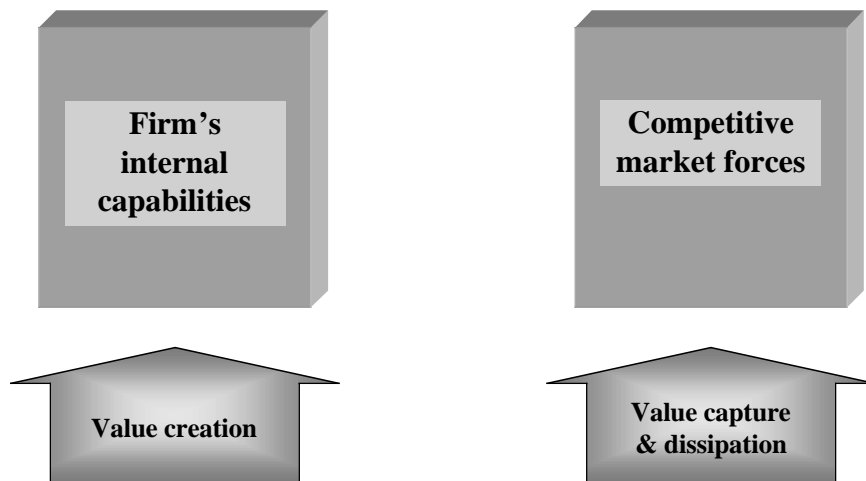


Competitive Strategy and Industry Structure

Competitive advantage and competitive strategy

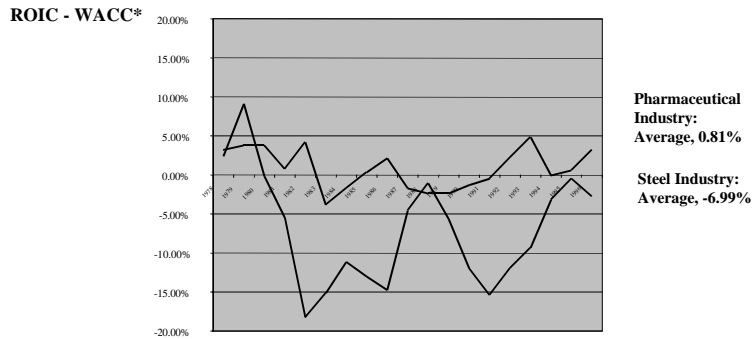
MECN 441
Professor Nabil I. Al-Najjar

Value creation vs. value capture



Profitability: *industry effects*

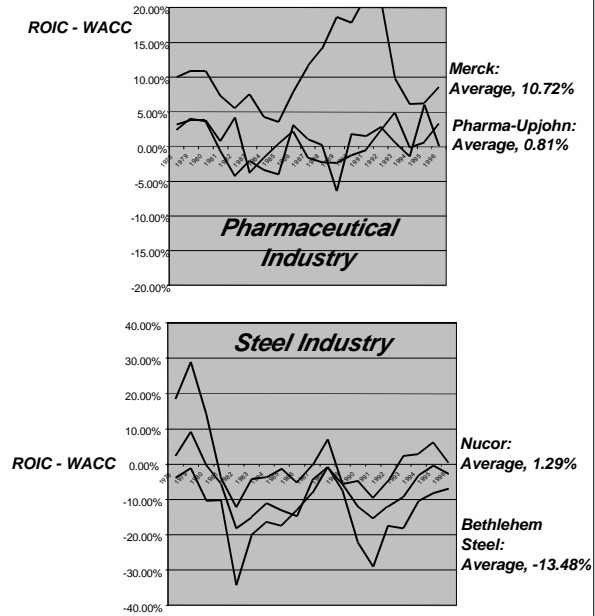
EXAMPLE: *Economic Profitability steel versus Pharmaceuticals, 1978-1998*



* Return on invested capital -weighted average cost of capital

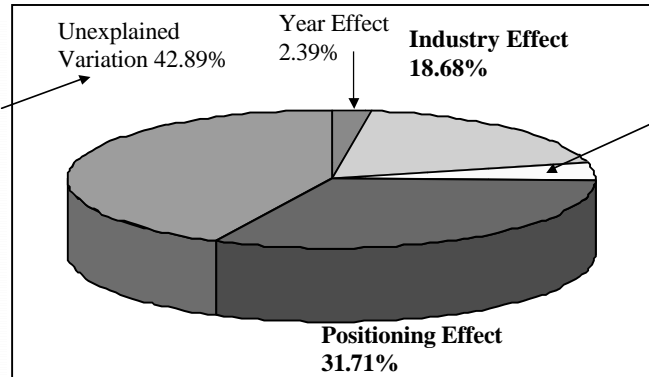
Source: Stern Stewart Performance 1000 Database

