FOURTH EDITION

# Marketing Management

## A RELATIONSHIP APPROACH

Svend Hollensen

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# BRIEF CONTENTS

# CONTENTS

# GUIDED TOUR


PART I

Assessing the competitiveness of the firm (internal)

PART I CONTENTS

PART I VIDEO CASE STUDY
**BYD electrical cars:** The Chinese electric car manufacturer is considering sales worldwide

Introduction to Part I
2 Identification of the firm's core competences
3 Development of the firm's competitive advantage



[1]

Each **Part introduction** lists the chapters and case studies within the part. It also includes a structure map that allows you to get a clearer picture of how the part relates to the other sections in the book.


PART III VIDEO CASE STUDY

Nivea: Segmentation of the sun-care market

Hamburg-based Beiersdorf AG can trace its origins back to a patent received for medical plasters in 1882 by the pharmacist Paul C. Beiersdorf. The business did not remain focused on this area alone: the first Labello lip-care stick was sold almost 100 years ago. In 1911, Nivea Creme (which literally means 'snow white') – the first stable, oil-and-water-based cream – was created. From early on, the company was looking abroad. Already by 1913 the company generated 42 per cent of its sales abroad.

The 1990s saw the start of Nivea's systematic expansion into an umbrella brand. Today, the process is regarded internationally as a classic example of successful brand development. Brand trust has been extended to a wide range of products: men's care, hair care, body care, face care, hand care, sun protection, bath and shower care, deodorants and make-up. Thanks to Nivea Sun, Beiersdorf is not just the European market leader for sun-care products; it was also the catalyst for the introduction of a sun protection factor as a new global standard.

For a long time, Beiersdorf was active in four business areas: cosmetics, toiletries, medicinal and pharmaceutical products. Since the 1990s, Beiersdorf has focused consistently on the growing market of skin and beauty care – a strategic decision that has now made Beiersdorf Germany's largest cosmetics company.

Today the company's skin-care products are sold in more than 100 countries.

Sales of the first full-spectrum range of men-care products for the mass market began in 1993. Today Nivea for Men also has a strong position on the global market and is consistently gaining market share.

The global market of cosmetics and toiletries totalled €250 billion in 2017. In the same year, Beiersdorf had total sales of nearly €7 billion, and €670 million in net income. The company had 17,700 employees as of 31 December 2017.

**Nivea sun care**

The Nivea Sun brand portfolio has grown to over 40 products, which can be characterised in four different categories:

**1 Sun protection**

It is vital that skin is adequately protected against the sun's harmful effects (although no sunscreen can provide total protection). Nivea Sun provides products that enable people to be as safe as possible. Nivea Sun also encourages the use of other forms of protection (e.g. wearing a sun hat and avoiding midday sun). Protection is the largest segment in the sun-care market.

**2 After-sun**

Providing cooling and refreshing effects for the skin after a whole day in the sun.

**3 Self-tan**

In contrast to protection and after-sun, the self-tan category is concerned mostly with cosmetic appeal. Many adults use self-tan to have an all-year-round sun-kissed glow.

**4 Whitening products**

The popularity of whitening products in Asia is based on the old Asian belief that 'white skin conceals facial defects' – a philosophy passed on for generations, and it reflects the traditional criteria for beauty.

The choice of product depends on usage occasion (when) – e.g. holiday, outdoor sports, gardening, working. This relates to the Sun Protection Factor (SPF) required, e.g. the SPF required for a holiday in Egypt differs greatly to outdoor work in the UK. This is one of the reasons why Nivea Sun includes a wide range of sun protection, from SPF 4 to 50+.

Source: Donka Zheleva/123RF.

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Sun protection is the primary benefit, but the preference by which this is delivered will vary by segment, e.g. convenience is important to men (so they choose spray applicators). Parents want to provide maximum protection for children (high SPFs and coloured products are therefore important).

Women are the main purchasers of sun care for the family. This is reflected in above-the-line (advertising) communications, generally targeted towards a female audience.

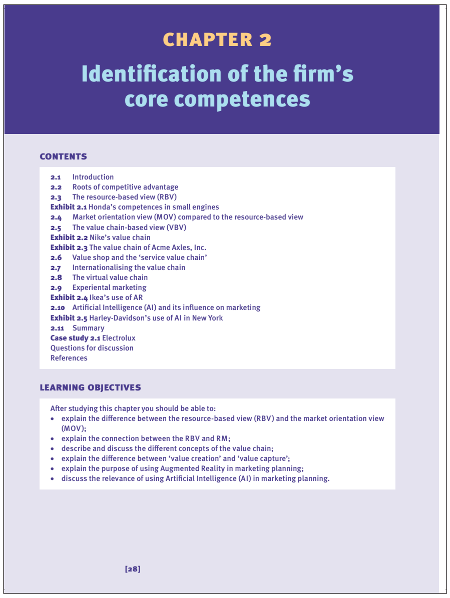
Children are not purchasers of sun care. However, Nivea Sun recognises it can play an important part in educating children from a young age to be safer when in the sun.

In Asia, Nivea has considerable success with a combination of sun-care and whitening products in face care. While there may be a market for bleaching products in these zones, Nivea sticks to gentle formulas. In 2005, Nivea was the world's first brand to introduce whitening products for men in Thailand.

[250] DEVELOPING MARKETING STRATEGIES

[251]

Following each part introduction, you will find a **video case study** from a leading international company. Read the case study, watch the video, which is available on the companion website via www.vitalsource.com, and then answer the questions.



CHAPTER 2

Identification of the firm's core competences

CONTENTS

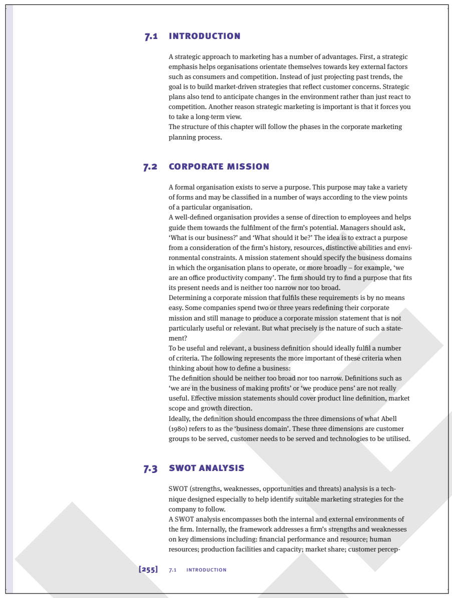


LEARNING OBJECTIVES

After studying this chapter you should be able to:

- explain the difference between the resource-based view (RBV) and the market orientation view (MOV);
- explain the connection between the RBV and RM;
- describe and discuss the different concepts of the value chain;
- explain the difference between 'value creation' and 'value capture';
- explain the purpose of using Augmented Reality in marketing planning;
- discuss the relevance of using Artificial Intelligence (AI) in marketing planning.

[28]



7.1 INTRODUCTION

A strategic approach to marketing has a number of advantages. First, a strategic emphasis helps organisations orientate themselves towards key external factors such as consumers and competition. Instead of just projecting past trends, the goal is to build market-driven strategies that reflect customer concerns. Strategic plans also tend to anticipate changes in the environment rather than just react to competition. Another reason strategic marketing is important is that it forces you to take a long-term view.

The structure of this chapter will follow the phases in the corporate marketing planning process.

7.2 CORPORATE MISSION

A formal organisation exists to serve a purpose. This purpose may take a variety of forms and may be classified in a number of ways according to the view points of a particular organisation.

A well-defined organisation provides a sense of direction to employees and helps guide them towards the fulfilment of the firm's potential. Managers should ask, 'What is our business?' and 'What should it be?' The idea is to extract a purpose from a consideration of the firm's history, resources, distinctive abilities and environmental constraints. A mission statement should specify the business domains in which the organisation plans to operate, or more broadly – for example, 'we are an office productivity company'. The firm should try to find a purpose that fits its present needs and is neither too narrow nor too broad.

Determining a corporate mission that fulfils these requirements is by no means easy. Some companies spend two or three years redefining their corporate mission and still manage to produce a corporate mission statement that is not particularly useful or relevant. But what precisely is the nature of such a statement?

To be useful and relevant, a business definition should ideally fulfil a number of criteria. The following represents the more important of these criteria when thinking about how to define a business:

The definition should be neither too broad nor too narrow. Definitions such as 'we are in the business of making profits' or 'we produce pens' are not really useful. Effective mission statements should cover product line definition, market scope and growth direction.

Ideally, the definition should encompass the three dimensions of what Abell (1980) refers to as the 'business domain'. These three dimensions are customer groups to be served, customer needs to be served and technologies to be utilised.

7.3 SWOT ANALYSIS

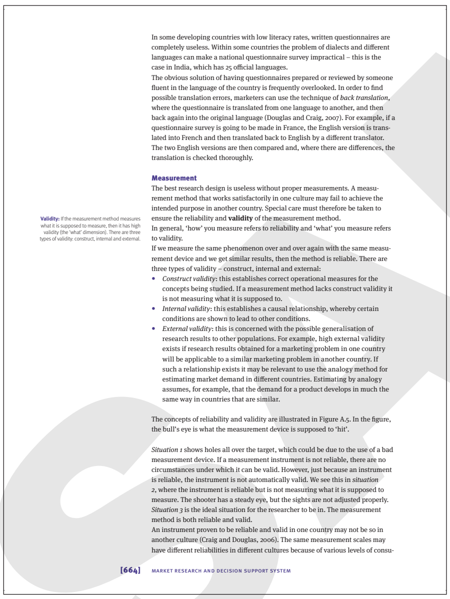
SWOT (strengths, weaknesses, opportunities and threats) analysis is a technique designed especially to help identify suitable marketing strategies for the company to follow.

A SWOT analysis encompasses both the internal and external environments of the firm. Internally, the framework addresses a firm's strengths and weaknesses on key dimensions including: financial performance and resource; human resources; production facilities and capacity; market share; customer percep-

[255] 7.1 INTRODUCTION

Each chapter begins with a set of **learning objectives** that will enable you to focus on what you should have achieved by the end of the chapter.

Short chapter introductions concisely introduce the themes and issues that are built upon within the chapter.



In some developing countries with low literacy rates, written questionnaires are completely useless. Within some countries the problem of dialects and different languages can make a national questionnaire survey impractical – this is the case in India, which has 25 official languages.

The obvious solution of having questionnaires prepared or reviewed by someone fluent in the language of the country is frequently overlooked. In order to find possible translation errors, marketers can use the technique of *back translation*, where the questionnaire is translated from one language to another, and then back again into the original language (Douglas and Craig, 2007). For example, if a questionnaire survey is going to be made in France, the English version is translated into French and then translated back to English by a different translator. The two English versions are then compared and, where there are differences, the translation is checked thoroughly.

**Measurement**

The best research design is useless without proper measurements. A measurement method that works satisfactorily in one culture may fail to achieve the intended purpose in another country. Special care must therefore be taken to ensure the reliability and **validity** of the measurement method.

**Validity:** If the measurement method measures what it is supposed to measure, then it has high validity (the 'what' dimension). There are three types of validity: construct, internal and external.

In general, 'how' you measure refers to reliability and 'what' you measure refers to validity.

If we measure the same phenomenon over and over again with the same measurement device and we get similar results, then the method is reliable. There are three types of validity – construct, internal and external:

- *Construct validity*: this establishes correct operational measures for the concepts being studied. If a measurement method lacks construct validity it is not measuring what it is supposed to.
- *Internal validity*: this establishes a causal relationship, whereby certain conditions are shown to lead to other conditions.
- *External validity*: this is concerned with the possible generalisation of research results to other populations. For example, high external validity exists if research results obtained for a marketing problem in one country will be applicable to a similar marketing problem in another country. If such a relationship exists it may be relevant to use the analogy method for estimating market demand in different countries. Estimating by analogy assumes, for example, that the demand for a product develops in much the same way in countries that are similar.

The concepts of reliability and validity are illustrated in Figure A.5. In the figure, the bull's eye is what the measurement device is supposed to 'hit'.

*Situation 1* shows holes all over the target, which could be due to the use of a bad measurement device. If a measurement instrument is not reliable, there are no circumstances under which it can be valid. However, just because an instrument is reliable, the instrument is not automatically valid. We see this in *situation 2*, where the instrument is reliable but is not measuring what it is supposed to measure. The shooter has a steady eye, but the sights are not adjusted properly. *Situation 3* is the ideal situation for the researcher to be in. The measurement method is both reliable and valid.

An instrument proven to be reliable and valid in one country may not be so in another culture (Craig and Douglas, 2006). The same measurement scales may have different reliabilities in different cultures because of various levels of consu-

[664] MARKET RESEARCH AND DECISION SUPPORT SYSTEM

KEY TERMS

**4Ps** The basic elements of the marketing mix: product, place (distribution), price and promotion; also called the controllable variables of marketing, because they can be controlled and manipulated by the marketer.

**7P mix** Besides the traditional 4Ps (product, price, place and promotion) it involves the additional 3Ps: People: This is where it all begins. It involves employees, management and the organisational culture. Process: It is the back-office, which represents the way the company's products and services are delivered. It involves supply chain management, logistics and service delivery. Physical evidence: It is how the company's products and services are presented in the market place. It involves facilities, store front, visual packaging, staff behaviour and staff dressing.

**Above-the-line advertising** Advertising in the mass media, including press, radio, television and internet. Normally handled by advertising agencies.

**Adoption process** The mental and behavioural stages through which a consumer passes before making a purchase or placing an order. The stages are awareness, interest, evaluation, trial and adoption.

**Advertising** Non-personal communication that is paid for by an identified sponsor and involves either mass communication via newspapers, magazines, radio, television and other media (e.g. billboards, bus stop signage), or direct-to-consumer communication via direct mail.

**Advertising agency** A marketing services firm that assists companies in planning, preparing, implementing and evaluating all or portions of their advertising programmes.

**Advertising objective** A specific communication task to be accomplished with a specific target audience during a specific period of time.

**Affordable approach** Setting the promotion budget at the level management thinks the company can afford.

**Agent** A marketing intermediary who does not take title to the products but develops a marketing strategy and establishes contacts abroad.

**AIDA** Awareness, interest, desire, action – the stages through which a consumer is believed to pass before purchasing a product.

**Allowance** Promotional money paid by manufacturers to retailers in return for an agreement to feature the manufacturer's products in some way.

**Always-a-share customers** Customers who have low switching costs and do not value long-term relationships with suppliers, making them more suited to transaction marketing.

**Ambush marketing** An attack from a hidden position. It occurs when a marketer works on connecting its product with a particular event in the minds of potential customers, without having paid sponsorship expenses for the event.

**Artificial intelligence (AI)** The development of a computer system that is able to perform tasks normally requiring human intelligence. AI emphasises the creation of intelligent machine learning where information is turned into creating a more customer engaging customer experience.

**Augmented reality (AR)** A live view of a physical, real-world environment whose elements are augmented (or supplemented) by computer-generated sensory input, such as sound, video, graphics or GPS data. AR technology allows consumers to interact virtually with three-dimensional product visualisations displayed on users' screens.

**Baby boom** The major increase in the annual birth rate following the Second World War and lasting until the early 1960s. The 'baby boomers', now moving into middle age, are a prime target for marketers.

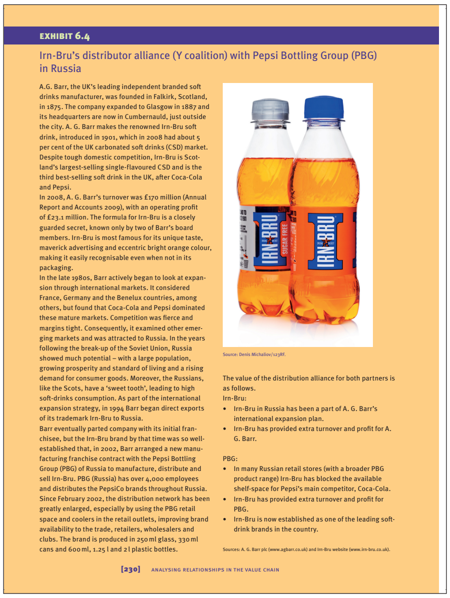
**Below-the-line advertising** Advertising that uses less conventional methods, which are handled directly by the company itself. It includes email campaigns towards decision makers, promotions and brochures placed at point of sale. It could also involve product demos and sampling at busy places such as malls and shopping centres.

**Benchmarking** The process of comparing the company's products and processes to those of competitors or leading firms in other industries to find ways to improve quality and performance.

**Benefit segments** Dividing the market into groups according to the different benefits that consumers seek from the product.

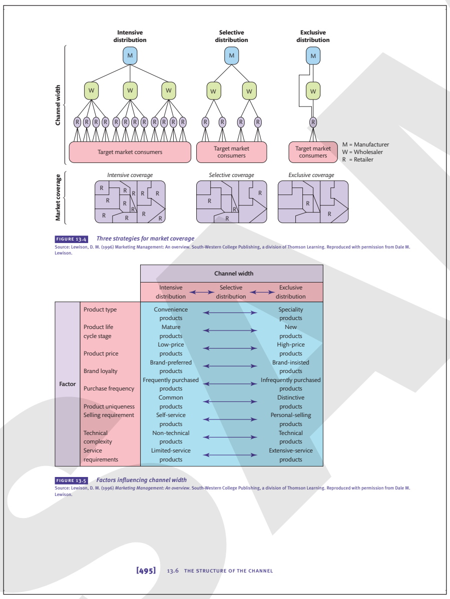
[677] KEY TERMS

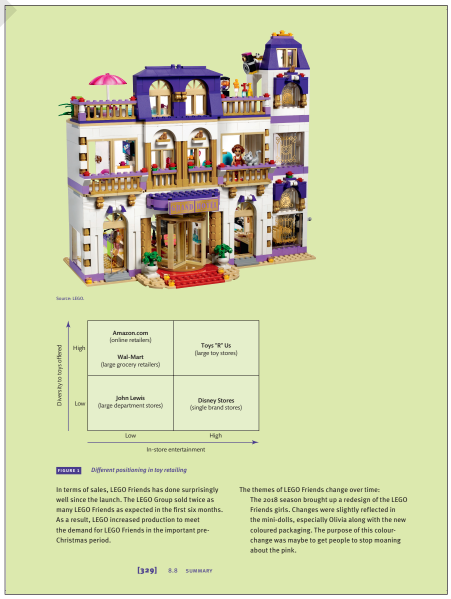
Key terms are highlighted in the text with a brief explanation in the margin where they first appear. These terms are also included in the Glossary at the end of the book.





New and engaging exhibits analyse and discuss specific companies to show how the theories in the chapter are used by well known brands in the business world.




Colour figures and photographs illustrate the key points and concepts and help clarify the topics discussed.

A **case study** concludes each chapter, providing a range of material for seminars and private study, by illustrating real-life applications and implications of the topics covered in the chapter. These also come with a set of questions to help you test your understanding of the case.

**Chapter summaries** reflect on what the chapter has covered and will help you to consolidate your learning and provide an important revision tool.

**Questions for discussion** provide a useful assessment to test your knowledge and encourage you to review and/or critically discuss your understanding of the main topics and issues covered in each chapter.
An extensive list of **references** at the end of each chapter directs you to other books, journal articles and websites, which will help you develop your understanding and inspire independent learning.

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Student resources for each chapter include:

- Full versions of the video case studies
- Extra case studies
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- Flash cards
- Weblinks

For instructors an instructor manual and Powerpoints are available.

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# PREFACE

*The World Is Flat*. This was the title of an international bestselling book by Thomas L. Friedman, published in first edition in 2005. It analyses globalisation, primarily in the early twenty-first century, and the picture has changed dramatically. The title is a metaphor for viewing the world as a level playing field in terms of commerce, where all players and competitors have an equal opportunity. We are entering a new phase of globalisation, in which there will be no single geographic centre, no ultimate model for success, no sure-fire strategy for innovation and growth. Companies from every part of the world will be competing with each other – for customers, resources, talent and intellectual capital – in every corner of the world's markets. Products and services will flow from many locations to many destinations. Friedman mentions that many companies in, for example, the Ukraine, India and China provide human-based sub-supplies for multinational companies, from typists and call centres to accountants and computer programmers. In this way these companies in emerging and developing countries are becoming integral parts of complex global supply chains for large multinational companies such as Dell, SAP, IBM and Microsoft.

As this new scene unfolds, the new global leaders increasingly will be forced to defend the ground they thought they had won and secured long ago. And their expansion into new markets will be challenged as never before. Their established processes and traditional business philosophies will be turned upside down by challengers whose experiences in new emerging markets cause them to see the world very differently and to do business in completely new ways. Many executives of developed-country companies are not prepared to deal with the massive wave of competition from skilled and determined new rivals. As the world is becoming a flat playing field, there is also an increasing need in different industry supply chains for creating relationships between the involved companies in the industry value chains. This has important implications for the way that we look at the marketing discipline in the individual firm. The consequence is that the development of marketing theory and practice is undergoing a paradigm shift from a transactional to a relationship orientation. As many companies are still relying on the traditional marketing approach, this book will bridge the gap between **relationship marketing (RM)** and **traditional (transactional) marketing (TM)**.

In the traditional transactional approach, **marketing management** is about planning, coordinating and controlling marketing activities that are aimed at satisfying customer needs and desires – and receiving money from sales.

In recent years, marketing has been undergoing considerable self-examination and internal debate. The overriding emphasis in the 'traditional' marketing approach is on acquiring as many customers as possible. Evidence is mounting, however, that traditional marketing is becoming too expensive and is less effective.

Many leading marketing academics and practitioners have concluded that a number of the long-standing practices and operating modes in marketing need to be evaluated, and we need to move towards a relationship approach that is based on repeated market transactions and mutual gain for buyers and sellers.

**Relationship marketing (RM):** The process of creating, maintaining and enhancing strong longterm relationships with customers and other stakeholders through mutual exchange and trust. RM seeks to build a chain of relationships between the firm and its main stakeholders.

**Transactional marketing (TM):** The major focus of the marketing programme (the 4 Ps) is to make customers buy. Independence among marketing actors ('arm's length') is considered vital for marketing efficiency.

**Marketing management:** The process of planning, executing and controlling marketing activities to attain marketing goals and objectives effectively and efficiently.

The 'new paradigm' is commonly referred to as relationship marketing (RM). Relationship marketing is not a new idea. Before the advent of mass production and mass media, relationship marketing was the norm; sellers usually had first-hand knowledge of buyers, and the successful ones used this knowledge to help keep customers for life.

Relationship marketing reflects a strategy and process that integrates customers, suppliers and other partners into the company's design, development, manufacturing and sales processes.

Fundamentally, relationship marketing draws from traditional marketing principles. Marketing can be defined as the process of identifying and satisfying customers' needs in a competitively superior manner in order to achieve the organisation's objectives. Relationship marketing builds on this.

The customer is still fundamental to a marketing relationship. Marketing exists to meet efficiently the satisfaction of customer needs, as well as those of the marketing organisation. There is a considerable body of knowledge in social sciences that sheds light on the many facets of human relationships. We draw from these sources to further our understanding of consumer relationships.

Marketing exchange seeks to achieve satisfaction for the consumer and the marketing organisation (or company). In this latter group we include employees, shareholders and managers. Other stakeholders (such as competitors, financial and governmental institutions) are also important. As we shall see later, relationships can cover a wide range of organisations in the environment, for example:

- governmental institutions
- industry associations
- European Union (EU) institutions
- religious groups.

However, the main focus of this book is still on the relationships between the firm and its closest external bodies, primarily the customers.

In the transactional approach, participants focus exclusively on the economic benefits of the exchange. Even though in relational exchange the focus widens, economic benefits remain important to all of the partners in marketing relationships.

With the relationship approach in mind, an integrated view of marketing management will be presented. To do this, the latest research findings in marketing management and related disciplines are summarised. Yet, marketing management is still a very practical discipline. People still have practical needs, firms still face practical problems and solutions still have to work in real life. Most marketers cannot and should not hide in labs. Marketing is a social science based on theories and concepts, but it also requires that most marketers meet with people, observe them, talk to them and understand their activities. In essence, marketing is a dialogue between sellers (marketers) and buyers (customers). This book reflects this applied approach. Together with important concepts and theories, my experience that has been obtained through work for many years with numerous companies – large and small, domestic and international – will be drawn on.

## TARGET AUDIENCE

This book is written for people who want to know how the relationship and the traditional marketing approach (in combination) affect the development of effective and efficient marketing plans. This book is aimed primarily at students, MBA/graduate students and advanced undergraduates who wish to go into business. It will provide the information, perspectives and tools necessary to get the job done. My aim is to enable you to make better marketing decisions. A second audience for this book is the large group of practitioners who want to build on the existing skills and knowledge already possessed. The book is of special interest to the manager who wishes to keep abreast of the most recent developments in the 'marketing management' field.

## UNIQUE FEATURES OF THIS BOOK

This marketing text tries to integrate the 'new' relationship approach in the traditional process of developing effective marketing plans. Compared to other marketing management books, this text will attach more importance to the following themes.

### Buyer–seller relationships

The guiding principle of this text is that of building relationships between buyers and sellers. Relationships is a growing trend, and for good reason. Dramatic changes in the marketing environment are presenting immense new opportunities for companies that really build and retain relationships with customers. Relationship marketing emphasises the tremendous importance of satisfied, loyal customers. Good customer relationships happen when all employees within the organisation develop the sensitivity and desire to satisfy customers' needs and wants. It may be argued that the traditional concept of marketing (as exemplified later in Chapter 1) does not adequately reflect the recognition of the long-term value of a customer. The argument is that many of the traditional definitions of marketing, although stressing the importance of customer needs and satisfaction, are essentially concerned with maximising the profitability of each transaction. Instead they should seek to develop longterm relationships with customers that cannot easily be duplicated by competitors.

#### Buyer–seller interaction on a global scale

Today's companies are facing fierce and aggressive competition. Today, most firms compete not only locally and nationally, but globally as well. Companies that have never given a thought to internationalisation now also face competition in their home market from international companies. Thinking globally also requires an understanding of the international diversity in buying behaviour and the importance of cross-cultural differences in both the **B2C** and **B2B** markets. This cross-cultural approach is centred on the study of the interaction between buyers and sellers (and their companies), who have different national and/or cultural backgrounds.

**Business-to-consumer (B2C):** Marketing that involves exchange relationships between a firm and its end customers, perhaps via retailers.
**Business-to-business (B2B):** Marketing that involves exchange relationships between two or more business customers and suppliers.

#### Creating competitive advantage through relationships with other companies

Greater emphasis is given to the development of competitive advantage, and consequently to the development of resources and capabilities and competences within the organisation and with other companies. Relationship marketing seeks to build a chain of relationships (networks or value net) between the organisation and its main stakeholders, including customers, suppliers, distribution channel intermediaries and firms producing complementary products and services. Relationships to competitors are also considered.

### Cross-functionalism

Marketing is not an isolated function. A marketer's ability to implement effectively a strategic marketing programme depends largely on the cooperation and competence of other functional areas within the organisation. Consequently, substantial attention is given to the interfunctional approach of marketing management. This includes: the concept of competitive advantages, **cross-functional teams** in the development of new products, **supply chain management**, internationalisation, quality management and ethics.

**Cross-functional team:** A team made up of individuals from various organisational departments, who share a common purpose.
**Supply chain management:** How products are moved from the producer to the ultimate consumer, with a view to achieving the most effective and efficient delivery system

## What is new in the fourth edition?

The main theme of this edition is how to build and retain B2B and B2C marketing relationships in the value chain, both offline but increasingly also online. Consequently, an important aspect of this edition is the strengthening of the online theme (social media, e-commerce, etc.), which is now incorporated in all the chapters and in many cases and exhibits.
In addition, there is a focus on marketing-related themes in connection with new technologies, like Artificial Intelligence (AI), Sharing economy, Gamification, 3-D Printing, Internet-of-Things (IoT), Omni-channel distribution and Blockchain technology.
There is also a focus on Chinese business cases (BYD electric, DJI drones and Huawei smartphones) as China is now the world's second largest economy, after the USA.
The book's chapters, cases and exhibits are totally updated with the latest journal articles and company information. Besides that, the following new concepts are introduced in the single chapters:

- Chapter 1 – discusses The SOSMAC model and gives an introduction to the KPI 'regime'.
- Chapter 2 - discusses how Artificial Intelligence (AI) can help marketers to create customer value.
- Chapter 3 – introduces the Sharing Economy.
- The intro to Part II– discusses the PESTEL analysis.
- Chapter 4 – discusses gamification and its use for marketers.
- Chapter 11 – discusses 3-D Printing – a possible industrial revolution in customization. In addition, it also discusses global mobile app marketing an introduces the Internet-of-Things (IoT) and its use for marketers.
- Chapter 12 – discusses subscription-based pricing.
- Chapter 13 – discusses multiple distribution and omni-channel strategy and introduces Blockchain technology and its influence on marketing and SCM.
- Chapter 14 – discusses a categorization of Social Media, the Social Media funnel and the development of the Social Media Marketing plan.

This edition presents 10 new case studies:

1. Part I Video case study: BYD electric cars – The Chinese electric car manufacturer is considering sales world-wide.
2. Chapter 2 case study: 2.1 Electrolux – A white goods manufacturer is considering growth opportunities worldwide.
3. Chapter 3 case study: 3.1 Nintendo Switch – Is this the 'Blue Ocean' come-back.

4. Part II Video case Study: Müller – Müller yoghurts are penetrating the US market and leaving again by a split-up with the Quaker Joint Venture.
5. Chapter 4 case study: 4.1 Spotify – The online streaming company is growing fast but suffering from financial imbalance.
6. Chapter 7 case study: 7.1 William Demant - One of the world's market leaders in hearing aids is defending its position with the Oticon Brand.
7. Chapter 11 case study: 11.1 Tinder dating app - The famous dating app brand is facing increasing competition from e.g. Badoo.
8. Chapter 12 case study: 12.1 Harley Davidson – How should the pricing strategy be affected by the new EU tariffs in 2018.
9. Chapter 15 case study: 15.1 DJI Technology Co. Ltd. – A Chinese 'born global' dominating the world market for drones with its Phantom and Marvic drones.
10. Chapter 16 case study: 16.1Huawei Smartphones – Expanding into International markets for smartphones.

Furthermore, several new exhibits have been added to the book.

## OUTLINE

The book is structured around the two main steps involved in marketing management – that is, the decision-making process regarding formulating, implementing and controlling a marketing plan:

- Step 1: Analysis of the internal and external situation (Parts I and II)
- Step 2: Planning and implementation of marketing activities (Parts III, IV and V).

The schematic outline of the book in figure 1 shows how the two main steps are divided into five parts. The book has a clear structure according to the marketing planning process of the firm. Based on an analysis of the competitive advantages of the firm (Part I) and the analysis of the external situation (Part II), the firm is able to develop marketing strategies (Part III) and marketing programmes (Part IV). Finally, the firm has to implement and control its activity in the market and, if necessary, make changes in the marketing strategy (Part V). Throughout the book this marketing planning process is seen in a relationship approach, as a supplement to the transactional approach.
The market research function gives a very important input to all five phases (parts) of this decision-making process, with a possible feedback to the marketing information system (MIS). Therefore, this section of the book is an Appendix, but a very important one, as the past marketing experiences are stored in the marketing information system, which may add important contributions to new marketing decision-making processes – i.e., for making better marketing decisions.

### Pedagogical/learning aids

Many aids to student learning come with the book. These include:

- Chapter learning objectives: these tell the reader what he/she should be able to do after completing each chapter.
- Case studies: there is a case study at the end of each chapter and each case study contains questions.

- Video case studies: each part starts with a video case study, which can be accessed on the book's website (via www.vitalsource.com).
- Exhibits: these examples from the real world illustrate the text and the marketing models.
- Summaries: each chapter ends with a summary of the main concepts.
- Discussion questions: at the end of each chapter the discussion issues are presented as questions.
- Marginal definitions: key concepts from the glossary are defined in the margins of the text.
- Glossary: a glossary provides a quick reference to the key terms in the book.

Supplementary material to accompany the book can be downloaded by lecturers via www.vitalsource.com.
Tables 1 and 2 show the video case studies and the chapter case studies in this book.

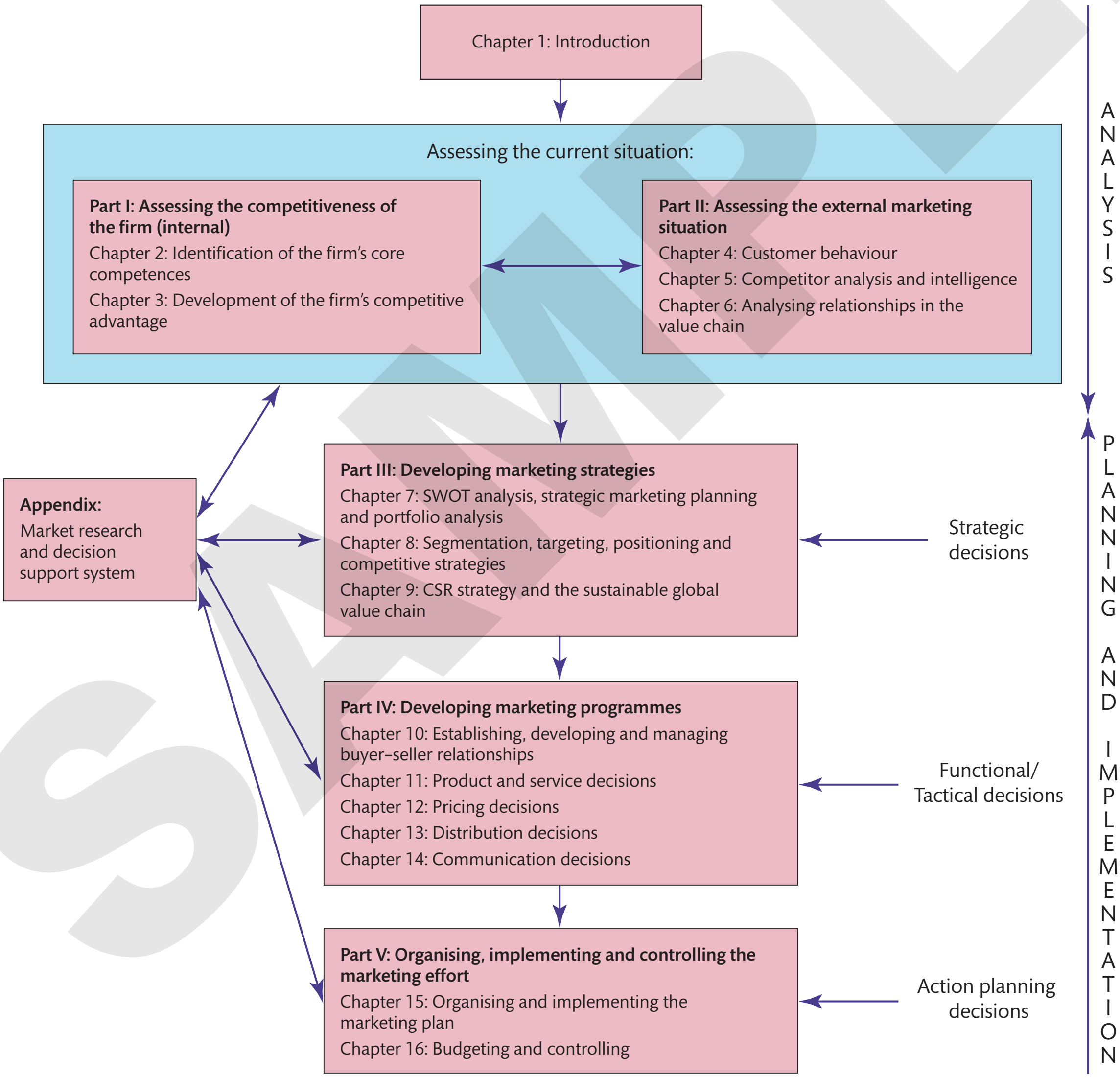

**TABLE 1** *Video case studies in the book: overview*

| PART | VIDEO CASE STUDY | LOCATION OF HEADQUARTERS | TARGET MARKET AREA AND TYPE |
|---|---|---|---|
| **Part I** Assessing the competitiveness of the firm (internal) | **BYD electrical cars**<br>The Chinese electric car manufacturer is considering sales worldwide | China | World B2C/B2B |
| **Part II** Assessing the external marketing situation | **Müller yogurts**<br>Penetrating the US market | Germany | USA B2C/B2B |
| **Part III** Developing marketing strategies | **Nivea**<br>Segmentation of the sun-care market | Germany | World B2C |
| **Part IV** Developing marketing programmes | **Tequila Avión**<br>A premium tequila is introduced | USA | USA/World B2C |
| **Part V** Organising, implementing and controlling the marketing effort | **Pret A Manger**<br>How to control the expansion of an international restaurant chain | UK | UK/USA/World B2C/B2B |

**TABLE 2** *Chapter case studies in the book: overview*

| CHAPTER | CHAPTER CASE STUDY | LOCATION OF HEADQUARTERS | TARGET MARKET AREA AND TYPE |
|---|---|---|---|
| **1** Introduction | **1.1 Hunter Boot Ltd**<br>The iconic British brand is moving into exclusive fashions | UK | World B2C |
| **2** Identification of the firm's core competences | **2.1 Electrolux**<br>A white goods manufacturer is considering growth opportunities worldwide | Sweden | World B2C |
| **3** Development of the firm's competitive advantage | **3.1 Nintendo Switch**<br>Is this the 'Blue Ocean' come-back? | Japan | World B2C |
| **4** Customer behavior | **4.1 Spotify**<br>The online music-streaming company is growing fast but is suffering financial imbalance | Sweden/UK | World B2B |
| **5** Competitor analysis and intelligence | **5.1 Cereal Partners Worldwide (CPW)**<br>The no. 2 world player is challenging the no. 1 – Kellogg | UK/Switzerland | World B2C |
| **6** Analysing relationships in the value chain | **6.1 ARM**<br>Challenging Intel in the world market of computer chips | UK | World B2B |
| **7** SWOT analysis, strategic marketing planning and portfolio analysis | **7.1 William Demant**<br>One of the world's market leaders in hearing aids is defending its position with the Oticon Brand | Denmark | World B2C/B2B |
| **8** Segmentation, targeting, positioning and competitive strategies | **8.1 LEGO Friends**<br>The world's third-largest toy manufacturer is moving into the girls' domain | Denmark | World B2C |

| | | | |
|---|---|---|---|
| **9** CSR strategy and the sustainable global value chain | **9.1 YouthAIDS**<br>Social marketing in a private, non-profit organisation | USA | World B2C/B2B |
| **10** Establishing, developing and managing buyer–seller relationships | **10.1 Dassault Falcon**<br>The private business jet, Falcon, is navigating in the global corporate business sector | France | World B2B |
| **11** Product and service decisions | **11.1 Tinder**<br>The famous dating app brand is facing increasing competition from e.g. Badoo | USA | World B2C |
| **12** Pricing decisions | **12.1 Harley-Davidson**<br>Is the image justifying the price level in a time of recession? | USA | World B2C |
| **13** Distribution decisions | **13.1** Bosch Indego<br>How to build B2B and B2C relationships in a new global product market - robotic lawnmowers | Germany | World B2C/B2B |
| **14** Communication decisions | **14.1** Orabrush Inc.<br>How a 'pull' B2C YouTube marketing strategy helped consumers to focus on the 'bad breath' problem | USA | World B2C |
| **15** Organising and implementing the marketing plan | **15.1** DJI Technology Co. Ltd.<br>A Chinese 'born global' is dominating the world market for drones with its Phantom and Marvic drones | China | World/Western Europe/USA B2C/B2B |
| **16** Budgeting and controlling | **16.1** Huawei smartphones<br>Expanding into the international markets for smartphones | China | World B2C/B2B |

# ABOUT THE AUTHOR

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Svend Hollensen
Sønderborg, Denmark
December 2018

# CHAPTER 1

# Introduction

## CONTENTS



## LEARNING OBJECTIVES

After studying this chapter you should be able to:

- describe how marketing management is placed in the overall company strategy;
- compare and discuss the differences and similarities between the traditional (transactional) marketing approach and the relationship marketing approach;
- explain the concept of SOSMAC;
- explain what implications the relationship marketing approach has on the traditional (transactional) marketing mix (the four Ps).

