Competitiveness Of The National Economies

SALTANAT KONDYBAYEVA, PHD

KONDYBAYEVASALTANAT@GMAIL.COM

Lecture № 5

Value Chain analysis and Porter’s theory of competitiveness

Outline

1. Introduction

2. Concept of Value Chain

3. Competitive Advantage and Costumer Value

4. Porter’s ‘Competitive Advantage of Nations’

5. Porter’s Stages of National Competitive Development

6. Value Chain Management

Goal of this lecture:

- ✓Giving a clear view to the Value chain analysis for assessing competitive advantage
- ✓ Analyzing the concept value chain
- ✓Defining the Competitive advantage and customer value
- ✓Analyzing the value chain approach for assessing competitive advantage
- ✓Analyzing the Strategic frameworks for value chain analysis
- ✓**Analyzing the** Porter's diamond model
- ✓**Analyzing the** Value chain management

Concept/Theory	Representative	Country	Main theses
1	2	3	4
Contemporary concepts and theories of competitiveness			
Krugman’s concept of competitiveness	Paul R. Krugman	USA	Productivity growth is the main driver of competitiveness. International competitiveness of countries is associated with their high standard of living
Porter’s theory of competitiveness	Michael E. Porter	USA	Competitiveness depends on long run productivity, which increase requires a business environment that supports continual innovation in products, processes and management. The four underlining conditions driving the global competitiveness of country’s companies include: factor endowments, demand conditions, related and supporting industries (clusters), and the firm’s strategy, structure and rivalry

How does one create a competitive advantage in the market?

Firstly, business is about understanding the needs of the customers and

Then strive to meet and exceed try by any means to satisfy such needs by any ethical means possible.

Value chain analysis is a strategic tool which is used to measure the importance of the customers’ perceived value.

Example

Intel

- Has dominated the chip industry
- Success is directly related to Intel's competitive strategy
- Strategy focuses on superior value and product leadership
- Heavy focus on product and advertising innovation and R&D investments
- Changing market needs have challenged Intel to adapt
- Intel is capitalizing on the Internet now

Concept of Value Chain

Refers to the accumulation of customer value along the chain of activities that lead to an end product or service

- ✓ Porter, 1985

Defining Customer Value

	Total Customer Benefit	***(Product, Service, Personnel, & Image Values)***
-	**Total Customer Cost**	***(Monetary, Time, Energy, & Psychic Costs)***
=	**Customer Delivered Value**	***(Profit to the Consumer)***

Value Chain Analysis

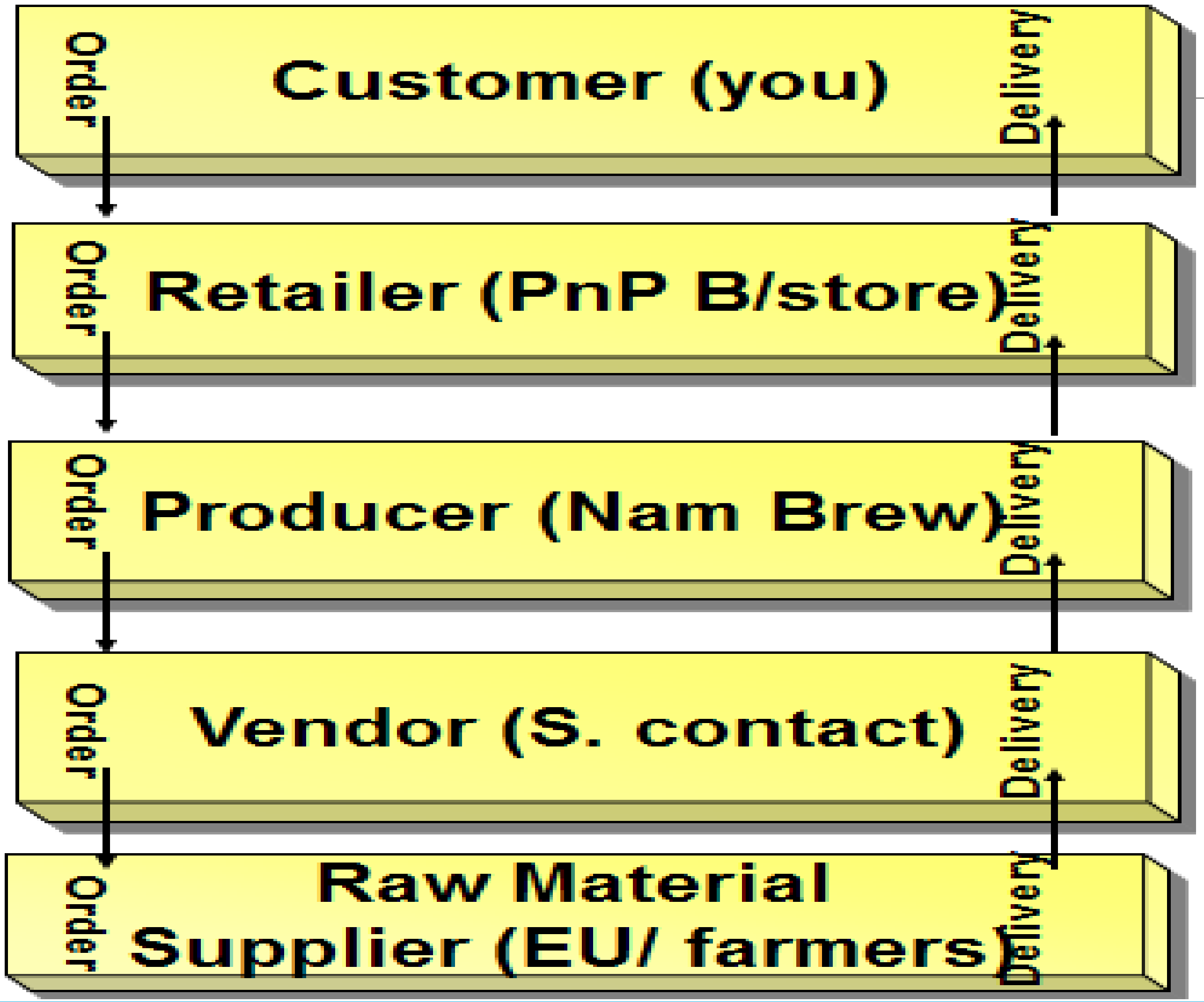
Focuses on how a business creates ***customer value*** by examining contributions of different internal activities to that value

Divides a business into a ***set of activities*** within the business

- Starts with inputs a firm receives
- Finishes with firm's products or services and after-sales service to customers

Allows for ***better identification*** of a firm's ***strengths and weaknesses*** since the business is viewed as a ***process***