Profitability: *positioning effects*



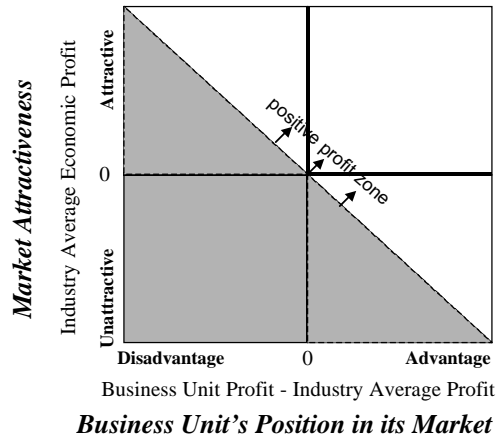
**Both matter
... to a somewhat different degrees**

This represents the variation in profitability across business units, across time that cannot be accounted for by the identity of the business unit, its industry, its corporate parent, or the particular year.



Source: Anita McGahan and Michael Porter, "How Much Does Industry Matter, Really?" *Strategic Management Journal*, 18, Summer 1997.

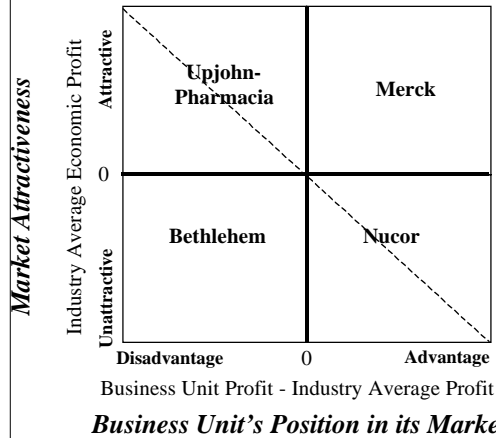
To generate returns on capital in the excess of the cost of capital ...



- ❖ Participate in attractive markets, i.e., markets that offer the typical or average player an economic profit, and/or ...
- ❖ Sustain competitive advantages in the markets in which you participate, i.e., outperform the typical player in the market.
- ❖ Both market choice and position within the market explain variation in firm performance over time.

Template based on Chapter 8 of McTaggart, J.M., P.W. Kotes, and M.C. Manken, *The Value Imperative* (New York: Free Press),

Steel versus Pharmaceuticals ...



- **Industries differ ...**
pharmaceuticals versus steel
- **... and so do firms within an industry:**
 - **firms with competitive advantages**
Merck, Nucor
 - **firms with competitive disadvantages**
Upjohn-Pharma., Bethlehem

How to measure a firm's success

- ❖ Why should we bother with this in the first place?
 - ◆
 - ◆
 - ◆
- ❖ What are common ways to perform such measurement?
 - ◆
 - ◆
 - ◆

** Discussion based on the article "strategy and the illusion of grad design" found in the packet.*

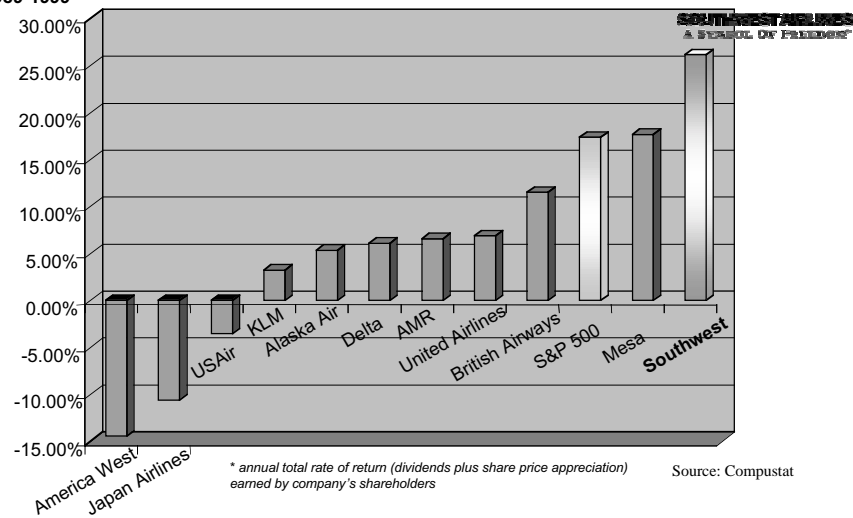
Rents

- ❖ Rents:
 - ◆ Accounting profits minus (risk adjusted) cost of capital
 - ◆ Economic profits
 - ◆ Economic value added (?)

- ❖ Rents as measure of competitive advantage
 - ◆ Rents vs. market share, revenue, growth .. as alternative measures.

Total Annual Shareholder Return, 1989-1999*

Airlines



Why can't everybody replicate the winners' formulas for success?