## 1.1 INTRODUCTION

In recent years, we have witnessed a steep decline in the effectiveness of traditional marketing tools (such as mass media advertising) with customers, who now actively seek ways to avoid the thousands of marketing messages they are bombarded with every day. At the same time, a dramatic shift has occurred in the way customers communicate with one another, for example in connection with the growth of social media. In response, marketing practices have moved to promote a more interactive dialogue between firms and customers, where both are actively involved in the exchange of information. Such a two-way communication approach – from here on termed **relationship marketing (RM)** – is facilitated when both entities are in regular contact with one another and the quality of communication channels between them is high. This transformation from traditional or **transactional marketing (TM)** to a focus on building and improving high-quality relationships can lead to a number of desirable marketing outcomes (Clark and Melancon, 2013).

**Transactional marketing (TM):** The idea that the major focus of the marketing programme (the 4 Ps) is to make customers buy. TM considers independence among marketing actors ('arm's length') to be vital for marketing efficiency.

**Relationship marketing (RM):** The process of creating, maintaining and enhancing strong long-term relationships with customers and other stakeholders through mutual exchange and trust. RM seeks to build a chain of relationships between the firm and its main stakeholders.

This aim of this book as a whole is to bridge the gap between the traditional, transactional marketing planning approach and the 'new' relational marketing approach. The book is structured according to the marketing management process in Figure 1.1, which is here shown as an iterative SOSMAC approach.

The planning process is iterative because we constantly have to monitor the **KPIs** in the control stage in order to see to which degree the company fulfills the objectives of key processes. If the fulfillment of a given process is too low we will have to go back to the earlier stages (boxes) and make adjustments. If the 'gap' between current performance and the objective is very big, we may even have to lower the original objectives. All the KPIs that are measured at the end of the year will then be used as input for the next year's situation analysis.

**KPIs (Key Performance Indicators):** KPIs are measurable values that show how effectively a company is achieving key business objectives. KPIs may be used at different levels of the company. High-level KPIs focus on the overall performance of the company, while low-level KPIs may focus on processes in departments (such as sales or customer satisfaction) or even at individual level.

## 1.2 THE MARKETING MANAGEMENT PROCESS

Though it is not always the case, the starting point for the marketing management process and the **marketing plan** should be the marketing strategy.

**Marketing plan:** A marketing plan is a written document that details the necessary actions to achieve the company's marketing objectives. It can be for a product or service, a brand or a product line. Basically, a marketing plan describes the marketing activities of a company in order to produce sales at the customer level. Marketing plans cover between one and five years. A marketing plan may be part of an overall business plan.

### Marketing strategy

Although 'marketing strategy' first became a popular business buzzword during the 1960s, it continues to be the subject of widely differing definitions and interpretations. The following definition, however, captures the essence of the term:

> *A marketing strategy is a fundamental pattern of present and planned objectives, resource deployments and interactions of an organisation with markets, competitors and other environmental factors.*

This definition suggests that a strategy should specify what (objectives to be accomplished), where (on which industries and product markets to focus), and how (which resources and activities to allocate to each product/market to meet environmental opportunities and threats) in order to gain a competitive advantage.

Rather than enforcing a single comprehensive strategy, many organisations have a hierarchy of interrelated strategies, each formulated at a different level of the

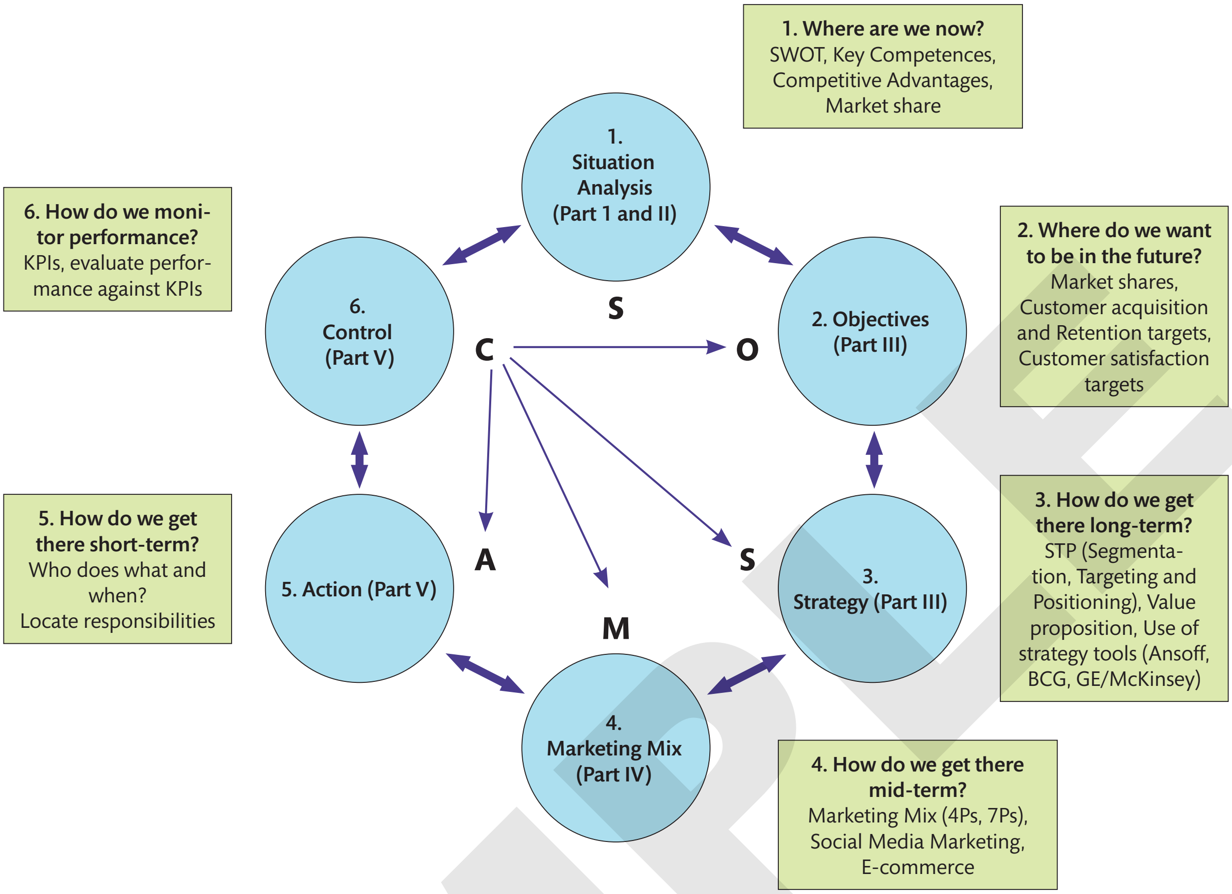


**FIGURE 1.1** *The SOSMAC process*

Source: based on the *PR Smith's SOSTAC® Digital Marketing Plan*, 2e, 2016.



firm. The three major levels of strategy in most large, multi-product organisations are:

1. corporate strategy;
2. business-level strategy;
3. functional strategies, e.g. marketing strategy.

In small, single-product companies, corporate and business-level strategic issues merge. Our primary focus is on the development of marketing strategies and programmes for individual product-market entries, but other functional departments – such as R&D and production – also have strategies and plans for each of the firm's product markets. Table 1.1 summarises the specific focus and issues dealt with at each strategy level.

## Mission and vision

The traditional strategy literature operates with a *hierarchical* definition of strategic marketing management. In this context, the terms **mission** and **objectives** have specific meanings. The corporate mission can be considered as a brief statement of the purpose of the company – what the organisation is and what it does ('Who are we?').

**Mission:** The purpose of the company. It is what the company wants to do for its customers. The mission statement should answer who the customers are and what value (products and services) should be provided to the customers.

**Objective:** A desired result at some future point in time. Objective should be specific, measurable, attainable, realistic and time-specific (SMART).

TABLE 1.1 Different planning levels in the company

| STRATEGY COMPONENTS | CORPORATE STRATEGY | BUSINESS STRATEGY | MARKETING STRATEGY |
|---|---|---|---|
| Scope/mission | Corporate domain – which businesses should we be in? | Business domain – which product markets should we be in within this business or industry? | • Target market definition<br>• Product-line depth and breadth<br>• Branding policies |
| Strategy | Corporate development strategy<br>• Conglomerate **diversification** (expansion into unrelated businesses)<br>• Vertical integration<br>• Acquisition and divestiture policies | Business development strategy Concentric (new products for existing customers or new customers for existing products) | • Product-market development plan<br>• **Line extension** and product elimination plans |
| Goals and objectives | Overall corporate objectives aggregated across businesses<br>• Revenue growth<br>• Profitability<br>• **Return on investment (ROI)**<br>• Earnings per share<br>• Contributions to other<br>• stakeholders | Constrained by corporate goals Objectives aggregated across product-market entries in the business unit<br>• Sales growth<br>• New product or market growth<br>• Profitability<br>• ROI<br>• Cash flow<br>• Strengthening bases of competitive advantage | Constrained by corporate and business goals Objectives for a specific product-market entry<br>• Sales<br>• Market share<br>• Contribution margin<br>• Customer satisfaction |
| Allocation of resources | • Allocation among businesses in the corporate portfolio<br>• Allocation across functions shared by multiple businesses (corporate R&D, MIS) | • Allocation among product-market entries in the business unit<br>• Allocation across functional departments within the business unit | Allocation across components of the marketing plan (elements of the marketing mix) for a specific product-market entry |
| Sources of competitive advantage | Primarily through superior corporate financial or human resources; more corporate R&D; better organisational processes or synergies relative to competitors across all industries in which the firm operates | Primarily through competitive strategy; business unit's competences relative to competitors in its industry | Primarily through effective product positioning; superiority on one or more components of the marketing mix relative to competitors within a specific product market |
| Sources of synergy | Shared resources, technologies, or functional competences across businesses within the firm | Shared resources (including favourable customer image) or functional competences across product markets within an industry | Shared marketing resources, competences, or activities across product-market entries |

**Diversification:** The market and product development strategy that involves expansion to a relatively large number of markets and products.

**Line extension:** Using a successful brand name to introduce additional items in a given product category under the same brand name, such as new flavours, forms, colours, added ingredients or package sizes.

**Return on investment (ROI):** A common measure of managerial effectiveness – the ratio of net profit to investment.

As an example, consider the mission statement of Coca-Cola, which sets out their mission and objectives as follows:

> *Our Roadmap starts with our mission, which is enduring. It declares our purpose as a company and serves as the standard against which we weigh our actions and decisions.*
>
> - *To refresh the world . . .*
> - *To inspire moments of optimism and happiness . . .*
> - *To create value and make a difference.*
>
> Source: www.thecoca-colacompany.com.

The mission statement may change if the company outlives the industry it started in, but it should still tie back to the core values. For example: 'Google's mission is to organise the world's information and make it universally accessible and useful.'

Ideally, the definition could cover Abell's three dimensions for defining the business: customer groups to be served, customer needs to be served and technologies to be utilised (Abell, 1980).

A vision statement is what the enterprise wants to become ('Where do we wish to go?'). The vision is a description of the company's 'desired future state'. Thus, the company may create a vision statement describing the organisation as it may be in, say, ten or more years. Note the emphasis on the future; the **vision** statement is not true today. Rather, it describes the organisation as it could become in the future.

**Vision:** What the company wants to become, i.e. the description of the company's desired future state.

A vision statement should build enthusiasm. It should provoke inspiration. It should stimulate people to care. It should 'rally the troops to action.' That is what President Kennedy accomplished with the vision statement he offered in early 1961. Kennedy said:

> *I believe that this nation should commit itself to achieving the goal, before this decade is out, of landing a man on the moon, and returning him safely to earth.*

Continuing with my running example in this chapter, the vision of Coca-Cola is:

> *Our vision serves as the framework for our Roadmap and guides every aspect of our business by describing what we need to accomplish in order to continue achieving sustainable, quality growth.*
>
> - *People: Be a great place to work where people are inspired to be the best they can be.*
> - *Portfolio: Bring to the world a portfolio of quality beverage brands that anticipate and satisfy people's desires and needs.*
> - *Partners: Nurture a winning network of customers and suppliers, together we create mutual, enduring value.*
> - *Planet: Be a responsible citizen that makes a difference by helping build and support sustainable communities.*
> - *Profit: Maximise long-term return to shareowners while being mindful of our overall responsibilities.*
> - *Productivity: Be a highly effective, lean and fast-moving organisation.*
>
> Source: www.thecoca-colacompany.com.

McDonald's combine their mission with a vision statement:

> *Our vision is to be the world's best 'quick service restaurant.' This means opening and running great restaurants and providing exceptional quality, service, cleanliness and value.*
>
> Source: www.mcdonalds.com.

### Objectives

Objectives in the hierarchical definition of strategy are the specific performance targets that firms aspire to in each of the areas included in a firm's mission statement. It is usually not enough for a firm just to assert that it wants to be a leader in its industry or that it wants to become a major diversified company. In addition, a firm needs to specify what it means to be a leader in its industry or what being a major diversified company means. Often, objectives are stated in financial or economic terms. Thus, for one firm being a 'leader' in an industry may mean having the largest market share, but for other firms leadership might mean being the most profitable firm in the industry, having the highest-quality products, or being the most innovative. In the same way, being a major diversified company may mean unrelated diversification across a wide variety of industries for one firm and a relatively narrow product and industry focus for another.

With respect to the hierarchical definition of strategy, comparing actual behaviour with objectives is one way that managers can come to know whether or not they have fulfilled a firm's mission. With a mission and objectives in place, a firm (according to the hierarchical definition of strategy) can then turn its attention to strategies. Strategies thus become the means through which firms accomplish their objectives and mission.

## Marketing plan

In most organisations, strategic planning is an annual process, typically covering just the year ahead. Occasionally, organisations may look at a practical plan that stretches three or more years ahead. To be most effective, the plan must be formalised, usually in written form, as an identifiable marketing plan.

The process of marketing management and the development of a marketing plan is no different from any other functional area of management in that it essentially comprises four key tasks: analysis, planning, implementation and control.

### Analysis

The starting point of marketing management decisions is analysis. Customers, competitors, trends and changes in the environment and internal strengths and weaknesses must each be fully understood by the marketer before effective marketing plans can be established. Analysis, in turn, requires information using systematic market research and a **marketing information system (MIS)**.

**Marketing information system (MIS):** A system in which marketing information is formally gathered, stored, analysed and distributed to managers in accord with their informational needs on a regular, planned basis.

**Big Data:** The vast collection of data from traditional and digital sources (inside and outside the company). It refers to the marketer's ability to aggregate, segment and use these data sets to ensure that the right message is being delivered to the right segment of customers.

The volume of digital data accessible for the marketer is now growing at an exponential rate. The use of **Big Data** – large pools of data that can be brought together and analysed to discern patterns and make better decisions – will become the basis of competition and growth for individual companies (McAfee and Brynjolfsson, 2012; Mazzei and Noble, 2017).

For example, manufacturers will be able to analyse incoming data and, in some cases, automatically repair software damage. In the retailing sector, it will be possible to track the behaviour of individual customers from internet click streams, update the customers' preferences and model their likely behaviour in real time. When the customers are then nearing the purchase decision regarding a specific product in the store, the retailer may automatically offer a bundle of products (cross-selling), together with reward programme benefits. Another example is McDonald's, which has equipped some stores with devices that gather operational data as they track customer interactions, traffic in stores and ordering patterns. Researchers can model the impact of variations in menus, restaurants designs and training on, among other things, sales and profitability.

### Planning

The second task of the manager is the planning process. The marketing manager must plan both long-term marketing direction for the organisation (strategic planning), including, for example, the selection of target markets, and the marketing programmes and tactics that will be used to support these strategic plans.

### Implementation

Both strategic and tactical plans must, of course, be acted upon if they are to have any effect. The implementation tasks of marketing management involve such activities as staffing, allocating tasks and responsibilities, budgeting and securing any financial and other resources needed to carry out the plans. Actions include activities such as placing an advert in the right media, delivering products, carrying out customer surveys and so on.

### Control

**Control:** The process by which managers ensure that planned activities are completely and properly executed.

**Effectiveness:** Doing the right thing – making the correct strategic choice.

**Marketing audit:** An analysis and evaluation of the internal and external marketing environment of the company.

The fourth, and sometimes neglected, task of the manager is measuring and evaluating progress against objectives and targets established in plans. **Control** of marketing plans can be problematical, with difficulties associated with both measuring marketing performance and pinpointing cause and effect. For example, market share – a frequently used measure of marketing performance and hence a basis for marketing control – needs very careful analysis and interpretation if it is to provide a useful basis for controlling the **effectiveness** of marketing strategies and plans. Both qualitative and quantitative techniques of control should be used by the marketing manager and include budgetary control, control of marketing mix effectiveness and, from time to time, a full **marketing audit**.

In the following section, the strengths and weaknesses of the hierarchical approach to marketing planning will be highlighted.

## Strengths of the hierarchical approach to marketing planning

The hierarchical approach has three important strengths. First, it emphasises the link between strategy and performance. Virtually all strategic management researchers – and most practising managers – are interested in the relationship between the actions taken by a firm and a firm's performance. The hierarchical definition provides explicit criteria for judging the performance quality of a firm's strategies – good strategies enable an organisation to reach its objectives and fulfil its mission; bad strategies make it more difficult for a firm to reach its objectives and fulfil its mission.

Second, this hierarchical definition focuses on the multiple levels of analysis that are important in formulating and implementing strategies. These levels of analysis vary in their degree of abstraction. Company missions are very abstract concepts. They specify what a firm wants to become but say little about how a firm will get to where it wants to go. Objectives translate missions into specific goals and targets and thus are less abstract. Strategies specify which actions firms will take to meet their objectives. Plans (the least abstract concept) focus on specific actions that need to be taken to implement strategies.

By emphasising the multiple levels of analysis in the strategic management process, hierarchical definitions appropriately emphasise the need in organisations to gather information, ideas, and suggestions from all parts of the firm in order to formulate effective strategies. In this conception of strategy, each part of a firm plays an important role. Senior managers specialise in establishing missions and objectives, divisional managers specialise in strategy formulation, and functional managers focus their efforts on tactics. No one of these tasks is more important than any other. Missions and objectives will never be achieved without strategies and tactics. Strategies without missions and objectives will be unfocused. Strategies without tactics are usually not implemented. And plans without strategies or missions are not likely to improve a firm's performance.

A third strength of the hierarchical definition is that it emphasises the fact that strategy, in order to have an impact on performance, cannot remain simply an idea in an organisation. Rather, it must be translated, through resource allocation, into action. An organisation's mission is often a statement of an idea, or a manifestation of the values, of top management. However, by itself a mission statement is likely to have little impact on a firm's performance. Rather, this mission statement must be linked with objectives, strategies and tactics. In choosing objectives, strategies and tactics, managers must make tough decisions, set priorities and allocate resources. Firms that translate their mission into actions increase the probability that they will improve their performance (McGuire et al., 2012).

## Weaknesses of the hierarchical approach to marketing planning

The most important weaknesses of the hierarchical approach are as follows. First, it has a very underdeveloped notion of the external competitive environment's impact on strategy formulation and implementation. Mission statements summarise where the senior management want an organisation to be in the long run, but the development of these statements is encouraged to focus inward. In choosing a mission, senior managers are encouraged to look inward, evaluating their own personal priorities and values. Certainly, this kind of analysis is an important step in developing a firm's mission.

Indeed, part of this book is devoted to this kind of internal analysis. Such an analysis, however, must be linked with the external analysis (Part II) in order for firms to choose missions, objectives, strategies and thus marketing plans that will add value to the firm.

A second weakness of the hierarchical definition is that it tends to focus, almost exclusively, on formal, routine, bureaucratic strategy-making processes. In this definition, strategic choices are made through systematic study and analysis. These analyses result in coherent, self-reinforcing sets of strategies that, taken together, lead a firm to reach its objectives and mission. There is little doubt that many organisations choose at least some of their strategies in this logical and systematic way. An enormous amount of research on formal strategic planning suggests that more and more firms are adopting explicit and formal planning systems to choose their strategies. The hierarchical definitions presented in Figure 1.1 tend to emphasise this formal, systematic aspect of choosing and implementing strategies.

**SMEs:** Small and medium-sized enterprises. In the EU, SMEs are characterised as having 250 employees or less; they comprise approximately 99 per cent of all firms.

Yet not all strategies are chosen in this way. Small and medium-sized enterprises **(SMEs)** choose strategies by discovering an unanticipated opportunity and exploiting that opportunity to improve performance, resulting in 'emerging strategies' (Mintzberg, 1987; Mintzberg and Waters, 1985). Firms also choose strategies 'retroactively' – that is, they engage in certain kinds of behaviour over time, and then, only after that pattern of behaviour is in existence, senior managers label these actions as a coherent or consistent strategy. Some firms stumble into their strategy by chance. All these are ways that firms can choose strategies, yet none of them is consistent with the formal, systematic strategic management process presented in Figure 1.1.

A third weakness of hierarchical approaches to defining strategy and strategic management is that, despite their apparent rigour and clarity, they often fail to give significant guidance to managers when they are applied in real organisations. There are literally thousands of objectives that an organisation could choose to support any given mission statement. Which objectives a firm should choose, which should be given priority and which should be ignored are questions that must be answered logically and with ideas that are not provided in the hierarchical definition. Moreover, there may be thousands of different strategies that firms could choose to support any given set of objectives. Which particular strategies a firm should choose goes beyond the hierarchical model.

## 1.3 The traditional (transactional) marketing (TM) concept versus the relationship marketing (RM) concept

### The traditional (transactional) marketing concept

The American Marketing Association (AMA) – an international organisation of practitioners and academicians – defines marketing as follows:

> *Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives.*

This definition describes what the traditional (transactional) marketing concept is: the conception, pricing, promotion and distribution of ideas, goods, and services. Moreover, the definition implies a list of activities for the marketer to undertake: the planning and execution of these four elements of competition so that individual and organisational objectives are satisfied.

Another characteristic of transactional marketing is the belief that independence of choice among marketing players provides a more efficient system for creating and distributing marketing value. Maintaining an arm's length relationship is considered vital for marketing efficiency. Industrial organisations and government policy makers believe that independence of marketing players provides each player freedom to choose his/her transactional partners on the basis of preserving their own self-interests at each decision point. This results in the **efficiency** of lowest-cost purchases through bargaining and bidding.

**Efficiency:** A way of managing business processes to a high standard, usually concerned with cost reduction.

The so-called **4Ps** are the epitome of what should be done and are also known as the 'marketing mix'. This transactional, micro-economic, and teacher-friendly marketing framework is straightforward to understand and use. Indeed, in the 1950s and 1960s the 4Ps approach proved very successful. In the USA, this was the era of mass manufacturing and **mass marketing** of packaged consumer goods and, because of that, marketing was often more about attracting than retaining customers.

**4Ps:** The basic elements of the marketing mix: product, place (distribution), price and promotion; also called the controllable variables of marketing, because they can be controlled and manipulated by the marketer.

**Mass marketing:** One-to-many communications between a company and potential customers with limited tailoring of the message.

The model of transaction marketing (as in the 4Ps) rests on three assumptions:

1. there is a large number of potential customers;
2. the customers and their needs are fairly homogeneous;
3. it is rather easy to replace lost customers with new customers.

Looking at today's markets and certainly when moving from consumer markets to industrial and service markets, this approach may not be appropriate.

### The relationship marketing (RM) concept

According to the traditional (transactional) marketing concept, the major focus of marketing programmes has been to make customers buy, regardless of whether they are existing or new customers. Often only a small part of the marketing budget has explicitly been allocated directly towards existing customers.

Since the 1980s, academics have been questioning this approach to marketing (for example, Grönroos, 1996 and 2006 and Gummesson, 1999). They argue that this approach to marketing is no longer broad enough because of the importance of customer retention, the changes in the competitive environment and the limitations of transaction marketing.

In Europe, this new direction of marketing thought was mainly initiated by the IMP (Industrial Marketing and Purchasing Group).

According to Gordon (1998: 9):

> *Relationship marketing is the ongoing process of identifying and creating new value with individual customers and then sharing the benefits from this over a lifetime of association. It involves the understanding, focusing and management of ongoing collaboration between suppliers and selected customers for mutual value creation and sharing through interdependence and organisational alignment.*

RM not only attempts to involve and integrate suppliers and customers. Besides a need for focusing on customer retention, Payne (1995) emphasises that RM indicates a shift towards the organisation of marketing activities around cross-functional activities. Payne (1995) presents a model Figure 1.2 where six markets need to be considered if the customer is to be served satisfactorily.

Customers remain the prime focus in the centre of the model but, as shown in Figure 1.2, there are five other markets where a detailed marketing strategy may be needed.

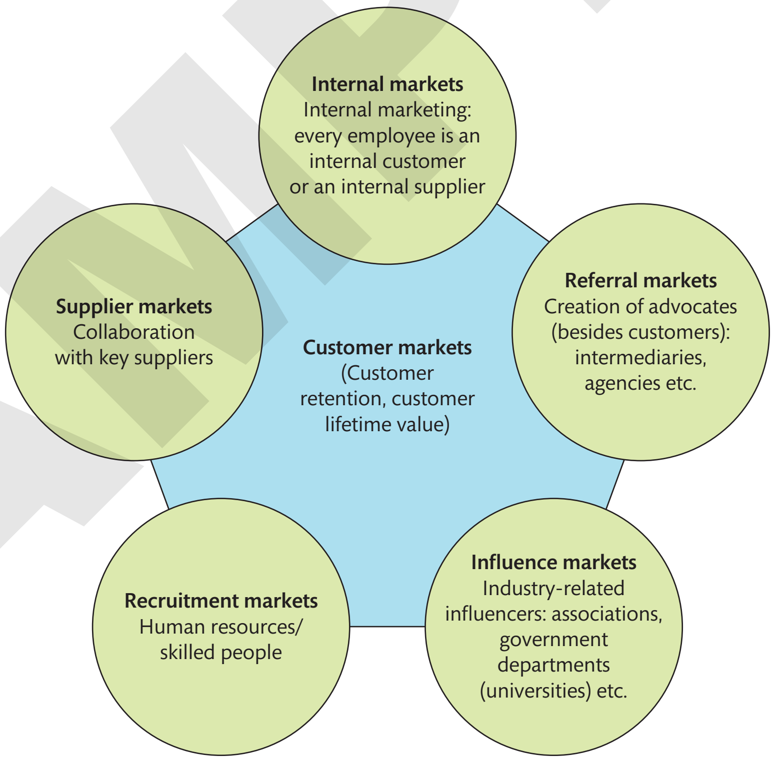


**FIGURE 1.2** *Relationship marketing's six-markets model*

Source: after Payne, A. (ed) (1995) *Advances in Relationship Marketing*, London: Kogan Page, p. 31. Reproduced with permission from Kogan Page and A. Payne.

RM attempts to involve and integrate customers, suppliers, and other infrastructural partners into a firm's developmental and marketing activities. Such involvement results in close interactive relationships with suppliers, customers or other value chain partners of the firm.

Relationships are the fundamental asset of the company. More than anything else – even the physical plant, patents, products or markets – relationships determine the future of the firm. Relationships predict whether new value will continue to be created and shared with the company. If customers are amenable to a deepening bond, they will do more business with the company. If employees like to work there, they will continue along their **learning curve** and produce more and better. If investors and bankers are happy with their returns, they will continue to keep their funds in the company.

**Learning curves:** Track the decreasing cost of production and distribution of products or services over time as a result of learning by doing, innovation and imitation.

**Paradigm:** A shared way of thinking or meta-theory that provides a framework for theory.

Thus, the development of relationship marketing points to a significant **paradigm** shift in marketing: competition and conflict to mutual cooperation, and independence and choice to mutual interdependence, as illustrated in Figure 1.3. Today, many companies realise the importance of the RM approach but most companies still operate with a mixture of the TM and RM approaches. Some firms are attaching more weight to RM than others and vice versa.

RM emphasises cooperation rather than competition and consequent conflict among the parties. It also emphasises cooperation rather than competition and consequent conflict among the marketing players. The exchange-based transactional marketing approach is based on a notion of mass markets where individual customers are anonymous. The goal is to make customers choose one particular **brand** over competing brands. This easily creates a situation of competition between the marketer and the customer.

**Brand:** An identifying feature that distinguishes one product from another; more specifically, any name, term, symbol, sign or design, or a unifying combination of these.

In transaction marketing situations, customers, as unidentified members of a segment, are exposed to a number of competing products, and they are supposed to make independent choices from among the available options. The two parties have conflicting interests. The starting point is that the customer does not want to buy; he or she has to be persuaded to do so.

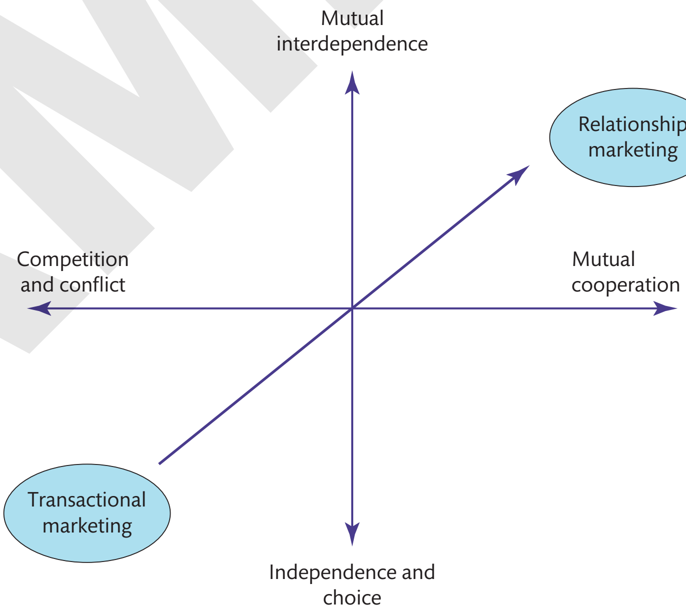


FIGURE 1.3 *Transactional and relationship marketing*

Source: adapted from Sheth, J. N. and Parvatiyar, A. (1995) 'The evolution of relationship marketing', *International Business Review*, 4(4), p. 400. Copyright © 1995 Elsevier. Reproduced with permission.

In RM, where interactions and cooperation exist at some level, the customer and the supplier or service provider are not totally isolated from each other. The relationship is based on value creation in interactions between the supplier or service provider and the customer. Cooperation is required to create the value that the customer is looking for. Of course, this does not mean that conflicts could not exist; however, cooperation is the driving force, not conflict.

In situations where there are a limited number of customers and/or where continuous interaction with customers occurs, a relationship approach is relatively easy to adopt, if this is considered profitable and appreciated by the customers. This is the case in many **business-to-business (B2B)** markets and in service markets. When a firm has mass markets with limited direct contact with its customers, a relationship approach is less obvious.

**Business-to-business (B2B):** Marketing that involves exchange relationships between two or more business customers and suppliers.

In summary of what has been said in sections 1.3.1 and 1.3.2, some important differences between the two marketing orientations are highlighted in Table 1.2.

### Importance of customer retention: a case study of how to bridge the gap between TM and RM

Recently, evidence has been provided about the value of long-term customer relationships and on how to improve performance by focusing on customer retention instead of single sales. It suggests that it can be up to ten times more expensive to win a customer than to retain a customer – and the cost of bringing a new customer to the same level of profitability as the lost one is up to 16 times more (Peppers and Rogers, 1993). Further evidence is provided by Lindgreen and Crawford (1999), who show that increasing customer retention from 80 per cent to 94 per cent in a food catering business quadrupled the value of its average customer. Moreover, existing satisfied customers can make up about two-thirds of the volume for an average business (Vavra, 1995).

It has been said that transaction marketing is too simplified a framework for today's businesses as they are confronted with many competitive challenges. Since the 1990s, markets have generally become mature and there is only little possibility for product differentiation. Therefore, customer retention is becoming more important. RM suggests that the company should focus on the ultimate market segment and serve customers as individuals. Companies can give individual customers, or logical groups of customers (where serving the individual uniquely makes no sense to either customer or supplier), the value each wants by using technology appropriately throughout the **value chain**. Often this means taking apart existing business processes and inserting technology into them. For example, when the internet is used for online ordering, the process for purchasing has been redesigned.

**Value chain:** Chain of activities by which a company brings in materials, creates a good or service, markets it and provides service after a sale is made. Each step creates more value for the consumer.

However, all this does not exclude transaction marketing. In a way, TM and RM become part of the same fundamental paradigm: *focus on customer satisfaction*. Although RM is a strong strategic concept, its implementation requires the use of powerful instruments. This instrumental dimension was largely neglected in the early academic discussion of the RM concept. Nevertheless, most companies and scholars do use the transactional paradigmatic framework when identifying adequate marketing instruments for building and maintaining relationships with customers.

## 1.4 BALANCING THE TRANSACTIONAL AND RELATIONSHIP CONCEPTS THROUGHOUT THE BOOK

This book establishes links between the traditional marketing (TM) approach and the relationship marketing (RM) approach. Some chapters (2–5) concentrate more on the traditional marketing approach, whereas Chapter 6 attempts to draw all the factors together into a true relationship (between-the-boxes) approach

**TABLE 1.2** Transactional and relationship marketing

| CATEGORY | TRANSACTIONAL MARKETING | RELATIONSHIP MARKETING |
|---|---|---|
| Focus | Economic transaction.<br>Decision focus on product/ brand and 4Ps. | Decision focus on relationships between firms in a network and individuals. |
| The marketing environment | Marketing rules are very clear, defined and constant.<br>Market is bound by countries and regions. | Marketing rules are relatively clear, defined and constant.<br>Market is relatively bound by network and alliances.<br>The boundaries between firms are blurred, if not completely eroded. |
| Parties involved | A firm and buyers are involved in a general market. Distant and impersonal contact. | Dyadic relationships: sellers, buyers and other firms. Face-to-face, close interpersonal contacts based on commitment and trust. |
| Goals | Each party's goals and objectives, while similar, are geared to what is best for them. | Shared goals and objectives ensure common direction. |
| Managerial intent | Transaction/sales volume and creating new customers are considered a success.<br>Customer attraction (to satisfy the customer at a profit). | Keeping the existing customers, retention, is considered to be a success.<br>Satisfy the customer, increase profit and attain other objectives, such as increased loyalty, decreased customer risk, etc. |
| Production focus | Mass production | Mass customisation |
| Communication | Communications structured and guarded. | Open communication avoids misdirection and bolsters effective working relationships. |
| Customers | Low customer interactivity.<br>Customers are less knowledgeable and informed. | High customer interactivity.<br>Customers are aware and informed. Their feedback can be immediate. |
| Competitive advantage/differentiation | The quality of the product is important for differentiation.<br>The marketing mix can be used for the differentiation. | Creativity is important for differentiation.<br>Long-term and close relationships, adaptation and putting the customer at the centre of the organisation are a source of differentiation. |
| Balance of power/ sharing | Active seller – less passive buyers.<br>Suspicion and distrust. Each party wary of the motives and actions of the other.<br>Sharing limited by lack of trust and different objectives. Often opportunistic behaviour. | Seller and buyer mutually active and adaptive (interdependent and reciprocal).<br>Mutual trust forms the basis for strong working relationships.<br>Sharing of business plans and strategies. |
| Organisation/ managerial level | Functional marketers (e.g. sales manager, product development manager).<br>Marketing is a concern of the marketing department. | Managers from across functions and levels in the firm.<br>Everyone in the organisation is a part-time marketer.<br>Specialist marketers (e.g. key account managers). |
| Formality | Formal (yet personalised via technology). | Formal and informal (i.e. at both a business and social level). |
| Duration | Discrete (yet perhaps over time). Short-term. | Continuous (ongoing and mutually adaptive, may be short- or long-term). |
| General advantages/ disadvantages | Advantage: independence of buyer and seller.<br>Disadvantage: the firm is in a vulnerable situation if a competitor makes a better offer to the customer. | Advantage: intimate knowledge of needs and markets (developed over time), which has been likened to reading the minds of customers.<br>Disadvantage: the firm is in a vulnerable situation if its business supplier (customer) disappears. |

Sources: adapted from Payne (1995); Lindgreen et al. (2000); Zineldin (2000); Håkansson and Waluszewski (2005); Grönroos (2006).



