and linked with companies operations and targets. Competitive advantage is much more complicated decision, the company is grounded within cost, innovation, differentiation leaderships, or focusing on operational effectiveness Excellency. Well investigated and defined competitive advantage has power to guide company more efficiently towards its strategic and tactical targets. The article presents a new approach to competitive advantage determination – simple and well understandable but, meanwhile, commodious of substantial information of particular company and its micro and macroeconomic background. Classic approach relies on M. Porter's value chain model which has later been modified by various researchers. The authors of the article assume that the classic value chain has become an insufficient tool to identify and develop competitive advantage for a modern company. Therefore, the authors investigate competitive advantage development models by using various sources. Based on theoretical background, expert survey and empirical experience, the authors propose a new competitive advantage determination model – the competitive advantage Iceberg model, according to which companies can determine their competitive advantage by following logical step by step order. The model is proposed to be an original method for determining company's competitive advantage.

## **1. Explanation of competitive advantage**

The main subject of the article is **competitive advantage**. M. Porter defines competitive advantage as the strategic advantage one business entity has over its rival entities within its industry. The term competitive advantage is the ability gained through various attributes and different level resources to perform at a higher level than others in the same industry or market. A competitive advantage exists when: 1) the company is able to deliver the same benefits as competitors but at a lower cost of goods (cost advantage); or 2) deliver benefits that over exceed those of competing products (differentiation advantage). A competitive advantage enables the company to create extra superior value for its customers and/ or superior profits for the company (Chaharbaghi, K., Lynch R., 1999).

A Dictionary of Economics by Oxford University Press defines competitive advantage as advantage a company possesses over its competitors. There are numerous sources of competitive advantage, including more efficient production techniques, brand image, consumer loyalty, and location. Possession of a competitive advantage should deliver a company a higher level of profit than obtained by its rivals (Black, J., Hashimzade, N., Myles, G., 2012).

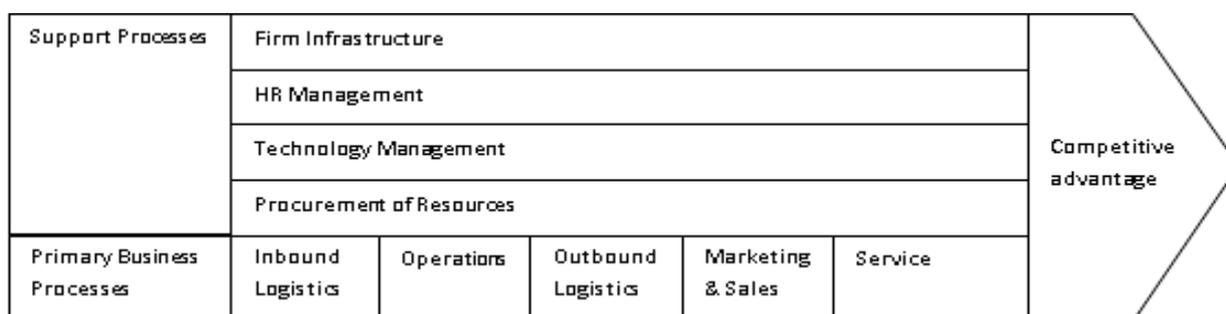
An advantage over competitors is gained by offering consumers greater value, either by means of lower prices or by providing greater benefits and better servicing facilities that could justify higher prices. This advantage may be achieved in various ways, including increased product performance, superior distribution methods, or creative advertising. Most forms of competitive advantage cannot be sustained in the longer term because competitors will initiate or find substitutes for the innovations that created it. A company is said to have sustainable competitive advantage (SCA) when it has resources that cannot readily be imitated or substituted (Oxford University Press, 2009).

J. Caune and A. Dzedons, strategic management scientists in Latvia, determine competitive advantage as follows: “competitive advantage is values formative operations and resources which ensure profitability of over average profitability level within industry, and are capable to maintain it in long-term conditions” (Caune, J., Dzedons, A., 2009).