Customer Value-Delivery Network*



COMPETITIVE ADVANTAGE AND CUSTOMER VALUE

Two criteria:

they must supply what customers want to buy, and

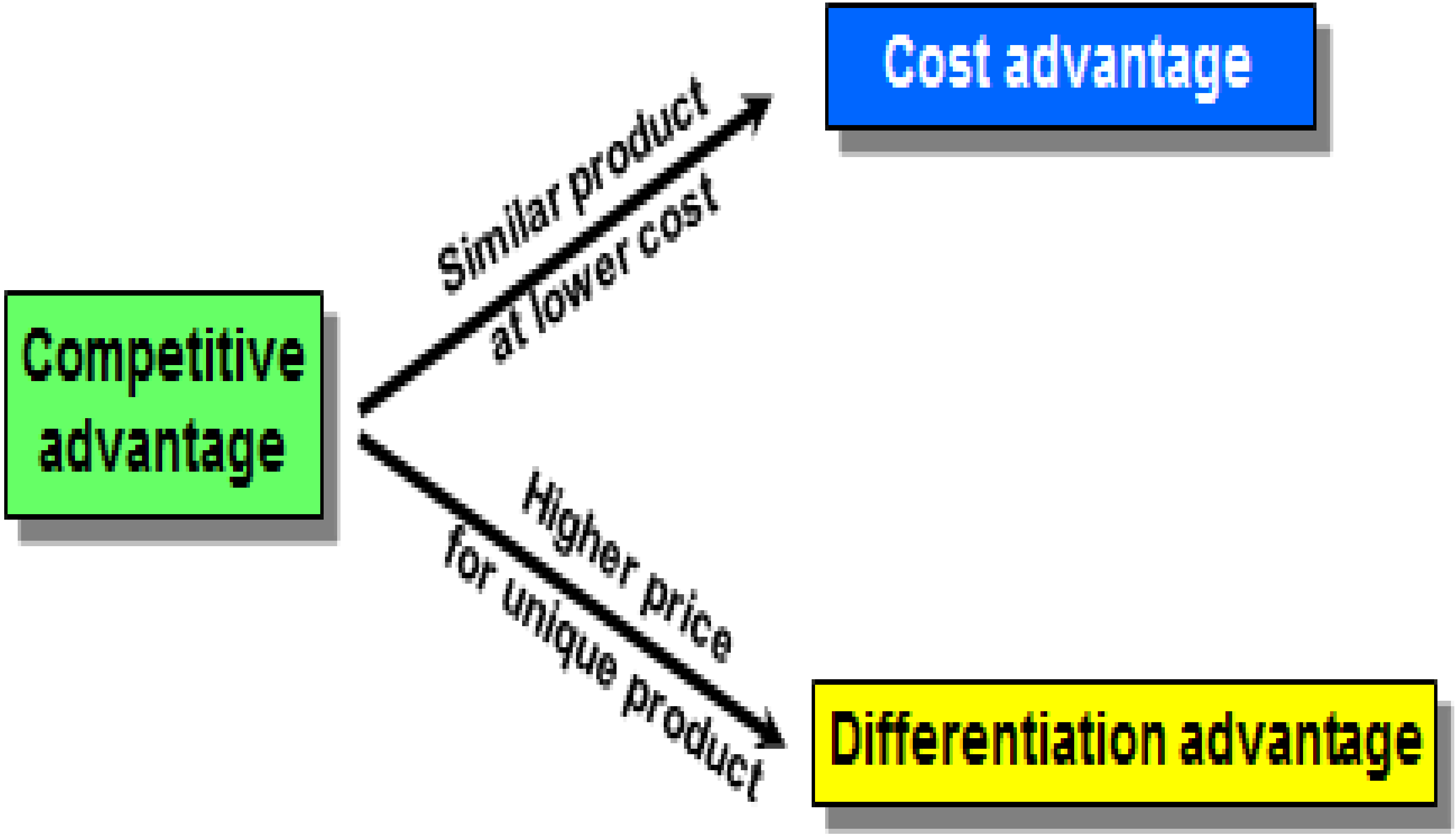
they must survive competition.

A firm's overall competitive advantage derives from the difference between the value it offers to customers and its cost of creating that customer value.

Competitive Advantage

- An advantage over competitors gained by offering consumers greater value than competitors offer.

Two main types of competitive advantage



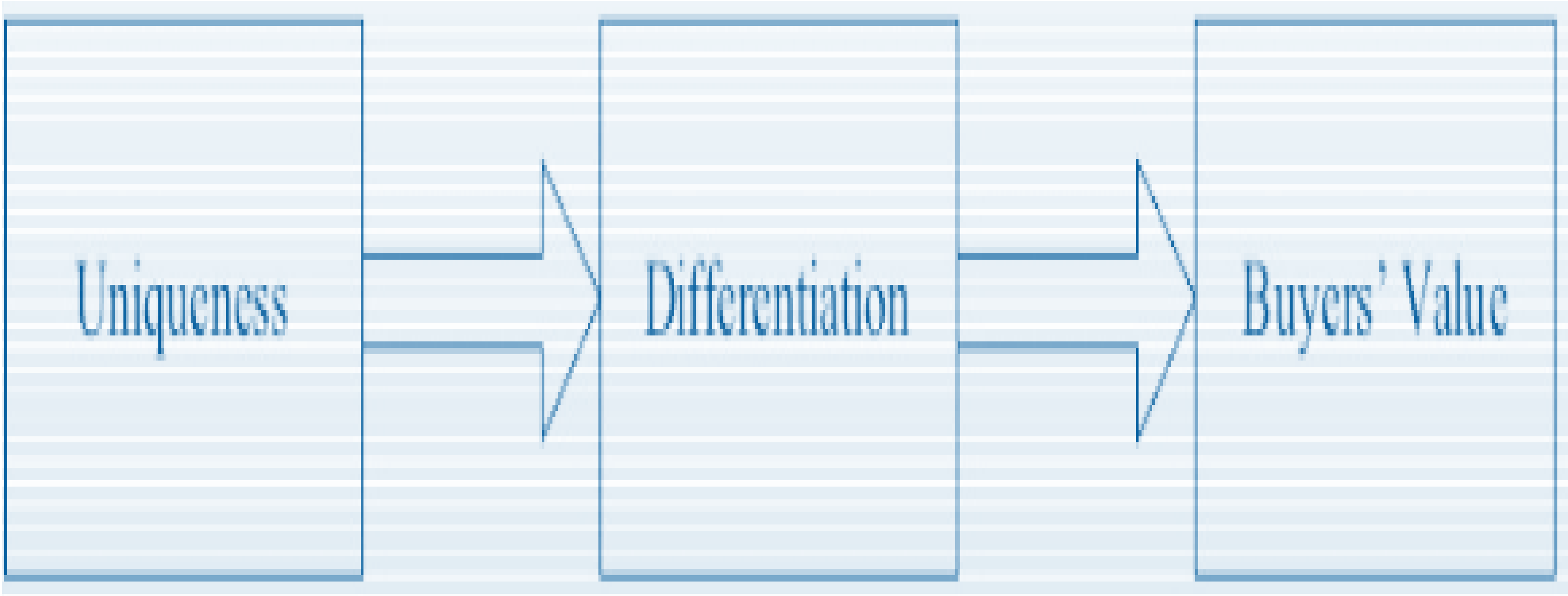
Differentiation Advantage

Industry offers homogenous products

Pay premium vs. Superior quality

On time delivery, producing better quality products, offering wide range of products or services to customers and providing unique customer value.