(between-the-boxes approach). The curved arrows next to Chapters 2–5 in Figure 1.4 indicate that the actors (firm, customer and competitor) are treated more independently of the relationship approach. In other words, these four chapters do not focus so much on the relationships to other important players in the value chain. These relationships (double arrows between the firm and the other actors) are then covered in Chapter 6, which also includes the firm's relations to suppliers and complementors. Hence, though there seems to be a paradigm shift going on from the transactional to the relationship marketing approach, most companies are still practising a mixture of both.

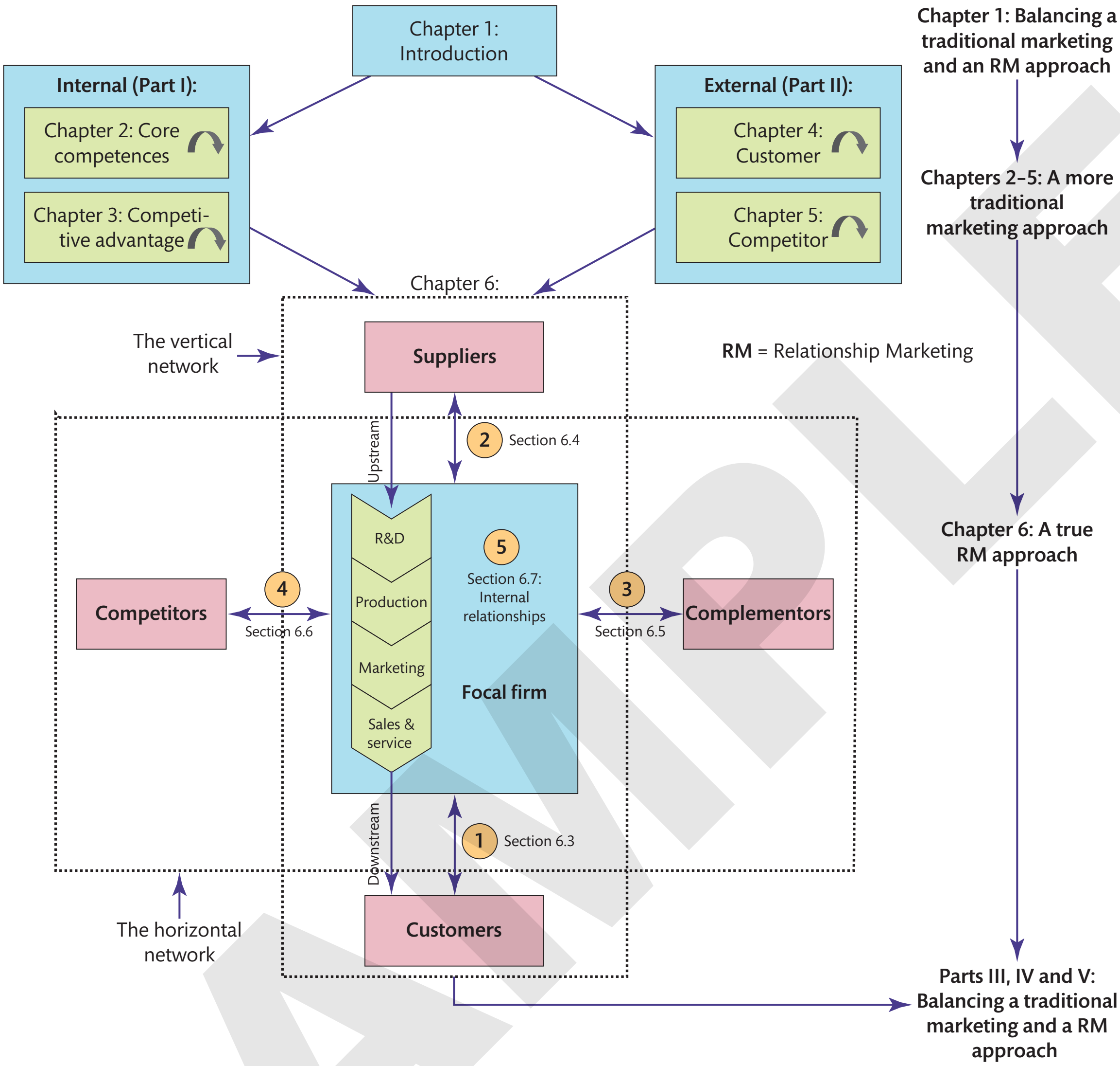


FIGURE 1.4 *Balancing the concepts of transactional and relationship marketing*

## 1.5 HOW THE RM CONCEPT INFLUENCES THE TRADITIONAL MARKETING CONCEPT

In the following sub-section, some of the consequences of a relationship orientation for the traditional four marketing parameters (4Ps) are given (Håkansson and Waluszewski, 2005).

### Product

A key impact of RM on product policy is the integration of customised elements in what were previously standardised products for mass markets. Modern information technology allows firms to individualise their products and services according to the varying needs of their customers.

RM, when appropriately implemented, results in products being cooperatively designed, developed, tested, piloted, provided, installed and refined. Products are not developed in the historical way, with the company producing **product concepts**, researching these with customers and then engaging in various research and development initiatives – leading to product introduction some time later. Rather, RM involves real-time interaction between the company and its priority customers as the company seeks to move more rapidly to meet customer requirements. The product is therefore the output of a process of collaboration that creates the value customers want for each component of the product and associated services. Products are not bundles of tangible and intangible benefits that the company assembles because it thinks this is what customers want to buy. Rather, products comprise an aggregation of individual benefits that customers have participated in selecting or designing. The customer thus participates in the assembly of an unbundled series of components or modules that together constitute the product or service. The product resulting from this collaboration may be unique or highly tailored to the requirements of the customer, with much more of the customer's knowledge content incorporated into the product than was previously the case.

**Product concept:** The end result of the marketing strategist's selection and blending of a product's primary and auxiliary components into a basic idea emphasising a particular set of consumer benefits; also called the product positioning concept.

## Price

Traditional marketing sets a price for a product, perhaps discounting the price in accordance with competitive and other marketplace considerations. The price seeks to secure a fair return on the investment the company has made in its more or less static product.

Relationship-orientated pricing is centred on the application of price differentiation strategies. The pricing should correspond to **customer lifetime values (CLTV)**. This proposal represents an attempt to estimate the net present value of the current and future potential of various customers or customer segments.

**Customer lifetime value (CLTV):** The present value of the future cash flows attributed to the customer relationship or the amount by which revenue from a given customer over time will exceed the company's costs of attracting, selling and servicing that customer. Use of customer lifetime value as a marketing metric tends to place greater emphasis on customer service and long-term customer satisfaction, rather than on maximising short-term sales.

In relationship marketing, the product varies according to the preference and dictates of the customer, with the value varying commensurately. So when customers specify that a product should have a specific feature and that certain services should be delivered before, during and after the sale, they naturally want to pay for each component of the package separately. Just as the product and services are secured in a process of collaboration, so too will the price need to reflect the choices made and the value created from these choices.

Business-to-business marketers, especially for larger capital goods and installations, have typically engineered the products and services to customer requirements and negotiated the prices of their services. But customers have not often been involved in all aspects of the value chain and the price/performance trade-offs that sellers have thought were necessary. RM invites customers into the pricing process, and all other value-related processes, giving customers an opportunity to make any **trade-offs** and to further develop trust in the relationship.

**Trade-off:** The balancing of two different options: if you have chosen a certain option, with certain advantages, you also have to live with some disadvantages.

## Distribution

The general message of RM regarding distribution is that it should get closer to the customer. Conventional marketing thinking sees distribution as the channel that takes the product from producer to consumer. In the case of the computer industry, Dell sees distribution as a direct sales approach, primarily using the internet, telephone sales and order placement, whereas IBM uses many approaches to distribution, including its own stores, a direct sales force and retailers that resell the firm's personal computers. RM instead considers distribution from the perspective of the customer – who decides where, how and when to buy the combination of products and services that constitute the vendor's total offering. Seen this way, distribution is not a channel but a process. The process allows customers to choose where and from whom they will obtain the value they want. Continuing the computer example just mentioned, the customer can choose whether to buy an off-the-shelf model from a reseller and take it home immediately, order one to be built to individual preferences at the factory and shipped within a week or so, or have one configured in-store that will be available within a few days. It thus may be more accurate to think of distribution as placement, giving customers choices with regard to the locations at which they will specify, purchase, receive, install, repair and return individual components of the products and services. That is, whereas traditional marketing considers a product as a bundled package of benefits, RM unbundles the product and service and allows the customer to initiate a placement decision for each element.

### Communication (promotion)

Traditional marketing sends smoke signals for all within a specific market segment to see. 'Buy me', the signals say to all who can see them. RM instead gives individual customers an opportunity to decide how they wish to communicate with the enterprise, how often and with whom. Mass promotion becomes support to build equity in the firm or brand, rather than a means to influence purchase directly. Therefore, the RM approach indicates the need for integrated communication and the demand for interactive communication.

Technology can make promotion become communication because technology can help individuals and international-orientated companies to interact more frequently and more effectively across borders (Czinkota and Samli, 2007). For the producer in the B2B market this communication may involve opportunities for supplier and customer to interact at the strategic level – considering each other's plans, customers, strategies and initiatives – so that both can consider how best to be interdependent over the planning horizon. It may also tie into the customer's and supplier's information and communications systems, letting staff in each firm feel as though they work with the other in an integrated way. In this way, the lines between supplier and customer can be further blurred. People are naturally prone to engage in relationships and social interactions with those of similar interests. Producers in the B2C market could relate and communicate in much the same way with their channel intermediaries, such as the retailers. And now, with technology, customers can be interactively and uniquely engaged. Using technologies such as the internet and social media such as Facebook and Twitter, companies can give consumers a host of options for communicating with the company and have information on hand to engage, inform and direct each customer with complete knowledge as to the customer's preferences and behaviours. As a consequence, marketing academics are beginning to study the impact of social media on marketing communication.

**7P mix:** Besides the traditional 4Ps (product, price, place and promotion) it involves the additional 3Ps: People: This is where it all begins. It involves employees, management and the organisational culture. Process: It is the back-office, which represents the way the company's products and services are delivered. It involves supply chain management, logistics and service delivery. Physical evidence: It is how the company's products and services are presented in the market place. It involves facilities, store front, visual packaging, staff behaviour and staff dressing.

The introduction to Part IV discusses the extended version of the 4P mix – the so-called **'7P' mix**. Then Part IV of this book further develops the implications of the RM approach on the traditional 4P marketing mix (product, price, place and promotion).

## 1.6 DIFFERENT ORGANISATIONAL FORMS OF RM

It is important to understand the nature of relationship. The boundaries of RM have been discussed since RM was first investigated in the 1970s (Healy et al., 2001). And it is possible to study relationships in different contexts. Figure 1.5 presents a context where it is possible to study relationships in three ways. The dyadic relationship is the basic, irreducible building block of inter-firm relationships. It can be used as the basis for studying a number of marketing phenomena, ranging from buyer–seller relationships, salesperson–purchasing agent interactions to inter-firm relationships and **strategic alliances**.

**Strategic alliances:** Informal or formal arrangements between two or more companies with a common business objective.

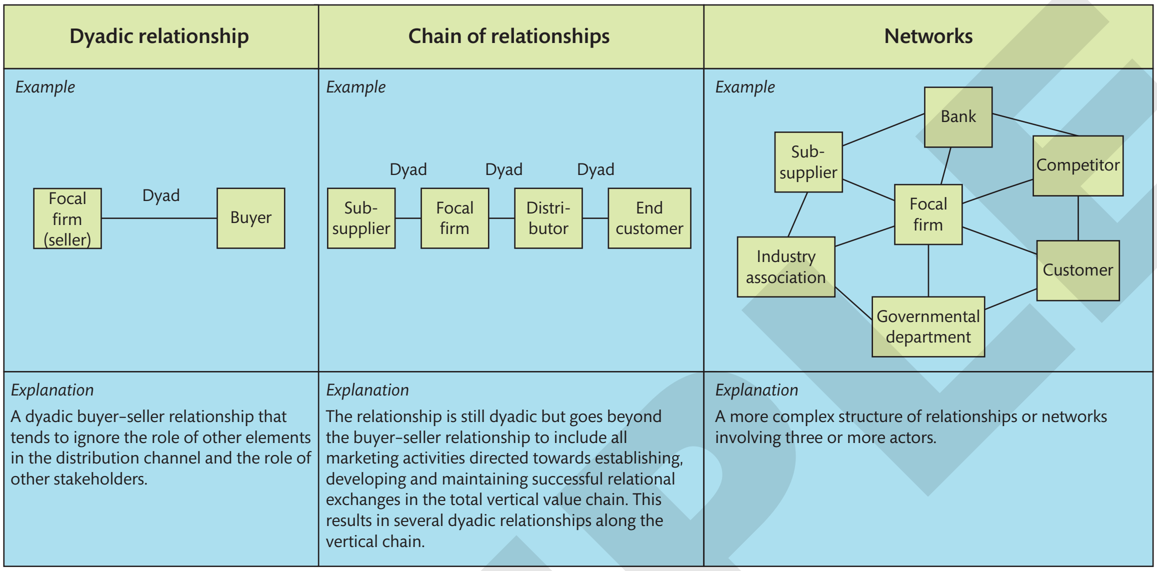


**FIGURE 1.5** *Forms of relationships*

Thus, a chain of relationships' key distinction from RM is that although the unit of analysis is still dyadic, the dyad can be other than one buyer–seller relationship. Furthermore, more than one dyad can be involved in any given exchange. From the relationship background, network theory evolved when researchers started looking beyond simple dyadic relationships and began to concentrate their research effort on the more complex structures of networks.

Network theory has been based on the players–activities–resources model, which suggests that networks are dynamic entities exhibiting interdependence and connectedness between actor bonds, activity links and resource ties (Håkansson and Johanson, 1992; Håkansson and Snehota, 1995). Networks that involve three or more players place great emphasis on the role of marketing in building and managing relationships with a company's many **stakeholders**, which could include suppliers, competitors, governments and employees, as well as customers.

**Stakeholders:** Individuals or groups having a stake in the organisation's well-being, such as shareholders or employees.

A related RM concept in Chinese culture is the so-called **guanxi**. It is composed of two Chinese characters: 'guan' (gate) and 'xi' (connection). It is a special type of relationship that bonds the exchange partners through a continual cooperation and exchange of favours.

**Guanxi:** Describes a personal connection between two people in which one is able to prevail upon another to perform a favour or service, or be prevailed upon. It is based on a complex nature of personalised networks of influence and social relationships, and is a central concept in Chinese society.

Western RM and Chinese guanxi share some basic characteristics, such as mutual understanding, cooperative behaviour and long-term orientation. In the Western RM society, written contracts are necessary to bind the exchanging partners to follow the rules, even among long-term relationship partners. In contrast, Chinese network systems emerge from personal agreement, not written contracts. Chinese B2B relations are often based on contracts or bonds between specific individuals, not between organisations. While China (among other Asian countries) is often portrayed as a 'relational society', it is also a low-trust society in which relationship orientation is only applied to insiders of the guanxi networks, but not to outsiders of networks such as a foreign firm. Guanxi members are tied together through an invisible and unwritten code of reciprocity, and the underlying motive for reciprocal behaviours is face-saving (Wang, 2007).

## 1.7 SUMMARY

Over the past twenty years, considerable emphasis has been placed on the importance of relationship marketing (RM). The reorientation of marketing has been at the expense of the traditional approach to marketing – that is, transactional marketing (the 4Ps). However, the premises of this book are that transactional marketing is still relevant and should be practised concurrently with various types of RM.

In RM, customers take a much more active role than they normally are given. The success of RM also, to a large extent, depends on the attitudes, commitment and performance of the employees. If they are not committed to their role as part-time marketers and are not motivated to perform in a customer-orientated fashion, the strategy fails. Besides customers and internal employees, the stakeholder view also includes other players in the RM process: suppliers, competitors and other external players.

The chapter ends with a categorisation of RM into three forms of organisation: dyadic relationships, chain of relationships and networks. The classic dyadic buyer–seller relationship tends to ignore the role of other stakeholders, whereas networks are a more complex structure of relationships involving several stakeholders.



### CASE STUDY 1.1

## Hunter Boot Ltd: the iconic British brand is moving into exclusive fashion

The Hunter boot brand (www.hunter-boot.com) has become a symbol of British country life and celebrity fashion. Hunter boots, designed over 150 years ago, were originally created to deal with Britain's rugged and unpredictable weather. Today, Hunter is firmly established as a fashion brand beloved by Hollywood celebrities.

Arthur Wellesley, the first Duke of Wellington, instructed his shoemaker, Hoby of St James Street, London, to modify his eighteenth-century boot. They designed the boots in soft calfskin leather, removed the trim and made the cut closer around the leg. It was hard to wear the new boots in battle but it was said that the Duke of Wellington wore the boots at the famous Battle of Waterloo in 1815. The boots were dubbed 'Wellingtons' or 'wellies' and the name stuck.

Wellingtons quickly caught on with patriotic British gentlemen eager to emulate their war hero. The original Wellington boots were made of leather; however, in America, where there was more experimentation in shoemaking, producers were beginning to manufacture using rubber. One such entrepreneur, Mr Henry Lee Norris, moved to Scotland in search of a suitable site to produce rubber footwear. Eventually he found it on the farm of the Castle Mill in Edinburgh. Norris began his boot-making company, the North British Rubber Company (the company changed its name to the Hunter Rubber Company in 2004), in 1856. Committed to fit, comfort, durability and performance Hunter Wellington boots bear two rare and coveted stamps of approval of the British royal family.

Production of the Wellington boot was dramatically boosted with the advent of World War I, due to the demand for a sturdy boot suitable for the conditions in flooded trenches. This made the wellies a functional necessity.

By the end of World War I, the North British Rubber Company had produced more than 1.8 million pairs of boots for soldiers. Shoe production ran 24 hours a day. Again the Wellington made an important contribution during World War II. At the outbreak of war in September

Source: Andrew Twort/Alamy Stock Photo

1939, although trench warfare was not a feature, those forces assigned the task of clearing Holland of the enemy had to work in terrible flooded conditions. By the end of the war, the Wellington had become popular among men, women and children for wear in wet weather. The boot had developed to become far roomier with a thick sole and rounded toe. Also, with the rationing of shoes at that time, labourers began to use them for daily work.

The company's most famous welly, the original Green Wellington, was made over 50 years ago in the winter of 1955. It was launched alongside the Royal Hunter – another boot that remains in Hunter's range today.

From 1966 to 2005 a number of ownership changes took place, and in 2006, the Hunter Rubber Company was placed into administration as a result of cash flow problems. In spite of a reported turnover of over £5 million, accountants from KPMG said the firm suffered from high manufacturing costs, including fuel costs, and made a loss from the expansion of its business to the US. Hunter reported a loss of £600,000 from September 2003 to the end of February 2005, when it had a net debt of £2.03 million.

In 2006, a private consortium led by Lord Marland, Peter Mullen and Julian Taylor bought Hunter out of administration and Hunter Boot Ltd was born. After rapid restructuring of the company, new supply routes and distribution partners were found in the UK and the US and the Hunter portfolio was rationalised to core products exhibiting the key skills and tradition of the company.

Hunter re-established itself as a major player in the traditional country and leisure footwear market in the UK in the aftermath of the 2006 acquisition and positioned itself as a strong contender in the US — opening showrooms on Seventh Avenue in New York and Carnaby Street in London. A new management team was also put in place.

One Hunter Wellington tall boot is made from 28 individual parts. Each part is individually tailored and assembled by hand to support specific parts of the foot, calf and ankle. Hunters continue to be made and finished by hand from natural rubber. Because of this degree of 'handmade' in the production of Hunter boots, the management moved manufacturing from Scotland to China to cut production cost. Retail prices were also increased by 20 per cent, and modern ranges in a selection of colours and textures were added.

A major breakthrough for Hunter in the realm of fashion, as opposed to farms, came in 2006 when Kate Moss was seen wearing an Original pair in black at the Glastonbury music festival. Since then, the Hunter boot has become a familiar sight among celebrities, on catwalks and on high streets, as well as in the countryside.

In September 2008, following the 2008 Olympics in Beijing, China, Hunter Boot Ltd sent specially made gold Wellington boots to every member of the Great Britain Olympic team who had won a gold medal at the Games.

In 2010 the UK Prime Minister David Cameron bought pink and purple pairs of Hunter boots for his US trip, as gifts for Barack Obama's daughters.

### Hunter Boot Ltd today

Since the downturn in 2006, Hunter has expanded its sales and profits rapidly, but in 2016 Hunter sales saw a nearly 10 per cent drop to £102.9 million, down from £113.7 million in 2015.

Development of profits were worse, dropping over a third from £14.1 million in 2015 to £9.2 million in 2016, the second consecutive year of decline for the retailer. The designer of the boots brand stated that its figures were in line with expectations and remained optimistic about the year ahead, hailing investment in new products and "direct to consumer" operations as the driving force.

Number of employees is app. 150.

Hunter has seen strong growth with international distribution in 30 countries.

Hunter is moving into alliances with exclusive fashion designers

In January 2009, Hunter announced that it would be collaborating with London-based luxury fashion designer Jimmy Choo for a limited-edition black Wellington boot, embossed with signature Jimmy Choo crocodile print and containing gold rivets and a leopard-print lining. Another boot was then launched in 2011.

The boots costs £250 and were sold exclusively online at www.jimmychoo.com (the original version normally costs around £80).

Jimmy Choo and Hunter Boot Ltd received a tremendous reaction from customers; the online waiting list opened on 1 May, and by 16 May more than 4,000 fashion-conscious customers had already joined it. Today, the luxurious Wellington boots have become a classic life-style item at Jimmy Choo and can be purchased regardless of the season, and not only in traditional black, but in several variations.

In March 2012, J. Mendel and Hunter — two iconic brands dating back to the nineteenth century — joined forces in a special collaboration to produce the most glamorous of Wellington boots: exclusive to North America, these limited-edition boots brought together the sumptuous look and feel of J. Mendel with the timeless functionality of Hunter Boot. The boots went on sale in November 2012 and retail at from $585 (£366) to $795 (£497) at Saks, Nordstrom, Gorsuch and hunter-boot.com.


Source: Michael Kemp/Alamy Stock Photo

**Questions**

1. What are the main reasons for the recent international marketing success of the Hunter Boots?
2. Recently Hunter has added outerwear (leather footwear and handbags) to their international product range. What are the pros and cons of extending the product range in this way? Should Hunter Boots Ltd include further products like eyewear and watches?
3. How should Hunter react on the last two years' negative financial development?

Sources: Based on www.Hunter-boot.com; bevan2bade's Blog: 'Hunter Wellington Boots and Celebrities' http://bevan2baderblogs experienceproject.com/770875.html).

## QUESTIONS FOR DISCUSSION

1. What are the similarities between relationship marketing (RM) and transactional marketing (TM)?
2. How does an RM strategy differ from a TM strategy?
3. Which kind of industries could benefit from the use of RM versus TM and vice versa?
4. In which situations would customers not be expected to be interested in RM?

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# PART I

# Assessing the competitiveness of the firm (internal)

## PART I CONTENTS



## BYD electrical cars: the Chinese electric car manufacturer is considering sales worldwide


Source: Lou-Foto/Alamy Stock Photo.

High levels of air pollution and carbon emissions, as well as a perceived energy shortage, are all cited as reasons why electric vehicles will surely become a major factor in the global auto industry going forward. The flip side of that coin is that high costs, short driving ranges, long charging times, lack of charging facilities and battery maintenance issues are major obstacles faced by all electric vehicle manufacturers.

So far, the negatives of electric vehicles appear to outweigh the positives in the minds of individual consumers. Despite the media hype, electric cars have not yet grabbed a meaningful share in any of the three major auto markets – North America, Western Europe or China – which collectively account for 60 percent of the total global auto market. Moreover, declining oil prices and the increase in energy supply caused by the development of shale gas reserves threaten to halt any momentum that may have been achieved in recent years when oil was trading above $100 per barrel. At the current price of $70 per barrel (end of summer 2018), the economics of electric vehicles have become a bit less attractive to the consumer.

Despite of these facts, the global number of electric vehicles has exploded since 2011. But the 320,000 electric cars bought worldwide in 2014 should be seen in comparison with the roughly 68 million new passenger cars that were bought worldwide in 2014. Three years later (2017), the total number of new passenger cars has increased to 74 million, but the sales of electric cars has increased to only 1,200,000.

There are two types of electric cars (EV = Electric Vehicles):

- *BEV (Battery Electric Vehicle)*, which has to be plugged into an electric power source to charge. Dependent on the vehicle, they have varying charging times and driving ranges.
- *PHEV (Plug-in Hybrid Electric Vehicle)*, which is a hybrid electric vehicle, a combination of a normal fuel driven engine with a battery that can be recharged by plugging it into an external source of electric power.

In principle EV = BEV + PHEV.

In 2017, 1.2 million electric cars were sold around the world, a new record. The number of Teslas, Nissan Leafs, BYDs and other EVs in circulation worldwide has now surpassed three million, an expansion of 50 percent from 2016. In 2017, there were approximately

**TABLE 1** *Global sales of EV (Electric Vehicles, 1,000 vehicles)*

| | 2016 (1,000 VEHICLES) | 2017 (1,000 VEHICLES) |
|---|---|---|
| China | 336 | 579 |
| United States | 160 | 198 |
| Norway | 50 | 62 |
| France | 29 | 118 |
| United Kingdom | 38 | 47 |
| Japan | 25 | 54 |
| Germany | 25 | 55 |
| Others | 77 | 87 |
| **Total** | **740** | **1,200** |
| Units (% split) | | |
| BEV (Battery Electronic Vehicles) | 480 (65%) | 814 (68%) |
| PHEV (Plug-in Hybrid Electric Vehicles) | 260 (35%) | 386 (32%) |
| **Total** | **740 (100%)** | **1,200 (100%)** |

Source: based on different public sources.

760,000 electric cars driving on American roads, along with a further 820,000 in Europe. Chinese drivers have become hugely enthusiastic about the technology in recent years and, in 2017, China could boast the largest fleet of EVs in any country: 1.23 million.

Table 1 provides an overview of the number of battery electric vehicles (BEV) and plug-in hybrid vehicles (PHEV) sold in selected countries last year. China had the highest sales figures of any nation by far with 579,000 EVs sold. The vehicles are starting to make inroads into China's highly competitive market and they had a 2.2 percent share of total car sales in 2017. That's more than EVs have in the U.S., where their market share stood at 1.2 percent last year.

In terms of sales, American customers bought 198,000 EVs in 2017, while 118,000 were sold in France. Norway has become renowned for its love affair with electric vehicles and it's still posting healthy sales figures. Last year, 62,000 EVs were sold in Norway and they had an impressive slice of the total car sales at 39 percent. In emerging economies where road quality and electrical infrastructure still need further refinement, the technology is still waiting to take off. In 2017, 2,000 EVs were sold in India; while in Brazil total sales figures amounted to only 360 EVs.

Of the total sales of EVs in 2017, the BEV type accounted for approximately 68 per cent of the total sales. The BEV share is higher in China. The reason for this is partly in the segment composition of Chinese plug-in sales. Half of the sales in China are in the Mini and Small segments, where PHEVs make less sense (PHEV is a better principle for bigger cars).

The key drivers of EV sales are:

- Government subsidies: any change of the government subsidies in buying an EV can influence the market size immediately.
- Cost of batteries: the costs of lithium ion batteries have decreased by 50 per cent during the last three years, 2015-17.

Table 2 shows the world-wide best-selling EVs in 2017.

In the United States, the most sold EVs are Tesla, Nissan Leaf and Chevrolet Bolt. In Europe, the most popular EVs are Renault ZOE, Nissan Leaf, BMW i3, Tesla Model S and VW e-Golf. In China, the best-selling brands in 2017 all came from China, e.g. BAIC, SAIC and BYD. The cost of these Chinese-made EVs can often be comparatively low. For example, the Zhidou D2 is a small EV, retailing for under USD7000 (after subsidies).

### BYD (China)

BYD Auto Co., Ltd. is a privately owned, Chinese automobile manufacturer and a wholly owned subsidiary of BYD Company. It was founded in January 2003, following

**TABLE 2** *The 10 best-selling EV brands in 2017*

| | HEADQUARTERS IN | TOTAL SALES WORLDWIDE (1,000 VEHICLES) |
|---|---|---|
| No. 1: BAIC EC-series | China | 78 |
| No. 2: Tesla models | USA | 55 |
| No. 3: Toyota Prius Prime (PHV) | Japan | 51 |
| No. 4: Nissan Leaf | Japan | 47 |
| No. 5: Tesla Model | USA | 46 |
| No. 6: Zhidou D2 | China | 42 |
| No. 7: Renault Zoe | France | 32 |
| No. 8: BMW i3 | Germany | 31 |
| No. 9: BYD song PHEV | China | 31 |
| No. 10: Chevrolet Bolt | USA | 28 |

Source: based on http://www.chinadaily.com.cn/a/201802/08/WS5a7b829ca3106e7dcc13b653.html and other public sources.

BYD Company's acquisition of Tsinchuan Automobile Company. Its principal activity is the design, development, manufacture and distribution of automobiles, buses, forklifts, rechargeable batteries and trucks sold under the BYD brand. In 2008, BYD Auto began selling its first mass-produced PHEV. It also has a 50:50 joint venture with Daimler AG, Shenzhen BYD Daimler New Technology Co., Ltd., which develops and manufactures luxury electric cars sold under the Denza brand.

BYD claims that the company name stands for 'Build Your Dream.' The manufacturer is also one of the key manufacturers of battery cells and has been the most aggressive among all Chinese EV makers in its push into cars that charge from the grid electricity.

BYD was the China's top performing EV manufacturer in 2016, with 100,000 units sold out of the company's total sale of 494,000 cars. The split between EVs and PHEVs was 50:50. In 2017, the Chinese competitor BAIC took over the leadership in selling EVs to the Chinese market. While BYD's EV sales are nearly only domestic, some of their other car models are exported to other developing countries. BYD cars are sold in Bahrain by Fakhro Motors; are distributed in the Dominican Republic by Peravia Motors (3,000 cars serve as taxis in the capital, Santo Domingo); and are offered to consumers in both Ukraine and Moldova.

The company has also expressed a desire to enter the European, Iranian and Israeli markets. BYD opened its Iranian branch under the name Karmania in 2016. BYD also opened its North American headquarters in Los Angeles in 2011 and planned to start selling EVs there in 2012. Although this plan ran into a number of delays, BYD have formulated a new target which would see their E6 model on American streets by the end of 2018.

In a move seen as a precursor to a US introduction, BYD hired the famous actor Leonardo DiCaprio as its global brand ambassador. He commands an enormous following in China where he is known as Little Li. His Twitter China account has followers in the millions.

### Questions/tasks

1. Please explain the key marketing problems for BYD's electric car business.
2. Please make an analysis of BYD's relevant environment for electric cars.
3. What are BYD's resources and capabilities in the electric car business?
4. Based on the analysis of question / task 1, 2 and 3, what are your recommendations for BYD's future marketing management initiatives?
5. Will the use of Leonardo DiCaprio help with penetration of the US EV market?

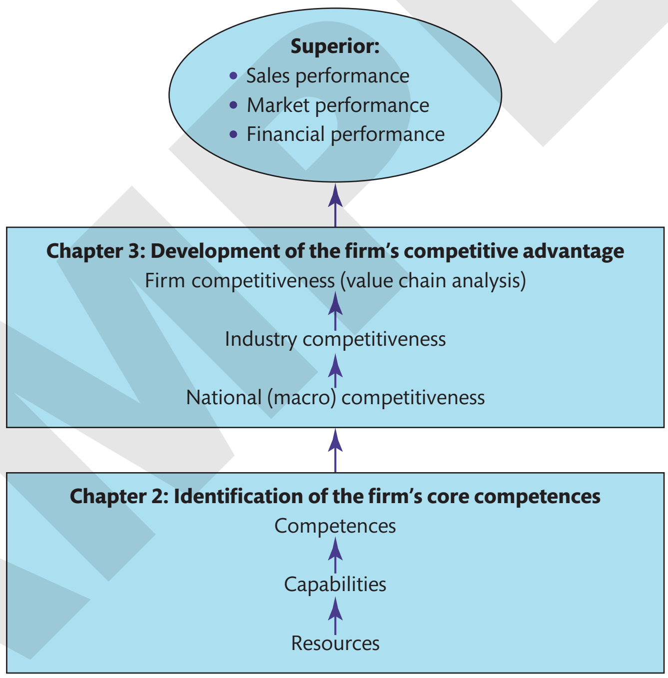
Source: based on different public sources.

# INTRODUCTION TO PART I

When the international economy was relatively static, competition was a ‘war of position’ in which firms occupied competitive space like squares on a chess-board. The key to competitive advantage was where a firm chose to compete. How it chose to compete was also important but secondary – a matter of execution. However, as markets fragment and product life cycles accelerate, dominating existing product segments becomes less important. In today’s dynamic business environment a firm’s success depends on anticipation of market trends and quick response to changing customer needs. The essence of strategy is not the structure of a firm’s products but the dynamics of its behaviour. In future the goal is to identify and develop the hard-to-imitate organisational capabilities that distinguish a firm from its competitors in the eyes of customers.

Part I covers the necessary internal analysis to assess the competitive advantages of the firm with regard to its customers and other stakeholders in the external environment, which is the focus of Part II.

The structure of Part I is shown in this diagram.




*The structure of part I*

Chapter 2 identifies the firm’s core competences, based on the assessment of its resources and capabilities. Capabilities can be described as what an organisation does as opposed to what it has (resources or assets). Chapter 3 then continues with how the core competences might be used in the development of competitive advantages, from the macro-level (country-specific advantages) to the micro-level (value chain analysis).

# CHAPTER 2

# Identification of the firm's core competences

## CONTENTS



## LEARNING OBJECTIVES

After studying this chapter you should be able to:

- explain the difference between the resource-based view (RBV) and the market orientation view (MOV);
- explain the connection between the RBV and RM;
- describe and discuss the different concepts of the value chain;
- explain the difference between 'value creation' and 'value capture';
- explain how 'experiential marketing' differs from 'traditional marketing';
- explain the purpose of using Augmented Reality in marketing planning;
- discuss the relevance of using Artificial Intelligence (AI) in marketing planning.

## 2.1 INTRODUCTION

Understanding competitive advantage is an ongoing challenge for decision makers. Historically, competitive advantage was thought of as a matter of position, where firms occupied a competitive space and built and defended market share. Competitive advantage depended on where the business was located and where it chose to provide services. Stable environments allowed this strategy to be successful, particularly for large and dominant organisations in mature industries.

This ability to develop a sustained competitive advantage today is increasingly rare. A competitive advantage laboriously achieved can be quickly lost. Organisations sustain a competitive advantage only so long as the services they deliver and the manner in which they deliver them have attributes that correspond to the key buying criteria of a substantial number of customers. Sustained competitive advantage is the result of an enduring value differential between the products or services of one organisation and those of its competitors in the minds of customers. Therefore, organisations must consider more than the fit between the external environment and their present internal characteristics. They must anticipate what the rapidly changing environment will be like and change their structures, cultures and other relevant factors so as to reap the benefits of changing times. Sustained competitive advantage has become more of a matter of movement and ability to change than of location or position.

The question of an enduring value differential raises the issue of why a firm is able to achieve a competitive advantage. To answer this, it is necessary to examine why and how organisations differ in a strategic sense. Identifying strengths and weaknesses requires introspection and self-examination. It also requires much more systematic analysis than has been done in the past.

### From capability to advantage

How well a company assembles the capabilities that a new business requires determines how successful it is at gaining and keeping positional advantage. Some capabilities are more important than others and combinations are generally harder to imitate than individual capabilities. The business builder's challenge begins with the need to assemble the capabilities that are most critical to making money in the business. Lasting competitive advantage comes only when companies assemble combinations of capabilities that are difficult to imitate. Competitive advantage may not call for superior capabilities in every area of a business. But control of the most important capabilities can determine how much of the value of a growing business will flow to its owner. For every opportunity, it is important to distinguish the capabilities that influence competitive success from those that are merely necessary to stay in business. Capabilities that are less critical can be outsourced or controlled by others.

## 2.2 ROOTS OF COMPETITIVE ADVANTAGE

**Market orientation view (MOV):** Outside-in perspective. Adapting the firm's resources to market conditions and the competitive environment.

**Resource-based view (RBV):** Inside-out perspective. Proactive quest for markets that allows exploitation of the firm's resources.

Two theoretical perspectives are particularly relevant for understanding how firms deploy scarce resources to create competitive excellence. These are: the **market orientation view** (MOV) and the **resource-based view** (RBV).

There is, however, a potential conflict between these two perspectives in the sense that one (MOV) advocates the advantages of outward-looking responsiveness in adapting to market conditions, while the other (RBV) is inward looking and emphasises the rent-earning characteristics of corporate resources and the development of corporate resources and capabilities. Quite simply, from a marketing viewpoint, if strategy becomes too deeply embedded in corporate capabilities it runs the risk of ignoring the demands of changing, turbulent marketing environments. Yet from a resource-based perspective, marketing strategies that do not exploit a company's distinctive competences are likely to be ineffective and unprofitable.

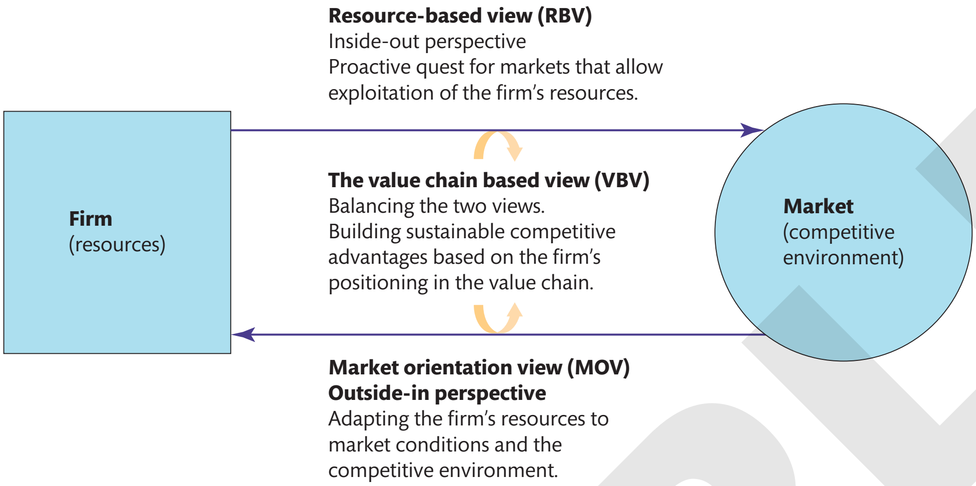



FIGURE 2.1 *The resource-based view versus market orientation*

**Value chain-based view (VBV):** Building sustainable competitive advantages based on the firm's positioning in the value chain.