## 2. Competitive advantage determination by various methodologies

### 2.1. M. Porter’s approach

According to M. Porter, competitive advantage can be identified through the value chain model – basic tool for analysing the sources of competitive advantage (Figure 1) (Porter M. E. 1998).



*Source: authors` construction based on M Porter*

Fig. 1. **M. Porter value chain**

To achieve a competitive advantage, the company must perform more value creating activities or assets in a way that create more total value than company`s competitors. In competitive terms, value is the amount buyers are willing to pay for what a company provides them. The value chain represents all the activities that are performed to design, market, deliver, and support the company's product. All the operations that construct the value chain can be divided into two broad groups – primary activities or primary business processes, and support activities or support business processes. Primary activities are the activities involved in physical creation of the product and its sales as well as after-sales assistance. Any or all of these primary activities may be vital in developing a competitive advantage. Support activities support the performance and operation of primary activities as well as each other by providing purchased inputs, technology, human resources, and other related functions (Porter M. E. 1998).

Porter's concept of competitive strategies explains that competitive advantage for a company exists when the company is able to 1) deliver the same benefits as competitors but at a lower cost of goods (cost advantage); or 2) deliver benefits that over exceed those of competing products (differentiation advantage). Competitive advantage enables the company to create extra superior value for its customers and/ or superior profits for the company. Another important aspect that has to be taken into account, according to Porter, is how broad or narrow is the company's served market segment. Based on this aspect, Porter formed a matrix that can help companies identify a set of generic strategies – cost leadership strategy, differentiation strategy, and focus strategy. The company can achieve the above-average performance in an industry by implementing one of these three strategies (Porter M. E., 1998).

Cost leadership strategy may be the clearest of the three generic strategies. It usually targets a broader aspect of the market and it is being the low cost producer in an industry for a particular level of quality and segment. The company that implements cost leadership strategy sells their products at

average industry prices to earn a profit higher than competitors, or even below the average industry prices to gain greater market share. The company may even operate in other related industries implementing this strategy – the company’s breadth is often important to maintain its cost advantage. According Porter, in the occurrence of price war, the company can still maintain profitability while its rivals suffer losses (Porter M. E., 1998).

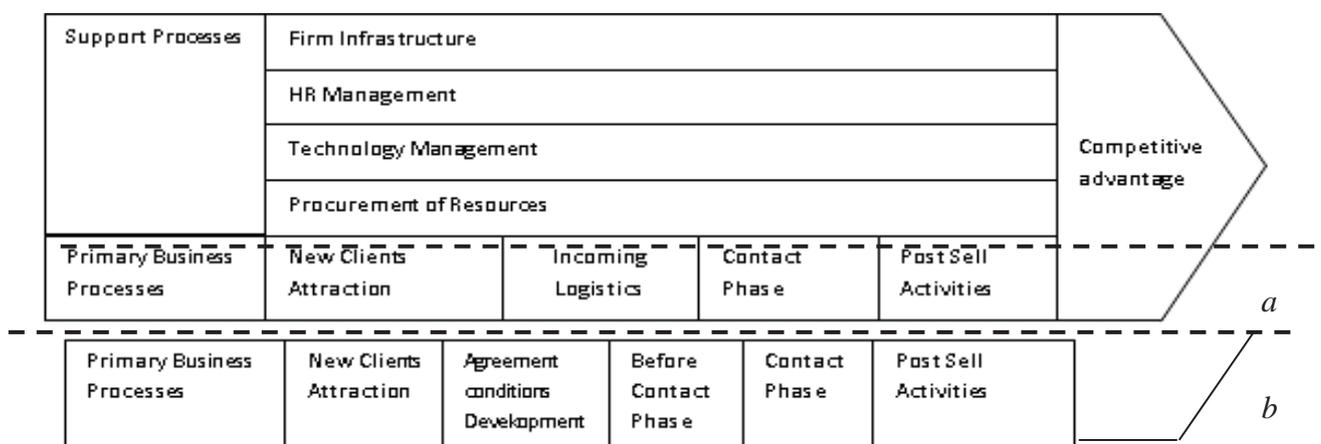
In a differentiation strategy, a company seeks to be unique in its industry along those dimensions that are important to buyers. It means that, by implementing differentiation strategy, a company seeks to develop such product or service that offers any type of unique attributes that are valued by customers and that customers perceive to be better than competition. Differentiation can be based on the product itself, the delivery system, the marketing approach as well as on other factors (Porter M. E., 1998).