Buyer’s Value



Low-Cost Advantage

Sources of relative low-cost advantage;

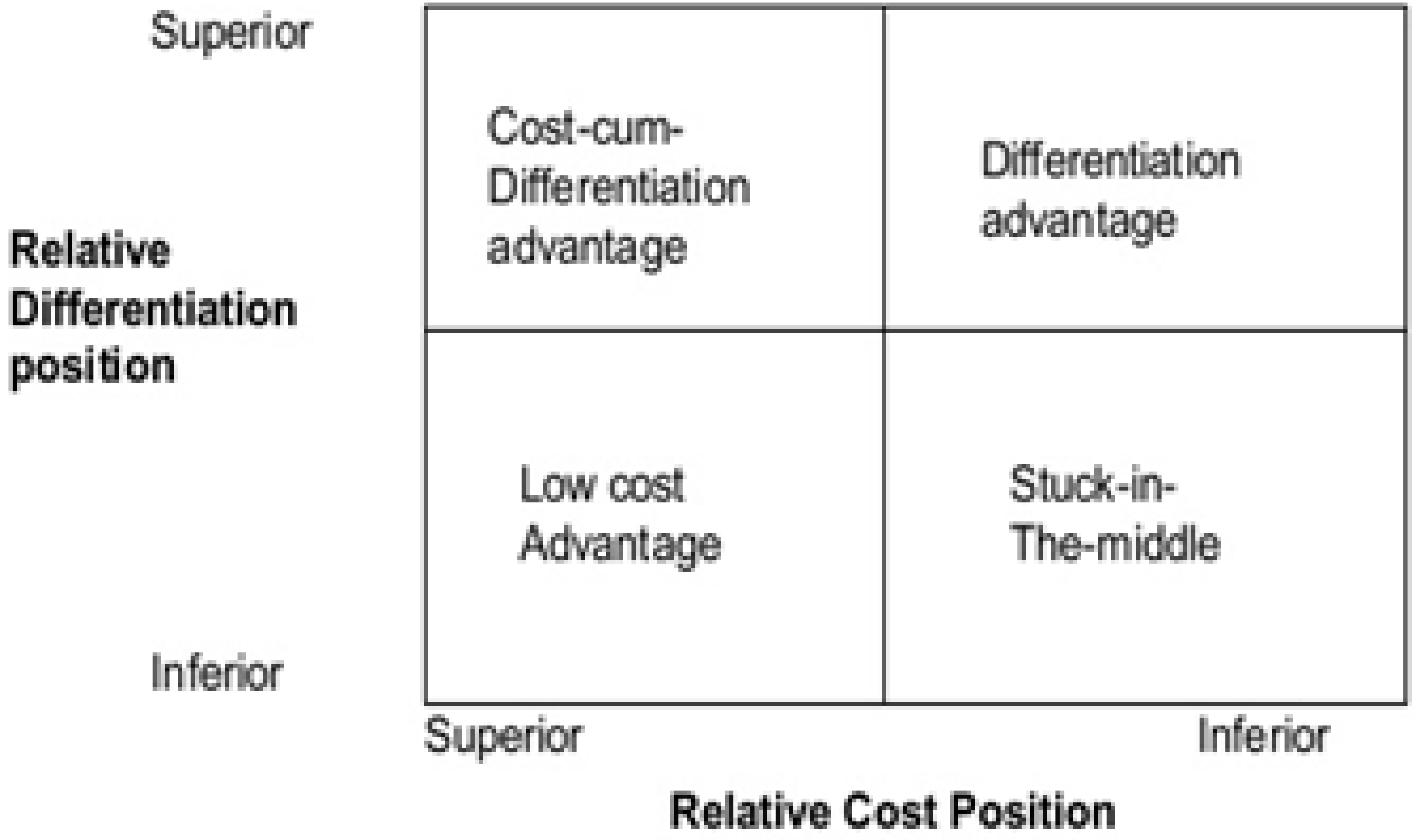
Access to low cost raw materials

Innovative process technology

Low cost access to distribution channels or customers

Superior operating management

Competitive Advantage through low cost and/or differentiation



The Value Chain Approach For Assessing Competitive Advantage

Internal cost analysis: This analysis is done in order to determine what are the profitability sources and the costs positions for the processes which created values internally associated with it.

Internal differentiation analysis: This analysis is done to determine what are the differentiation sources within the internal value-creating processes.

Vertical linkage analysis: This analysis is done so that one can make sense out of the relationships and associated costs amongst the external suppliers and customers so that it can lead to the maximization of customer value, while minimizing the costs at the same time.

New Market Entrants

- Entry Ease/Barriers
- Geographical Factors
- Incumbents Resistance
- New Entrant Strategy
- Routes To Market

Supplier Power

- Brand Reputation
- Geographical Coverage
- Product/Service Level Quality
- Relationships With Customers
- Bidding Processes/Capabilities

Competitive Rivalry

- Number and Size of Firms
- Industry Size and Trends
- Fixed/Variable Cost Bases
- Product/Service Ranges
- Differentiation, Strategy

Buyer Power

- Buyer Choice
- Buyers Size/Number
- Change Cost/Frequency
- Product/Service Importance
- Volumes, JIT Scheduling

Product and Technology Development

- Alternatives Price/Quality
- Market Distribution Changes
- Fashion and Trends
- Legislative Effects

Factors That Influence National Competitive Advantage

- **Factor conditions:** This refers to position of the nation with respect to the factors of production. It includes skilled labour, infrastructure, etc. which are necessary to compete in a given industry
- **Demand conditions:** This refers to the nature of domestic demand for the industry’s good or service.
- **Related and supporting industries:** The presence or absence in the nation of supplier industries and related industries that are internationally competitive
- **Firm strategy, structure and rivalry:** The conditions in the nation governing how companies are created organized and managed. It also looks at the nature of domestic rivalry.