However, we argue that the **value chain-based view** (VBV) provides a way of reconciling this potential conflict – it represents a balanced view of the RBV and the MOV – see Figure 2.1.

We will now look at the two theoretical perspectives.

## 2.3 THE RESOURCE-BASED VIEW (RBV)

Most firms that apply a relationship marketing approach are probably somewhere in this stage of the transition process. A true transition towards a relationship marketing strategy requires a focus on competences and resources in the relationship (because partners in the relationship use each other's resources, Grönroos, 1996). This section focuses on identification of a single firm's competences from an RBV.

According to the resource-based theory, which has its roots in economic theory (e.g. Penrose, 1959) and early strategy theory (Ansoff, 1965; Selznick, 1957), the long-term competitiveness of a company depends on its resources that differentiate it from its competitors, that are durable and that are difficult to imitate and substitute (e.g. Fahy, 2002; Grant, 1991). Each firm is unique and this uniqueness stems from the resources it possesses, their compatibility with one another and/or the way they are deployed. Furthermore, this uniqueness is relatively long lasting, because the resources of the company are relatively immobile (Barney, 1991; Sharma and Erramilli, 2004).

Various definitions and classifications for resources have been proposed in the literature. The most important in the current context are briefly described here.

### Resources

The resources of the firm in the competence-based approach are typically classified into two types: tangible and intangible resources. Tangible resources are inputs into a firm that can be seen, touched and/or quantified. They include assets such as plant and equipment, access to raw materials and finance, a trained and skilled workforce and a firm's organisational structure. Intangible resources range from intellectual property rights, such as patents, trademarks and copyrights, to the know-how of personnel, informal networks, organisational culture and a firm's reputation for its products (Deering et al., 2008). The dividing line between the tangible and intangible is often unclear and how they are classified varies a little from one writer to another. Despite the problems with classification, proponents of the competence-based approach agree on the relative importance of the two types of resource. Although it is clear that both types of resource are required for any business to operate, competence-based theorists argue that intangible resources are the most likely source of competitive advantage. The reason for this, it is argued, is that, being less visible, they are more difficult to understand and imitate than tangible resources. As such, they are therefore more likely to be a source of competitive advantage (Collis and Montgomery, 2008).

I use the word 'resource' as the most generic term to qualify the basic unit of asset, skill, ability, expertise, knowledge, etc. owned and controlled by one firm. Grant (1991) describes six types of resource: technological, financial, physical, human, organisational and reputation. Resources are extremely diverse, as shown in Figure 2.2 (examples are given in brackets).

The dotted line in Figure 2.2 represents a specific resource (e.g. technical) measured on six criteria. However, the resource-based theory does not consider all resources possessed by a company but focuses only on critical (or strategic) resources, i.e. those that are the basis of the company's sustainable competitive advantage. To determine such resources, various authors have proposed a number of 'tests' (see also Grant, 1991; Prahalad and Hamel, 1994; Trott, Maddocks and Wheeler, 2009), the most important of which are:

- competitive superiority test, which evaluates if and to what extent the research contributes to differentiating the company from its competitors;
- imitation test, which analyses actual and potential competitors' difficulties in imitating the resource, due, for example, to its physical uniqueness, path dependency, casual ambiguity or economic deterrence;
- duration test, which measures if the resource's benefits will also be generated in the long term;
- appropriateness test, which verifies if the company owning the resource is able to exploit the advantages generated in the market;
- substitutability test, which assesses how difficult it is for competitors to replace the resource with an alternative that gives the same advantages.

The very basis of RBV is to increase the ability of the firm to act upon, shape and transform its environment. The objective is no longer to adapt to the environmental forces but to choose a strategy that allows the best exploitation (the best return) of resources and competences given the external opportunities. It means taking into account the external opportunities, but with the objective of creating value beyond existing market standards. As a consequence, the strategic options for a firm are derived from its resource profile: the business portfolio is an output of the search of applications carried out for one competence.

### Competence

One resource – such as a privileged access to raw material – may be a source of competitive edge. However, a greater competitive advantage should emerge from

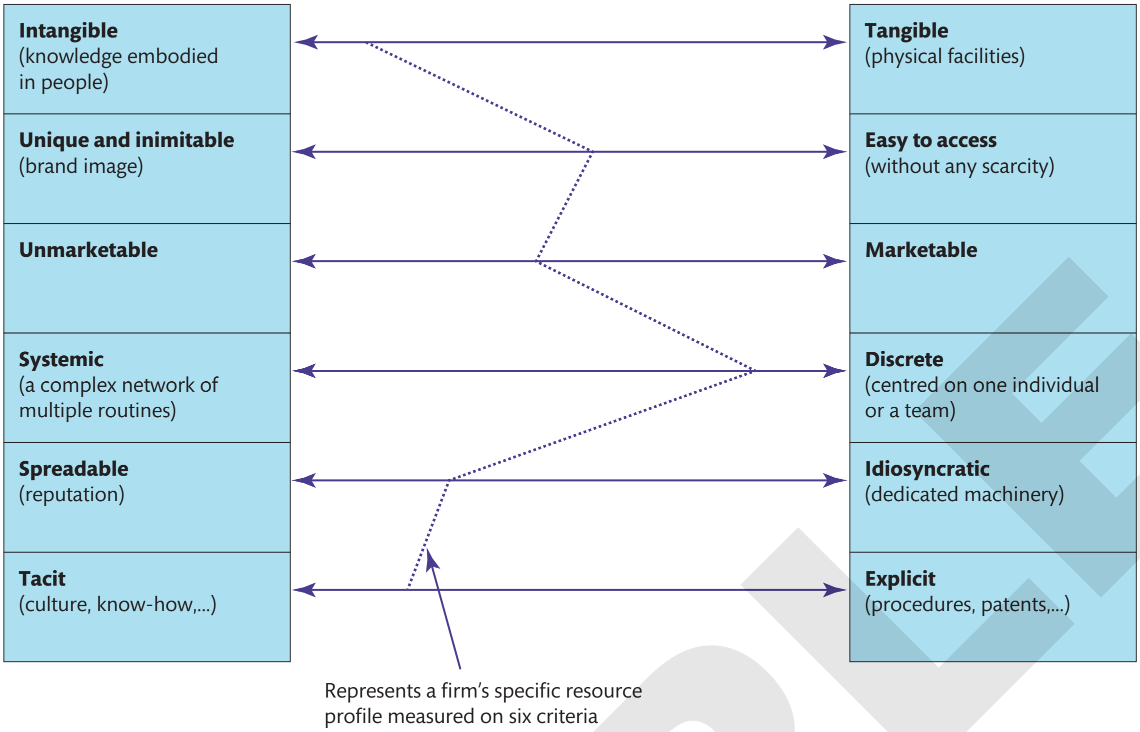



**FIGURE 2.2** *Resource profile*

competences – that is, the combination of different types of resources. It is the way in which these resources are assembled, or combined, for the execution of an activity that creates the difference between firms. This distinctive combination of resources emerges through organisational learning. Competence examples may be found in engineering knowledge, production expertise or marketing abilities.

Competence may be described by the following three attributes:

1. *Proprietariness*: a competence is a firm-specific set of resources.
2. *Learning*: a competence results from years of experience accumulated in a small number of fields (where the firm may dominate).
3. *Pervasiveness*: a competence is diffused pervasively throughout the entire firm and exists within several product lines (or strategic business units – SBUs).

**Core competences:** The principal distinctive capabilities possessed by a company – what it is really good at.

A **core competence**, as articulated by Prahalad and Hamel (1990), has three traits: it makes a contribution to perceived customer benefits; it is difficult for competitors to imitate; and it can be leveraged to a wide variety of markets. Knowing a firm's core competence is important for developing strategy. By concentrating on the core competence and outsourcing other activities, managers can use their company's resources in four ways: they maximise returns by focusing on what they do best; they provide formidable barriers against the entry of competitors; they fully utilise external suppliers' strengths and investment that they would not be able to duplicate; and they reduce investment and risk, shorten cycle times and increase customer responsiveness.

Figure 2.3 shows the connection between resources, core competences, sustainable competitive advantages and competitive excellence.

Resources alone are not a basis for competitive advantage. It is the way in which resources are integrated with each other to perform a task or an activity that provides the capability for an organisation to compete successfully in the market-

**EXHIBIT 2.1**

## Honda's competences in small engines

A famous example of a business strategy that was clearly based on a focus on a core competency is Honda's application of small-engine technology to a variety of products requiring small engines (motorcycles, jet skis, lawn mowers, etc.).

When Honda introduced motorcycles in the US market, it had focused most of its attention on selling its higher-value (but problem-plagued) motorcycles through a dealer network. At the same time, it introduced a series of much smaller motorcycles with little fanfare through sporting goods stores. While their larger motorcycles floundered competing against the likes of firmly established Harley-Davidson, Honda's smaller-engine motorcycles found a ready audience with a more utilitarian 'nicest people' demographic group. This turned out to be Honda's beachhead into the US marketplace.

Although it is true that the small engines in both the motorcycles and the scooters were Honda's core competence, that core competence alone did not ensure success. Honda succeeded because it also looked to the other end of the value chain – it listened to what the customer wanted.

It turned out to be both a customer and a product very different from what Honda had envisioned. Honda quickly refocused its distribution channels and adjusted its product mix to meet the unexpected market demand. In the long term, Honda was able to refocus its efforts and eventually capture market share in the higher-value motorcycle market.


*The ability to concentrate on customers and understand their changing needs is the first step in the value chain-based view.*

Source: Lyroky/Alamy Stock Photo.

Sources: adapted from Prahalad and Hamel (1990); Webb and Gile (2001).

place. This being the case, the most important resource for any organisation is the skill and knowledge possessed by the organisation's employees. It is this skill and knowledge, acquired over time and embedded in the firm's culture, that influences how it operates and determines its success.

Whether or not resources and capabilities have the potential to become core competences depends on how difficult they are for competitors to acquire and how valuable they are to the firm as a basis for competitive advantage. When they are rare, difficult to imitate, non-substitutable and they allow a firm to exploit opportunities or neutralise threats, then they can be considered core competences and serve as the basis of an organisation's sustained competitive advantage.

A resource becomes a source of sustainable competitive advantage only if it passes several tests. First, it must be competitively superior and valuable in the product market. Second, it must be difficult to imitate. Third, it must not be easy to replace by an alternative capability. Fourth, it must be durable. Fifth, it must be difficult to move. If the capability can move with an employee then it is the employee, not the corporation, that will acquire the value.

Some individual capabilities may pass the tests. A world-class brand, for example, will continue to confer advantage on its owner. But few individual capabilities are unassailable and even a first-to-market advantage can fade away

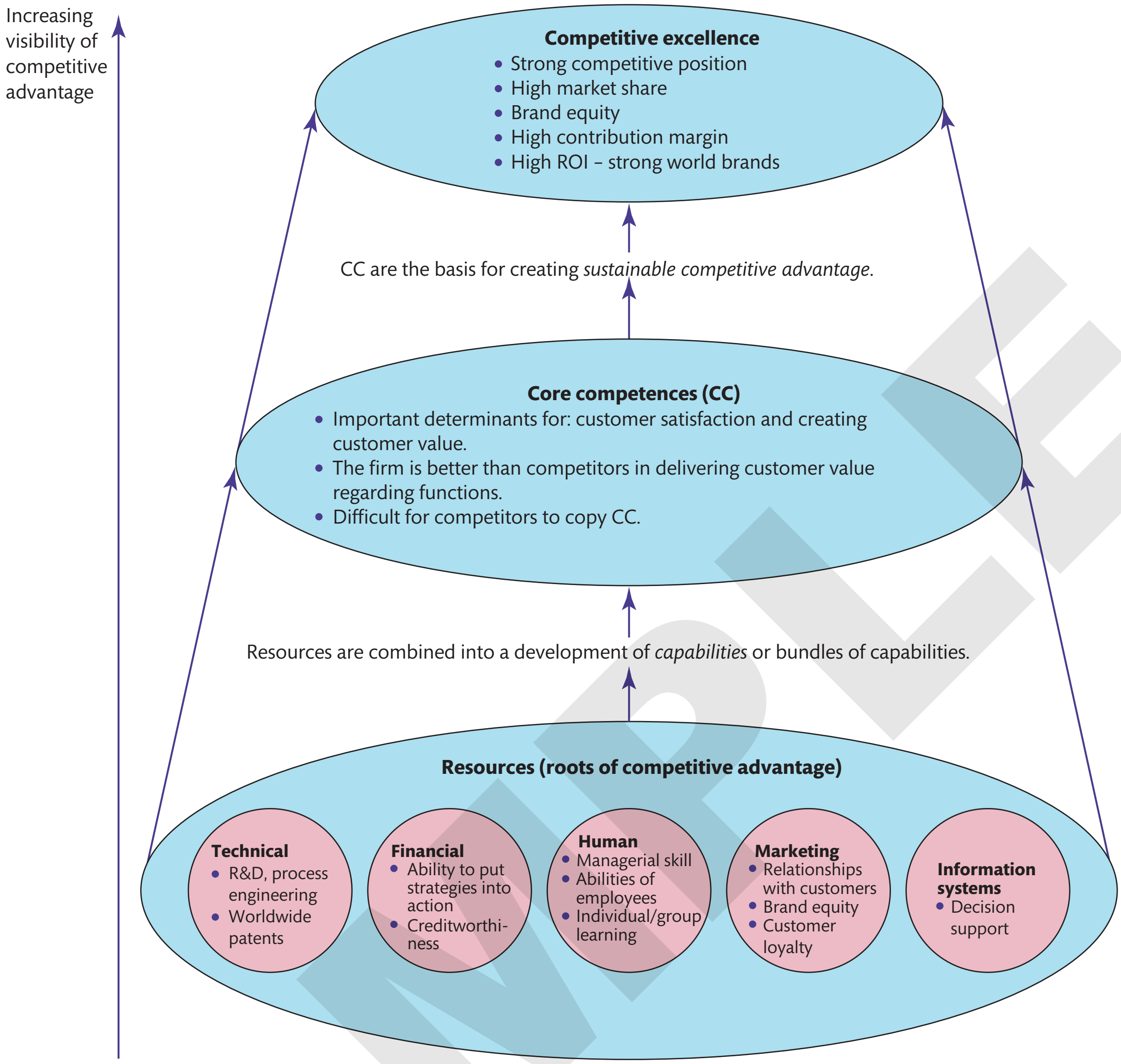



**FIGURE 2.3** *The roots of competition*

Source: inspiration from Grant (1991).



without proper support. The key to sustaining competitive advantage as a business grows is to assemble a bundle of distinctive capabilities that together satisfy the criteria.

The capabilities in the bundle can be built in-house, borrowed by means of alliances, or acquired out of house. As each new capability is added to the bundle, greater competitive advantage accrues because the combination becomes more difficult for competitors to imitate or substitute and more difficult for employees to acquire from the company.

Cardy and Selvarajan (2006) classify competences into two broad categories: *personal* or *corporate*. Personal competences are possessed by individuals and include characteristics such as knowledge, skills, abilities, experience and personality. Corporate competences belong to the organisation and are embedded processes and structures that tend to reside within the organisation, even when individuals leave. These two categories are not entirely independent. The collection of personal competences can form a way of doing things or a culture that becomes embedded in the organisation. In addition, corporate characteristics can determine the type of personal competences that will best work or fit in the organisation.

## 2.4 MARKET ORIENTATION VIEW (MOV) COMPARED TO THE RESOURCE-BASED VIEW

The MOV, or fit model, suggests that the firm adapts its assets to its environmental constraints in order to obtain a fit with the environment. Basically, MOV is about adapting to the market environment (Kohli and Jaworski, 1990). It can be understood as a culture, rather than a set of behaviours and espoused values (Beverland and Lindgreen, 2005). MOV can be defined as a culture in which all employees are committed to the continuous creation of superior value for the customers (Vesanen, 2007). However, adaptation to different customers in different countries can be an expensive **business model**. In this regard, you get very satisfied customers but the costs involved in producing this **customer value**/satisfaction might also be very high.

**Business model:** The fundamental strategy underlying the way a business unit operates.

**Customer value:** The difference relation between the values the customer gains from owning and using a product and the costs of obtaining that product.

**TABLE 2.1** Main differences between the resource-based view and the market orientation view

| | MARKET ORIENTATION VIEW (MOV) | RESOURCE-BASED VIEW (RBV) |
|---|---|---|
| **Basic principle** | Adapt firm's resources to the requirements of its competitive environment, i.e. to key success factors | Proactive quest for environments that allow the best exploitation of the firm's resources |
| **Strategic analysis** | Centred on industry structure and market attributes | Emphasis on internal diagnosis |
| **Formulation process** | Outside-in | Inside-out |
| **Source for competitive edge** | Market positioning in relation to local competitive environment | Firm's idiosyncratic set of resources and competences |

Table 2.1 summarises the main differences between the RBV and the MOV. As both views (models) have advantages and disadvantages, a way of bridging the gap between the RBV and the MOV will now be covered.

### Exploitation versus exploration

A key feature of today's market environment is market turbulence, which refers to the unpredictability of customer needs and preferences. In dynamic markets customer needs shift rapidly and it is difficult to forecast such changes. Today, marketers are being challenged by the huge volume of data ('Big Data') that is well beyond the capacity of their organisations to comprehend and use. The accelerating diversity of market demands must be met with a set of appropriate and matching capabilities to deal with them. The greater the mismatch between the increasingly fluctuating demands of the market and the relatively immobile and homogeneous resources to the firm, the greater the capability gap (Day, 2011). In other words, the drivers who are widening the marketing capability gap are increasing the complexity of the market – interacting with an accelerating rate of market changes and the serious organisational difficulties involved in responding (see also Figure 2.4).

Day (2011) discusses four different strategies for closing the 'marketing capability gap'. The starting point is two different dimensions: inside-out (resource-based view) versus outside-in (market orientation view) and **exploitation** versus **exploration.**

Figure 2.4 illustrates the starting point for closing the market capability gap. As shown, the company faces different options. The static and non-complex characteristic of the 'exploiting' alternative is illustrated by showing only one market,

**Exploitation:** Exploiting current markets enables the firm to secure efficiency and endows it with short-term success and bottom-line profits in a few, well-defined market segments, without too much complexity.

**Exploration:** Exploration refers to generating new knowledge, searching for new marketing possibilities and ensuring long-term survival by reviewing the firm's product- and market portfolio in an experimental way.

whereas the 'exploring' alternative is illustrated by three different markets, where an experimental mindset is needed.

There is a trade-off connected to balancing exploitation and exploration. When there is much focus on market exploitation, the company may utilise existing market knowledge to take advantage of a few current markets, which are already known and where the company can make short-term profits. However, short-term exploitation may also have the consequence that the company could become rigid, inert and slow in chasing new market opportunities. On the other hand, when there is more focus on long-term market exploration, the company can develop creative and proactive thinking and experimentation, but it may also pursue market opportunities that are too uncertain, risky and costly.

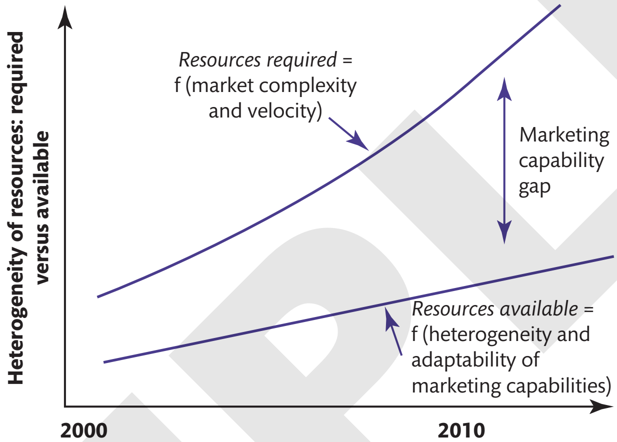



**FIGURE 2.4** *The marketing capability gap*

Source: Day, G. (2011) 'Closing the Marketing Capabilities Gap', *Journal of Marketing*, 75, July: 183–95, republished with permission of American Marketing Association; permission conveyed through Copyright Clearance Center, Inc.

Combining both exploitation and exploration can provide synergistic outcomes, but as both concepts compete for scarce resources and managerial attention, having a well-balanced combination of both concepts is an extremely challenging task, which involves trade-offs.

In order to cope with the 'marketing capability gap', Day (2014) recommends that the company reflects on its business model and its ability to respond adaptively. The company should analyse what the target customers think and what they actually do. In a time of accelerating complexity, deep customer insight should be supported by an early warning system, where the objective is to combine measures of ultimate success with intermediate diagnostic (early warning) metrics that can be used to identify a possible widening or narrowing of the 'marketing capability gap'. The underlying assumption is that the marketing mix decisions will become more effective and timely when they are guided by developing the adaptive marketing capabilities.

## 2.5 THE VALUE CHAIN-BASED VIEW (VBV)

The RBV focuses on what the firm has, whereas the VBV focuses on what the firm does. In addition, the VBV integrates some elements of the MOV, but it does not ignore the costs of performing the activities.

Resources *per se* do not create value. Rather, value creation results from the activities in which the resources are applied.

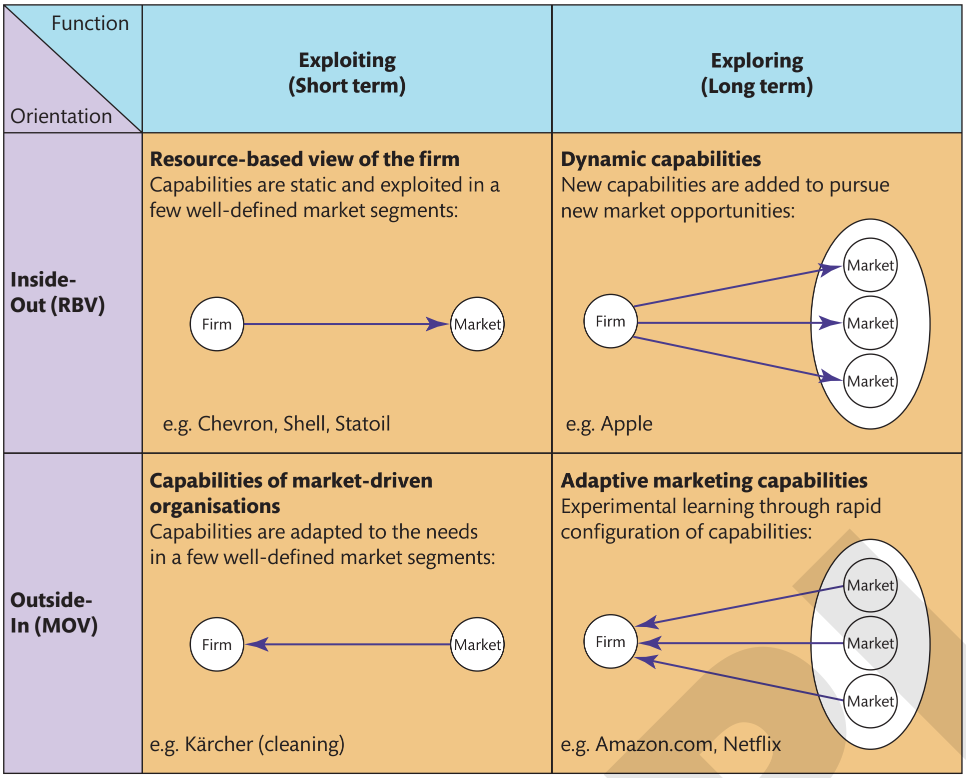



**FIGURE 2.5** *Development of marketing capabilities*

Source: Based on Day (2011), p. 187.



The foundation of competitive advantage is a product and/or service that provides value to the business's customers (McPhee and Wheeler, 2006).

## The value chain

Porter's work (1985) is the key reference on value chains and value configuration analysis for competitive advantage.

Value chains are created by transforming a set of inputs into more refined outputs. The strategic challenges associated with managing a value chain are related to manufacturing products with the right quality at the lowest possible cost. The ways to reduce costs – or increase value – are primarily found through economies of scale, efficient capacity utilisation, learning effects, product and information flows and quality measures. Critical drivers of value creation in chains also include the interrelationships between primary activities, on the one hand, and product development, marketing and service, i.e. support activities, on the other hand.

The firm's value chain, as shown in Figure 2.6 for example, provides a systematic means of displaying and categorising activities. The activities performed by a firm in any industry can be grouped into four generic categories. The two main functions, 'Research and Development' (R&D) and 'Production' cover the so-called **upstream functions**, which are mainly handled by engineers. The two last main functions, 'Marketing' and 'Sales and service' cover the so-called **downstream functions**, which normally are the functions closest to the customers, and these functions are handled by a variety of job profiles, among others marketing-educated people. The concepts of upstream and downstream originate from the oil and gas industry, referring to an oil or gas company's loca-

**Upstream functions:** Functions closest to the suppliers of raw materials or components used for production, i.e. in-bound logistics. It can also be activities related to design or advanced production technology (R&D and Production).

**Downstream functions:** Functions closest to the customers, so that they add value to the final product by customization or differentiation (Marketing and Sales & service).

tion in the supply chain. The closer to the end-user a function (e.g. refinery of oil) or company is, the further downstream it is said to be.

At each stage of the value chain there exists an opportunity to contribute positively to the firm's competitive strategy by performing some activity or process in a way that is better than the competitors and so providing some uniqueness or advantage. If a firm attains such a competitive advantage that is sustainable, defensible, profitable and valued by the market, then it may earn high rates of return, even though the industry may be unfavourable and the average profitability of the industry modest.

In competitive terms, value is the amount that buyers are *willing to pay for what a firm provides them (perceived value)* less the sacrifices that the customers offer to obtain access to the value (e.g. money, time). A firm is profitable if the value it commands exceeds the costs involved in creating the product. According to the 'formula' in Figure 2.10, it is implied that customer-perceived value should be higher than 1. Creating value for buyers that exceeds the cost of doing so is the goal of any generic strategy. Value, instead of cost, must be used in analysing competitive position, since firms often deliberately raise their costs in order to command a premium price via differentiation. The concept of buyers' perceived value will be discussed further in this chapter.

The value chain displays total value and consists of value activities and margin. Value activities are the physically and technologically distinct activities that a firm performs. These are the building blocks by which a firm creates a product that is valuable to its buyers. Margin is the difference between total value (price) and the collective cost of performing the value activities.

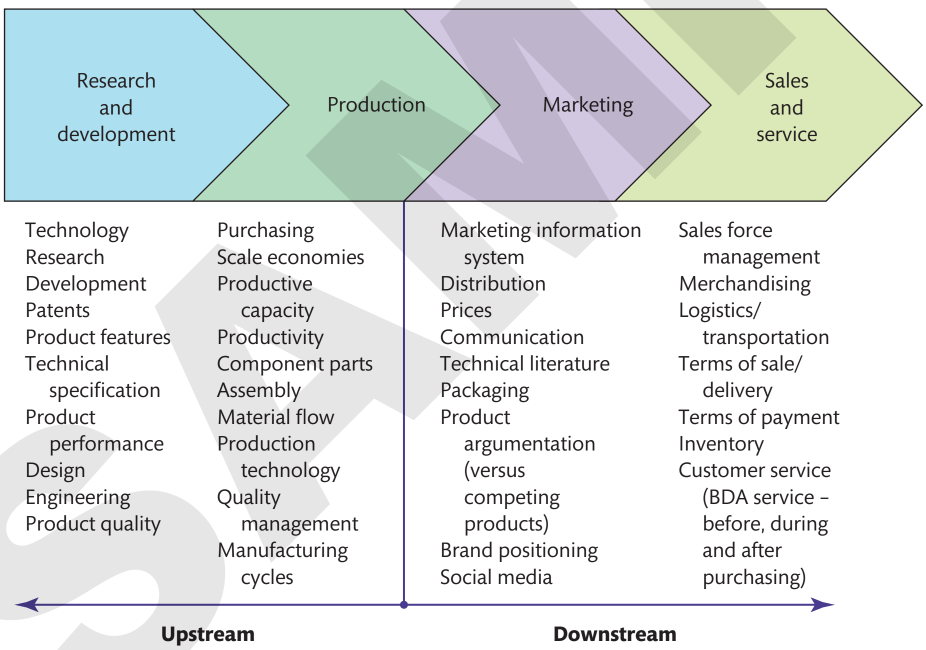



**FIGURE 2.6** *A simplified version of the value chain*

Source: from *Global Marketing*, 6th ed, Financial Times Prentice Hall (Hollensen, S., 2014) p. 30, © Pearson Education Limited 2014.

Competitive advantage is a function of either providing comparable buyer value more efficiently than competitors (lower cost), or performing activities at comparable cost but in unique ways that create more customer value than the competitors are able to offer and, hence, command a premium price (differentiation). The firm might be able to identify elements of the value chain that are not worth the costs. These can then be unbundled and produced outside the firm (outsourced) at a lower price.

Value activities can be divided into two broad types: *primary activities* and *support activities*. Primary activities are the activities involved in the physical creation of the product, its sale and transfer to the buyer and after-sales assistance. In any firm, primary activities can be divided into five generic categories. Support activities support the primary activities and each other by providing purchased inputs, technology, human resources and various firm-wide functions.

## Primary activities

The primary activities of the organisation are grouped into five main areas: inbound **logistics**, operations, outbound logistics, marketing and sales and service.

**Logistics:** The activities involved in moving raw materials and parts into a firm, moving in-process inventory through the firm and moving finished goods out of the firm.

1. Inbound logistics are the activities concerned with receiving, storing and distributing the inputs to the product/service. These include materials, handling, stock control, transport, etc.
2. Operations transform these various inputs into the final product or service: machining, packaging, assembly, testing, etc.
3. Outbound logistics collect, store and distribute the product to customers. For tangible products this would involve warehousing, material handling, transport, etc.; in the case of services it may be more concerned with arrangements for bringing customers to the service if it is in a fixed location (e.g. sports events).
4. Marketing and sales provide the means whereby consumers/**users** are made aware of the product or service and are able to purchase it. This would include sales administration, **advertising**, selling, etc. In public services, communication networks (which help users access a particular service) are often important.
5. Services cover all the activities that enhance or maintain the value of a product or service, such as installation, repair, training and spare parts

**User:** The buying-centre role played by the organisational member who will actually use the product.

**Advertising:** Non-personal communication that is paid for by an identified sponsor and involves either mass communication via newspapers, magazines, radio, television and other media (e.g. billboards, bus stop signage), or direct-to-consumer communication via direct mail.

Each of these groups of primary activities is linked to support activities.

## Support activities

These can be divided into four areas: procurement, technology development, human resource management and infrastructure.

1. Procurement refers to the process of acquiring the various resource inputs to the primary activities (not to the resources themselves). As such, it occurs in many parts of the organisation.
2. Technology development refers to the fact that all value activities have a 'technology', even if it is simply know-how. The key technologies may be concerned directly with the product (e.g. R&D, product design) or with processes (e.g. process development), or with a particular resource (e.g. raw material improvements).
3. Human resource management is a particularly important area that transcends all primary activities. It is concerned with the activities involved in recruiting, training, developing and rewarding people within the organisation.
4. Infrastructure encompasses the systems of planning, finance, quality control, etc., which are crucially important to an organisation's strategic capability in all primary activities. Infrastructure also consists of the structures and routines of the organisation that sustain its culture.

Having looked at Porter's complex value chain model, a simplified version will be used in most parts of this book (see Figure 2.6). This simplified version of the

**EXHIBIT 2.2**

## Nike's value chain

In the 1980s, Nike learnt that manufacturing had become a commodity that could be outsourced for less cost and better quality than it could achieve with its internal resources. Nike realised that its core competences were in product development and marketing, and so management grew the company around a strategy of designing innovative products that met evolving customer needs.

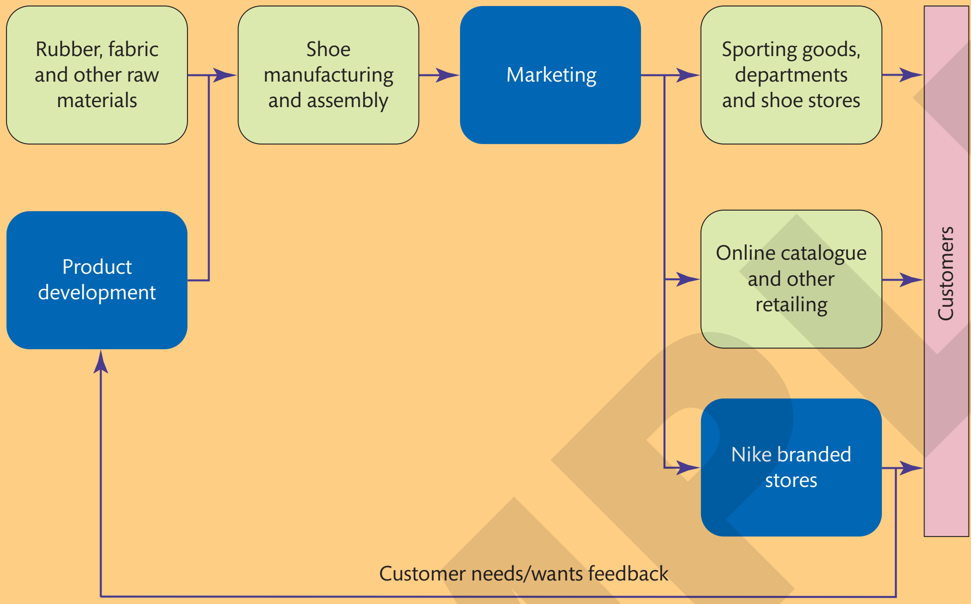



FIGURE 2.7 *Nike's simplified value chain*

The value chain in Figure 2.7 shows a simplified view of the athletic-shoe industry. Nike owns and controls just three elements: product development, marketing and its branded retail stores. All serve Nike's strategic purpose: by owning and operating its branded stores the firm obtains valuable feedback directly from customers, which drives new product development. For B2B service providers seeking to do business with Nike, this suggests that some of the most lucrative opportunities are in supporting new-product development (shoe design and materials technologies), branded-store architecture and choosing store locations.

Sources: adapted from Ramaswamy, 2008; Crain and Abraham, 2008, pp. 34–5.

value chain is characterised by the fact that it contains only the primary activities of the firm.

As indicated in Figure 2.6, a distinction is also made between the production-orientated 'upstream' activities and the more marketing-orientated 'downstream' activities.

### From value chain to value constellation

As markets are getting more complex, the value chain of the single firm cannot be seen independently from the value chains of other actors in the market network (Prahalad and Ramaswamy, 2000).

Normann and Ramirez (1993) argue that strategic analysis should focus on the value-creating system itself within the different players – suppliers, business partners, customers and internal employees should work together to co-produce value.

Although value activities are the building blocks of competitive advantage, the value chain is not a collection of independent activities, but a system of interdependent activities. The value chains of different players are related to each other by linkages within the total industry (Jonk et al., 2008). Linkages are relationships between the way in which one value activity is performed and the cost or performance of another.

In understanding the competitive advantage of an organisation, the strategic importance of the following types of linkage should be analysed in order to assess how they contribute to cost reduction or value added. There are two kinds of linkage (see Figure 2.8):

- *Internal linkages* between activities within the same value chain, but perhaps on different planning levels within the firm.
- *External linkages* between different value chains 'owned' by the different players in the total value system.

Normann and Ramirez (1993) use the term 'value constellation' to describe the 'chain' of different players' value chains and their relationships (see Figure 2.8). Figure 2.8 also stresses the importance of information management as a tool for coordinating information between the different players in the value chain.

The global furniture chain IKEA is used as an example of the new logic of value. IKEA's goal is not to create value for customers but to mobilise customers to create their own value from the company's various offerings (see Figure 2.9). IKEA's strategy is based on cost leadership (high volume production and standardised items) combined with turning consumers into **prosumers**, where IKEA's customers are expected to supply their time for assembly work after purchase.

**Prosumer:** A contraction of *producer and consumer*. Prosumers are half-consumers and half-proactive producers of the value creation.

### Internal linkages

There may be important links between the primary activities. In particular, choices will have been made about these relationships and how they influence value creation and strategic capability. For example, a decision to hold high levels of finished stock might ease production scheduling problems and provide a faster response time to the customer. However, it will probably add to the overall cost of operations. An assessment needs to be made of whether the added value of extra stock is greater than the added cost. Sub-optimisation of the single value chain activities should be avoided. It is easy to miss this point in an analysis if, for example, the marketing activities and operations are assessed separately. The operations may look good because they are geared to high-volume, low-variety, low-unit-cost production. However, at the same time the marketing team may be selling quickness, flexibility and variety to the customers. When put together these two positions representing potential strengths are weaknesses because they are not in harmony, which is what a value chain requires. The link between a primary activity and a support activity may be the basis of competitive advantage. For example, an organisation may have a unique system for procuring materials. Many international hotels and travel companies use their computer systems to provide immediate quotations and bookings worldwide from local access points.

