CHAPTER 1

HOW VALUE AND ADVANTAGE AFFECT FIRM ACTIVITIES

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WHAT IS VALUE

Organisations exist for a reason. They must have a purpose that drives their strategy. Regardless of whether it is public, private, for profit or nonprofit, the business will have some underlying reason for being in existence. If that purpose and strategy is not clear or well understood it can affect alliance activity, and more importantly impact whether the business creates or destroys value. The purpose should have something to do with creating value for stakeholders such as itself, its shareholders, customers, suppliers and other interested parties. So what is value?

At an individual stakeholder or customer level, value means different things to different people and at different times it can be valued in vastly different ways. Treacy and Wiersema[1] suggested that 'value' is made up of components including: price, time, premium service and quality, and see 'value' as being the combination of the costs customers pay and the benefits they receive. This

applies to both the products sold and services offered. Product costs include 'price and less than perfect reliability including the whole life cost of ownership. Service costs include mistakes, delays and inconvenience because customers are said to pay with both their time and money.' Outlining the benefit side, value comes out of the features and needs fulfilled by the product and from the kinds of service benefits provided, and these are only seen as benefits if they 'substantially exceed competitors' offerings'.

Many people value low price, others high quality, some fast service, while others are concerned about environmentally friendly goods and are prepared to pay more for that benefit because they value it. So in simple terms value is 'the overall price paid or investment made for the benefits gained in return'.

As suggested, the 'overall price' can be made up of both explicit and implicit factors. For example, the 'price' you pay for access to a daily newspaper might include the face price of the newspaper, the time it takes you to get that paper, and the effort in researching which paper to buy. It also includes the hidden implications of not buying another paper or a substitute (e.g. reading a website) which could provide you with the same or better benefits at a lower overall price, such as reduced cost of disposal afterwards. There are also psychological prices paid as well, perhaps less for buying a newspaper but imagine the stress and risks involved in some investments such as buying a house, changing job, or perhaps selecting and managing alliance partners . . . although much of that stress disappears when purchasing from a trusted brand or someone who has a positive identity and reputation in that field.

Businesses talk about their 'value proposition' for customers. What they aim to communicate is the benefits achieved by investing in a product, service or solution from their organisation instead of others. Failure to articulate this message succinctly and clearly may mean the customer can't see the value in the proposition and the sale is lost. Sometimes an organisation's product or service by itself is not enough to solve a problem so customer prospects go elsewhere. Take

the simple example of buying a car. Without servicing, financing support, car insurance and breakdown protection the car may not be attractive for some people. This is where an example of a joint value proposition using alliances would make sense for some customers and is why many car dealerships have just those relationships in place, either with sister companies or external partners.

Organisations measure and define value for their shareholders and key stakeholders in different ways. For profit businesses emphasise the value they achieve in the form of financial revenue and profitability statements. When taken together with the future prospects for the firm these translate into higher value share prices if it is a listed organisation. Not for profit and public sector organisations may emphasise the creation of other value, for example people treated and lives saved by the National Heath Service (NHS) as well as value for money indicators and stakeholder satisfaction metrics. Many organisations now also generate more holistic scorecards that address not just financial value creation but also other metrics, for example customer and employee satisfaction, innovation, process improvement and others such as those termed 'the triple bottom line', which includes social and environmental measures as well as financial. All of these metrics should relate back to the purpose of the organisation and align with the value proposition for customers as well, because clearly the source of a company's long-term prosperity is in its satisfied customers. However, consideration also needs to be given to suppliers and other partners, and from an alliance perspective, any alliance activity should also relate to one or more of those goals.

Exercise 1: Value proposition

Select one of your products or services. Can you articulate in one sentence a compelling value proposition for your customer? How does it compare against competitors and other alternatives?

In this age of increasing competition and choice, customers, suppliers and others usually have many avenues to realise their benefits and goals. So in order to attract and retain its target audience an organisation must deliver greater value than other options available. For example, Tesco, the leading supermarket and growing retailer, seeks to offer equal or better products at the same or lower cost and in a more convenient location than its competitors either online at Tesco.com, or via its Express and large edge of town outlets. The benefit for the shopper is that they can trust Tesco to offer them a similar or better basket of goods when and where they want it at a cost that is at least as good as the other suppliers. Sainsburys by comparison suffered in the late 1990s with poor stock and inventory management so they lost out for many years, as have many of the specialist retailers and food operators that cannot compete with Tesco on price even though many may offer better service. Supply chain management is a key factor in successful retailing. As organisations rely more on external sources, and suppliers move to become alliance partners, it will be interesting to see whether the alleged adversarial practices by some dominant leading players can be sustained in the future.