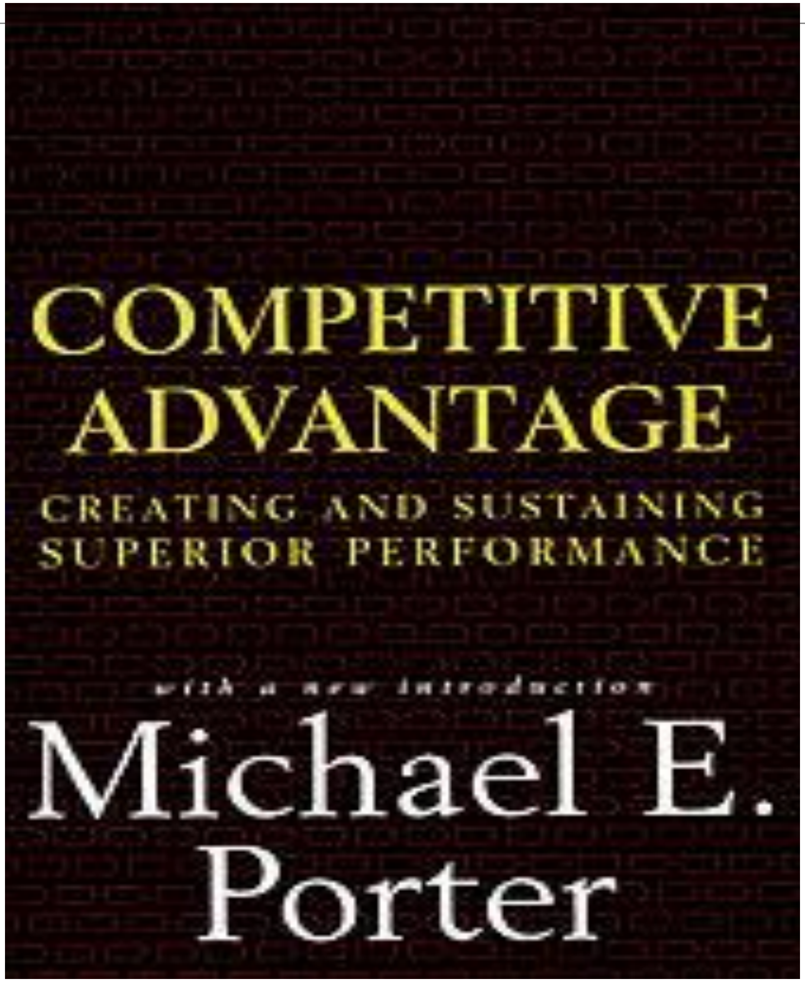
Porter’s ‘Competitive Advantage of Nations’: An Assessment

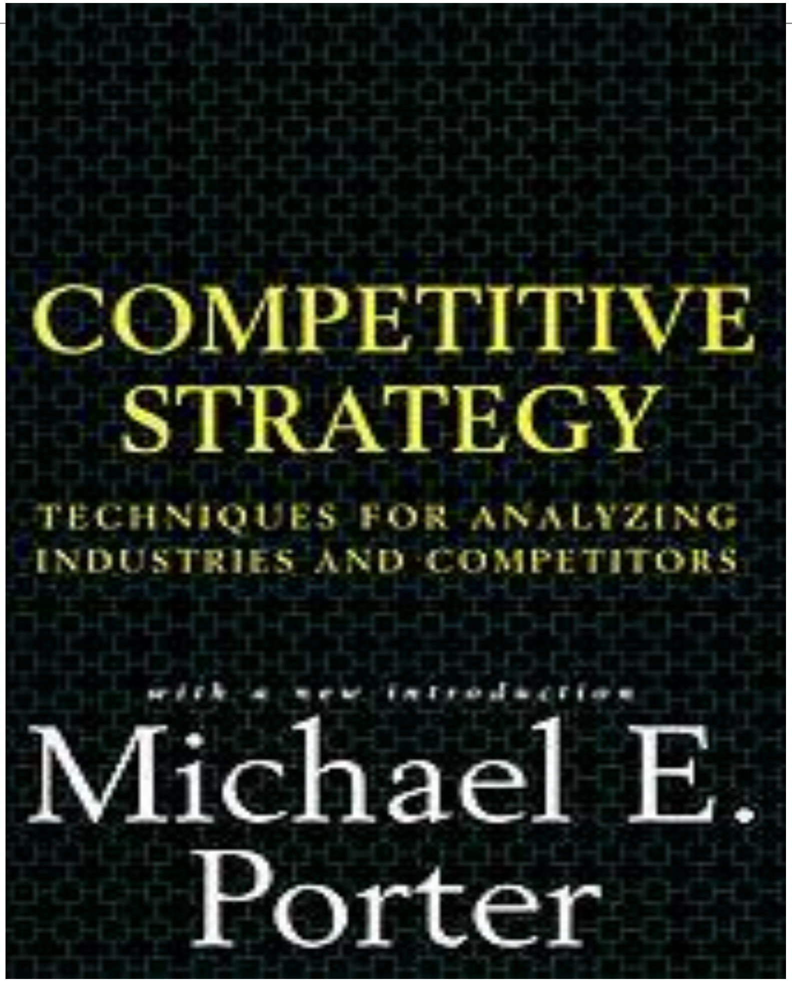
The Competitive Advantage of Nation’s is focused on addressing a question which lies at the heart of economic and managerial science:

‘Why do some social groups, economic institutions and nation’s advance and prosper?’

(Porter, 1990 : xi)

Porter's Two Monographs





Porter conducted a comprehensive study on 10 leading nations to learn what leads to competitive advantage of nation's.

United States

Germany

Italy

Sweden

United Kingdom

Japan

Korea

Denmark

Singapore

Switzerland

The Theory

- The primary role of a nation is to provide ‘home base’ to a firm.
- Home base is the nation in which the essential competitive advantages are created and sustained.
- Usually home base will be the location of most productive jobs, core technologies and the most advanced skills.