### External linkages

One of the key features of most industries is that a single organisation rarely undertakes all value activities from product design to distribution to the final

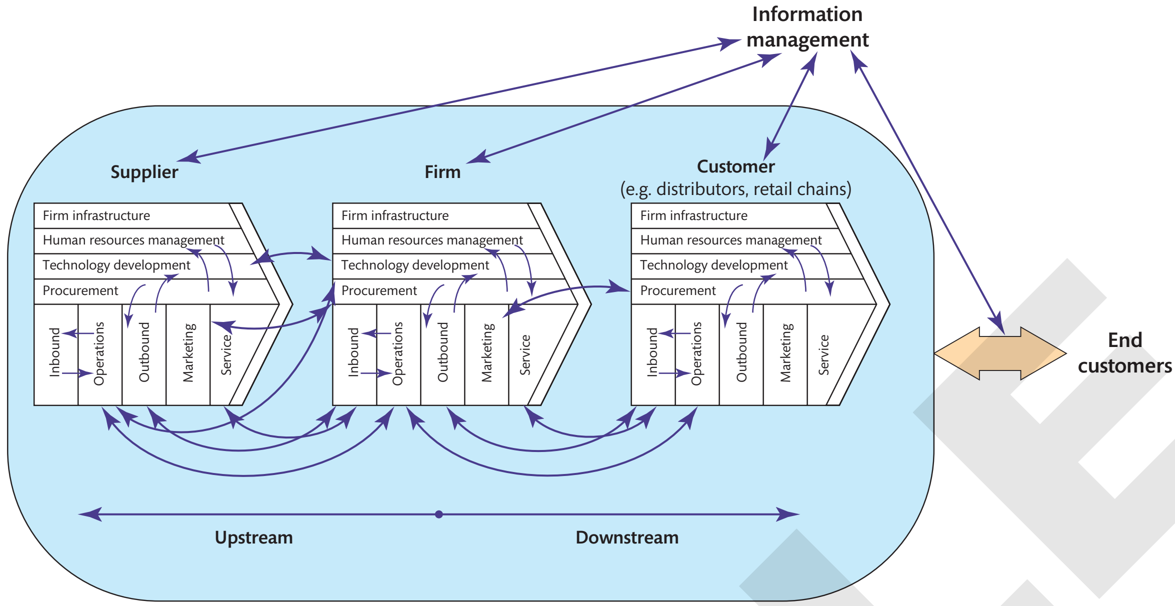



**FIGURE 2.8** *Model of some inter- and intra-firm relationship*

Source: adapted from Lings, I. N. (2000) 'Internal marketing and supply chain management', *Journal of Services Marketing*, 14(1): 34. Copyright © Emerald Publishing Group. All rights reserved. Reproduced with permission.

| | Design | Parts | Assembly | Logistics | Marketing | Service |
|---|---|---|---|---|---|---|
| Traditional furniture stores | • Independent designers<br>• Sophisticated complex designs | • High work-in-progress<br>• Handicraft, custom manufacturing | • Labour intensive<br>• Built to order | • Transport costly, bulky finished product | • Fragmented<br>• Expensive, high street display | • Full service<br>• Small lot delivery to customers |
| IKEA | • In-house designers<br>• Simple design to cost | • Modular interchangeable parts<br>• Mass production<br>• New cheaper raw materials | • By customer | • Computerised<br>• Transport modular parts | • Leverage Scandinavian image<br>• Cheap out-of-town displays | • Self-service<br>• Customer transports home |

**FIGURE 2.9** *The business system of IKEA*

Source: from Kumar, N., Scheer L. and Kotler, P. (2000) 'From market driven to market driving', *European Management Journal*, 18(2). Copyright © 2000 Elsevier. Reproduced with permission.

consumer. There is usually a specialisation of roles and any single organisation usually participates in the wider value system, which creates a product or service. In understanding how value is created, it is not enough to look at the firm's internal value chain alone. Much of the value creation will occur in the supply and distribution chains and this whole process needs to be analysed and understood.

Suppliers have value chains (upstream value) that create and deliver the purchased inputs used in a firm's chain. Suppliers not only deliver a product, but also can influence a firm's performance in many other ways. For example, Benetton, the Italian fashion company, managed to sustain an elaborate network of suppliers, agents and independent retail outlets as the basis of its rapid and successful international development during the 1970s and 1980s.

In addition, products pass through the value chain channels (channel value) on their way to the buyer. Channels perform additional activities that affect the buyer and influence the firm's own activities. A firm's product eventually becomes part of its buyer's value chain. The ultimate basis for differentiation is a firm and its product's role in the buyer's value chain, which determines the buyer's needs. Gaining and sustaining competitive advantage depends on understanding not only a firm's value chain, but how the firm fits into the overall value system.

There are often circumstances where the overall cost can be reduced (or value increased) by collaborative arrangements between different organisations in the value system. It will be seen in Chapter 9 that this is often the rationale behind joint ventures (e.g. sharing technology in the international motor manufacture and electronics industries).

## Customer value proposition (CVP)

The successful company will try to find a way to create value for its customers – that is, a way to help customers to solve a problem or get an important job done (Johnson et al., 2008). Once we understand the 'job' and all its dimensions, including the full process for how to get it done, we can design the offering (= **customer value proposition**).

**Customer value proposition:** The sum of benefits offered to the target customers, relative to the price charged. In order to be a market leader this relationship must be better than competitors' offers.

A conventional view of the value proposition is provided by Knox et al. (2003) in their review of approaches to customer relationship management. They say a value proposition is:

> *an offer defined in terms of the target customers, the benefits offered to these customers, and the price charged relative to the competition.*

In other words, the role of value propositions is to ask the fundamental question 'What business are we in?' from a customer perspective. It places the 'Who is the customer?' together with the 'What are the product and service attributes?' that can not only satisfy current demand but also address latent demand. However, some branding advocates believe that the value proposition is more than the sum of product features, prices and benefits. They argue that it also encompasses the totality of the experience that the customer has when selecting, purchasing and using the product. These customer experiences and also the service quality are very important elements in the process of designing the CVP. For example, Molineux (2002) states that:

> *the value proposition describes the total customer experience with the firm and in its alliance partners over time, rather than [being limited to] that communicated at the point of sale.*

Perceived value is the *relation* between the benefits customers realise from using the product/service and the costs (direct and indirect) they incur in finding, acquiring and using it (see Figure 2.10). The higher this relationship is, the better the perceived value for the customer.

Please do not think of Figure 2.10 as a mathematical formula for calculating an exact measure of customer-perceived value (CPV). Instead, think of it as what the customer *gets* compared to what the customer *gives* in order to be able to use or consume the product or service. Hopefully this relationship (CPV = 'get'/'give') is higher than 1. Then real customer-perceived value (CPV) has been created. After the product or service has been purchased and is used or consumed, the level of the customer's satisfaction can be evaluated. If the actual customer satisfaction with the purchase and quality exceeds initial expectations, then the customer will tend to buy the product or service again and the customer may become loyal towards the company's product or service (brand loyalty).

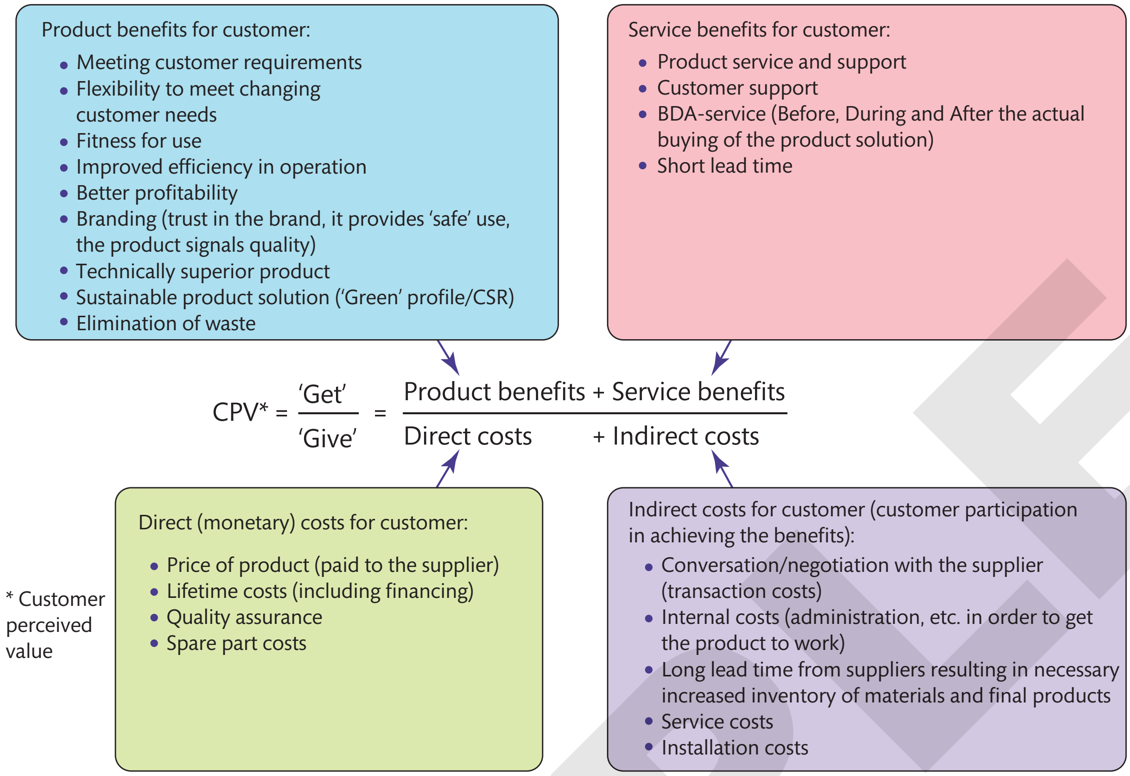



**FIGURE 2.10** *Illustration of customer value (perceived value)*

Sources: Adapted from Anderson et al. (2007, 2008); McGrath and Keil (2007); and Smith and Nagle (2005).

The components driving customer benefits include product values, service values, technical values and commitment value. The components driving costs fall into two categories: those that relate to the price paid and those representing the internal costs incurred by the customer. These components can be unbundled into salient attributes. Commitment to value, for example, includes investment in personnel and customer relations. Internal costs might reflect set-up time and expense, maintenance, training and energy.

If the benefits exceed the costs then a customer will at least consider purchasing your product. For example, the value to an industrial customer may be represented by the rate of return earned on the purchase of a new piece of equipment. If the cost reductions or revenue enhancements generated by the equipment justify the purchase price and operating costs of the equipment through an acceptable return on investment, then value has been created. Customer value is thus defined either by the cost reductions that the product can provide in the customer's activities or by the performance improvements that the customer can gain by using the product. Porter's generic strategies of cost or differentiation (1980) are aimed at improving either the cost or value of a product relative to the average of the industry.

When we talk about customer value we should be aware that the customer value is not only being created by the company itself. Sometimes customer value is created in a co-creation process with customers or suppliers (Grönroos, 2009), or even with complementors and/or competitors. This extended version of 'customer value creation' leads us to the concept of the value net, which is introduced in section 6.2.

## EXHIBIT 2.3

# The value chain of Acme Axles, Inc.

Acme Axles, Inc. (a disguised name) makes custom-designed axles, wheels and related parts for trailers, tractors, generators, welders and other equipment requiring axle systems. Acme differentiates itself from its competitors by providing fast, on-time delivery of high-quality, custom-designed axles. The value chain outline for Acme and the axle industry is shown in Figure 2.11.

There are three levels of value chain analysis:

- The industry value chain consists of the different firms in the vertical supply chain.
- The company's (Acme Axle, Inc.) internal value chain consists of the different functions in the company.
- Operational activities of a certain function (only the detailed description of operational activities is shown).

Natural resource extraction (i.e., ore mining and rubber plantations), raw material fabrication (i.e., steel foundries and tyre manufacturers) and industrial parts manufacturing are the supplier links in the value chain. Customer links include military and non-military ground equipment manufacturing. These downstream manufacturers use the axle systems as components of the equipment, such as welding trailers, airport baggage handling trailers, golf carts and tractors.

Source: adapted from Donelan and Kaplan, 1998.

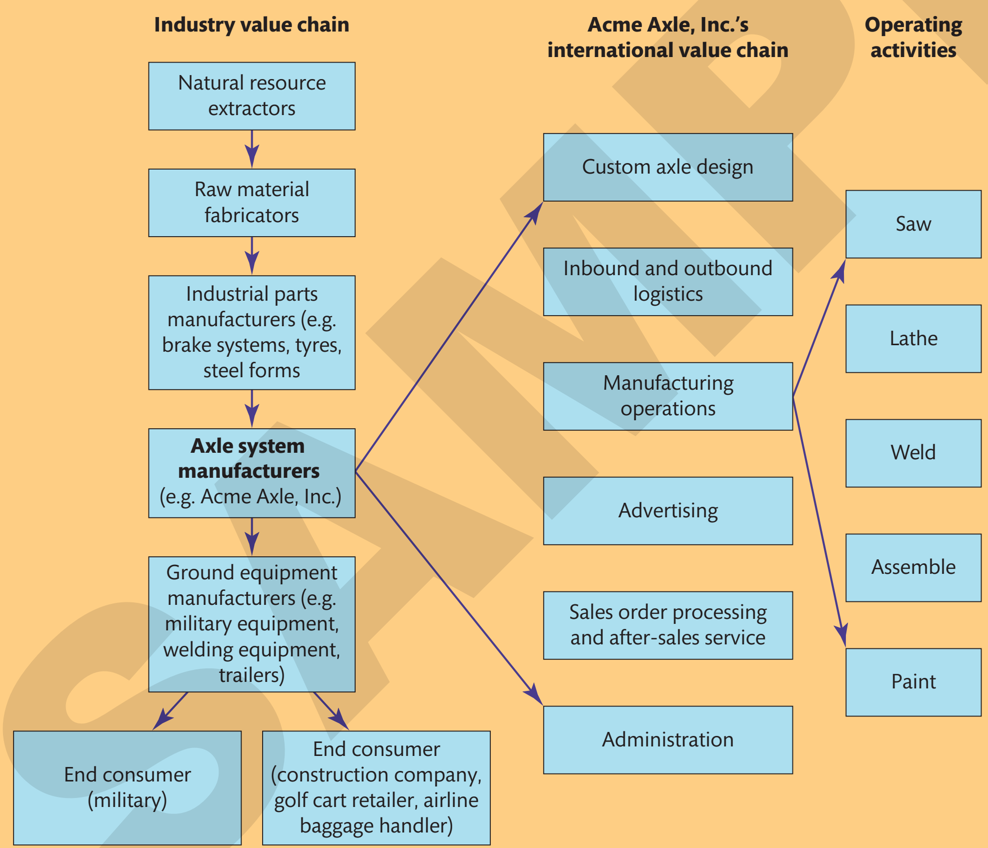



**FIGURE 2.11** *The value chain of Acme Axles, Inc.*

**Perception:** The process by which people select, organise and interpret sensory stimulation into a meaningful picture of the world.

Understanding customers' **perceptions** of value is key to this part of the process and is where many companies fall down. Too often, management determines what it believes the customer wants, develops and makes the product, then adds up the costs of production and puts a standard margin on top of that. The major problems with this approach are that the product may not effectively address changing customer needs and the price may be too high for created customer value.

Value-driven companies spend enough time with customers to obtain a fundamental understanding of their customers' businesses and of their current and latent needs. They want to understand which product features really provide customer benefits and which ones are merely going to add to the product cost without giving customers any additional reason to buy. They also determine the price that will deliver value to their customers early in the product development process. From that, they deduct their target profit and give their engineers and operations people firm targets for the cost of the final product or its components.

### Superior value

Delivering value may not be enough to achieve competitive advantage. Excellent quality is no advantage if your competitors all have similar offerings. Competitive advantage requires that the value of your product or service is superior to that of your competitors. The major challenge here is that your competitors are providing a moving target by continuously improving the value they provide.

Competitive advantage can be accomplished by providing the greatest level of benefits through a differentiation strategy. It can also be accomplished by enabling a customer to achieve the 'lowest life cycle cost' compared to comparable products. It is important to recognise that lowest life cycle cost does not require the lowest purchase price. Lowest life cycle cost can be achieved by helping the customer reduce start-up, training or maintenance costs.

### Value creation and value capture

A business model defines the way a company generates perceived value for customers (value creation) and how it captures some of this value as profit (value capture). Value creation expresses the benefits the company creates for its customers, similar to the customer perceived value (CPV) illustrated in Figure 2.10. Customer perceived value is created if 'get'/'give' is bigger than 1.

As corporate practice demonstrates, the development of a sustainable and profitable business model is very challenging. In this connection, value creation and value capture are two key tasks to consider. Four broad positions, each depicting a particular combination of **value creation** and **value capture**, are illustrated in Figure 2.12.

**Value creation:** The total range of benefits that are provided for customers who will find them consistently useful.

**Value capture:** The part of the 'value creation' that is kept for the company itself as net profit. It is influenced by bargaining power of buyer and seller.

In the following, the four different positions are briefly explained:

1. Nightmare: in this position, companies are creating CPV for the customers but are not able to turn a part of the value creation into profit. All the total added value goes to the customers. The reason for this is normally poor revenue logic. Poor revenue logic is the problem for online companies such as Skype and Spotify. Millions of people are users of their services and users feel that these brands deliver great value for them, but too few users are actually customers who pay for the products. For most users it is enough with the 'Freemium' model.
2. Hell: companies that neither create enough value for customers nor develop a functioning value creation system are doomed for failure. Fiat in Italy

could be an example of this. The car company's products and its value positions were not competitive enough and, as a consequence, Fiat lost market share – even in Italy, where its market share fell from around 60 per cent in 1985 to 30 per cent in 2013.

3. Fantasy: in this position, the company does not create much value for its customers but it still remains a profitable firm. Examples of this position are energy utility (half-public) companies, which often score poorly on customer perceived value (value creation), but remain profitable because of the monopoly market position and the lack of choice for customers.
4. Heaven: in this position, the company has a sustainable and profitable business model that scores high, both on perceived customer value (value creation) and on value capture. Apple and Nespresso are good examples. Apple has succeeded in developing its brand perception as being the coolest smartphone brand in the world market. Nespresso's revenue logic is built on the so-called 'Gillette' model (razor-blade model). High-quality coffee machines in elegant design are sold for a cheap price through licensing partners. Nespresso does not make any profit on its coffee machines. Instead, the high profits are earned on the Nespresso capsule sales, where the gross margins are estimated to be around 85 per cent, compared with around 40 per cent for regular ground coffee (Matzler et al., 2013). A second component of Nespresso's revenue model is the cross-selling of coffee accessories (coffee cups, sugar sachets, amaretti biscuits, cocoa powder for milk-based recipes, etc.). Furthermore, for the bigger Nespresso machines in cafés, Nespresso also provides complete on-site service maintenance of the coffee machines to ensure that the cafés always provide the best coffee for their customers.

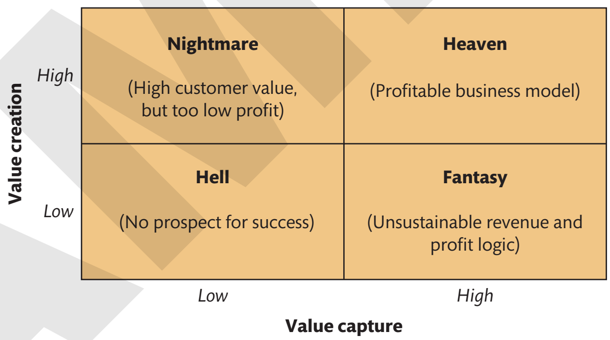



**FIGURE 2.12** *Four broad positions, each depicting a particular combination of value creation and value capture*

Source: based on Matzler et al. (2013), p. 32.

In order to get to the 'Heaven' position it is not enough just to sell coffee in capsules, as in the case of Nespresso; this idea may be copied very quickly by competitors. What is hard to copy is the entire system – the complete business model – which is the unique foundation for a sustained and profitable operation.

A growing number of companies realise that it is not enough to look at 'value capture' in terms of optimising short-term financial performance. According to Porter and Kramer (2011), companies must take the lead in bringing business and society together. The solution lies in the principle of **shared value**, which involves creating value also for society by addressing its needs and challenges, e.g. by reducing the company's energy consumption but at the same time also reducing the $CO_2$ emissions to the atmosphere.

**Shared value:** Creating economic value not only for the company itself but also for the society by addressing its needs and challenges. It is about connecting company success with social progress in society.

## 2.6 VALUE SHOP AND THE 'SERVICE VALUE CHAIN'

**Service value chain / value shop:** A model for solving problems in a service environment, similar to workshops. Value is created by mobilising resources and deploying them to solve a specific customer problem.

**Value network:** The formation of several firms' value chains into a network, where each company contributes a small part to the total value chain.

Michael Porter's value chain model claims to identify the sequence of key generic activities that businesses perform in order to generate value for customers. Since its introduction in 1985, this model has dominated the thinking of business executives. Yet a growing number of services businesses, including banks, hospitals, insurance companies, business consulting services and telecommunications companies, have found that the traditional value chain model does not fit the reality of their service industry sectors. Stabell and Fjeldstad (1998) identified two new models of value creation **– Service value chain** / **value shop** and **value networks**. Fjeldstad and Stabell argue that the value chain is a model for making products, while the value shop is a model for solving customer or client problems in a service environment. The value network is a model for mediating exchanges between customers. Each model utilises a different set of core activities to create and deliver distinct forms of value to customers.

The main differences between the two types of value chains are illustrated in Table 2.2.

Value shops (as in workshops, not retail stores) create value by mobilising resources (e.g. people, knowledge and skills) and deploying them to solve specific problems such as curing an illness, delivering airline services to the passengers or delivering a solution to a business problem. Shops are organised around making and executing decisions – identifying and assessing problems or opportunities, developing alternative solutions or approaches, choosing one, executing it and evaluating the results. This model applies to most service-orientated organisations, such as building contractors, consultancies and legal organisations. However, it also applies to organisations that are primarily configured to identify and exploit specific market opportunities, such as developing a new drug, drilling a potential oilfield or designing a new aircraft.

Different parts of a typical business may exhibit characteristics of different configurations. For example, production and distribution may resemble a value chain, and research and development a value shop.

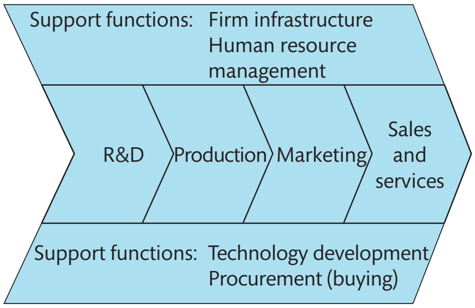
Value shops make use of specialised knowledge-based systems to support the task of creating solutions to problems. However, the challenge is to provide an integrated set of applications that enable seamless execution across the entire problem-solving or opportunity-exploitation process. Several key technologies and applications are emerging in value shops – many of which focus on utilising people and knowledge better. Groupware, intranets, desktop video conferencing and shared electronic workspaces enhance communication and collaboration between people – essential to mobilising people and knowledge across value shops. Integrating project planning with execution is proving crucial – for example, in pharmaceutical development, where bringing a new drug through the long, complex approval process a few months early can mean millions of dollars in revenue. Technologies such as inference engines and neural networks can help to make knowledge about problems and the process for solving them explicit and accessible.

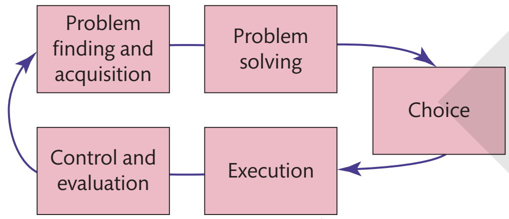
The term 'value network' is widely used. Most often it refers to a group of companies, each specialising in one piece of the value chain and linked together in some virtual way to create and deliver products and services.

Some of the most IT-intensive businesses in the world are value networks – banks, airlines and telecommunications companies, which core services are typically being supplemented by other value network partners. Most of

**TABLE 2.2** The traditional value chain versus the service value chain

| TRADITIONAL VALUE CHAIN MODEL | SERVICE VALUE CHAIN ('VALUE SHOP') MODEL |
|---|---|
| Value creation through transformation of inputs (raw material and components) to products. | Value creation through customer problem solving. Value is created by mobilising resources and activities to resolve a particular and unique customer problem. Customer value is not related to the solution itself but to the value of solving the problem. |
| Sequential process ('first we develop the product, then we produce it and finally we sell it'). | Cyclical and iterative process. |




| | |
|---|---|
| The traditional value chain consists of primary and support activities. *Primary activities* are directly involved in creating and bringing value to customers: upstream activities (product development and production) and downstream activities (marketing and sales and service). *Support activities* that enable and improve the performance of the primary activities are procurement, technology development, human resource management and firm infrastructure. | The primary activities of a value shop are:<br>1. *Problem finding*: activities associated with the recording, reviewing and formulating of the problem to be solved and choosing the overall approach to solving the problem.<br>2. *Problem solving*: activities associated with generating and evaluating alternative solutions.<br>3. *Choice*: activities associated with choosing among alternative problem solutions.<br>4. *Execution*: activities associated with communicating, organising and implementing the chosen solution.<br>5. *Control and evaluation*: activities associated with measuring and evaluating to what extent implementation has solved the initial situation. |
| Examples: production and sale of furniture, consumer food products, electronic products and other mass products. | Examples: banks, hospitals, insurance companies, business consulting services and telecommunications companies. |

Source: after Stabell, C.B. and Fjeldstad, Ø.B. (1998) 'Configuring value for competitive advantage: on chains, shops and networks', *Strategic Management* 19: 413–37. Reproduced with permission from John Wiley & Sons.



their technology provides the basic infrastructure of the 'network' to mediate exchanges between customers. But the competitive landscape is now shifting beyond automation and efficient transaction processing to monitoring and exploiting information about customer behaviour. The purpose of that is to add more value to customer exchanges through better understanding of usage patterns, exchange opportunities, shared interests and so on. Data mining and visualisation tools, for example, can be used as tools to identify both positive and negative connections between customers.

Competitive success often depends on more than simply performing your primary model well. It may also require the delivery of additional kinds of complementary value. Adopting attributes of a second value configuration model can be a powerful way to differentiate your value proposition or defend it against competitors pursuing a value model different to your own. It is essential, however, to pursue another model only in ways that leverage the primary model. For example, Harley-Davidson's primary model is the chain – it makes and sells products. Forming the Harley Owners Group (HOG) – a network of customers

– added value to the primary model by reinforcing the brand identity, building loyalty and providing valuable information and feedback about customers' behaviours and preferences (see Case study 12.1). Amazon.com is a value chain like other book distributors and initially used technology to make the process vastly more efficient. Now, with its book recommendations and special interest groups, it is adding the characteristics of a value network. Our research suggests that the value network in particular offers opportunities for many existing businesses to add more value to their customers and for new entrants to capture market share from those who offer less value to their customers.

## Combining the 'product value chain' and the 'service value chain'

Blomstermo et al. (2006) make a distinction between *hard* and *soft services*. Hard services are those where production and consumption can be decoupled. For example, software services can be transferred into a CD, or some other tangible medium, which can be mass-produced, making standardisation possible. With soft services, where production and consumption occur simultaneously, the customer acts as a co-producer and decoupling is not viable. The soft-service provider must be present abroad from its first day of foreign operations. Figure 2.13 is mainly valid for soft services, but at the same time in more and more industries we see that physical products and services are combined.

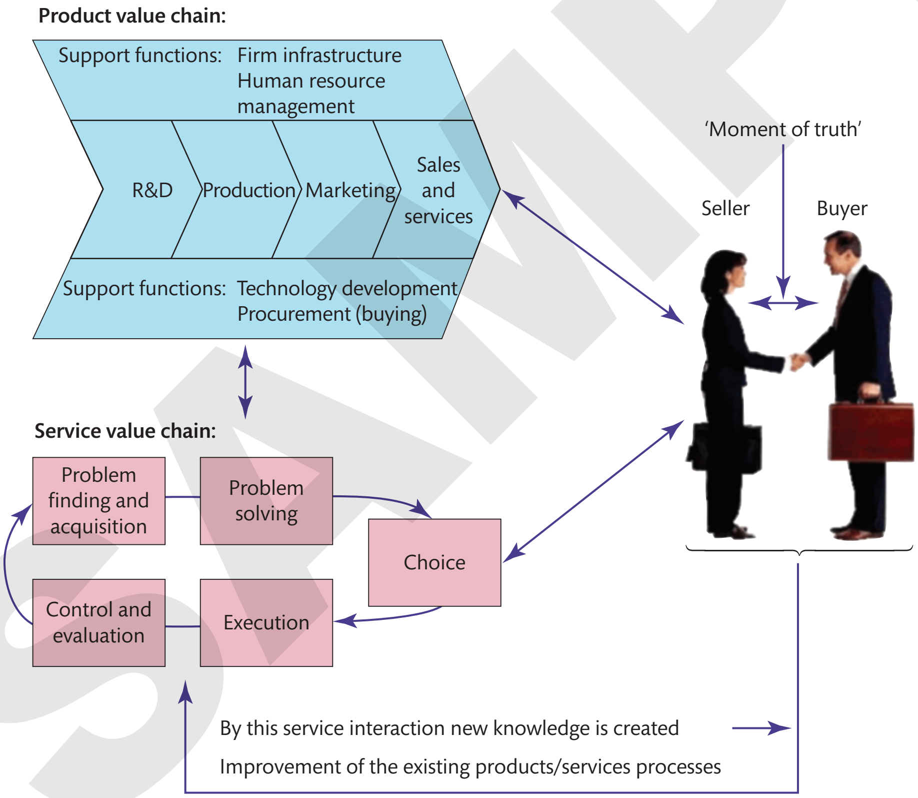



FIGURE 2.13 *Combining the 'product value chain' with the 'service value chain'*

Most product companies offer services to protect or enhance the value of their product businesses. Cisco, for instance, built its installation, maintenance and network-design service business to ensure high-quality product support and to strengthen relationships with enterprise and telecom customers. A company may also find itself drawn into services when it realises that competitors use its products to offer services of value. If it does nothing, it risks not only the commoditisation of its own products – something that is occurring in most product markets, irrespective of the services on offer – but also the loss of customer relationships. To make existing service groups profitable – or to succeed in launching a new embedded service business – executives of product companies must decide whether the primary focus of service units should be to support existing product businesses or to grow as a new and independent platform.

When a company chooses a business design for delivering embedded *services* to customers, it should remember that its strategic intent affects which elements of the delivery life cycle are most important. If the aim is to protect or enhance the *value* of a product, the company should integrate the system for delivering it and the associated *services* in order to promote the development of product designs that simplify the task of *service* (e.g., by using fewer subsystems or integrating diagnostic software). This approach involves minimising the footprint of *service* delivery and incorporating support into the product whenever possible. However, if the company wants the *service* business to be an independent growth platform, it should focus most of its delivery efforts on constantly reducing unit costs and making the *services* more productive (Auguste et al., 2006).

In the 'moment of truth' (e.g., in a consultancy service situation), the seller represents all the functions of the focal company's 'product' and 'service' value chain – at the same time. The seller (the product and service provider) and the buyer create a service in an interaction process: 'The service is being created and consumed as it is produced.' Good representatives on the seller's side are vital to service brands' successes, being ultimately responsible for delivering the seller's promise. As such, a shared understanding of the service brand's values needs to be anchored in their minds and hearts to encourage brand-supporting behaviour. This internal brand-building process becomes more challenging as service brands expand internationally, drawing on workers from different global domains.

Figure 2.13 also shows the cyclic nature of the service interaction ('moment of truth') where the post-evaluation of the service value chain gives input for the possible redesign of the 'product value chain.' The interaction shown in Figure 2.13 could also be an illustration or a snapshot of a negotiation process between seller and buyer, where the seller represents a branded company that is selling its projects as a combination of 'hardware' (physical products) and 'software' (services). Furthermore, it is important to realise that buyers are increasingly active co-creators of value (Vargo and Lusch, 2008).

Certainly one of the purposes of the 'learning nature' of the overall decision cycle in Figure 2.13 is to pick up the 'best practices' among different kinds of international buyer–seller interactions. This would lead to implications for a better set-up of: the 'service value chain' (value shop) the 'product value chain' the combination of the service and product value chains.

## 2.7 INTERNATIONALISING THE VALUE CHAIN

### International configuration and coordination of activities

All internationally orientated firms must consider an eventual internationalisation of the value chain's functions. The firm must decide whether the responsibility for the single value chain function is to be moved to the international markets or is best handled centrally from head office. Principally, the value chain function should be carried out where there is the highest competence (and the most cost-effectiveness) and this is not necessarily at head office (Bellin and Pham, 2007).

**Glocalisation:** The development and selling of products or services intended for the global market, but adapted to suit local culture and behaviour. (Think globally but act locally.)

**Diffusion:** The spread of a new product through society.

The two extremes in 'global marketing' (globalisation and localisation) can be combined into the so-called '**glocalisation**' framework, as shown in Figure 2.14. This global marketing strategy strives to achieve the slogan 'Think globally but act locally' (the so-called 'glocalisation' framework), through dynamic interdependence between headquarters and subsidiaries. Organisations following such a strategy coordinate their efforts, ensuring local flexibility while exploiting the benefits of global integration and efficiencies, as well as ensuring worldwide **diffusion** of innovation. A key element in knowledge management is the continuous learning from experiences. In practical terms, the aim of knowledge management as a learning-focused activity across borders is to keep track of valuable capabilities used in one market that could be used elsewhere (in other geographic markets), so that firms can continually update their knowledge. However, knowledge developed and used in one cultural context is not always easily transferred to another. The lack of personal relationships, the absence of trust and 'cultural distance' all conspire to create resistance, friction and misunderstandings in cross-cultural knowledge management.

With globalisation becoming a centrepiece in the business strategy of many firms – be they engaged in product development or providing services – the ability to manage the 'global knowledge engine' to achieve a competitive edge in today's knowledge-intensive economy is one of the keys to sustainable competitiveness. But in the context of global marketing, the management of knowledge is de facto a cross-cultural activity, whose key task is to foster and continually upgrade collaborative cross-cultural learning. Of course, the kind and/or type of knowledge that is strategic for an organisation and that needs to be managed for competitiveness varies depending on the business context and the value of different types of knowledge associated with it.

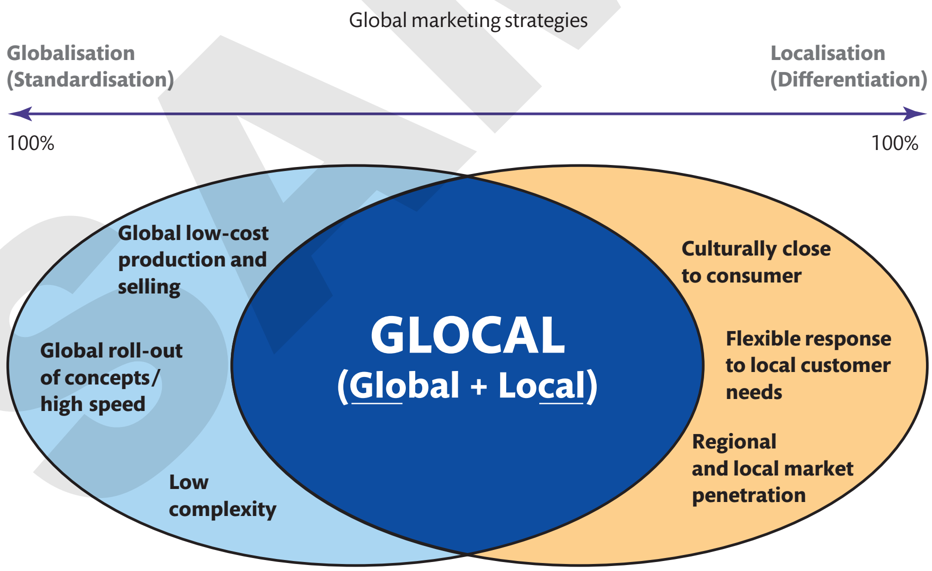



FIGURE 2.14 *The glocalisation framework*

Source: from *Global Marketing*, 6th ed, Financial Times Prentice Hall (Hollensen, S., 2014) p. 22, © Pearson Education Limited 2014.

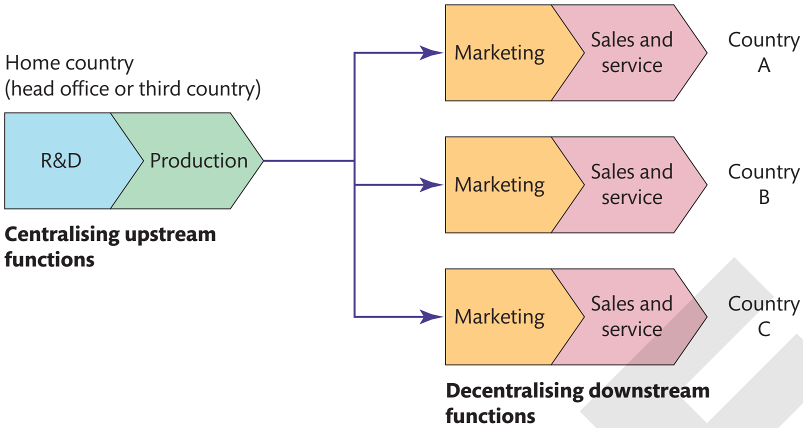



FIGURE 2.15 *Centralising the upstream activities and decentralising the downstream activities*

A distinction immediately arises between the activities labelled on Figure 2.6 as downstream and those labelled as upstream activities. The location of downstream activities, those more related to the buyer, is usually tied to where the buyer is located. If a firm is going to sell in Australia, for example, it must usually provide service in Australia and it must have salespeople stationed in Australia. In some industries it is possible to have a single salesforce that travels to the buyer's country and back again; other specific downstream activities, such as the production of advertising copy, can sometimes also be performed centrally. More typically, however, the firm must locate the capability to perform downstream activities in each of the countries in which it operates. In contrast, upstream activities and support activities are more independent of where the buyer is located (see Figure 2.15). However, if the export markets are culturally close to the home market, it may be relevant to control the entire value chain from head office (the home market).

This distinction carries some interesting implications. First, downstream activities create competitive advantages that are largely country-specific: a firm's reputation, brand name and service network in a country grow largely out of its activities and create entry/mobility barriers largely in that country alone. Competitive advantage in upstream and support activities often grows more out of the entire system of countries in which a firm competes than from its position in any single country.

Second, in industries where downstream activities or other buyer-tied activities are vital to competitive advantage, there tends to be a more multi-domestic pattern of international competition. In many service industries, for example, not only downstream activities but frequently upstream activities are tied to buyer location and global strategies are comparatively less common. In industries where upstream and support activities, such as technology development and operations, are crucial to competitive advantage, global competition is more common. For example, there may be a large need in firms to centralise and coordinate the production function worldwide to be able to create rational production units that are able to exploit economies of scale.

Furthermore, as customers increasingly join regional cooperative buying organisations, it is becoming more and more difficult to sustain a price differentiation across markets. This will put pressure on the firm to coordinate a European price policy.