In order to continually beat its rivals or maintain its position as the favoured supplier of its customers, organisations need to deliver better value and do it more consistently for their customers and other stakeholders than other options. At its most fundamental, this is the basis of competitive advantage.

UNDERSTANDING COMPETITIVE ADVANTAGE

For a prosperous future an organisation needs to ensure that its strategy will produce both value and competitive advantage. Alliances done well will enhance value, but done badly could result in serious value destruction, increased risk and erosion of

competitive advantage. While luck and indeed hope are not unknown strategies for winning, and are important for success, they are not enough. There is usually something more powerful underpinning any firm advantage. It is also one of the reasons why prospective partners might see the organisation as attractive to work with in the future.

So value is now understood but what is competitive advantage and how do you get it? A brief step into the academic world with a skim of the literature will help clarify but remember, this book is not an academic critique or deep review of all the related concepts. These factors are introduced here to help the learning and reinforce the practical approach addressed in Part II.

Rappaport stated that productivity, the value of output produced by a unit of labour or capital, was the foundation for creating competitive advantage. He then went on to say 'a business creates competitive advantage when the long term value of its output or sales is greater than its total costs, including its costs of capital. This advantage can be achieved by providing superior value or lower prices.'[2] Tate & Lyle is a world leading manufacturer of renewable food and industrial ingredients. They have a competitive advantage in the manufacturing of speciality syrups (e.g. Lyle's) and treacles through the nature of the manufacturing process and sheer scale of the business. Focus and ongoing development, both in manufacturing capabilities and the increasing variety of products available to its customers, as well as development of market share are used as measures to ensure continued competitive advantage.

Michael Porter, the leading strategy guru, has written extensively about competitive advantage[3]. He said that competitive advantage 'grows fundamentally out of the value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay and superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price.'[4]

In his early work Porter[5] presented his three 'generic strategies': cost leadership, differentiation and focus as the basis for competitive advantage. Porter argued that you should only focus on one generic strategy or there is a risk of getting 'stuck in the middle'. The concept of only being able to adopt one of the generic strategies has, however, been dismissed by many authors[6], most notably citing the Japanese car industry and its approach to the US, and Walmart, both offering differentiation and lower costs.

Depending on how you define focus, in the UK, Tesco and BT are examples of firms following all the generic competitive strategies. The BT website[7] states eight strategic priorities which include each of the strategies above:

- Keep a relentless focus on improving customer satisfaction
- Put broadband at the heart of BT
- Create mobility services and solutions
- Transform our network for the 21st century
- Achieve competitive advantage through cost leadership
- Lead the world in network centric ICT solutions
- Reinvent our traditional business
- Motivate our people and live the BT values

In their book *The Discipline of Market Leaders*, Treacy and Wiersema[8] argued that new rules meant that a different strategic approach was needed for competitive advantage. They suggested that four new premises underpinned the 'New World of Competition' where the buyer was now king:

- Companies can no longer raise prices in lockstep with higher costs; they have to try to lower costs to accommodate rising customer expectations.
- Companies can no longer aim for less than hassle-free service. Their customers enjoy effortless, flawless and instant performance from one industry and want it from every other.

- Companies can no longer assume that good basic service is enough; customers demand premium service – and raise their standards continuously.
- Companies can no longer compromise on quality and product capabilities. They must build products to deliver nothing less than superiority and eye-popping innovation.

The disciplines proposed by Treacy and Wiersema were built on the overarching value proposition the companies pursued and these disciplines shaped the entire organisation, from its culture to its public perception. The disciplines all needed to be in existence but with a clear focus on one. They are best total cost, best product or best total solution. Calling them their Value Disciplines the authors presented each as:

Operational Excellence (best total cost) – providing the customer with reliable products or services at competitive prices, delivered with minimal difficulty or inconvenience. Current well-known examples include Tesco, Vodafone and Dell.