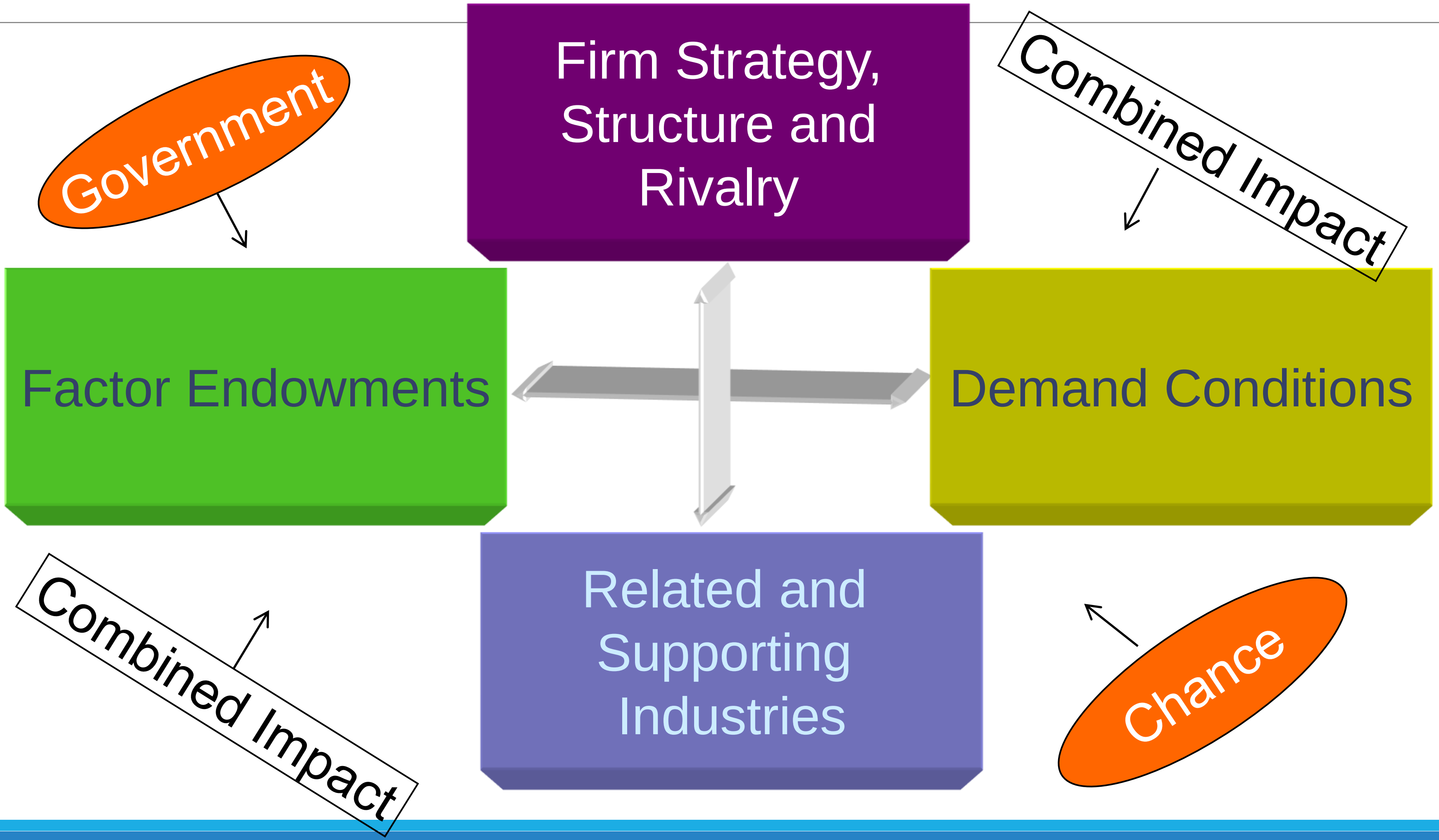
Competitive Advantage of Nation’s

Michael Porter* describes four keys to a nation’s competitive advantage in relation to other countries

- Factor Endowments
- Demand conditions
- Related and supporting industries
- Firm Strategy, Structure and Rivalry.

* Popularly referred to as *“Porter’s Diamond”*

Porter's Diamond
Determinants of National Competitive Advantage



Factor Conditions:

BASIC FACTORS – Natural resources, climate, location and demographics

ADVANCE FACTORS – Communication Infrastructure, skilled labour, Research facilities and so on.

Basic factors can provide only an initial advantage

They must be supported by advanced factors to maintain success.

E.g. Switzerland was the First country to experience labour shortages. They abandoned labour-intensive watches and concentrated on innovative/high-end watches.

Japan has high priced land and so its factory space is at a premium. This led to just-in-time inventory techniques.

Sweden has a short building season and high construction costs. These two things combined created a need for pre-fabricated houses.

Demand Conditions:

Home country Demand plays an important role in producing competitiveness.

Enables better understand the needs and desires of the customers

It shapes the attributes of domestically made products and creates pressure for innovation and quality.

E.g. 1 Italian ceramic Industry after the world war II There was a postwar housing BOOM !!

Consumers wanted cool floors because of Hot climatic conditions

E.g. 2 Japan’s knowledgeable buyers of cameras made that industry to innovate and grow tremendously

E.g. 3 The French wine industry. The French are sophisticated wine consumers. These consumers force and help French wineries to produce high quality wines.

Related and Supporting Industries:

Benefits of investment in advanced factors by Suppliers and related industries is significant

Creates clusters of supporting industries, thereby achieving a strong competitive position internationally.

E.g.1

The enamel production unit was available.

The glazes production was also favorable.

These two were the main composition of producing tiles.

This reduces the Transportation cost.

E.g. 2 Switzerland success in pharmaceutical industry is closely related to its international success in technical dye industry.

Firm Strategy, Structure & Rivalry:

Long term corporate vision (Strategy) is a determinant of success

Ability of the companies to develop and sustain a competitive advantage requires the 4th attribute.

Presence of domestic rivalry improves a company’s competitiveness

E.g. 1

Low entry barriers to market in the tile industry

Rivalry became very intense

Breakthroughs in both product and process technologies

E.g. 2

Japan has high priced land and so its factory space is at a premium

This led to just-in-time inventory techniques

(Japanese firms can’t have a lot of stock taking up space, so to cope with the potential of not have goods around when they need it)

They innovated traditional inventory techniques.