The distinctive issues of international strategies, in contrast to domestic, can be summarised in two key dimensions of how a firm competes internationally. The

first is called the *configuration* of a firm's worldwide activities, or the location in the world where each activity in the value chain is performed, including the number of places. For example, a company can locate different parts of its value chain in different places – for instance, factories in China, call centres in India and retail shops in Europe. IBM is an example of a company that exploits wage differentials by increasing the number of employees in India from 9,000 in 2004 to 50,000 by 2007 and topping with 130,000 in 2014. Most of these employees are in IBM Global Services, the part of the company that is growing fastest but has the lowest margins – which the Indian employees are supposed to improve by reducing (wage) costs rather than raising the prices (Nadhe, 2014).
The second dimension is called *coordination*, which refers to how identical or linked activities performed in different countries are coordinated with each other (Porter, 1986; Sanchez, 2007).

## 2.8 THE VIRTUAL VALUE CHAIN

By introducing the virtual value chain, Rayport and Sviokla (1996) have extended the conventional value chain model, which treats information as a supporting element in the value-adding process (see Figure 2.16).
Each of the physical value chain activities might make use of one or all four of the information processing stages of the virtual value chain, in order to create extra value for the customer. That is the reason for the horizontal double arrows (in Figure 2.16) between the different physical and virtual value chain activities. In this way (in relation to Figure 2.16), information can be captured at all stages of the physical value chain. Obviously such information can be used to improve performance at each stage of the physical value chain and to coordinate across it. However, it can also be analysed and repackaged to build content-based products or to create a new line of business.
A company can use its information to reach out to other companies' customers or operations, thereby rearranging the value system of an industry. The result might be that traditional industry sector boundaries disappear. The CEO of Amazon.com, Jeffrey P. Bezos, clearly sees his business as not bookselling, but the information-broker business.

### Online customer value proposition (OCVP)

Regarding the customer value proposition that can be created along the virtual value chain, it is very important to develop a profound understanding of the customer's online experience.

Marketers must understand specific characteristics of online channels and the benefits they offer to customers. To help formulate the online customer value proposition (OCVP), we need to consider the special characteristics of the internet and its online services as perceived by customers using them. Six criteria can be used to determine the sustainability of the formulated OCVP, in order to reach online customers (Chaffey, 2005):

1. Content: online content is rich, which means it provides something that other channels cannot. Often this means more detailed, in-depth information to support the buying process or product usage. However, often online product catalogues simply replicate what is in offline catalogues without adding extra information, images or example applications. Messaging through email and SMS is also key to providing unique content – these

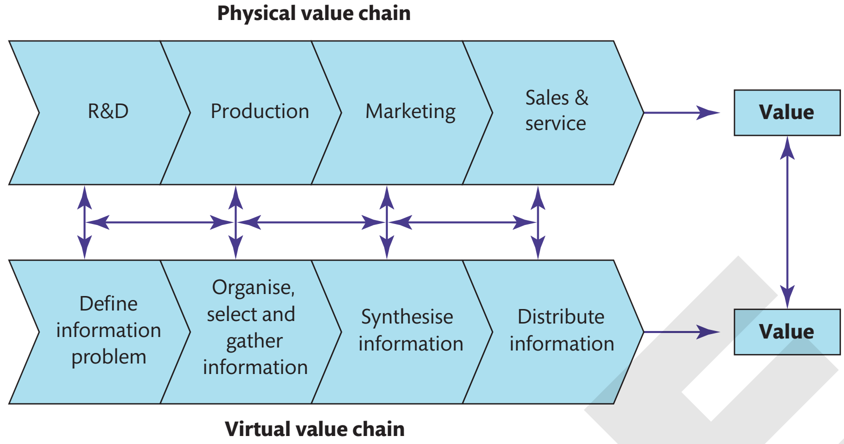



FIGURE 2.16 *The virtual value chain as a supplement to the physical value chain*

media can be used to deliver timely, relevant media to individuals. As well as text-based content, which is king for business-to-business, there is also interactive content, which is king for consumer sites and particularly brands. FMCG brands now use the internet to deliver what they term as 'digital assets', which support offline branding campaigns.

2. Customisation: in this case, mass-customisation of content (whether received as website pages or email alerts) and commonly known as 'personalisation'. Of course, Amazon is quoted many times as an example of this and it actually has a 'Director of Personalisation'. The ability for a subscriber to an online email service to tailor their messages by selectively opting-in to particular types of message is a further example of customisation.
3. Community: these days this is also known as 'social networks'. Online channels such as the internet are known as 'many-to-many' media, meaning that your audiences can contribute to the content.
4. Convenience: this is the ability to select and purchase and in some cases use, products from your desktop at any time: the classic 24/7/365 availability of a service. Online usage of products is, of course, restricted to digital products such as music or other data services. Amazon has advertised offline using a cartoon showing a Christmas shopper battling in queues clutching several bags, to reinforce the convenience message.
5. Choice: the internet gives a wider choice of products and suppliers than via conventional distribution channels. For example, Tesco.com provides Tesco with a platform to give consumers a wider choice of products (financial, travel, white goods) with more detailed information than is physically available in store.
6. Cost reduction: the internet is widely perceived as a relatively low-cost place of purchase. A key component of the low-cost airline carriers' OCVP is that it is cheaper than phone bookings. This simple price differential, together with the limited change behaviour required from phone booking to online booking, has been a key factor in, for example, Ryanair's online ticketing channel effectively replacing all other booking modes.

## 2.9 EXPERIENTIAL MARKETING

The previous section describes and explains value creation as a result of both the product and service offering. However, as services increasingly become commo-

**Customer experience:** When a company intentionally uses products in combination with services to engage the individual customer in a way that creates a memorable event, which can characterised in one of four groups: entertainment, educational, aesthetic or escapist.

**Experiential Marketing:** Focuses on helping consumers experience a brand, by engaging as many human senses as possible.

ditised – think of smartphone services sold solely on price – 'experiences' have emerged as the next step in how we can provide 'customer value'. This process of generating customer value from product solutions, services and finally to customer experiences is shown in Figure 2.17. A **customer experience** occurs when a company intentionally uses products in combination with services to engage an individual customer in a way that creates a memorable event (Pine and Gilmore, 1998).

Unless companies want to be in a commoditised business, they will be compelled to upgrade their offerings to the next stage of customer value creation: 'customer experience'.

**Experiential marketing** is a growing trend worldwide, evident in most sectors of the global economy. Essentially it describes marketing initiatives that give consumers in-depth, tangible experiences in order to provide them with sufficient information to make a purchase decision. It has evolved as a response to a perceived transition from a service economy to one personified by the experiences in which consumers participate.

Increasingly, consumers are involved in the processes of both defining and creating value and the co-created experience of consumers through the holistic brand value structure becomes the very basis of marketing.

Pine and Gilmore (1998) suggest that we think about experiences across two bi-polar constructs:

- *Involvement/participation*: This dimension refers to the level of interactivity between the supplier and the customer. At a 'low degree' lies passive participation, where the participant's experience the event as observers or listeners. Such participants include classic symphony goers. At the other end of the spectrum lies 'active participation', in which customers play key roles in creating the performance or event. Such participants could be joining a rock concert.
- *Intensity/connection*: This dimension refers to the perception of the strength of feeling towards the interaction. Watching a film at the theatre (e.g. IMAX Theatre) with an audience and 3D screen and advanced sound is associated with a 'high degree' of intensity/connection compared to watching the same film at home on a DVD.

We can sort experiences into four broad categories, according to where they fall along the spectra of the two dimensions:

1. *Entertainment*: entertainment can be defined as something that amuses, pleases, or diverts (especially a performance or show), or as the pleasure afforded by being entertained and amused. For example, fashion shows at designer boutiques and upmarket department stores usually involve a low degree of customer involvement and intensiveness.
2. *Educational*: activities in the educational zone involve those where participants are more actively involved, but the level of intensiveness is still low. In this zone, participants acquire new skills or increase those they already have. Many company offerings include educational dimensions. For example, cruise ships often employ well-known authorities to provide semi-formal lectures about their itineraries – a concept commonly referred to as 'edutainment.' Likewise, the Ferrari Driving Experience is a two-day programme that is designed to narrow the gap between driving ability and a Ferrari's performance capability (Atwal and Williams, 2009). This type of experience typically involves active participation by the consumer in

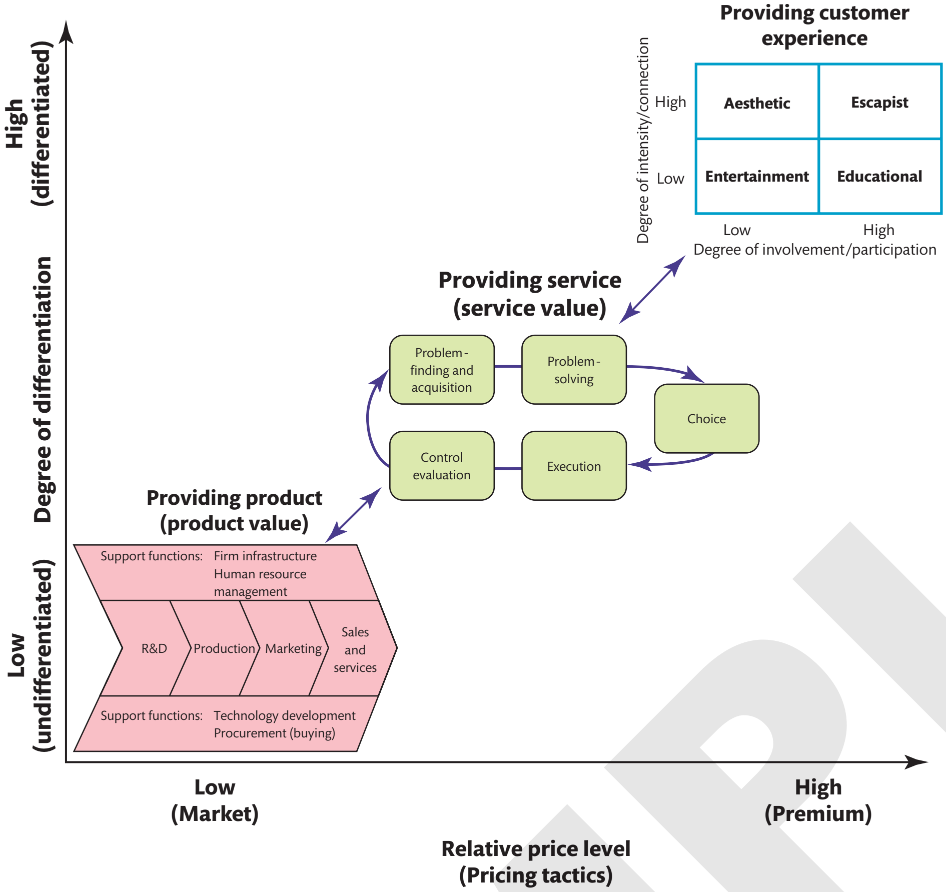



**FIGURE 2.17** *Providing customer value – also through customer experience*

Source: from *Global Marketing*, 6th ed, Financial Times Prentice Hall (Hollensen, S., 2014) p. 38, © Pearson Education Limited 2014.

educational activities of a stimulating nature, thus ensuring that the event enhances an experience.

3. *Aesthetic*: when the element of activity is reduced to a more passive involvement in nature, the event becomes aesthetic. A high degree of intensiveness is clearly evident within this activity but has little effect on its environment, such as admiring the architectural or interior design of designer boutiques. Here the customers are involved in a very intense experience (such as a tourist viewing the Grand Canyon from its rim) but they are not personally involved in the event (i.e., not climbing down the Grand Canyon, as would be the case with escapism). Luxury brand activity is of an aesthetic nature, with customers immersing themselves in the experience but with little active participation. The experience of watching a Cirque du Soleil show is similar to this kind of customer experience.
4. *Escapism*: escapism can be defined as a tendency to escape from daily realities or routines by indulging in daydreams, fantasies, or entertainment that provides a break from reality. Escapist activities are those that involve a high degree of both involvement and intensiveness, and are clearly a central feature of much of luxury consumption or life style experiences connected to the fitness trend. This is clearly evident within the luxury tourism and hospitality sector, characterised by the growth of specialised holiday offerings, where the customers are intensively involved with co-creating the customer experiences. The experience of joining a Zumba dance course is similar to this kind of customer experience.

In conclusion, whereas traditional marketing frameworks view consumers as rational decision makers, focused on the functional features and benefits of products, experiential marketing views consumers as emotional beings, focused on achieving memorable experiences. In this connection the use of new technologies, such as social media, have also aided the potential for experiential marketing. This is of particular relevance given the increasing significance of the internet as a communication and distribution channel within the luxury sector. Finally, the more a company engages all five senses in the creation of a 'customer experience', the more effective and memorable it can be.

### Augmented reality (AR)

**Augmented reality (AR):** A live view of a physical, real-world environment whose elements are ***augmented*** (or supplemented) by computer-generated sensory input, such as sound, video, graphics or GPS data. AR technology allows consumers to interact virtually with three-dimensional product visualisations displayed on users' screens.

The way in which **augmented reality (AR)** has been used in marketing campaigns can be seen as a form of experiential marketing because it focuses not only on a single product/service, but also on an entire experience created for the customers. The technology enhances the customer's current perception of reality. By contrast, virtual reality replaces the real world with a simulated one. With the help of advanced AR the information about the surrounding real world of the user becomes interactive and digitally manipulatable.

The importance of experiential marketing is recognised as a means of creating value for the end consumer, who will be motivated to make faster and more positive purchasing decisions (see also Exhibit 2.4). Consequently, AR experimental marketing will be considered to affect mainly the pre-purchase stage due to the fact that AR has the most impact at the pre-purchase stage. At this stage the consumer is evaluating their choices before taking the final purchase decision and AR has the power to 'put the product in the hands of the users' – giving them the opportunity to test the product as if they already owned it. Furthermore, AR has the potential to provide customers with an experience they appreciate and will tell their friends about.

## 2.10 ARTIFICIAL INTELLIGENCE (AI) AND ITS INFLUENCE ON MARKETING

**Artificial intelligence (AI):** The development of a computer system that is able to perform tasks normally requiring human intelligence. AI emphasises the creation of intelligent machine learning where information is turned into creating a more customer engaging customer experience.

In relation to marketing, artificial intelligence (AI) is the use of machine learning in combination with human creativity to create a more engaging customer experience on an individual level, in order to attract, engage and retain the customer's interest and business.

AI-driven sentiment analysis tools are helping marketing, sales and customer support teams use image recognition technology to better connect with their customers.

Advocates of AI claim that AI can and will improve the customer experience. Figure 2.18 shows how AI – in the back-office – is used together with Big Data and the Internet-of-Things (IoT) to create user-interfaces with the consumer, in form of:

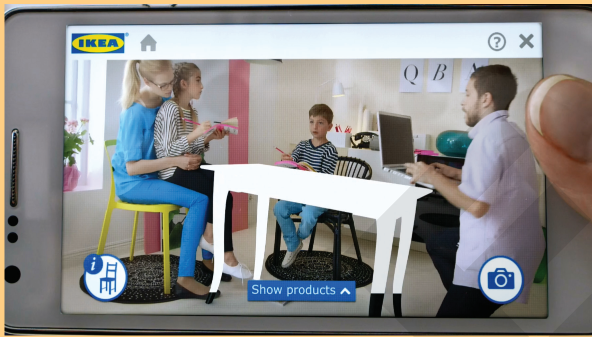
1. AI Assistants (platforms) – voice-controlled.
2. Web-based interfaces and smartphone Apps – screen-controlled.

AI assistants and the corresponding platforms can handle personal queries through an audio-only interface between user and AI. The rise of AI Assistants such as Amazon Alexa / Echho, Google Home, Apple Siri, Microsoft Cortana and the use of advanced voice-recognition technology has changed the way that companies present information to target groups. The competition and consolida-

## EXHIBIT 2.4

### IKEA's use of AR

In its 2014 catalogue, IKEA has produced an interactive online element based on AR, in which viewers can actually see a piece of furniture in their home before buying it. Viewers can accelerate their decision making by easily dragging an item from the catalogue and placing it anywhere in the simulated space on their smartphone or tablet screen and then immediately taking a screenshot of that selection. Such technology allows for more personally interactive catalogues and enhances playfulness and convenience, as well as stimulates consumers' buying intentions and impressions of a brand.




Source: IKEA Ltd.

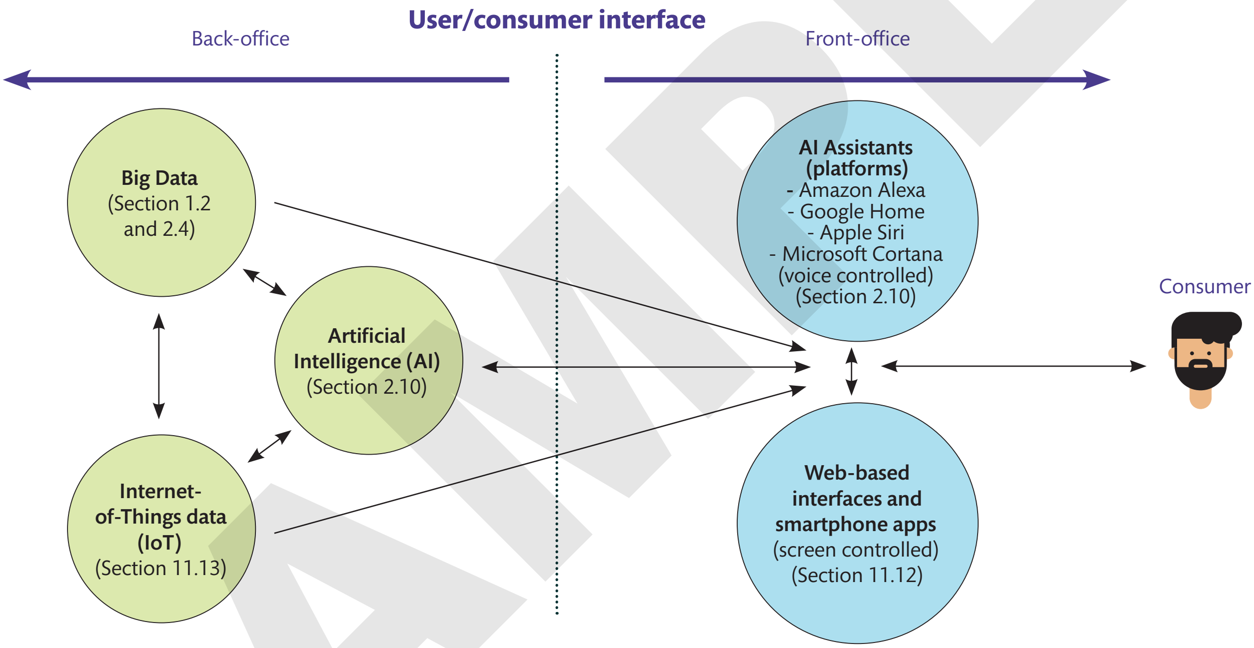



**FIGURE 2.18** *Overview figure showing IT connections between back- and front-office in consumer relationships*

tion among AI platforms will mean that only a few will be left standing, but the remaining platforms will receive a lot more power and attention. It is expected that the focus of many brands should shift: from reinforcing direct relationships with consumers to optimising their positions on AI Assistants (platforms). Push marketing (getting platforms to promote a brand) will become more important, while pull marketing (persuading consumers to seeks products) will become less so (Dawar and Bendle, 2018).

AI helps pinpoint a one-off problem or identify a growing issue faster than individuals can do manually. This makes it much easier for marketing teams to focus on key business decisions and proactive customer service before there is a PR or social media backlash.

AI may help developers to identify potential problems quickly and respond accordingly. Some of the new solutions will trigger alerts and automatically prompt customers to solve these issues (Davenport and Ronanki, 2018). Rather than simply responding to random inquiries, companies can build up AI models that anticipate what the consumer wants and subsequently respond proactively. Once customers purchase a product, companies can present them with similar items that may interest them as well. Companies like Amazon and Netflix have invested a lot of time and money into this kind of personalisation and had a lot of success with it (Korzeniowski, 2018).

A customer may also take a photo of a product and use it to create a negative social media post without naming the brand. AI-driven sentiment analysis can not only identify the product, but it can automatically understand the level of customer dissatisfaction, analyse the impact to the brand, notify the internal customer experience team, initiate a remedy and log all this data for later use. In the era of influencer marketing, the ability to automatically sense and respond to customer interactions enables companies to achieve a competitive advantage.

AI can look at data points such as these when deciding if and how to respond to customer interactions:

- Are customers engaging on social media?
- Are customers responsive to their emails?
- Are they clicking or engaging with marketing content, including looking at specific pages on a website or clicking on links in emails?
- Are there frequent calls or emails between the seller and the customer?
- Did a key influencer leave the company?

AI can tie this data together to form a true customer forecast and determine how likely a potential buyer is to buy. If there are gaps between a seller's predictions and the AI solution's findings, the personal sales force can be proactively alerted to help. AI will not replace the sales team, but it can help your sales reps to carry out responsibilities that are time-intensive. In this way, AI can be put to use to help the sales team to perform more effectively.



## 2.11 SUMMARY

A business model defines the way a company generates perceived value for customers (value creation) and how it captures some of this value as profit (value capture). In order to create value for customers, resources, capabilities and competences are needed in the organisation.

Competences are the skills, knowledge and technologies that an organisation possesses and on which its success depends. Although an organisation will need to reach a threshold level of competence in all its activities, it is likely that only some of these activities are core competences. These core competences underpin the ability of the organisation to outperform the competition and therefore must be defended and nurtured. Core competences concern those resources that are fundamental to a company's strategic position.

In this chapter, three basic perspectives on identification of core competences have been presented:

- resource-based view (RBV): an inside-out perspective;
- market orientation view (MOV): an outside-in perspective;
- value chain-based view (VBV): between the RBV and the MOV.

The RBV emphasises the importance of firm-specific assets and knowledge. The underlying approach of the RBV is to see the firm as a bundle of tangible and

**EXHIBIT 2.5**

## Harley-Davidson's use of AI in New York

In 2017 Asaf Jacobi's Harley-Davidson (H-D) dealership in New York was selling one or two H-D motorcycles per week. This was not a satisfying result.

He then started working with the AI-driven marketing platform of AI company Adgorithms. H-D started with defining characteristics and behaviors of high-value past customers, and they came to this profile: those who either had completed a purchase, added an item to an online cart, viewed website content, or were among the top 25 per cent in terms of time spent on the H-D website.

Then H-D contacted the company, Adgorithms, which is the creator of 'Albert', one of the world's leading artificial intelligence marketing platforms. In this way, Adgorithms identified similar potential customers who resembled these past customers and created micro segments with whom Albert could run test campaigns before extending its efforts more widely. It used the data gathered through these tests to predict which possible headlines (visual combinations and many other campaign variables) would most likely convert different audience segments to actual buyers through various digital channels (social media, search, display and email or SMS).

For example, when it discovered that ads with the word 'call' – such as, 'Don't miss out on a preowned Harley with a great price! Call now!' – performed 447 per cent better than ads containing the word 'Buy', such as, 'Buy a pre-owned Harley from our store now!' Albert immediately changed 'buy' to 'call' in all ads across all relevant channels.

By this, Adgorithms finds real customers in the wild by determining what actual online behaviors have the highest probability of resulting in conversions to the stage of actual buying and then finding potential buyers online who have similar behaviors, the 'lookalikes'. To determine what worked, Adgorithms used AI to look

Source: ImageBROKER/Alamy Stock Photo.

only at performance: Did this specific action increase conversions? Did this keyword generate sales? Did this spend increase ROI?

Rather than base media buying decisions on past performance and gut instincts, AI acts instantly and autonomously, modifying its media buying strategy in real-time, based on ever-changing performance parameters of each campaign variable.

The best way to discover AI's potential is to run some small, quick, reversible experiments, perhaps within a single geographic territory, brand, or channel.

The results of the AI based campaign were convincing. Jacobi's H-D dealership went from getting one qualified lead to 40 per day. In the first month, 15 per cent of those new leads were "look-alikes," meaning that the people calling the dealership to set up a visit resembled previous high-value customers and therefore were more likely to make a purchase. By the third month, the dealership's leads had increased 2930 per cent, 50 per cent of them look-alikes, motivating Jacobi to set up a new call center with six new employees to handle all the new business.

Source: based on Power (2017).



intangible resources, and to see some of these resources as costly to copy and trade. A firm's resource position can lead to sustained competitive advantage. Especially in knowledge-intensive firms, distinctive capabilities consist of intangible resources. In contrast to the MOV, which takes the environment as the critical factor determining an organisation's strategy, the RBV assumes that the key factors for success lie within the firm itself in terms of its resources, capabilities and competences. The choice of the firm's strategy is not dictated by the

constraints of the environment but is influenced more by calculations of how the organisation can best exploit its core competence relative to the opportunities in the external environment.
The MOV is basically about adapting to the market environment by concentrating mainly on customers and their needs.
The VBV integrates elements of both the RBV and the MOV, but it does so without ignoring the costs of performing the activities. The value chain provides a systematic means of displaying and categorising activities. Value activities can be divided in different ways:

- primary and support activities;
- upstream and downstream activities.

At each stage of the value chain the firm seeks to add value and thus compete with its rivals. The simplified version of the value chain used throughout this text contains only the primary activities of the firm. The value chain is not a collection of independent activities but a system of interdependent activities. The firm's value chain activities are also related to other actors' value chains. Competitive advantages are created if the firm can:

- offer better perceived value for customers;
- perform the value chain activities at a lower cost than competitors.

Today, the right combination of the product value chain and the service value chain is not a sufficient competitive differentiator. Adding 'customer experiences' and 'experiential marketing' occurs when a company intentionally uses products in combination with services to engage individual customers in a way that creates a memorable event, which can characterised in one of four groups: entertainment, educational, aesthetic or escapist.
Engaging the customer and adding customer experiences is further exemplified by the use of augmented reality (AR), which is a digital way of putting the product in the hands of the users and giving them the opportunity to test the product without paying for it. Consequently, AR is especially effective in the pre-purchase stage of the buying process.
The use of Artificial Intelligence (AI) helps the marketer segment the audience into smaller target groups and it also helps with creating more personalised marketing campaigns and ads for consumers and it also creates more leads in the market. The traditionally crucial manufacturer assets, such as capability and brands, will become less important as consumers' attention shifts to AI assistants, and value of consumer data and AI's predictive ability will be more important.

**CASE STUDY 2.1**

## Electrolux

Electrolux was incorporated as Elektromekaniska AB in 1901. In 1919, the founder, Axel Wenner-Gren, merged that company with Swedish AB Lux to form Aktiebolaget Electrolux (AB Electrolux - at that time spelled with a k instead of c). It was listed on the Stockholm stock exchange in 1930.
The idea for the modern vacuum cleaner was born in Vienna, Austria, in 1908. While out on a walk, Axel Wenner-Gren, a Swedish businessman, caught sight of an awkward-looking machine in a shop window. "If I could make this machine lighter and cheaper," thought Wenner-Gren, "I could sell one in every home." The rest is history. Wenner-Gren went on to commission the manufacturing of the Lux 1vacuum cleaner.
In 1921, Electrolux introduced the vacuum cleaner model V, the first vacuum cleaner adapted for use in ordinary

homes. The model was such a resounding success that Swedish maids protested when it was launched, in fear of becoming unemployed. Now, virtually anyone could clean the home, they argued.

Wenner-Gren founded Electrolux around a door-to-door sales model. This close consumer contact provided insight into the consumers' needs and desires. This is the foundation for Electrolux extensive consumer insight work.

Electrolux had showrooms in the best downtown locations in over 30 markets by 1929. You could not buy their products in these showrooms, but only look at them and book a time for a home visit where the product could be showcased by a trained salesman.

Electrolux marketing set a precedent. Cars and motorbikes shaped like a vacuum cleaner were used to promote Electrolux and the best artists were hired to develop advertisements.

Electrolux history can roughly be divided into three eras:

1. Wenner-Gren era – Electrolux operates internationally, but is still only a small player.
2. Acquisition era – Electrolux starts to grow intensely by acquisitions and becomes a conglomerate-like business with a diversified portfolio of brands and product offerings.
3. Modern era – Electrolux consolidates its market share and focuses on its core business. Creation of 'One Electrolux' – a global consumer insight-driven company.

Important years:

| | |
|---|---|
| 1919 | Electrolux is founded, producing a new type of vacuum cleaners |
| 1922 | Absorption refrigerator invented and production starts in 1925 |
| 1950 | First household laundry machine |
| 1962 | Acquisition of Elektro Helios first commercial products |
| 1978 | Acquisition of Husqvarna, outdoor products |
| 1984 | Acquisition of Zanussi, Italy |
| 1986 | Acquisition of White Consolidated, USA, incl. the Frigidaire brand |
| 1994 | Acquisition of AEG Hausgeräte, Germany |
| 1996 | Acquisition of Refripar, Brazil |
| 2001 | Acquisition of Email, Australia |
| 2006 | Spin off of Husqvarna |
| 2008 | Launch of Electrolux brand in the US |
| 2011 | Acquisition of Egyptian Olympic Group |
| 2011 | Acquisition of Chilean CTI |
| 2015 | Acquisition of Shanghai Veetsan Commercial Machinery, one of the largest manufacturers of professional dishwashers in China |
| 2015 | GE terminated the agreement pursuant to which Electrolux had agreed to acquire the GE Appliances. Shortly after GE sold GE Appliances to Haier |
| 2016 | From February 1, Jonas Samuelsen is working as the new CEO, after former CEO Keith Mcloughlin retired |

Source: Jeff Gilbert/Alamy Stock Photo.

Today, Electrolux is one of the world's leading producers of appliances for households and professional use.

The Electrolux sells about 60 million products annually across 150 countries under various brands. Some of its products include refrigerators, freezers, cookers, dishwashers, washing machines and small domestic appliances (primarily vacuum cleaners). These products are sold under brands such as Electrolux, AEG Zanussi, Frigidaire, and Electrolux Grand Cuisine. Electrolux operates in in the following regions: Europe, Middle East, Africa (EMEA), North America (NA), Latin America (LA) and Asia Pacific (APAC).

Electrolux is headquartered in Stockholm, Sweden and the group employed 55,400 people as of December 31, 2016.

As seen in Figure 1, the Electrolux organisation consists of a geographical division principle – four regions concentrating about Major Appliances– plus two further product divisions (Small Appliances and Professional Products), which will not be in focus in this case study.

In January 2016, the Electrolux Board of Directors declared that Jonas Samuelson would take up the role of President and CEO of Electrolux as of February 1, 2016.

In the financial year ended December 2016 (FY2016), Electrolux recorded total revenues of SEK106 billion (USD12.2 billion).

Table 1 lists the financial results for the four major regions (exclusive the last two divisions, Small Appliances and Professional Products) in the following year.

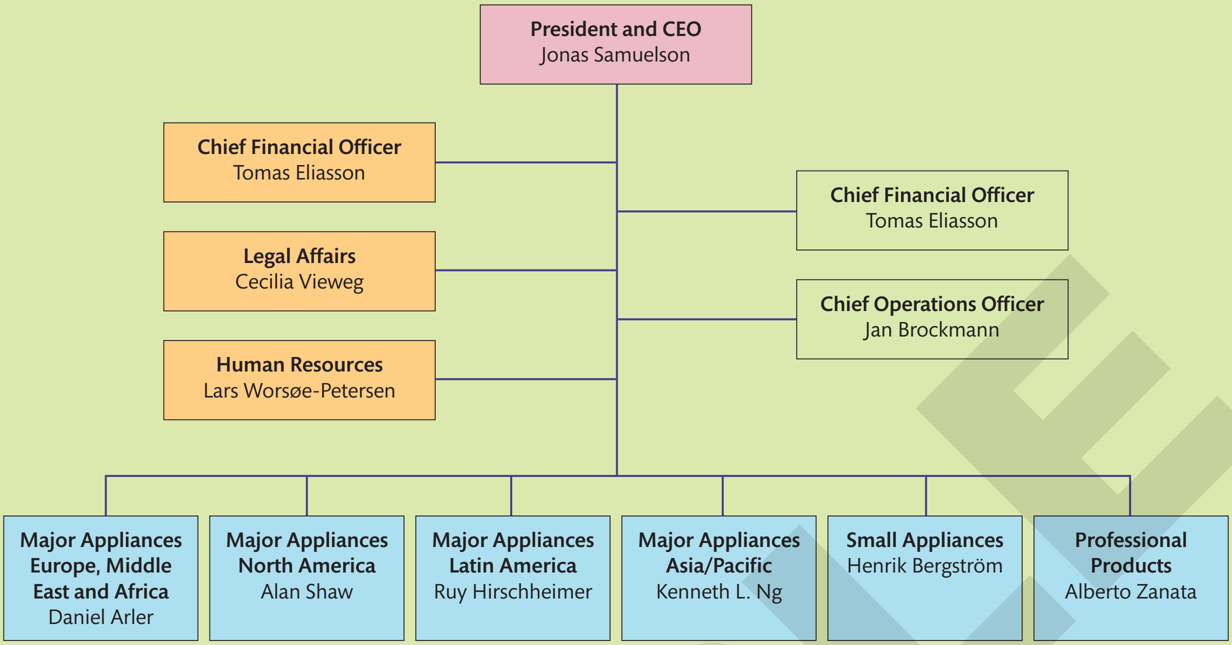



**FIGURE 1** *The organisation of major divisions in the Electrolux group*

Source: Electrolux (2016) financial report.

**TABLE 1** *Electrolux' key 2016 financial results (number of employees) for four key regions*

| REGION | NET SALES (BILLION SEK) | % | OPERATING INCOME (BILLION SEK) | % | OPERATING MARGIN (OPERATING INCOME / NET SALES IN %) | NUMBER OF EMPLOYEES |
|---|---|---|---|---|---|---|
| EMEA | 37.8 | 35% | 2.5 | 43% | 6.6% | 20,991 |
| NA | 43.4 | 41% | 2.7 | 47% | 6.2% | 10,064 |
| LA | 15.4 | 15% | 0.0 | 0% | 0.0% | 16,218 |
| APAC | 9.4 | 9% | 0.4 | 10% | 6.4% | 8,127 |
| Total | 106.0 | 100% | 4,6 | 100% | 5.5% | 55,400 |

Source: based on Electrolux Financial report 2016.

The United States is the single biggest Electrolux market, accounting for approximately one third of the total net sales (35%), followed by Brazil (8%) and Germany (5%).
Electrolux has sales subsidiaries in 28 countries across all the four regions.
Electrolux operates 53 manufacturing facilities in 18 countries, including several in each of the four regions. The group's manufacturing operations consist mainly of the assembly of components made by suppliers. The need for cost-efficient manufacturing has become increasingly important due to globalisation and the emergence of manufacturers from low-cost areas. Approximately 60 per cent of the Electrolux household appliances are today manufactured in low-cost areas that are near rapidly-growing markets for household appliances.

### Major appliances – major product lines

Electrolux kitchen products in major appliances include:

- kitchen (Hot: cookers, hobs, ovens; Cold: refrigerators, freezers);
- laundry (washing machines, dryers etc.);
- home comfort (air conditioners, air cleaners and heat pumps).

In 2016, these kitchen products accounted for approximately 60 per cent of the Electrolux' total sales and the company commands significant global market shares in all major categories of kitchen appliances. Moreover, Electrolux also commands significant global market shares in home laundry (washing machines), which accounted for approximately 20 per cent of the Electrolux' total sales in 2016.

The largest global market shares commanded by Electrolux is for cookers. In fact, know-how from the world's best chefs and restaurants is utilised by Electrolux when developing consumer appliances. In recent years, Electrolux has strengthened its leading position in built-in appliances through extensive product launches and partnerships with kitchen manufacturers. Electrolux also offers restaurants and industrial kitchens complete solutions for cookers, ovens, refrigerators, freezers and dishwashers. In this regards, Electrolux's strongest position is in Europe, where, for example, about half of all Michelin-starred restaurants use kitchen appliances from Electrolux.

In the laundry segment, Electrolux also holds strong positions in front-load washing machines, especially in the European market.

### Electrolux branding and consumer behavior

Electrolux focuses on eight strategic brands: AEG, Electrolux, Eureka, Frigidaire, Westinghouse and Zanussi. A tradition of focusing on design and quality has ensured AEG has a leading position in the market for appliances in (with decreasing importance) Germany, Austria, Benelux countries and Scandinavia. Electrolux is a leading brand in large parts of Europe and Latin America. In North America, Frigidaire is the Electrolux brand for appliances in the mass-market segment. In addition to these strategic brands, there are a large number of smaller, regional and local brands. Electrolux's aim, however, is to further reduce the number of brands over time.

In Australia, the most well-known Electrolux brand is Westinghouse.

Electrolux develops solutions to create contact with and engage consumers throughout the purchase and usage process. The aim is to establish an intimate dialog with consumers and strengthen the overall experience of the Electrolux offering. The '360 degree consumer experience' process focuses on consumers and on creating the best customer experience of Electrolux at different stages, from exploring various alternatives, visiting websites and choosing products at retailers to installing and using the products.

Consumer decisions regarding the purchase of household appliances are increasingly based on visits to various websites and blogs, as well as the use of social media. This means that the Electrolux websites are some of the most important tools for convincing customers. Online sales are expected to increase significantly in pace with a growing number of internet users, driven particularly by consumers in Asia/Pacific and China. Generally, online sales for Electrolux have increased in recent years.

### The world market – Global competition regarding major household appliances

The total worldwide sales volume of major appliances was 491 million units in 2016 (Table 3).

The world household appliances industry is still rather fragmented with no single manufacturer commanding more than 15 per cent of the world market (Table 3). Fragmentation reflects the high incidence of transport costs, persistent differences in consumers' preferences and brand loyalty.

The world's top ten manufacturers, ranked by volume sales, include two South Korean companies, two Chinese companies, two US companies (actually only one as GE Appliances has been acquired by Haier in 2016), and one each from Sweden, Germany, Japan and Turkey.

**TABLE 2** *The major regional brands*

| MARKET SEGMENT | NORTH AMERICA | LATIN AMERICA | EUROPE | ASIA/PACIFIC |
|---|---|---|---|---|
| **Ultra Luxury** | Elexctrolux Grand Cuisine, Molteni | | | |
| **Premium** | Electrolux | Electrolux | Electrolux AEG | Electrolux |
| **Mass Market** | Frigidaire Eureka | Electrolux Frigidaire | Zanussi Regional brands | Westinghouse* Regional brands |

Global and strong strategic brands are to increase in value. Investments will be made in premium brands in all markets. Electrolux aims to reach more consumer segments with strategic brands and with products preferred by more consumers.