- ❖ What allows Southwest or Merck to sustain its competitive advantage over time?
 - ◆ What is their formula for success?
 - ◆ Why can't other airlines imitate Southwest formula for success?
 - ◆ Why can't other pharmaceutical companies imitate Merck's formula for success?

- ❖ Can there be such a thing as a *formula* for success?

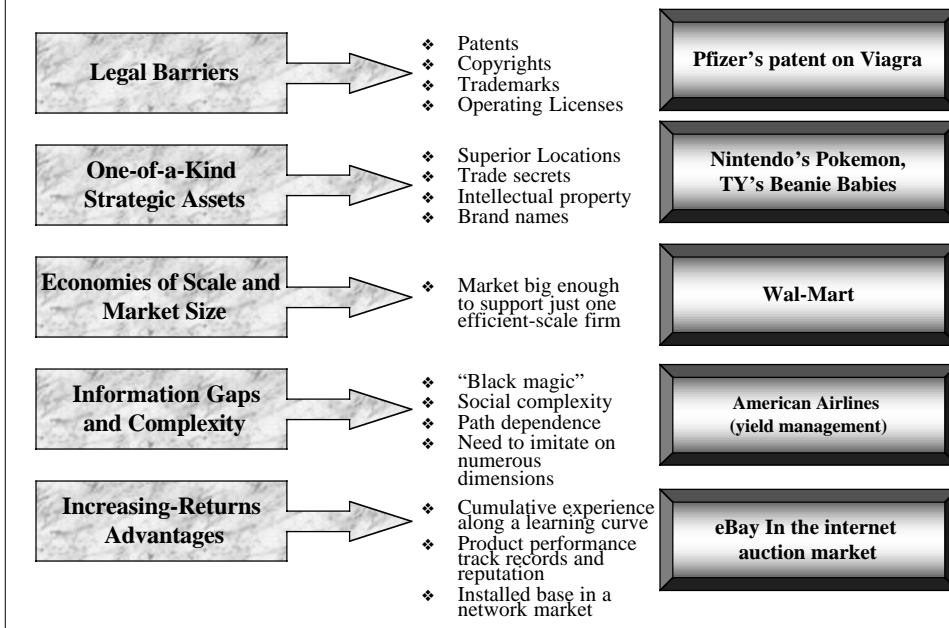
Why strategy is hard?

- ❖ Competitive strategy is hard because competitive forces are relentlessly pushing to equalize returns on capital throughout the economy

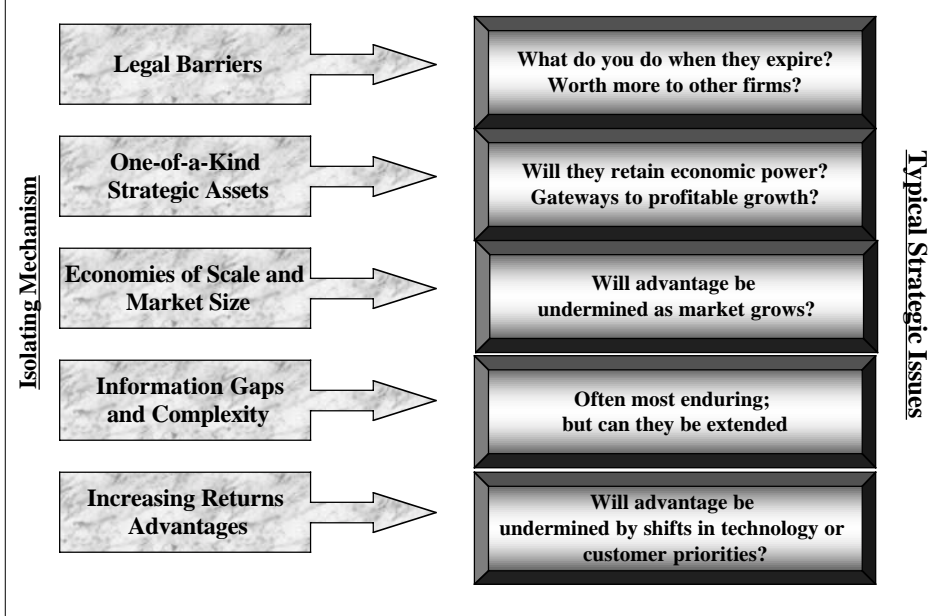
- ❖ *Isolating mechanisms* are characteristics of firm/market combinations that impede the destruction of incumbent firm profits through imitation

- ❖ Rumelt defines them as
“... *phenomena that limit the ex post equilibrium of rents among agents.*”

Isolating Mechanisms: *Types and examples*



But these mechanisms raise strategic issues



Summary: rents depends on both market economics and competitive position