International Trade and Investment

Contribution Towards The Theory

Direct relation with Stages of National Competitive Development

Porter’s Stages of National Competitive Development

Driver of Development	Source of competitive advantage	Examples
Factor Condition	•Basic factors of production i.e., Natural Resources, Geographic Locations, Unskilled Labour	CANADA, AUSTRALIA, SINGAPORE, SOUTH KOREA before 1980
Investment	•Investment in Capital equipment. •Transfer of technology. •Presence of national consensus in favour of investment over consumption	JAPAN during 1960's SOUTH KOREA during 1980's
Innovation	All four determinants of national advantage interact to drive the creation of new technology	JAPAN since late 1970's ITALY since early 1970's
Wealth	Emphasis on managing existing wealth Competitive Advantage	UK during post war period USA Switzerland since 1980

Government Policy
&
Nation's Competitiveness

The differences between Porter's

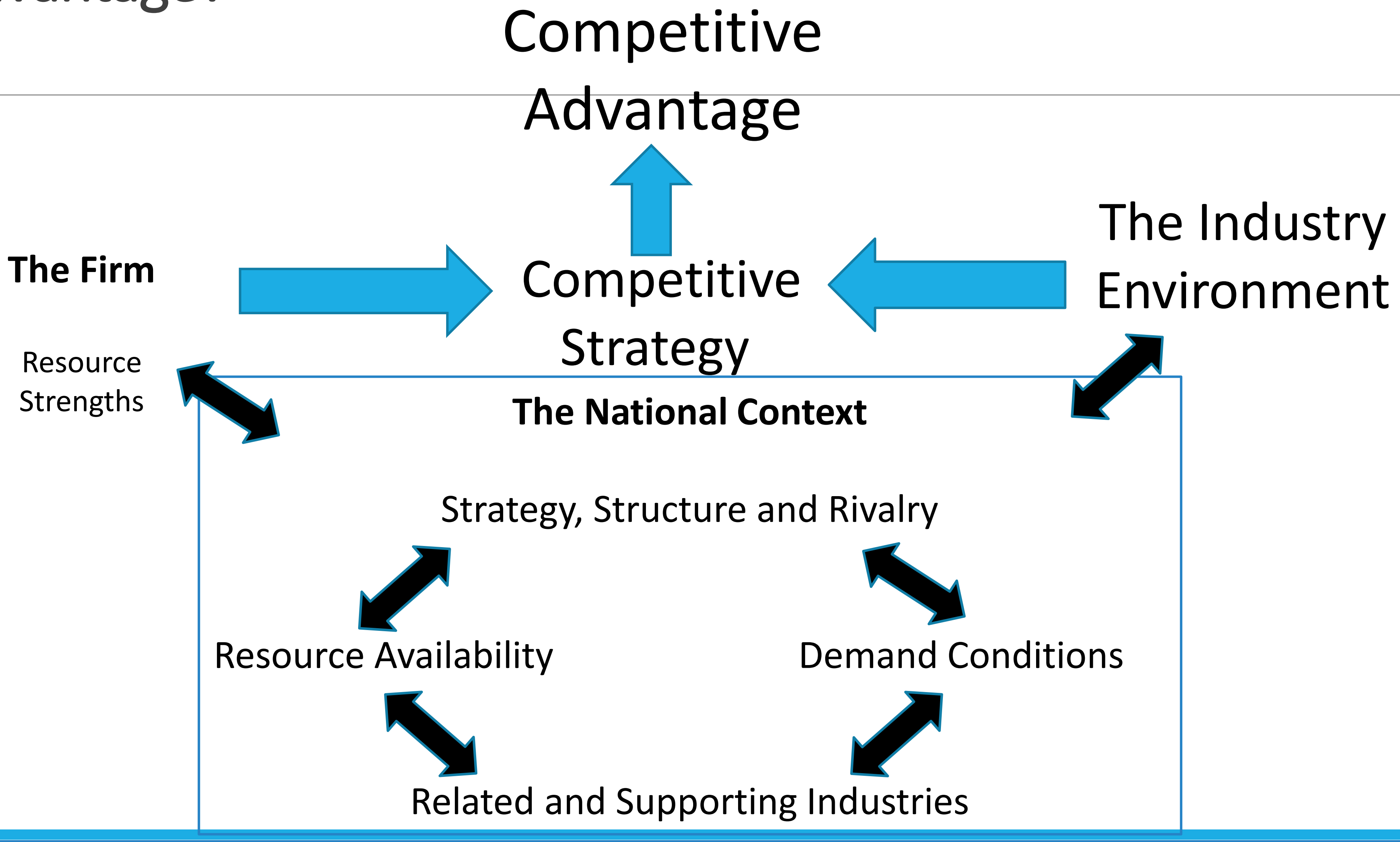
theory of national competitive advantage and the existing theory of international trade and investment are highlighted by their respective public policy implications.

Policy Measure	Traditional Thinking	Porter Model
Devaluation	Improves competitiveness of domestic industries by giving them cost advantage over overseas competitors.	Devaluation is detrimental to the upgrading process: it encourages dependence upon price competition and a concentration upon price sensitive industries and segments. It discourages investment in innovation and automation.
Policy towards R&D	Govt. Investment in R&D stimulates the innovation within the country. Defense-based research offers commercial spin-offs. Cooperative research pools efforts and avoids wasteful duplication.	Govt. should support research into commercially relevant technologies in preference to defence. Support research institutions focused upon industry clusters/crosscutting technologies. Cooperative research is of limited value.

Government Procedure	Provides secure home demand for domestic firms hence encourages investment and economies of learning and scale. Defense procurement, in particular, provides an early market for technically sophisticated products.	While government can act as an early, sophisticated buyer, procurement can easily act to protect weak national champions from international and domestic rivalry, and distort product development from global market needs.
Regulation of product and process standards	Stringent regulations impose costs which hamper competitiveness in home and overseas markets.	Stringent performance, safety and environmental standards can pressure firms to improve quality, upgrade technology and provide superior product features. Particularly beneficial are regulations which anticipate standards which will spread internationally.

Antitrust Policy and Regulation of Competition	The presence of international competition means that domestic monopolies and mergers are ineffective in creating and exercising market power. The interests of global competitiveness may require the relaxation of antitrust constraints in order to encourage strategic alliances and the development of world-class competitors.	Antitrust Policy plays an important role in maintaining the strength of domestic rivalry. But must not act as a barrier to vertical collaboration, between suppliers and buyers, that is integral to innovation. Regulation of competition, on the other hand, is likely to be detrimental to rivalry and new enterprise creation: deregulation of competition and privatization of domestic monopolies usually spurs national advantage.

How competitive strategy is interlinked with competitive advantage?



According to Porter's Competitive advantage of nation, there has been a shift from a static to a dynamic analysis of competitive advantage.

Competitive advantage is a consequence of change through the emergence of new technologies, changing buyers need, new industry segment, shifting input supply conditions, or changes in government regulations.

Competitive advantage is subject to erosion. A firms ability to sustain the same depends upon the ease with which competitors can duplicate the competitive advantage.

Targeting customers which are demanding and have difficult needs, a firm can help establish leadership in quality and innovation.

Value Chain Management

Value

- The performance characteristics, features and attributes, and any other aspects of goods and services for which customers are willing to give up resources (i.e., spend money).

The Value Chain

- The entire series of organizational work activities that add value at each step beginning with the processing of raw materials and ending with the finished product in the hands of end users.