While cost leadership differentiation strategies seek competitive advantage in a broad range of industry segments, the strategy aims at cost advantage (cost focus) or differentiation (differentiation focus) in a narrow segment. This is the greatest difference between focus strategy and other two strategies. The premise is that the needs of the target audience can be better serviced by focusing entirely on it (Porter M. E., 1998).

The generic strategies are not by premise compatible with one another. If a company attempts to achieve an advantage on both cost leadership and differentiation, it may end up with achieving no advantage. For example, the benefits of optimising the company’s strategy for one specific segment (focus) cannot be gained if a company simultaneously serves a broad range of segments (i.e. adapts the main elements of cost leadership and/or differentiation strategies) (Porter M. E., 1998).

**2.2. Value chain modifications and criticism**

M. Benkenstein has provided interpretations on the services value chain. He modified the value chain so it could be more appropriate for product as a service – for project type services and for continuous type services (Figure 2). For project type services, four activities are highlighted as primary: new clients attraction, incoming logistics, contact phase, and post sales activities.



Source: authors` construction based on M Benkenstein

Fig.2. M.Benkenstein’s value chain for project type services (a) and continuous type services(b)

For continuous type services, the following activities are highlighted as primary: new clients’ attraction, agreement conditions development, before contact phase process; and post sales activities.

However, Benkenstein's provided value chains for services have not highlighted a company's marketing importance; besides, contact phase is versus Porter's sales and marketing connected activities. Another aspect that should be taken into account is that Benkenstein represents the German management school that merges marketing and sales as one structure within a company (Benkenstein, M., Uhrich, S., 2009).

Porter's model has later been modified by several other scientists. It can be concluded that known scientists have amended Porter's approach of determining company's competitive advantage. Besides, the popularity of very first classic approach and its later modifications, challenge of merging theory, and strategy still remains.

The previous analysis identifies fragmented approach to analyse. Main disadvantages of currently existing competitive advantage determination models include: 1) lack of accomplished strategy flow and instruments system; 2) fragmented highlights of one or several particular aspects; and 3) controversial hierarchy flows of the functional, business level, global and corporate strategies.

After considering all the criticism and the authors' personal practical experience, the authors concluded that the classic Porter model was not the most sufficient tool for identifying and developing the company's competitive advantage. Challenge still remains how to set competitive advantage step by step.

### **2.3. Other authors approaches to competitive advantage determination**

Although, M. Porter value chain is classical and the most known approach to set competitive advantage, there are a lot of other authors who tried to distanced from Porter's approach and have developed their own methodologies for determining competitive advantage. For instance, Rindova and Fomburn in their developed model "Systematic model of competitive advantage" look at the company's competitive advantage development as logical outcome of six processes. These six processes are: strategic investments, industry paradigms, resource allocations, strategic plots, strategic projections, and definitions of success. All six processes are interrelated. Throughout their research, Rindova and Fomburn have concluded that competitive advantage development process is interactive, and it is built through a social influence process. Rindova and Fomburn also suggest that competitive advantage development process is a learning process (Rindova, V. P., Fomburn, C. J., 1999).