*Brand in Australia

Source: based on ElectroluxError! Reference source not found., Financial report 2015.

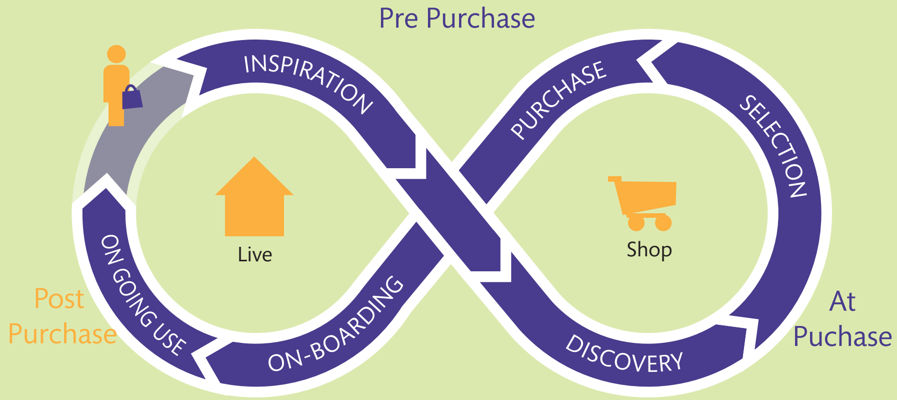



**FIGURE 3** *The '360 degree consumer experience' process*

Source: based on general information on Electrolux.com.

**TABLE 3** *Total worldwide sales volume of major appliances in 2016*

| PRODUCT | WORLDWIDE SALES VOLUME – 1000 UNITS |
|---|---|
| Dishwashers | 22,567 |
| Large cooking appliances | 115,615 |
| Refrigeration appliances | 153,834 |
| Microwaves | 65,311 |
| Home laundry appliances (washing machines) | 133,746 |
| Total | 491,072 |

Source: based on Euromonitor report.

**TABLE 4** *Top 10 (+ rest) manufacturers on the world market 2016 (total sales volume: 491 million units from Table 3)*

| MANUFACTURER OF MAJOR APPLIANCES | HEADQUARTERS (HQ) | VOLUME SHARE % |
|---|---|---|
| Whirlpool | US | 12.6 |
| Haier | China | 11.0 |
| Electrolux | Sweden | 7.1 |
| LG | South Korea | 6.1 |
| Bosh-Siemens (BSH) | Germany | 5.8 |
| Samsung | South Korea | 4.7 |
| Midea | China | 3.8 |
| Panasonic | Japan | 3.5 |
| Arcelik | Turkey | 3.0 |
| General Electric Appliances (now part of Haier) | US | 2.6 |
| Rest | - | 39.8 |
| Total | | 100.0 |

Source: based on Euromonitor report 2016.

In Table 4, the total sales volume is divided among the top 10 world manufacturers, plus the rest.

Only a few of the manufacturers offer the whole product range and are present in all key world markets. In fact, only Whirlpool, AB Electrolux, Haier and Samsung have a clear global orientation. Others (like Bosch Siemens BSH, Miele from Germany, Panasonic from Japan or Arcelik from Turkey) have a strong regional position or are leaders in specific product niches (sometimes of high quality – like Miele). While they may not be present on all geographical markets, most manufacturers offer complete or nearly complete lines of major household appliances.

## Market development in the regions

### EMEA (Europe, Middle East and Africa)

The European market is fragmented and characterised by widely varying consumer patterns between countries. In Europe there are also a large number of manufacturers, brands and retailers. Structural overcapacity and price pressure has led to ongoing industry consolidation.

Europe comprises Electrolux' largest market and the company has a broad offering under the three main brands: Electrolux, AEG and Zanussi. In many countries and segments, Electrolux has strong market positions with a particularly strong position in kitchen appliances, such as cookers, refrigerators and built-in appliances.

In Eastern Europe, the level of market development varies substantially between countries. The geographic spread plays its part in hindering manufacturers and retailers from capturing substantial market shares. Eastern Europe is dominated by Western manufacturers and a large market for replacement products is emerging.

Penetration is low in Africa, but growth is high and in line with increasing household purchasing power.

The Middle East offers a base for regional manufacturing, but is impacted by the political uncertainty. The main Electrolux market is within home comfort.

In major appliances, Electrolux has the following market shares in the different sub regions:

| | |
|---|---|
| Western Europe: | 16% |
| Eastern Europe: | 13% |
| Africa: | 2% (higher in North Africa – 30% in Egypt through Olympic Group) |
| Middle East: | 5% |

The major Electrolux competitors in the EMEA region include BSH (no. 1), Whirlpool (no. 2), Arcelik (no. 3 – Turkish), Samsung (no. 4), Miele (no. 5) and LG Electronics (no. 6).

### NA (North America)

North America (USA and Canada) is a mature, homogenous market with high product penetration that is dominated by replacement products. Large homes allow space for many household appliances, including large appliances. The market is comprised of several domestic and global manufacturers. Four major retailers (Sears, Lowe's, Home Depot and Best Buy) sell 70 per cent of the appliances on the market. The recovery in the housing sector is expected to generate opportunities for growth in the coming years.

Electrolux has approximately 19 per cent of the market share of major appliances in the NA region.

The major Electrolux competitors in this region include Whirlpool (no. 1), GE Appliances (no. 2), Samsung (no. 3) and LG Electronics (no. 4).

### LA (Latin America)

Brazil is the largest market in the region (accounts for 50 per cent of the total market in LA) and the two largest manufacturers (Whirlpool and Electrolux) account for about 80 per cent of the appliances market. Despite the economic slowdown in the region, there exists considerable growth potential for appliances in the longer term, especially in low-penetrated categories. The growing middle class is expected to drive demand for basic cookers, refrigerators and washing machines. Growing interest for energy and water efficiency may also drive demand.

The Electrolux brand occupies a strong position in Latin America through its innovative products and close collaboration with market-leading retail chains. Brazil is Electrolux' largest market in the region and accounts for about 60 per cent of Electrolux sales. In major Latin American countries such as Brazil, Chile and Argentina, Electrolux is the market leader in a large number of product categories in appliances.

Electrolux has approximately 35 per cent of the market share of major appliances in the LA region.The major Electrolux competitors in this region include Whirlpool (no. 1), GE Appliances (no. 2), Samsung (no. 3) and LG Electronics (no. 4).

### APAC (Asia Pacific)

China is the world's largest total market for household appliances, measured by volume. The market share of Electrolux in the Chinese market is relatively low, but there is great potential for increased sales to the rapidly expanding middle class in major Chinese cities.

Japan is the world's third-largest single total market for major appliances and is dominated by major domestic manufacturers and retailers. Small living spaces have led to consumer demand for more compact products, such as hand-held vacuum cleaners. Penetration is high in Australia and New Zealand and demand is primarily driven by design and innovations as well as water and energy efficiency. Competition between manufacturers from Asia and Europe is intense.

About half of Electrolux appliance sales in the region are in Australia, where Electrolux is the market leader. The Electrolux brand is positioned in the premium segment with a focus on innovation, energy and water efficiency and design. The Westinghouse and Simpson brands command strong positions in the mass-market segment.

Electrolux has the following market share in the different sub-regions:

| | |
|---|---|
| Australia: | 40% |
| South East Asia (including China): | 1% |

The major Electrolux competitors in these regions include:

South East Asia & China:

Haier (no. 1), Samsung (no. 2), LG Electronics (no. 3), Midea (no. 4), Whirlpool (no. 5), BSH (no. 6) and Panasonic (no. 7).

Pacific:

Samsung (no. 1), Fisher & Paykel (no. 2), Haier (no. 3), LG Electronics (no. 4) and Panasonic (no. 5).

### Questions/tasks

You are hired by Jonas Samuelson (CEO of Electrolux) as a specialist in International Marketing and you are supposed to answer / solve the following tasks:

1. Please discuss and evaluate Electrolux's key competitive advantages in the major appliances market.
2. Explain and discuss how Electrolux can turn its competences into new worldwide growth for its major appliances.

Source: based on a variety of public sources.

## QUESTIONS FOR DISCUSSION

1. Explain the differences between the RBV, the MOV and the VBV.
2. What is the connection between the RBV and the RM approach?
3. What is the purpose of the value chain?
4. Why is it relevant to make a split between upstream and downstream activities in the value chain?
5. Is the value chain also a relevant model for services?
6. How can the firm create competitive advantage by the use of resources and competences in the firm?

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# CHAPTER 3

# Development of the firm's competitive advantage

## CONTENTS



## LEARNING OBJECTIVES

After studying this chapter you should be able to:

- define the concept 'international competitiveness' in a broader perspective from a macro level to a micro level;
- discuss the basic sources of competitive advantages;
- explain how 'economies of speed' can be used as a competitive advantage;
- explain how Porter's traditional competitive-based five forces can be extended to a relationship (five sources) model;
- define the steps in competitive benchmarking and explain how these steps are related to the outsourcing decision process;
- discuss the drivers for the 'sharing economy'.

## 3.1 INTRODUCTION

Competitiveness is how effective and efficient a firm is, relative to its rivals, at serving customers and resellers. Effectiveness has to do with the quality of products, market share and profitability; efficiency has to do with response speed and low costs. Both effectiveness and efficiency depend ultimately on competitive rationality – the strength of the firm's competitive drives and its decision-making skills.

The topic of this chapter is how a firm creates and develops competitive advantage in the international market. The development of a firm's international competitiveness takes place interactively with the business environment. The firm must be able to adjust to customers, competitors and public authorities. To be able to participate in the international arena, the firm must have established a competitive basis consisting of resources, competences and relations to others in the international arena.

## 3.2 GENERAL SOURCES OF COMPETITIVE ADVANTAGE

Depending on the degree of internationalisation of its business, a company has access to different general sources of competitive advantage. A globally operating company may derive competitive advantage from qualities that are perhaps not available to firms with a regional or domestic focus, such as:

- economies of scale;
- economies of scope;
- strategic thinking as a core competence;
- exploitation of local advantages;
- ability to provide global services;
- company-specific competitive advantages;
- the ability to use human resources in developing competitive advantage.

### Economies of scale (efficiencies of global scale and volume)

Economies of scale are often the main feature of a market. The theory is that the greater the economies of scale, the greater the benefits accruing to those with a high sales volume. As a result, the competition to achieve larger market share is intense. Economies of scale can come about because larger plants are more efficient to run, and their cost per unit of output may be relatively less. There may be overhead costs that cannot be avoided – even by the smaller organisations – but can be spread over larger volumes by the bigger firms. Economies of scale may also be the result of learning. With increasing cumulative production the manufacturer learns more and finds more efficient methods of production. All of these effects tend to increase competition by offering incentives to buy market share in order to become the lowest-cost producer. By the same token, economies of scale also produce significant barriers against new entrants to the market. The higher the initial investment, the more difficult it is to justify the investment for a new entry. But such economies of scale do not always last forever.

Hence, where economies through large-scale operations are substantial, a firm will do all it can to achieve scale economies. Attempts to capture scale economies may lead a firm to compete for market share aggressively, thus escalating pressures on other firms. A similar situation occurs when a business's fixed costs are high and the firm must spread them over a large volume. If capacity can only be added in large increments, the resulting excess capacity will also intensify competition.

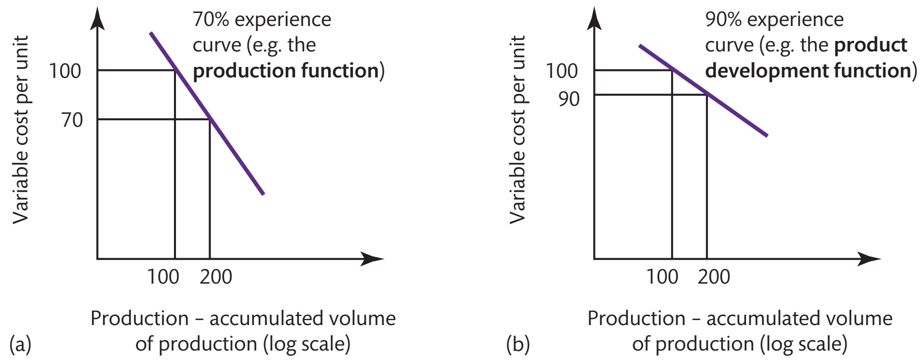


**FIGURE 3.1** *Experience curves in different functions*

Source: Hax, A.C. and Majluf, N.S. (1984) *Strategic Management: An Integrative Perspective*, 1st ed, Prentice Hall, Englewood Cliffs, NJ, p. 121. Copyright © 1984. Reproduced with permission from Pearson Education, Inc.

Experience effects are based on size over time, rather than size at a particular point in time. The experience effect reflects the improvements (usually resulting in lower costs) that result from economies of scale, learning and improved productivity over time.

For example, capital costs do not increase in direct proportion to capacity. Higher capacity results in lower depreciation charges per unit of output, lower operating cost in the form of the number of operatives, lower marketing, sales, administration and research and development costs, and lower raw materials and shipping costs. It is generally recognised, however, that cost reductions apply more to the value-added elements than to bought-in supplies. In fact, the Boston Consulting Group discovered that costs decrease by up to 30 per cent for every cumulative doubling of output. This phenomenon (a so-called 70 per cent **experience curve** (learning curve): every time production output doubles, the unit cost falls to 70 per cent of the former cost) is shown in part (a) of Figure 3.1. This experience curve would be typical for the production function, whereas the experience curve is less sensitive for value functions such as marketing and product development (see part (b) of Figure 3.1). The reason is that these functions are more innovative in nature. While there are many implications for marketing strategy, particularly in relation to pricing policy, discussion will be confined to the product/market implications.

**Experience curve (learning curve):** The drop in the average per-unit production cost that comes with accumulated production experience.

Large economies of scale exist when there are high fixed costs versus **variable costs** in the predominant business model. Large organisations can amortise the fixed costs over greater volumes, which gives them a big advantage over small competitors.

**Variable cost:** A cost that varies directly in line with an organisation's production or sales. Variable costs are a function of volume.

However, Toyota taught the Western world that many fixed costs can be reduced. By reducing in-process inventories, set-up times for machinery and the overhead costs inherent in an inventory-intensive batch-manufacturing process, Toyota flattened the scale economics of assembling a car. CAD (computer-aided-design) systems had a similar effect on reducing the fixed cost of designing a new model. As a result, there is no relationship between a car producer's market share and its profitability. Analogous innovations have flattened scale economics in steel, electric-power generation and computers – and rendered transitory what were once thought to be sustainable advantages (Kalpič, 2008).

Strategists in industries that today see leading companies enjoying scale-based competitive advantage ought to ask themselves if the fundamental trade-offs that create today's high fixed costs might change. Consider Intel. A barrier to potential competitors is the US$700 million cost to design a new family of microprocessors and the US$3 billion needed to build a new fabrication facility. However, disruptive technologies such as Tensilica's modular microprocessor architecture are flattening the scale economics of design. And small fabrication facilities, or mini-fabs, could reduce the fixed costs of production. Such technologies take root at the bottom end of the market first, but their capabilities are improving all the time (Christensen, 2001).

### Economies of scope (transfer of resources, experience, ideas and successful concepts across products and markets)

A second source of competitive advantage, intertwined with scale economics, has been breadth of product range. For example, through the 1970s, Caterpillar's scope gave the company an unassailable advantage in construction equipment against smaller competitors such as Komatsu. Only Caterpillar was large enough to absorb the complexity-driven overhead costs of developing, manufacturing and distributing a full product range. Caterpillar's dealers did not need to carry equipment from other manufacturers in order to offer customers what they needed. Caterpillar's huge installed base of equipment in the field meant its dealers, who were the largest dealers in each market, could afford to stock the part necessary to offer 24-hour delivery of any spare part to any Caterpillar owner. No competitor could match this at that time.

Scope economies are also derived from activities in interrelated geographical markets. If they are strong, a sustainable advantage in one market can be used to build sustainability in another. The term 'scope economy' is not just a new name for synergy; it actually defines the conditions under which synergy works. To achieve economies of scope, a company must be able to share resources across markets, while making sure that the cost of those resources remains largely fixed. Only then can economies be effected by spreading assets over a greater number of markets.

Global companies can transfer resources between business units in different parts of the world. These resources may include personnel (such as experienced production managers), funds (global organisations usually have a lower capital cost than domestic firms) and superior market information. Firms such as Kraft-Jacobs-Suchard, the Swiss chocolate and coffee manufacturer owned by Philip Morris, transfer their managers to operations where they need their specific know-how, for example in the growing markets of Eastern Europe, and profit from the capital transfer capacity of their company to respond quickly to market opportunities wherever they occur.

A global company is also able to transfer experience, ideas and successful concepts from one country to another. McDonald's country managers in Europe, for example, meet regularly to compare notes on products and promotional ideas, but also how to avoid waste, and to discuss whether such ideas might be appropriate in other markets. Faster knowledge transfer and learning result in superior customer benefits through lower prices and improved product and service features.

Finally, global companies often have a stronger brand reputation than can be achieved by domestic companies. As travel and communication across national boundaries increase, this potential for transfer of brand reputation is likely to grow.

### Time-based competition (TBC)

Competitive advantage is a constantly moving target. The most successful firms know how to keep moving, always staying alert and proactive. Today, time represents a powerful source of competitive advantage and includes managing time in production and service delivery, in new product development and introduction and in sales distribution.

**Time to market:** The time it takes for a company to develop a new product and turn it into a product which people can buy.

Time can be expressed in a variety of ways: cycle time, **time to market**, new product development time, time elapsed between order placement and payment and real-time customer responsiveness. Time-based competitors focus on both activity and system delivery times as measures in all phases of their operations.

**Time-based competition:** Competition based on providing time utility by delivering a product when the consumer wants it.

**Lead time:** The time from the moment the customer places an order to the moment it is received by the customer.

All **time-based competition** (TBC) uses process strategies to reduce one or more of the various types of **lead times** faced by the company. They are implemented using such tactics as team building, organisational flattening, flexible manufacturing systems and simultaneous engineering. The key challenge facing any company attempting to implement TBC is to ensure that there is a proper fit between how the company competes in the marketplace, the specific TBC process strategies selected and the specific implementation tactics used.

By competing on time, a company enjoys first-entrant advantages that include higher pricing, higher market share, improved customer service and productivity improvement. The goal of TBC, like just-in-time, is to eliminate all wasted time from activities in the value chain. Such time-reduction methods can be seen in overlapping product development activities through simultaneous engineering, improving communication channels between various functions (including customers and suppliers), through set-up times and smoothing production flow. The underlying premise of TBC is that the company fastest at responding to market needs will lead the rest.

The time-based competitor is able to use customer feedback to offer new products in less time, quickly discontinuing products that do not sell well. In an early example of TBC, Yamaha was overwhelmed when Honda responded to its challenge in motorcycles. Honda launched many new motorcycle models in just a few months. Yamaha was forced to admit defeat and retreat from its position as market leader. Honda's gain of market share and its market dominance were a direct result of time-based strategies.

A strategy built on leadership alone or flexible manufacturing alone would not have been sufficient for Honda because Yamaha could have matched it on each score. Honda's competitive advantage came from optimising synergies between time-based characteristics of lower prices, flexible processes, top quality and heightened awareness of consumers via consumer service programmes.

However, that TBC is not everything is shown by the VCR industry, where success in controlling the industry standard perhaps can indicate all competitive advantages in other areas.

Sony, as the first-to-market, initially had many competitive advantages over JVC, such as innovation and differentiation. Yet losing in the industry standard war to JVC's VHS format, due to a lack of network building, diminished Sony's many competitive advantages in the VCR business. Sony had to abide by the standard set by JVC and reduce its own Betamax system to a niche product, hurting its performance in the business (Ma, 2000a).

The first-generation approach to speed has been radical in many ways. Managers in North America and Europe changed forever how they thought about manufacturing, for example. Borrowing from the Japanese, they introduced methodologies that helped to boost production speed and to match supply and demand more accurately. As the speed of manufacturing and service delivery increased, attention shifted upstream towards the much longer, less tangible product-development process. By breaking down functional barriers and introducing concurrent design processes, companies cut product development time by 30 per cent or more.

Today the focus is also on strategy. The companies that can make decisions fast, change direction nimbly and figure out when to enter and exit markets will enjoy competitive advantage.

Speed plays an increasingly important role in more traditional strategic moves, such as mergers and acquisitions. Traditionally, acquisitions were used to buy earnings and remove competitors in mature markets. Now, innovation and access to capabilities drive many mergers and acquisitions. In those cases, senior managers must identify, execute and assimilate acquisitions very quickly or they will lose the deal. Partnerships can substantially enhance a company's ability to move swiftly by enabling it to focus on what it does best and fastest.

## 3.3 INTRODUCTION OF A HOLISTIC MODEL OF COMPETITIVENESS: FROM MACRO TO MICRO LEVEL

The theory of firm competitiveness implicitly assumes that the 'competitiveness of nations' is not simply based on country-specific factors but heavily influenced by firm-specific factors, as the latter is deeply ingrained in and shapes the former. On the other hand, the competitive advantage developed by a firm in its home market is determined to a significant extent by the national business environment, with benefits being derived from access to resources and skills and competitive pressures derived from other national firms creating the need to invest and innovate.

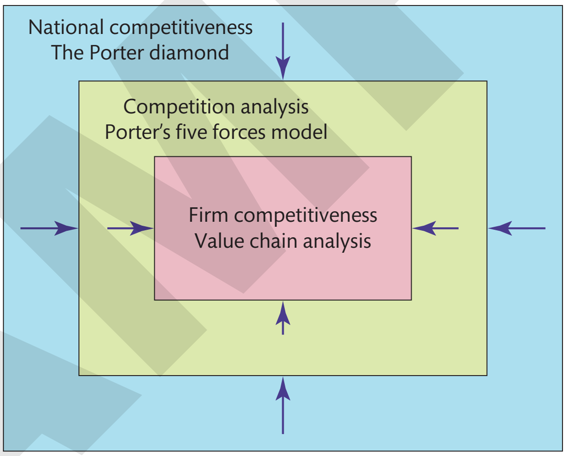


FIGURE 3.2 *Three levels of international competitiveness*

The need to understand the advantages gained by firms in industries in these countries is valuable for the individual firm in seeing what it is about its own location that can determine its ability to gain competitive advantage.

It is relevant to look at why a nation becomes the base for successful international competition in an industry or how it is that firms in an industry from a particular country can create competitive advantage, and then sustain it over time. This section focuses on the three levels of analysis – nation, industry and firm (see Figure 3.2).

To enable an understanding of the development of a firm's international competitiveness in a broader perspective, a model in three stages (see Figure 3.3) will be presented:

1. analysis of national competitiveness (the Porter diamond) – macro level;
2. competition analysis in an industry (Porter's five forces) – meso level;

3. value chain analysis – micro level:
   a. competitive triangle;
   b. **benchmarking**.

**Benchmarking:** The process of comparing the company's products and processes to those of competitors or leading firms in other industries to find ways to improve quality and performance.

**Porter's five forces model:** The state of competition and profit potential in an industry depends on five basic competitive forces: new entrants, suppliers, buyers, substitutes and market competitors.

The analysis starts at the macro level and then moves into the firm's competitive arena through **Porter's five forces model**. Based on the firm's value chain, the analysis is concluded with a discussion of which activities/functions in the value chain are the firm's core competences (and must be developed internally in the firm) and which competences must be placed with others through alliances and market relations.

The graphical system used in Figure 3.3 (which will be referred to throughout this chapter) places the models after each other in a hierarchical windows logic, where you get from stage 1 to stage 2 by clicking on the icon box: 'Firm strategy, structure and rivalry.' Here, Porter's five forces model appears. From stage 2 to 3 we click the middle box labelled 'Market competitors/Intensity of rivalry' and the model for a value chain analysis/competitive triangle appears.

### Individual competitiveness and time-based competition

In this chapter the analysis ends at the firm level but it is possible to go a step further by analysing individual competitiveness (Veliyath and Zahra, 2000). The factors influencing the capacity of an individual to become competitive would include intrinsic abilities, skills, motivation levels and the amount of effort involved. Traditional decision-making perspectives maintain that uncertainty leads executives to search for additional information with which to increase certainty. However, Kedia et al. (2002) showed that some executives increase competitiveness by using tactics to accelerate analysis of information and alternatives during the decision-making process. For example, these executives examine several alternatives simultaneously. The comparison process speeds their analysis of the strengths and weaknesses of options.

## 3.4 ANALYSIS OF NATIONAL COMPETITIVENESS (PORTER'S DIAMOND)

Analysis of national competitiveness represents the highest level in the entire model (Figure 3.3). Michael E. Porter called his work *The Competitive Advantage of Nations* (1990), but as a starting point it is important to say that it is firms that are competing in the international arena, not nations. Yet the characteristics of the home nation play a central role in a firm's international success. The home base shapes a company's capacity to innovate rapidly in technology and methods, and to do so in the proper directions. It is the place from which competitive advantage ultimately emanates and from which it must be sustained. Competitive advantage ultimately results from an effective combination of national circumstances and company strategy. Conditions in a nation may create an environment in which firms can attain international competitive advantage, but it is up to a company to seize the opportunity. The national diamond becomes central to choosing the industries to compete with, as well as the appropriate strategy. The home base is an important determinant of a firm's strengths and weaknesses relative to foreign rivals.

Understanding the home base of foreign competitors is essential in analysing them. Their home nation yields them advantages and disadvantages. It also shapes their likely future strategies.

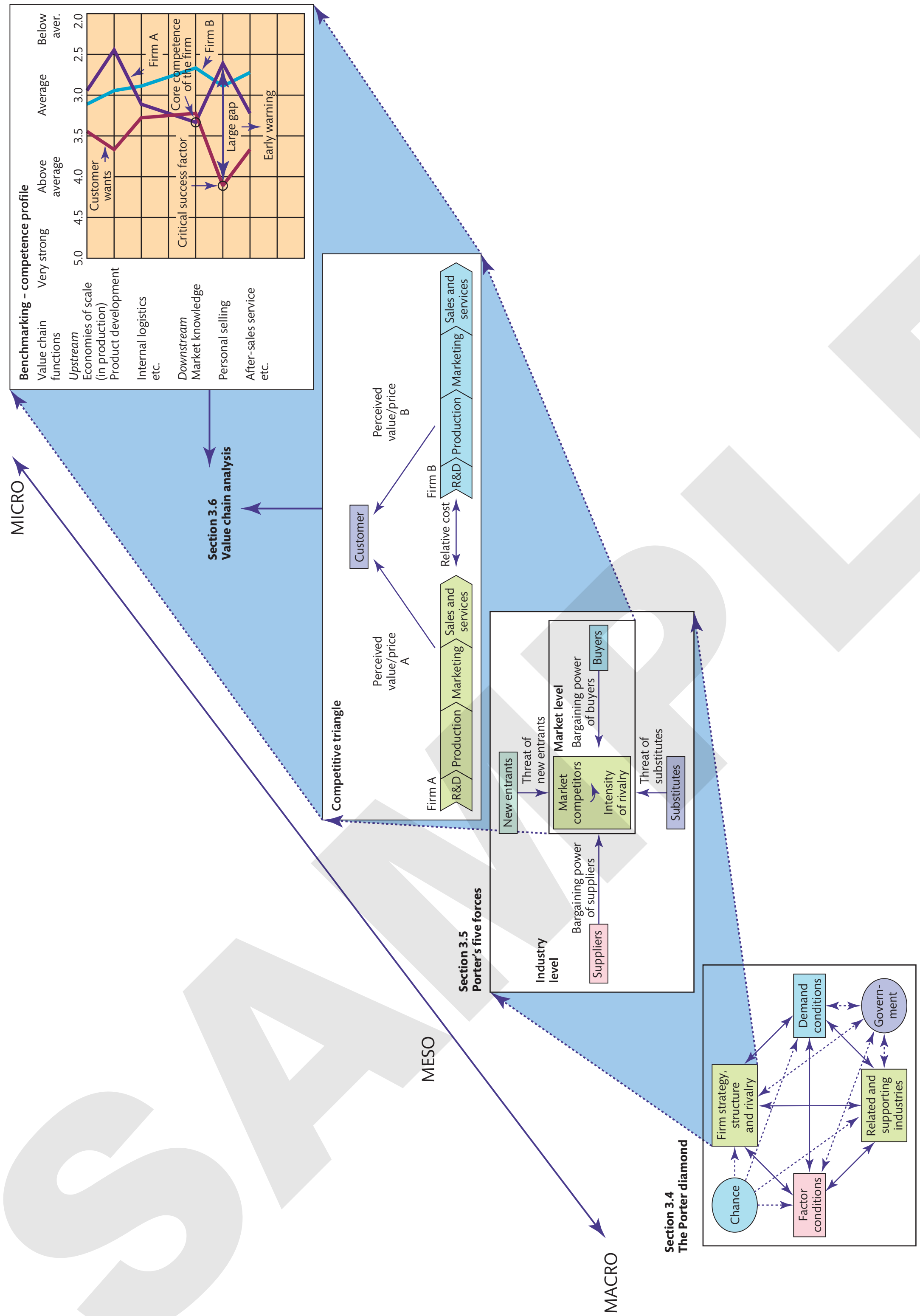


**FIGURE 3.3** *Development of a firm's international competitiveness*



Porter (1990) describes a concentration of firms within a certain industry as industrial clusters. Within such industrial clusters, firms have a network of relations to other firms in the industry: customers (including firms that work on semi-manufactured goods), suppliers and competitors. These industrial clusters may go worldwide, but they will usually have their starting point and location in a certain country or region of a country.

A firm gains important competitive advantages from the presence in its home nation of world-class buyers, suppliers and related industries. They provide insight into future market needs and technological developments. They contribute to a climate for change and improvement, and become partners and allies in the innovation process. Having a strong cluster at home unblocks the flow of information and allows deeper and more open contact than is possible when dealing with foreign firms. Being part of a cluster localised in a small geographic area can be even more valuable, so the central question we can ask is: what accounts for the national location of a particular global industry? The answer begins, as does all classical trade theory, with the match between the factor endowments of the country and the needs of the industry.

**Porter's diamond:** The characteristics of the 'home base' play a central role in explaining the international competitiveness of the firm – the explaining elements consist of factor conditions, demand conditions, related and supporting industries, firm strategy, structure and rivalry, chance and government.

Let us now take a closer look at the different elements in **Porter's diamond**. Throughout the analysis, the Indian IT/software industry (especially illustrated by the Bangalore area) will be used as an example (Nair et al., 2007).

## Factor conditions

We can make a distinction between 'basic and advanced' factors. Basic factors include natural resources (climate, minerals, oil), where the mobility of the factors is low. These factors can also create the ground for international competitiveness, but they can never turn into real value creation without the advanced factors, such as sophisticated human resources (skills) and research capabilities. Such advanced factors also tend to be specific to the industry.

In the Indian software industry, Bangalore has several engineering- and science-orientated educational institutions. Also, the Indian Institute of Science (a research-orientated graduate school) can be identified as essential in the development of the software industry in the region. The presence of the public-sector engineering firms and the private engineering colleges has attracted young people from the country to Bangalore and it has created a diverse, multilingual, tolerant and cosmopolitan culture. One of the most critical success factors of the industry was the availability of advanced and highly educated human resources, but with generalised skills. These generalists (not specialists in software or programming) could be trained into problem solvers in specific areas, based on industry needs.

## Demand conditions

These factors are represented in the right-hand box of Porter's diamond (see Figure 3.3). The characteristics of this element that drive industry success include the presence of early home demand, market size, its rate of growth and sophistication.

There exists an interaction between scale economies, transportation costs and the size of the home market. Given sufficiently strong economies of scale, each producer wants to serve a geographically extensive market from a single location. To minimise transportation costs the producer chooses a location with large local demand. When scale economies limit the number of production locations, the size of a market will be an important determinant of its attractiveness. Large home markets will also ensure that firms located at that site develop a cost advantage based on scale and often on experience as well.

An interesting pattern is that an early large home market that has become saturated forces efficient firms to look abroad for new business. For example, the Japanese motorcycle industry, with its large home market, used its scale advantages in the global marketplace after an early start in Japan. The composition of demand also plays an important role.

A product's fundamental or core design nearly always reflects home-market needs. In electrical transmission equipment, for example, Sweden dominates the world in the high-voltage distribution market. In Sweden there is a relatively large demand for transporting high voltage over long distances, as a consequence of the location of population and industry clusters. Here the needs of the home market shaped the industry that was later able to respond to global markets (with ABB as one of the leading producers in the world market).

The sophistication of the buyer is also important. The US government was the first buyer of chips, and remained the only customer for many years. The price inelasticity of government encouraged firms to develop technically advanced products without worrying too much about costs. Under these conditions the technological frontier was clearly pushed much further and much faster than it would have been had the buyer been either less sophisticated or more price sensitive.

The Indian software industry was kick-started in connection with the Y2K problem (a problem caused due to a coding convention in older systems that assigned only two digits for the year count, thereby creating a potential disruption as the calendar year turned 2000), where US firms contracted with Indian software firms that had employees who were skilled in older programming languages, such as Cobol and Fortran. As their experience with US firms increased and the Y2K problems were solved, India-based software firms began diversifying and offering more value-added products and services. Serving demanding US customers forced the Indian software firms to develop high-quality products and services. Later on, this experience helped to address the needs of IT customers in Germany, Japan and other markets.

### Related and supporting industries

The success of an industry is associated with the presence of suppliers and related industries within a region (Chen and Hsieh, 2008).

In many cases, competitive advantages come from being able to use labour that is attracted to an area to serve the core industry, but which is available and skilled for supporting this industry. Coordination of technology is also eased by geographic proximity. Porter argues that Italian world leadership in gold and silver jewellery has been sustained in part by the local presence of manufacturers of jewellery-making machinery. Here, the advantage of clustering is not so much transportation cost reductions but technical and marketing cooperation. In the semiconductor industry, the strength of the electronics industry in Japan (which buys the semiconductors) is a strong incentive to the location of semiconductors in the same area. It should be noted that clustering is not independent of scale economies. If there were no scale economies in the production of intermediate inputs, then the small-scale centres of production could rival the large-scale centres. It is the fact that there are scale economies in both semiconductors and electronics, coupled with the technological and marketing connections between the two, that gives rise to clustering advantages.

In the beginning, Bangalore's lack of reliable supporting industries (such as telecommunication and power supply) was a problem, but many software firms installed their own generators and satellite communication equipment. Recently, firms that provide venture capital, recruitment assistance, network, hardware maintenance and marketing/accounting support have emerged in the Bangalore area to support the software firms. Also, the presence of consulting firms such as KPMG, PriceWaterhouseCoopers and Ernst & Young can assist incoming multinational companies with entering the Indian market by solving, for example, their currency and location problems. Consequently, a whole system of support has now evolved around the software industry.

### Firm strategy, structure and rivalry

This fairly broad element includes how companies are organised and managed, their objectives and the nature of domestic rivalry.

One of the most compelling results of Porter's study of successful industries in ten different nations is the powerful and positive effect that domestic competition has on the ability to compete in the global marketplace. In Germany, the fierce domestic rivalry among BASF, Hoechst and Bayer in the pharmaceutical industry is well known. Furthermore, the process of competition weeds out inferior technologies, products and management practices, and leaves as survivors only the most efficient firms. When domestic competition is vigorous, firms are forced to become more efficient, adopt new cost-saving technologies, reduce product development time and learn to motivate and control workers more effectively. Domestic rivalry is especially important in stimulating technological developments among **global firms**.

**Global firm:** A firm that by operating in more than one country gains marketing, production, R&D and financial advantages in its costs and reputation that are not available to purely domestic competitors.

The small country of Denmark has three producers of hearing-aids (William Demant with the brand Oticon, Widex and GN ReSound), which are all within the top ten of the world's largest producers of hearing-aids. In 1996 William Demant (with the brand Oticon) and Widex fought a violent technological battle to be the first in the world to launch a 100 per cent digitalised hearing-aid. Widex (the smaller of the two producers) won, but forced William Demant at the same time to keep a leading edge in technological development.

In relation to the Indian software industry, most firms in the Bangalore area experience fierce competition. The competition for future customers is not just with local firms, but also with firms outside Bangalore and multinational companies such as IBM and Accenture. It has resulted in a pressure on firms not only to deliver quality products and services, but also to be cost-effective. This competition has encouraged firms to seek international certifications, with a rating in software development. Today the Bangalore area has the world's highest concentration of companies with the so-called CMM-SEI (Carnegie Mellon University's Software Engineering Institute) Level 5 certification (the highest quality rating).

### Government

According to Porter's diamond model, government can influence and be influenced by each of the four main factors.

Governments can play a powerful role in encouraging the development of industries within their own borders that will assume global positions. Governments finance and construct infrastructure, providing roads, airports, education and healthcare, and can support use of alternative energy (e.g. wind turbines) or other environmental systems that affect factors of production.

In relation to the Indian software industry, the federal government in Delhi had already targeted software as a growth area in the 1970s, because of its high skill requirements and labour intensity. Through the 1970s and 1980s the industry was mainly dominated by public sector companies such as CMC. In 1984 the government started liberalising industrial and investment policies, which gave access to IT companies from abroad, such as Texas Instruments. One of the new initiatives was also setting up 'Technology Parks' – for example, the Software Technology Parks (STP) in Bangalore. The liberation policy continued throughout the 1980s and 1990s. In 1988 NASSCOM (National Association of Software and Service

Companies) was formed. NASSCOM is an association of IT firms that acts as a catalyst for the industry growth by supporting IT research and education in India. In 1999 the Ministry of Information Technology was set up to coordinate the IT initiatives at government, academic and business levels.
Thus, Bangalore's success in becoming a software hub can be attributed to the state government's active role in the early and later stages of the industry's evolution.