Value Chain Management (cont’d)

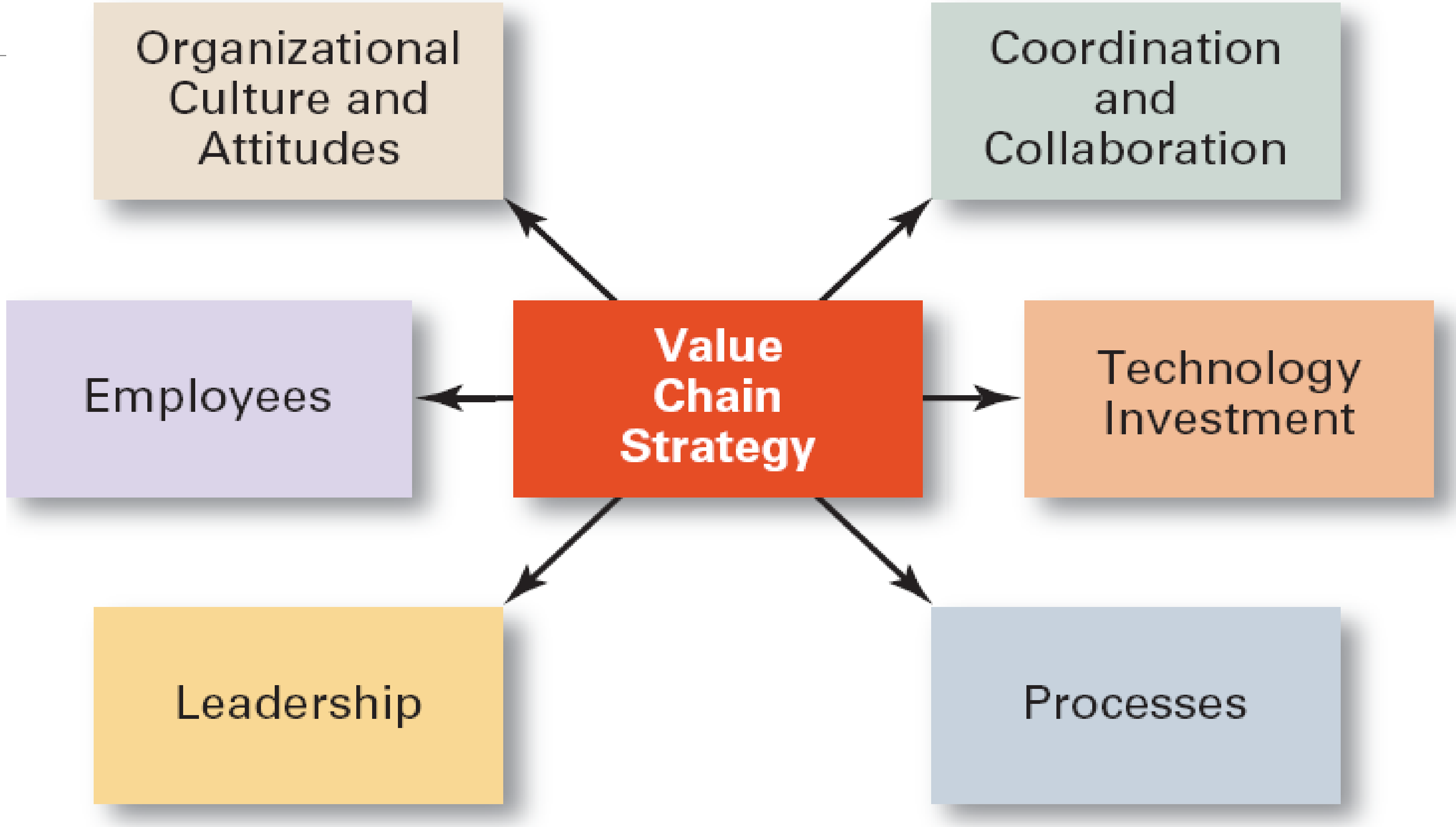
What is Value Chain Management?

- The process of managing the entire sequence of integrated activities and information about product flows along the entire value chain.

Goal of Value Chain Management

- To create a value chain strategy that fully integrates all members into a seamless chain that meets and exceeds customers’ needs and creates the highest value for the customer.