Product Leadership (best product) – providing products that continually redefine the state of the art. Current examples include Starbucks, Intel, Cisco, HP and Disney.

Customer Intimacy (best total solution) – selling the customer a total solution, not just a product or service. Current examples here include Reuters, BT, IBM and the top professional services firms like Ernst & Young and Deloitte.

Exercise 2: Value disciplines

Which of the three value disciplines does your company adopt as its primary focus? Would your customers, suppliers and other stakeholders agree?

Each of the 'generic' strategies presented above is fundamentally a 'competitive' strategy. These strategies may have underlying tactics and objective where third parties and alliance partners are used. Indeed Porter[9] presented seven different ways for firms to consider differentiation, and one of the ways was to link with other firms in alliances (the others being: product features, links between functions, timing, location, product mix and reputation).

In more recent times, Porter has discussed the basis of competitive advantage as being drawn from the activities that an organisation undertakes. He stated 'ultimately all differences between companies in cost or price derive from the hundreds of activities required to create, produce, sell and deliver their products and services. Overall advantage or disadvantage results from all a company's activities not only a few.'[10] He later went on to highlight the risks of outsourcing and partnering without due care as it might deliver operational effectiveness but compromise future competitive advantage. Therefore before thinking about alliances or any other form of external relationship, the organisation must first know what it wants to focus on and where value is really created for customers, as it needs to be sure that it is going to deliver value and competitive advantage, and not erode or destroy future benefits.

There are various methods of analysis to support strategic decision-making and this is a well-trodden path for academics and practitioners alike. Kenneth Andrews is one of the earliest individuals to be associated with work about how strategy should be designed or formulated in order to achieve competitive advantage. He wrote, 'The interdependence of purpose, policies, and organised action is crucial to the particularity of an individual strategy and its opportunity to identify competitive advantage. It is the unity, coherence, and internal consistency of a company's strategic decisions that position the company in its environment and give the firm its identity, its power to mobilise its strengths, and its likelihood of success in the marketplace.'[11]

Andrews held the view that the principal 'subactivities' of strategy formulation were identifying opportunities and threats in the environment, including undertaking some form of risk assessment to the alternatives available. He also outlined the need to undertake a review of the internal situation to assess the resources 'on hand and available'. Rumelt[12] argued that competitive advantage could normally be traced to one of three roots; superior skills, superior resources or superior position, again reflecting that advantage can come either internally or externally. Position in this context could be associated with either size or scale and brand, and once in a good position it is usually defensible.

In their influential article 'Competing on Capabilities: The New Rules of Corporate Strategy' Stalk, Evans and Shulman[13] explain that the key to competitive advantage now is '*how*' the company chooses to compete and not just '*where*' it competes. As also proposed by Andrews, the '*how*' is determined by two separate but complementary forms of analysis, the external, industry-based analysis, and the internal, resource or core competence based perspective.

We shall focus in much more depth in Part II on the need for effective internal and external analysis. There is, however, a view that even with all the internal and external analysis available, uncontrollable factors and in-situ events may impact the chosen strategy and affect competitive advantage potential, both positively and negatively[14]. Good old luck also plays a part, although you will probably not come across too many examples where luck has resulted in any lengthy form of value creation or advantage!

To summarise, value and competitive advantage mean different things to different people. You are on the right track if you are delivering more value to your customers, more consistently than your competitors or other substitutes. Enhanced brand and reputation as well as increasingly positive results are an output from successful execution and past performance. To attempt to define value and advantage it could be considered that 'competitive

advantage is determined by the sum of the activities undertaken by an organisation and value is created from the effective deployment of a firm's core competences and broader assets into attractive well qualified external opportunities'.

The capabilities to deliver the activities can be built organically within the organisation, purchased at arm's length, acquired from merger or acquisition, or borrowed from alliances with other organisations. As will be seen in Part II, knowing which option to use and when, then executing well, is important as it affects value creation and advantage, yet is a competence lacking in many organisations.

Having now got a perspective on value creation and competitive advantage, Chapter 2 introduces one of the major options for achieving it, alliances, which is increasingly becoming a primary strategic choice for delivery of organisation strategy.