Also Garry L. Adams, a researcher, claims that learning based culture is an important aspect in achieving the competitive advantage. He claims that a company can revitalise its products and processes as well as create new attractive ones by continuously developing learning and innovation processes. In his developed model "KMS-sustainable competitive advantage development process model", Adams states that companies develop their competitive advantages through bundling and synergistic merging of various company resources. Its main idea is that organisations achieve competitive advantage through the systematic application of learning, knowledge acquisition, and knowledge application via product, service, and process innovation (Adams, G., L., Lamont, B. T., 2003).

## **3. Overview of the CA Iceberg model**

After all the considerations that were made throughout the paper, the authors provide their concept on determining the competitive advantage. It provides empirically easy usable structure for

determination of competitive advantage. The main innovation in the CA Iceberg is the ability to link each component of company processes, starting from stakeholder goals to operational activities, in accurate and simple to follow order. During expert surveys, the authors of the paper have identified that the majority of experts, entrepreneurs, and managing directors do not link theoretically made competitive advantage with functional, business, global and corporate strategies. The CA Iceberg model consists of 9 logically sequenced steps.

Step 1 starts with shareholders goals. It is rare when strategic management theory authors speak about goals initially, before initial methodologies of competitive advantage. The authors believe that every company exists in order to satisfy its stakeholders' interests. Those goals, whatever kind - either profit maximisation, long-term business developing, serving hobby, either growing share of market, or surviving always determinate company's available resources which is the key component of competitive advantage. Therefore, the very first step of model is to determine the stakeholder's strategic goals according to one of goal setting methodologies. According to the authors' conclusions on the expert survey, qualitatively settled goals of a stakeholder are hard to be announced, even for an entrepreneur itself.

Comprehensive strategic audit in company's key areas should be performed In Step 2. This part includes limited amount of external audits. The tools can vary upon industry, product or service components and latest available instruments. The authors of the paper highlight several most popular and empirically used ones. Key component at Step 2 is to use various methodologies, meanwhile, keeping stakeholder goals as guideline. In particular edition of CA ICEBERG, the following audits are highlighted: resources audit, value chain analysis, portfolio analysis, product added value analysis, core competences analysis, market and lifestyle trends analysis, competitors analysis, existing performance analysis, and consumer and their need states analysis. Various methodologies can be linked with strategic audit; the key point in CA ICEBERG model is to have strategic audit made from various angles.

The company's strategic orientation has to be identified in Step 3, taking into account the key findings of strategic audit. There are 4 available orientations - customer, inter-functional, competitors, or market. Orientation route should be guided based on stakeholder's goals and strategic audit. During the expert survey, the authors of the paper identified that some of entrepreneurs and managing directors guessed their company orientation. It is impossible to define company's competitive advantage before setting the company orientation but despite hundreds of strategic management approaches, still it is a reality.

Step 4 in the CA Iceberg Model is related with the definition of company's superiority potential. Here two general options are available - cost leadership or differentiation. A lot of new information and approaches have been generated as other superiority angles, like innovation superiority, process innovation etc. but the nature of those aspects reflect on leadership differentiation. As mentioned, direction of competitive advantage is only Stage 4 after definitions of smart stakeholder's goals, strategic audit, and company's orientation profile.

Step 5 opens gates to strategy setting. According to the defined competitive strategy, goals and orientation, growth strategy can be defined theoretically observed by various scenarios upon available resources and time pressure in the goals. Then, in accordance with the company's competitive advantage, managers should be able to identify the most effective and appropriate stakeholders' goals for the company's growth strategy.

Step 6 is the first step that can be seen externally without professional analysis, and it is related with corporate strategy development. The authors of the paper assert importance of hierarchy of strategy setting. Tactical strategy developments before business unit or corporate strategy setting lead to company's controversial actions which have a nature to weaken the company. Corporate strategy sets the rules of company game, after knowing very well goals, available resources, environments, consumer demands, and company superiority versus other players- competitors.