Six Requirements for Successful Value Chain Management

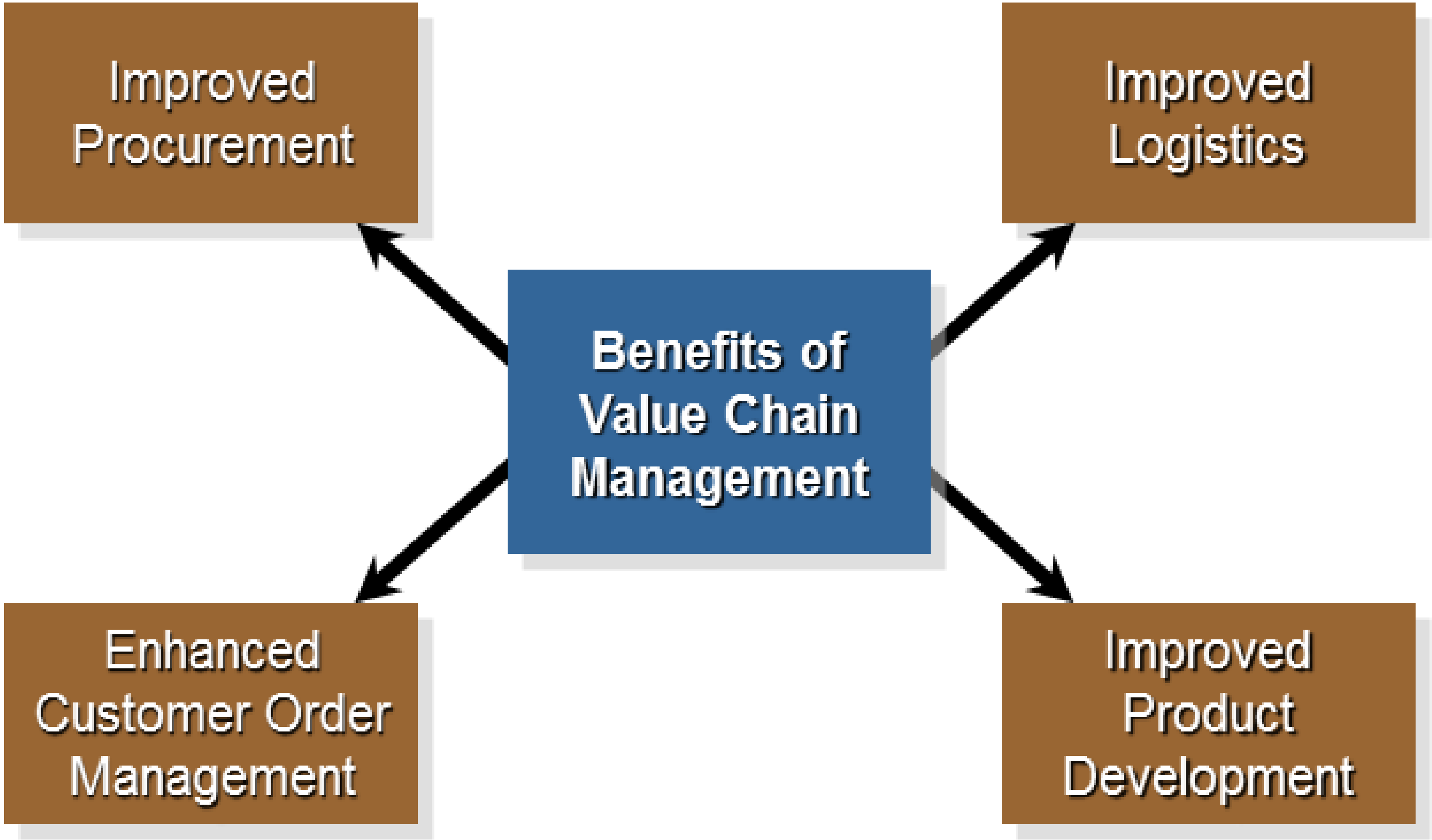


Value Chain Management (cont'd)

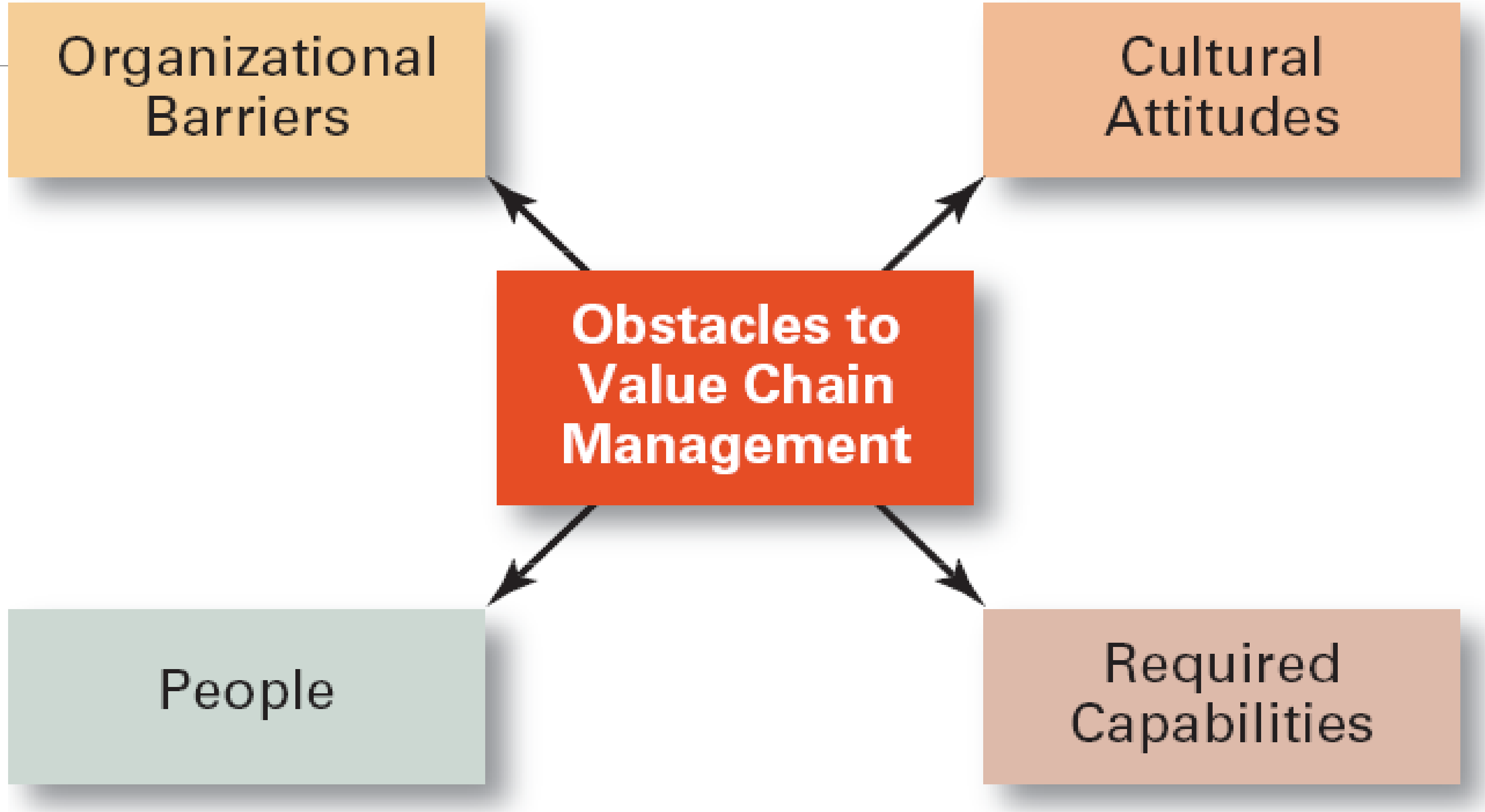
Requirements for Value Chain Management

- A new business model incorporating:
  - Coordination and collaboration
  - Investment in information technology
  - Changes in organizational processes
  - Committed leadership
  - Flexible jobs and adaptable, capable employees
  - A supportive organizational culture and attitudes

Benefits of Value Chain Management



Obstacles to Successful Value Chain Management



Value Chain Management (cont'd)

Obstacles to Value Chain Management

- Organizational barriers
  - Refusal or reluctance to share information
  - Reluctance to shake up the status quo
  - Security issues
- Cultural attitudes
  - Lack of trust and too much trust
  - Fear of loss of decision-making power
- Required capabilities
  - Lacking or failing to develop the requisite value chain management skills

Value Chain Management (cont'd)

Obstacles to Value Chain Management (cont'd)

- People
  - Lacking commitment to do whatever it takes
  - Refusing to be flexible in meeting the demands of a changing situation
  - Not being motivated to perform at a high level
  - Lack of trained managers to lead value chain initiatives


Thank you

REFERENCES

The Competitive Advantage of Nations, 1990, Michael Porter

Excerpts from the PDF Article Grant R Review on Porter sent by Prof. Y.C. Kim.

Strategic Management Journal, Vol. 12, No. 7. (Oct., 1991), pp. 535-548.