Steps 7, 8 and 9 define business unit, functional and operational strategies. Business unit strategy reflects companies where various business units are involved and their strategy. Functional strategies include various departments' strategies. Operational strategies can be developed after setting functional strategies. If to follow step by step the CA ICEBERG model, company managers in all levels should have clear guidelines to act in accordance and beneficially to company targets.

Permanent circulation is an important aspect of the CA Iceberg model between results back to stakeholder goals and up on according the steps. Competitive advantage setting within the CA Iceberg model is not a permanent process; it is permanent and regular information circulation, decision revision and upgrading if required in order reconsidering profitability and sustainability of the determined competitive advantage.

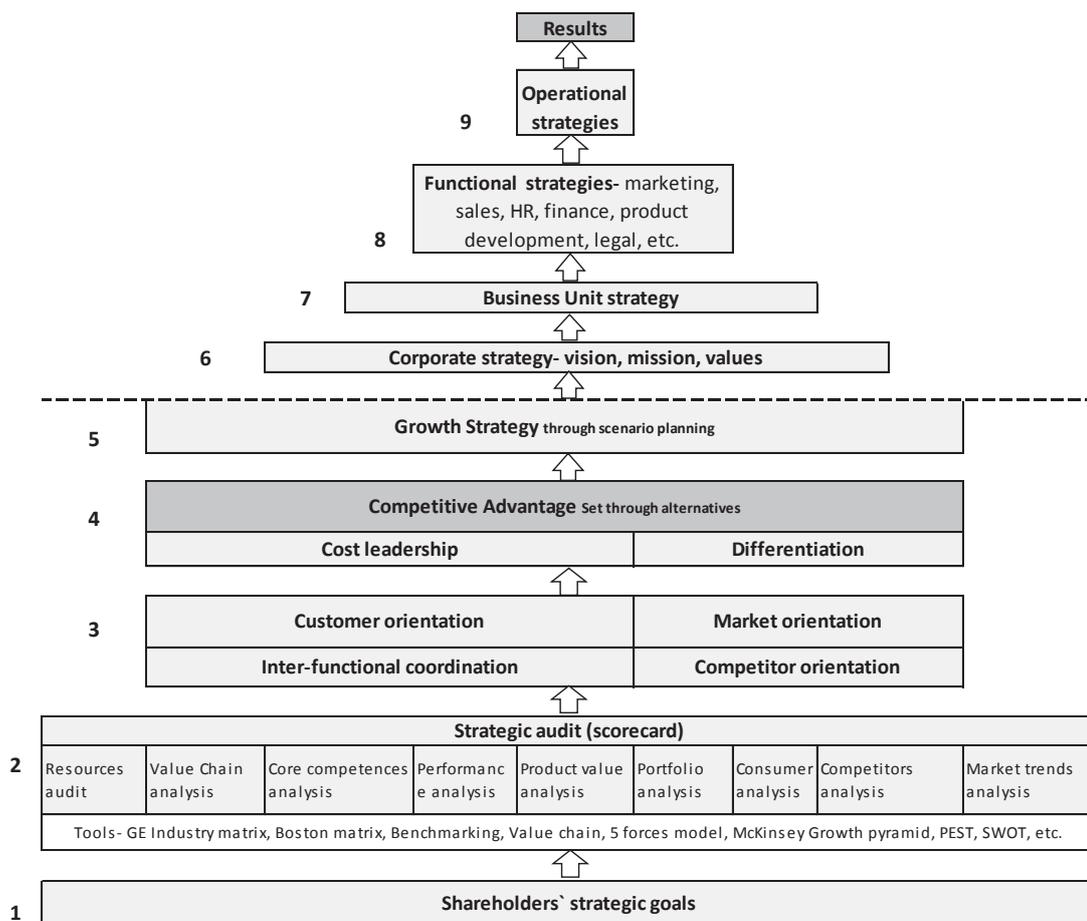
## **Research results and discussion**

The research results are integrated in the CA Iceberg model. The CA Iceberg model is illustrated in Figure 3.

According to the model's description, its structure is formed by 9 logically sequenced steps that can be divided into two main levels – "below the borderline" level and "above the borderline" level. All the elements in "below the borderline" level are the most essential ones for the company and these elements are known to internal stakeholders only, while elements in "above the borderline" level can also be seen by external stakeholders.

Opinions about the developed CA Iceberg model widely vary. For instance, experts Oleg Goussev (SPI Group) and Andris Putnins (University of Latvia) rate the model's usage effectiveness regarding company's competitive advantage determination as excellent and very useful, while an expert Dr.oec. Janis Caune mentions that the result the authors' have provided is no model. Model's empirical usage index is evaluated on 7, 16 from maximum 10 points by experts. Experts highlight several comments for the model. One is related with the existing situation in business environment that competitive advantage is hard to achieve with the exiting methodologies and the CA ICEBERG does not disperse doubts. "The model is great and very detailed. The reason for the "mark 7" is that it seems that in the business world - competitive advantage is much harder to achieve than it is presented in the Iceberg model. In the Iceberg model, competitive advantage is defined/achieved in Step 4. From my experience, Step 4 is where the company's management just realises that there is an opportunity to create a competitive advantage. You are absolutely right, they realise it probably after analysing Steps 1,2,3. In Step 4, they know there is an opportunity and have an idea what needs to be done to create this competitive advantage. Then, the model correctly points out; they would design their corporate strategy (Step 6). Then, they would go through Steps 7, 8, 9 to implement this strategy. And only then, if Steps 6,7,8,9 have been implemented successfully and your competitors have not managed to do the same – the

company has truly achieved competitive advantage, which can be very hard to do in practice and where most businesses fail. For my company, competitive advantage sits somewhere next to "Result", right on top of the Iceberg (Step 10), just because it is so difficult to achieve in practice. I know what my competitive advantage can be, but I have not achieved it yet. In order to achieve it, I need to get Steps 6,7,8,9 right. Also, I need to make sure that I do it better than my competitors. And do it faster." Another comment is: "For a practical use, it contains too much information (nine layers - difficult to remember) but the concept - Iceberg with the SH interests being the defining factor is very intuitive and conceptually reflective of the nature of competitive advantage."



Source: authors` construction based on the research results

Fig. 3. **The CA Iceberg model**

Experts appreciate and highlight models organisational structure: "CA Iceberg model is a good approach to visualise and conceptualise what is the competitive advantage in action - what consists of and what the tools of building and further keeping it alive are within the organisation. It is a good example of holistic cross-functional strategic management approach to business." Meanwhile, the experts highlight challenge of human aspect to be able to implement model in business environment daily: "This is a very disciplined approach, and would force people to think specifically and strategically about aspects of day to day business that they may otherwise pay little attention to. As with all models of this nature, their effectiveness relies so heavily on the individual and the importance of disciplined marketing activities to him and the organisation for which he works." Experts highlight need to be more focused on

precise tools: "The models appears efficient but it would be interesting to review some additional more in-depth materials, covering individual research tools, in order to access the applicability of these technologies / tools in respect of company."

### **Conclusions and proposals**

The authors have made the following **conclusions**.

1. Iceberg principle unites instant competitive advantage determination methods and approaches in one supplemented holistic method.

2. Iceberg principle provides competitive advantage integrity between the company shareholders tasks and growth strategy in a consequent built.

3. Iceberg principle identifies and highlights contiguity of shareholders tasks, company mission and values, its competitive advantage and corporative, business unit and operation strategies.

**Proposals** for further research.

1. Develop further Step 2 in details to differentiate precise tools for strategic audit to various industries.

2. Consider visual streamline opportunity referring on the expert comments to facet for more laconic construction.

3. Include information flows in the Model, to make it more understandable.

4. Empirically approbate model in the environment with expert methods.

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