### Chance

According to Porter's diamond, national/regional competitiveness may also be triggered by random events.
When we look at the history of most industries we also see the role played by chance. Perhaps the most important instance of chance involves the question of who comes up with a major new idea first. For reasons that have little to do with economics, entrepreneurs will typically start their new operations in their home countries. Once the industry begins in a given country, scale and clustering effects can cement the industry's position in that country.
In relation to the development of competitiveness within the Indian software industry (especially in Bangalore), two essential events can be identified:

1. The Y2K problems (described earlier), which created the increased demand for services of Indian software firms.
2. The collapse of the dot-com boom in 2001 in the USA and Europe, which created the search for ways to cut costs by outsourcing software functions to India.

From the firm's point of view, the last two variables, chance and government, can be regarded as exogenous variables that the firm must adjust to. Alternatively, the government may be considered susceptible through lobbying interest organisations and mass media.
In summary, we have identified six factors that influence the location of global industries: factors of production, home demand, the location of supporting industries, the internal structure of the domestic industry, government and chance. We have also suggested that these factors are interconnected. As industries evolve, their dependence on particular locations may also change. For example, the shift in users of semiconductors from the military to the electronics industry has had a profound effect on the shape of the national diamond in that industry. To the extent that governments and firms recognise the source of any locational advantages that they have, they will be better able to both exploit those differences and anticipate their shifts.
In relation to the software industry in India (Bangalore), which was used throughout the diamond model, the following conclusions may be given (Nair et al., 2007).
The software industry in Bangalore started off by serving not its domestic customers but the demanding North American customers. Also, the rivals for the software firms tend not to be so much local but more global.
The support needed for software services is much less sophisticated than for manufacturing. For the manufacturing sector it is also important to have access to a well-functioning physical infrastructure (transport, logistics, etc.), which is not necessary for the software industry, where most of the logistics can be done over the internet. That is one of the reasons why Bangalore's software industry created international competitiveness but the manufacturing sector did not.

The software industry is very much dependent on advanced and well-educated human resources as the key factor input.
While the Bangalore-based firms started off at the low end of the value chain (performing coding work for the Y2K problem), they have continuously moved in the direction of delivering more value-added service in emerging areas.

### The 'double diamond' and 'multiple diamond' framework

**Double diamond:** The international competitiveness of an industry in a country is not only dependent on its home country diamond conditions but also on those of its trading partners.

A key limitation of Porter's (1990) diamond model is its main focus on only home country conditions (Rugman et al., 2012; Zhang and London, 2013). The **double diamond** framework addresses this concern. Rugman and D'Cruz (1993) suggested that the international competitiveness of Canadian firms depended not only on their home country diamond conditions but also on those of their trading partner, the United States. Consequently, the sources of a firm's international competitive advantage are not only limited to the home country advantages, according to Porter's single diamond model, but they can also be achieved by sensing and developing competitive advantages in relationship with multiple 'diamonds' in several host countries.

## 3.5 COMPETITION ANALYSIS IN AN INDUSTRY

The next step in understanding the firm's competitiveness is to look at the competitive arena in an industry, which is the top box in the diamond model (see Figure 3.3).
One of the most useful frameworks for analysing the competitive structure has been developed by Porter. Porter (1980) suggests that competition in an industry is rooted in its underlying economic structure and goes beyond the behaviour of current competitors. The state of competition depends upon five basic competitive forces, as shown in Figure 3.3. Together these factors determine the ultimate profit potential in an industry, where profit is measured in terms of long-run return on invested capital. The profit potential will differ from industry to industry (Brookfield et al., 2008).
To make things clearer we need to define a number of key terms. An *industry* is a group of firms that offer a product or class of products that are close substitutes for each other. Examples are the car industry and the pharmaceutical industry (Kotler, 1997, p. 230). A *market* is a set of actual and potential buyers of a product and the sellers. A distinction will be made between industry and market level, as we assume that the industry may contain several different markets. This is why the outer box in Figure 3.3 is designated 'industry level' and the inner box 'market level'.
Thus the *industry level* (Porter's five forces model) consists of all types of actors (new entrants, suppliers, substitutes, buyers and market competitors) that have a potential or current interest in the industry.
The *market level* consists of actors with a current interest in the market; that is, buyers and sellers (market competitors). In section 3.6 (value chain analysis) this market level will be further elaborated on as the buyers' perceived value of different competitor offerings will be discussed.
Although division into the above-mentioned two levels is appropriate for this approach, Levitt (1960) pointed out the danger of '**marketing myopia**', where the seller defines the competition field (i.e. the market) too narrowly (Brookfield et al., 2008). For example, European luxury car manufacturers showed this myopia with their focus on each other rather than on the Japanese mass manufacturers, who were new entrants into the luxury car market.

Marketing myopia: The failure of a company to define its organisational purpose from a broad consumer orientation.

The goal of competition analysis is to find a position in industry where the company can best defend itself against the five forces, or can influence them in its favour. Knowledge of these underlying pressures highlights the critical strengths and weaknesses of the company, shows its position in the industry, and clarifies areas where strategy changes yield the greatest pay-off. Structure analysis is fundamental for formulating competitive strategy.

Each of the five forces in the Porter model in turn comprises a number of elements that combine to determine the strength of each force, and its effect on the degree of competition. Each force is now discussed.

## Market competitors

The intensity of rivalry between existing competitors in the market depends on a number of factors:

- *Concentration of the industry*: numerous competitors of equal size will lead to more intense rivalry. There will be less rivalry when a clear leader (at least 50 per cent larger than the second) exists with a large cost advantage.
- *Rate of market growth*: slow growth will tend towards greater rivalry.
- *Structure of costs*: high fixed costs encourage price cutting to fill capacity.
- *Degree of differentiation*: commodity products encourage rivalry, while highly differentiated products, which are hard to copy, are associated with less intense rivalry.
- *Switching costs*: when switching costs are high – because the product is specialised, the customer has invested a lot of resources in learning how to use the product or has made tailor-made investments that are worthless with other products and suppliers (high asset specificity) – rivalry is reduced.
- *Exit barriers*: when barriers to leaving a market are high, due to such factors as lack of opportunities elsewhere, high vertical integration, emotional barriers or the high cost of closing down a plant, rivalry will be more intense than when exit barriers are low.

Firms need to be careful not to spoil a situation of competitive stability. They need to balance their own position against the well-being of the industry as a whole. For example, an intense price or promotional war may gain a few percentage points in market share but lead to an overall fall in long-run industry profitability as competitors respond to these moves. It is sometimes better to protect industry structure than to follow short-term self-interest.

## Suppliers

The cost of raw materials and components can have a major bearing on a firm's profitability. The higher the bargaining power of suppliers, the higher the costs. The bargaining power of suppliers will be higher in the following circumstances:

- supply is dominated by few companies and they are more concentrated than the industry they sell to;
- their products are unique or differentiated, or they have built up switching costs;
- they are not obliged to contend with other products for sale to the industry;
- they pose a credible threat of integrating forwards into the industry's business;

- buyers do not threaten to integrate backwards into supply;
- the market is not an important customer to the supplier group.

A firm can reduce the bargaining power of suppliers by seeking new sources of supply, threatening to integrate backwards into supply and designing standardised components so that many suppliers are capable of producing them.

### Buyers

The bargaining power of buyers is higher in the following circumstances:

- buyers are concentrated and/or purchase in large volumes;
- buyers pose a credible threat of integrating backwards to manufacture the industry's product;
- products they purchase are standard or undifferentiated;
- there are many suppliers (sellers) of the product;
- buyers earn low profits, which creates a great incentive to lower purchasing costs;
- the industry's product is unimportant to the quality of the buyers' products, but price is very important.

Firms in the industry can attempt to lower buyer power by increasing the number of buyers they sell to, threatening to integrate forward into the buyer's industry and producing highly valued, differentiated products. In supermarket retailing, the brand leader normally achieves the highest profitability, partially because being number one means that supermarkets need to stock the brand – thereby reducing buyer power in price negotiations.

Customers who purchase the product but are not the end user (such as OEMs or distributors) can be analysed in the same way as other buyers. Non-end customers can gain significant bargaining power when they can influence the purchase decision of customers downstream (Porter, 2008). Over the years, ingredient supplier DuPont has created enormous clout by advertising its 'Teflon' brand not only to the manufacturers of cooking equipment, but also to downstream end-customers (households). See also the section on ingredient branding in Chapter 11.

### Substitutes

The presence of substitute products can reduce industry attractiveness and profitability because they put a constraint on price levels.

If the industry is successful and earning high profits it is more likely that competitors will enter the market via substitute products in order to obtain a share of the potential profits available. The threat of substitute products depends on the following factors:

- the buyer's willingness to substitute;
- the relative price and performance of substitutes;
- the costs of switching to substitutes.

The threat of substitute products can be lowered by building up switching costs. These costs may be psychological. Examples are the creation of strong, distinctive brand personalities, and maintaining a price differential commensurate with perceived customer values.

### New entrants

New entrants can serve to increase the degree of competition in an industry. In turn, the threat of new entrants is largely a function of the extent to which barriers to entry exist in the market. Some key factors affecting these entry barriers include the following:

- economies of scale;
- product differentiation and brand identity, which give existing firms customer loyalty;
- capital requirements in production;
- switching costs – the cost of switching from one supplier to another;
- access to distribution channels.

Because high barriers to entry can make even a potentially lucrative market unattractive (or even impossible) to enter for new competitors, the marketing planner should not take a passive approach but should actively pursue ways of raising barriers to new competitors.

High promotional and R&D expenditures and clearly communicated retaliatory actions to entry are some methods of raising barriers. Some managerial actions can unwittingly lower barriers. For example, new product designs that dramatically lower manufacturing costs can make entry by newcomers easier.

## Strategic groups

**Strategic group:** A group of firms (or strategic business units, or brands) operating within an industry where the firms (or strategic business units, or brands) within a group compete for the same group of customers (segment), using similar market-related strategies

A **strategic group** can be defined a group of companies (or strategic business units, or brands) operating within an industry where the firms (or strategic business units, or brands) within a group compete for the same group of customers (segment), using similar market-related strategies. An industry could have only one strategic group if all the firms followed essentially the same strategy. At the other extreme, each firm could be a different strategic group.

Companies in different strategic groups compete for a different group of customers using strategies that are different than other strategic groups. So different strategic groups do not compete with each other, since they are pursuing different groups of customers.

Strategic group analysis is then a technique used to provide management with information in regards to the firm's position in the market and a tool to identify their direct competitors. The five forces industry analysis will form the first step in this process (Porter, 1980). After having identified the forces, the major competitors in the industry based on competitive variables will also be outlined. Competitors will then be divided into strategic groups based on similarities in strategies and competitive positions. For this purpose, Porter's three generic strategies (low cost, differentiation and focus) can be used (Porter, 1985).

For example, in the auto industry, consumers who buy low-priced brands such as Suzuki, Kia or Hyundai, etc., buy them because they are inexpensive (low-cost strategy), while those who buy a Toyota Camry, Honda Accord, etc., are willing to pay a higher price for a car that is bigger, has more features/options, is more reliable, etc. (differentiation strategy). Finally, people who buy a Rolls Royce or Jaguar (focus strategy) are willing to pay a fortune for something that is very unique and prestigious.

Often a two-dimensional grid is made to position firms along an industry's two most important dimensions in order to distinguish direct rivals (those with similar strategies or business models) from indirect rivals. Firms may try to shift to a more favourably situated group, and how hard such a move proves to be will depend on whether entry barriers for the target strategic group are high or low.

## The collaborative 'five sources' model

Porter's original model is based on the hypothesis that the competitive advantage of the firm is best developed in a very competitive market with intense rivalry relations.

The five forces framework thus provides an analysis for considering how to squeeze the maximum competitive gain out of the context in which the business is located – or how to minimise the prospect of being squeezed by it – on the five competitive dimensions that it confronts.

Over the past two decades, however, an alternative school (e.g. Reve, 1990; Kanter, 1994; Burton, 1995) has emerged, which emphasises the positive role of cooperative (rather than competitive) arrangements between industry participants, and the consequent importance of what Kanter (1994) has termed 'collaborative advantage' as a foundation of superior business performance.

An all-or-nothing choice between a single-minded striving for either competitive or collaborative advantage would, however, be a false one. The real strategic choice problem that all businesses face is where (and how much) to collaborate, and where (and how intensely) to act competitively.

Put another way, the basic questions that firms must deal with in respect of these matters are as follows:

- Choosing the combination of competitive and collaborative strategies that are appropriate in the various dimensions of the industry environment of the firm.
- Blending the two elements together so that they interact in a mutually consistent and reinforcing, and not counterproductive, manner.
- In this way, optimising the firm's overall position and drawing upon the foundation and utilisation of both collaborative and competitive advantage.

This points to the imperative in the contemporary context of complementing the competitive strategy model with a sister framework that focuses on the assessment of collaborative advantage and strategy. Such a complementary analysis, which is called the *five sources framework* (Burton, 1995), is outlined below.

TABLE 3.1 The five sources model and the corresponding five forces in the Porter model

| PORTER'S FIVE FORCES MODEL | THE FIVE SOURCES MODEL |
|---|---|
| Market competitors | Horizontal collaborations with other enterprises operating at the same stage of the production process/producing the same group of closely related products (e.g. contemporary global partnering arrangements among car manufacturers). |
| Suppliers | Vertical collaborations with suppliers of components or services to the firm – sometimes termed vertical quasi-integration arrangements (e.g. the keiretsu formations between suppliers and assemblers that typify the car, electronics and other industries in Japan). |
| Buyers | Selective partnering arrangements with specific channels or customers (e.g. lead users) that involve collaboration (value co-creation) extending beyond standard, purely transactional relationships (Vargo et al., 2008). |
| Substitutes | Related diversification alliances with producers of both complements and substitutes. Producers of substitutes are not natural allies but such alliances are not inconceivable (e.g. collaborations between fixed-wire and mobile telephone firms in order to grow their joint network size). |
| New entrants | Diversification alliances with firms based in previously unrelated sectors, but between which a blurring of industry borders is potentially occurring, or a process (commonly due to new technological possibilities) that opens up the prospect of cross-industry fertilisation of technologies/business that did not exist before (e.g. the collaborations in the emerging multimedia field). |

Source: Burton, J. (1995) 'Composite strategy: the combination of collaboration and competition', *Journal of General Management*, 21(1): 1–23. Reproduced with permission from The Baybrooke Press Ltd.

Corresponding to the array of five competitive forces that surround a company – as elaborated in Porter's treatment – there are also five potential sources for the building of collaborative advantage in the industrial environments of the firm (the **five sources model**). These sources are listed in Table 3.1.

**Five sources model:** Corresponding to Porter's five competitive forces there are also five potential sources for building collaborative advantages together with the firm's surrounding actors.

In order to forge an effective and coherent business strategy, a firm must evaluate and formulate its collaborative and competitive policies side by side. It should do this for two purposes:

- to achieve the appropriate balance between collaboration and competition in each dimension of its industry environment (e.g. relations with suppliers, policies towards customers/channels);
- to integrate them in a way that avoids potential clashes and possibly destructive inconsistencies between them.

This is the terrain of composite strategy, which concerns the bringing together of competitive and collaborative endeavours.

## 3.6 VALUE CHAIN ANALYSIS

Until now we have discussed the firm's international competitiveness from a strategic point of view. To get closer to the firm's core competences we will now look at the market-level box in Porter's five forces model, which addresses buyers and sellers (market competitors). Here we will look more closely at what creates a competitive advantage among market competitors towards customers at the same competitive level.

### The competitive triangle

Success in the marketplace is dependent not only upon identifying and responding to customer needs, but also upon our ability to ensure that our response is judged by customers to be superior to that of competitors (i.e. high perceived value). Several writers (e.g. Porter, 1980; Day and Wensley, 1988) have argued that causes of difference in performance within a market can be analysed at various levels. The immediate causes of differences in the performance of different firms, these writers argue, can be reduced to two basic factors (D'Aveni, 2007):

1. The *perceived value* of the product/services offered, compared to the *perceived sacrifice*. The perceived sacrifice includes all the 'costs' the buyer faces when making a purchase, primarily the *purchase price*, but also acquisition costs, transportation, installation, handling, repairs and maintenance (Ravald and Grönroos, 1996). In the models presented, the (purchase) price will be used as a representative of the perceived sacrifice. D'Aveni (2007) presents a strategic tool for evaluating how much a customer is willing to pay for a perceived benefit of a product/service.
2. The firm-related *costs* incurred in creating this perceived value.

These two basic factors will be further discussed later in this section.

The more value customers perceive in a market offering relative to competing offerings, and the lower the costs in producing the value relative to competing producers, the higher the performance of the business. Hence, firms producing offerings with a higher perceived value and/or lower relative costs than competing firms are said to have a competitive advantage in that market.

**Competitive triangle:** Consists of a customer, the firm and a competitor (the 'triangle'). The firm or competitor 'winning' the competition depends on perceived value offered to the customer compared to the relative costs between the firm and the competitor.

**Perceived value:** The customer's overall evaluation of the product/service offered by a firm, compared to a price paid.

This can be illustrated by the **competitive triangle** (see Figure 3.3). There is no one-dimensional measure of competitive advantage, and **perceived value** (compared to the price) and relative costs have to be assessed simultaneously. Given this two-dimensional nature of competitive advantage it will not always be clear which of the two businesses will have a competitive advantage over the other. Looking at Figure 3.4, firm A will clearly have an advantage over firm B in case I, and clearly have a disadvantage in case IV, while cases II and III do not immediately allow such a conclusion. Firm B may have an advantage in case II, if customers in the market are highly quality conscious and have differentiated needs and low price elasticity, while firm A may have a similar advantage in case II when customers have homogeneous needs and high price elasticity. The opposite will take place in case III.

Even if firm A has a clear competitive advantage over firm B, this may not necessarily result in a higher return on investment for A, if A has a growth and B a hold policy. Thus, performance would have to be measured by a combination of return on investment and capacity expansion, which can be regarded as postponed return on investment.

While the relationship between perceived value, relative costs and performance is rather intricate, we can retain the basic statement that the two variables are the cornerstone of competitive advantage. Let us take a closer look at these two fundamental sources of competitive advantage.

### Perceived value advantage

We have already observed that customers do not buy products; they buy benefits. Put another way, the product is purchased not for itself but for the promise of what it will 'deliver'. These benefits may be intangible – that is, they may relate not to specific product features but rather to such things as image or reputation. Alternatively, the delivered offering may be seen to outperform its rivals in some functional aspect.

| | | Perceived value (compared to the purchase price) | |
|---|---|---|---|
| | | Higher for A | Higher for B |
| Relative costs | Lower for A | I | II |
| | Lower for B | III | IV |

FIGURE 3.4 *Perceived value, relative costs and competitive advantage*

Perceived value is the customer's overall evaluation of the product/service offered. So, establishing what value the customer is actually seeking from the firm's offering (value chain) is the starting point for being able to deliver the correct mix of value-providing activities. It may be some combination of physical attributes, service attributes and technical support available in relation to the particular use of the product. This also requires an understanding of the activities that constitute the customer's value chain.

Unless the product or service we offer can be distinguished in some way from its competitors there is a strong likelihood that the marketplace will view it as a 'commodity', and so the sale will tend to go to the cheapest supplier – hence the importance of seeking to attach additional values to our offering to mark it out from the competition.

What are the means by which such value differentiation may be gained? If we start in the value chain perspective (see section 2.5), we can say that each activity in the business system adds perceived value to the product or service. Value, for the customer, is the perceived stream of benefits that accrue from obtaining the product or service. Price is what the customer is willing to pay for that stream of benefits. If the price of a good or service is high, it must provide high value, otherwise it is driven out of the market. If the value of a good or service is low, its price must be low, otherwise it is also driven out of the market. Hence, in a competitive situation, and over a period of time, the price that customers are willing to pay for a good or service is a good proxy measure of its value.

If we look especially at the downstream functions of the value chain, a differential advantage can be created with any aspect of the traditional 4P marketing mix: product, distribution, promotion and price are all capable of creating added customer perceived value. The key to whether improving an aspect of marketing is worthwhile is to know if the potential benefit provides value to the customer.

If we extend this model, particular emphasis must be placed upon the following (see Booms and Bitner, 1981; Magrath, 1986; Rafiq and Ahmed, 1995):

- *People*: these include both consumers, who must be educated to participate in the service, and employees (personnel), who must be motivated and well trained in order to ensure that high standards of service are maintained. Customers identify and associate the traits of service personnel with the firms they work for.
- *Physical aspects*: these include the appearance of the delivery location and the elements provided to make the service more tangible. For example, visitors experience Disneyland by what they see, but the hidden, below-ground support machinery is essential for the park's fantasy fulfilment.
- *Process*: the service is dependent on a well-designed method of delivery. Process management assures service availability and consistent quality in the face of simultaneous consumption and production of the service offered. Without sound process management, balancing service demand with service supply is extremely difficult.

Of these three additional Ps, the firm's *personnel* occupy a key position in influencing customer perception of product quality. As a consequence, the *image* of the firm is very much influenced by the personnel. It is therefore important to pay particular attention to the quality of employees and to monitor their performance. Marketing managers need to manage not only the service provider – customer interface – but also the actions of other customers; for example, the number, type and behaviour of other people will influence a meal at a restaurant.

### Relative cost advantage

Each activity in the value chain is performed at a cost. Getting the stream of benefits that accrue from the good or service to the customer is thus done at a certain 'delivered cost', which sets a lower limit to the price of the good or service if the business system is to remain profitable. Decreasing the price will thus imply that the delivered cost be first decreased by adjusting the business system. As mentioned earlier, the rules of the game may be described as *providing the highest possible perceived value to the final customer, at the lowest possible delivered cost*.

A firm's cost position depends on the configuration of the activities in its value chain versus that of competitors and its relative location on the cost drivers of each activity. A cost advantage is gained when the cumulative cost of performing all the activities is lower than competitors' costs. This evaluation of the **relative cost position** requires an identification of each important competitor's value chain.

**Relative cost position:** A firm's cost position depends on the configuration of the activities in its value chain versus that of its competitors.

In practice, this step is extremely difficult because the firm does not have direct information on the costs of competitors' value activities. However, some costs can be estimated from public data or interviews with suppliers and distributors.

Creating a relative cost advantage requires an understanding of the factors that affect costs. It is often said that 'big is beautiful'. This is partly due to economies of scale, which enable fixed costs to be spread over a greater output, but more particularly it is due to the impact of the *experience curve*.

The experience curve is a phenomenon that has its roots in the earlier notion of the learning curve. The effects of learning on costs were seen in the manufacture of fighter planes for the Second World War. The time taken to produce each plane gradually fell as learning took place. The combined effect of economies of scale and learning on cumulative output has been termed the 'experience curve'. The Boston Consulting Group estimated that costs reduced on average by approximately 15–20 per cent each time cumulative output doubled.

Subsequent work by Bruce Henderson, founder of the Boston Consulting Group, extended this concept by demonstrating that all costs, not just production costs, would decline at a given rate as volume increased. In fact, to be precise, the relationship that the experience curve describes is between real unit costs and cumulative volume.

This suggests that firms with greater market share will have a cost advantage through the experience curve effect, assuming that all companies are operating on the same curve. However, a move towards a new manufacturing technology can lower the experience curve for adopting companies, allowing them to leapfrog over more traditional firms and thereby gain a cost advantage even though cumulative output may be lower.

The general form of the experience curve and the above-mentioned leapfrogging to another curve are shown in Figure 3.5.

Leapfrogging the experience curve by investing in new technology is a special opportunity for SMEs and newcomers to a market, since they will (as a starting point) have only a small market share and thereby a small cumulative output.

The implications of the experience curve for the pricing strategy will be discussed further in Chapter 12. According to Porter (1980), there are other cost drivers that determine the costs in value chains:

- *Capacity utilisation*: under-utilisation incurs costs.
- *Linkages*: costs of activities are affected by how other activities are performed. For example, improving quality assurance can reduce after-sales service costs.
- *Interrelationships*: for example, different SBUs sharing R&D, purchasing and marketing will lower costs.
- *Integration*: for example, deintegration (outsourcing) of activities to subsuppliers can lower costs and raise flexibility.
- *Timing*: for example, first movers in a market can gain cost advantage. It is cheaper to establish a brand name in the minds of the customers if there are no competitors.
- *Policy decisions*: product width, level of service and channel decisions are examples of policy decisions that affect costs.
- *Location*: locating near suppliers reduces in-bound distribution costs. Locating near customers can lower out-bound distribution costs. Some producers locate their production activities in Eastern Europe or the Far East to take advantage of low wage costs.
- *Institutional factors*: government regulations, tariffs, local content rules, etc., will affect costs.

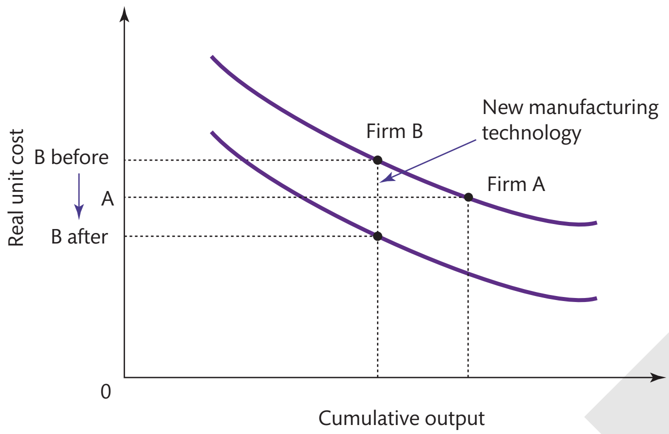


FIGURE 3.5 *Leapfrogging the experience curve*

## Competitive benchmarking

The ultimate test of the efficiency of any marketing strategy has to be in terms of profit. Those companies that strive for market share, but measure market share in terms of volume sales, may be deluding themselves to the extent that volume is bought at the expense of profit.

Because market share is an 'after the event' measure, we need to utilise continuing indicators of competitive performance. This will highlight areas where improvements in the marketing mix can be made.

**Competitive benchmarking:** A technique for assessing relative marketplace performance compared with main competitors.

In recent years a number of companies have developed a technique for assessing relative marketplace performance, which has come to be known as **competitive benchmarking**. Originally, the idea of competitive benchmarking was literally to take apart a competitor's product, component by component, and compare its performance in a value engineering sense with your own product (Kolar and Toporisic, 2007). This approach has often been attributed to the Japanese, but many Western companies have also found the value of such detailed comparisons.

The concept of competitive benchmarking is similar to what Porter (1996) calls 'operational effectiveness' (OE), meaning performing similar activities better than competitors perform them. However, Porter (1996) also thinks that OE is a necessary but not a sufficient condition for outperforming rivals. Firms also have to consider strategic (or market) positioning, meaning the performance of *different* activities from rivals or performing similar activities in different ways. Only a few firms have competed successfully on the basis of OE over a long period. The main reason is the rapid diffusion of best practices. Competitors can rapidly imitate management techniques and new technologies with support from consultants.

However, the idea of benchmarking is capable of extension beyond this simple comparison of technology and cost-effectiveness. Because the battle in the marketplace is for 'share of mind' it is customers' perceptions that we must measure.

The measures that can be used in this type of benchmarking programme include delivery reliability, ease of ordering, after-sales service, the quality of sales representation and the accuracy of invoices and other documentation. These measures are not chosen at random, but are selected because of their importance to the customer. Market research, often based on in-depth interviews, would typically be employed to identify what these 'key success factors' are. The elements that customers identify as being the most important (see Figure 3.6) then form the basis for the benchmark questionnaire. This questionnaire is administered to a sample of customers on a regular basis: for example, German Telecom carries out a daily telephone survey of a random sample of its domestic and business customers to measure customers' perceptions of service. For most companies, an annual survey might suffice; in other cases, perhaps a quarterly survey – particularly if market conditions are dynamic. The output of these surveys might typically be presented in the form of a competitive profile, as in the example in Figure 3.6.

Most of the criteria mentioned above relate to downstream functions in the value chain. Concurrently with closer relations between buyers and suppliers, especially in the industrial market, there will be more focus on the supplier's competences in the upstream functions.

| **Examples of value chain functions (mainly downstream functions)** | **Customer** Importance to customer (key success factors) | | | | | **Own firm (Firm A)** How do customers rate performance of our firm? | | | | | **Key competitor (Firm B)** How do customers rate performance of key competitor? | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *High importance* | | | | *Low importance* | *Good* | | | | *Bad* | *Good* | | | | *Bad* |
| | 5 | 4 | 3 | 2 | 1 | 5 | 4 | 3 | 2 | 1 | 5 | 4 | 3 | 2 | 1 |
| Uses new technology | | | | | | | | | | | | | | | |
| High technical quality and competence | | | | | | | | | | | | | | | |
| Uses proven technology | | | | | | | | | | | | | | | |
| Easy to buy from | | | | | | | | | | | | | | | |
| Understands what customers want | | | | | | | | | | | | | | | |
| Low price | | | | | | | | | | | | | | | |
| Delivery on schedule | | | | | | | | | | | | | | | |
| Accessible for enquiries | | | | | | | | | | | | | | | |
| Takes full responsibility | | | | | | | | | | | | | | | |
| Flexible and quick | | | | | | | | | | | | | | | |
| Known contact person | | | | | | | | | | | | | | | |
| Provides customer training | | | | | | | | | | | | | | | |
| Take account of future requirements | | | | | | | | | | | | | | | |
| Courteous and helpful | | | | | | | | | | | | | | | |
| Specified invoices | | | | | | | | | | | | | | | |
| Gives guarantees | | | | | | | | | | | | | | | |
| ISO 9000 certified | | | | | | | | | | | | | | | |
| Right first time | | | | | | | | | | | | | | | |
| Can give references | | | | | | | | | | | | | | | |
| Environment conscious | | | | | | | | | | | | | | | |

FIGURE 3.6 *Competitive benchmarking (example with only a few criteria)*



### Development of a dynamic benchmarking model

On the basis of the value chain's functions, we will suggest a model for the development of a firm's competitiveness in a defined market (Collis and Rukstad, 2008). The model will be based on a specific market, as the market demands are assumed to differ from market to market, and from country to country.

Before presenting the basic model for development of international competitiveness, we will first define two key terms:

1. Critical success factors: those value chain functions where the customer demands/expects the supplier (firm X) to have a strong competence.
2. Core competences: those value chain functions where firm X has a strong competitive position.

## The strategy process

The model for the strategy process is shown in Figure 3.7.

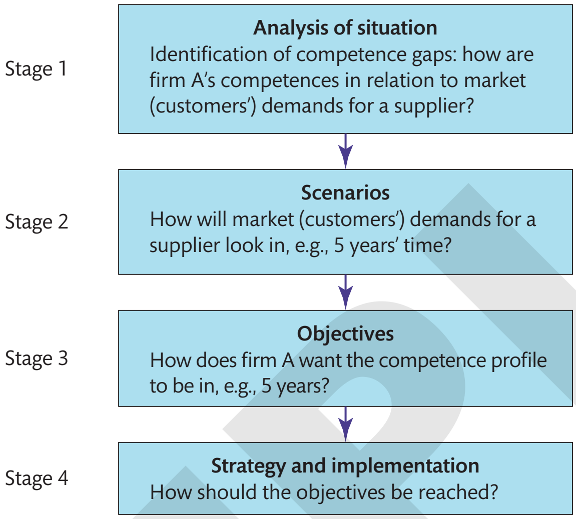


**FIGURE 3.7** *Model for development of core competences*

Source: Hollensen, S. (2001). *Global Marketing: A Market Responsive Approach*, 2nd ed, Financial Times Prentice Hall, p. 95, © Pearson Education Limited 2001.

## Stage 1: Analysis of situation (identification of competence gaps)

We will not go into detail here about the problems there have been in measuring the value chain functions. The measurements cannot be objective in the traditional way of thinking, but must rely on internal assessments from firm representatives (interviews with relevant managers) supplemented by external experts ('key informants'), who are able to judge the market's (customers') demand, now and in the future.

The competence profile for firm A in Figure 3.3 (top-right diagram) is an example of how a firm is not in accordance with the market (= customer) demand. The company has its core competences in parts of the value chain's functions where customers place little importance (that is, market knowledge in Figure 3.3).

If there is a generally good match between the critical success factors and firm A's initial position, it is important to concentrate resources and improve this core competence to create sustainable competitive advantages.

If, on the other hand, there is a large gap between customers' demands and the firm's initial position in critical success factors in Figure 3.3 (as with the personal selling functions), it may give rise to the following alternatives:

- improve the position of the critical success factor(s);
- find business areas where firm A's competence profile better suits the market demand and expectations.

As a new business area involves risk, it is often important to identify an eventual gap in a critical success factor as early as possible (Allen et al., 2005). In other

words, an ‘early warning’ system must be established that continuously monitors the critical competitive factors so that it is possible to start initiatives that limit an eventual gap as early as possible.
In Figure 3.3 the competence profile of firm B is also shown.

### Stages 2 and 3: Scenarios and objectives

To be able to estimate future market demand, different scenarios are made of the possible future development. These trends are first described generally, then the effect of the market’s future demand/expectations on a supplier’s value chain function is concretised.
By this procedure the described ‘gap’ between market expectations and firm A’s initial position becomes more clear. At the same time, the biggest gap for firm A may have moved from personal sales to, for example, product development.
From knowledge of the market leader’s strategy it is possible to complete scenarios of the market leader’s future competence profile.
These scenarios may be the foundation for a discussion of objectives and of which competence profile the company wants in, say, five years’ time. Objectives must be set realistically and with due consideration of the organisation’s resources (the scenarios are not shown in Figure 3.3).

### Stage 4: Strategy and implementation

Depending on which of firm A’s value chain functions are to be developed, a strategy is prepared. This results in implementation plans that include the adjustment of the organisation’s current competence level.

## 3.7 BLUE OCEAN STRATEGY AND VALUE INNOVATION

Kim and Mauborgne (2005a, b, c) use the ocean as a metaphor to describe the competitive space in which an organisation chooses to swim. Red oceans refer to the frequently accessed market spaces where the products are well-defined, competitors are known and competition is based on price, product quality and service. In other words, **red oceans** are an old paradigm that represents all the industries in existence today.

**Red oceans:** Tough, head-to-head competition in mature industries often results in nothing but a bloody red ocean of rivals fighting over a shrinking profit pool.

**Blue oceans:** The unserved market, where competitors are not yet structured and the market is relatively unknown. Here it is about avoiding head-to-head competition.

In contrast, the **blue oceans** denote an environment where products are not yet well defined, competitors are not structured and the market is relatively unknown. Companies that sail in the blue oceans are those beating the competition by focusing on developing compelling value innovations that create uncontested market space. Adopters of blue ocean strategy believe that it is no longer valid for companies to engage in head-to-head competition in search of sustained, profitable growth.
In Michael Porter’s models (1980, 1985), companies are fighting for competitive advantage, battling for market share and struggling for differentiation; blue ocean strategists argue that cut-throat competition results in nothing but a bloody red ocean of rivals fighting over a shrinking profit pool.
A blue ocean is a market space that is created by identifying an unserved set of customers, then delivering to them a compelling new value proposition. This is done by reconfiguring what is on offer to better balance customer needs with the economic costs of doing so. This is as opposed to a red ocean, where the market is well defined and heavily populated by the competition.
Blue ocean strategy should not be a static process but a dynamic one. Consider The Body Shop. In the 1980s, The Body Shop was highly successful, and rather

than compete head on with large cosmetics companies, it invented a whole new market space for natural beauty products. During the 1990s The Body Shop also struggled, but that does not diminish the excellence of its original strategic move. Its genius lay in creating a new market space in an intensely competitive industry that historically competed on glamour (Kim and Mauborgne, 2005b).

The work of Kim and Mauborgne (2005a) is based on a study of 150 strategic moves that spanned more than 100 years (1880–2000) and 30 industries. Kim and Mauborgne's first point in distinguishing this strategy from the traditional strategic frameworks is that in the traditional business literature the company forms the basic unit of analysis, and the industry analysis is the means of positioning the company. Their hypothesis is that since markets are constantly changing in their levels of attractiveness, and companies over time vary in their level of performance, it is the particular *strategic move of the company*, and not the company itself or the industry, which is the correct criterion for evaluating the difference between red and blue ocean strategies.

## Value innovation

Kim and Mauborgne (2005a) argue that tomorrow's leading companies will succeed not by battling competitors but by making strategic moves, which they call **value innovation**.

**Value innovation:** A strategic approach to business growth, involving a shift away from a focus on the existing competition to one of trying to create entirely new markets. Value innovation can be achieved by implementing a focus on innovation and creation of new market space.

The combination of value with innovation is not just marketing and taxonomic positioning. It has consequences. Value without innovation tends to focus on value creation on an incremental scale, and innovation without value tends to be technology-driven, market-pioneering or futuristic – often overshooting what buyers are ready to accept and pay for. Conventional Porter logic (1980, 1985) leads companies only to compete at the margin for incremental share. The logic of value innovation starts with an ambition to dominate the market by offering a tremendous leap in value. Many companies seek growth by retaining and expanding their customer base. This often leads to finer segmentation and greater customisation of offerings to meet specialised needs. Instead of focusing on the differences between customers, value innovators build on the powerful commonalities in the features that customers value (Kim and Mauborgne, 1997).

Value innovation is intensely customer-focused, but not exclusively so (Abraham, 2006). Like value chain analysis it balances costs of delivering the value proposition with what the buyer values are, and then resolves the trade-off dilemma between the value delivered and the costs involved. Instead of compromising the value wanted by the customer because of the high costs associated with delivering it, costs are eliminated or reduced if there is no or less value placed on the offering by the customer. This is a real win–win resolution that creates a compelling proposition. Customers get what they really want for less, and sellers get a higher rate of return on invested capital by reducing start-up and/or operational delivery costs. The combination of these two is the catalyst of blue ocean market creation (Sheehan and Vaidyanathan, 2009). Exhibit 3.1 illustrates this by using the case of Formule 1.

The output of the value innovation analysis is the value curves of the different marketers in the industry (also called 'strategy canvas' in Kim and Mauborgne, 2005 – see Exhibit 3.1). These different value curves raise four basic questions for the focal firm:

1. Which factors should be reduced well below the industry standard?
2. Which of the factors that the industry takes for granted should be eliminated?

3. Which factors should be raised well above the industry standard?
4. Which factors should be created that the industry has never offered?

These four questions can be reduced to two simple strategies in order to create 'value innovation' (see Figure 3.8):

- reducing costs (1 and 2);
- increasing customer value (3 and 4).

When both strategies are being realised at the same time, the 'overlapping' area will be higher (= increasing 'value innovation').

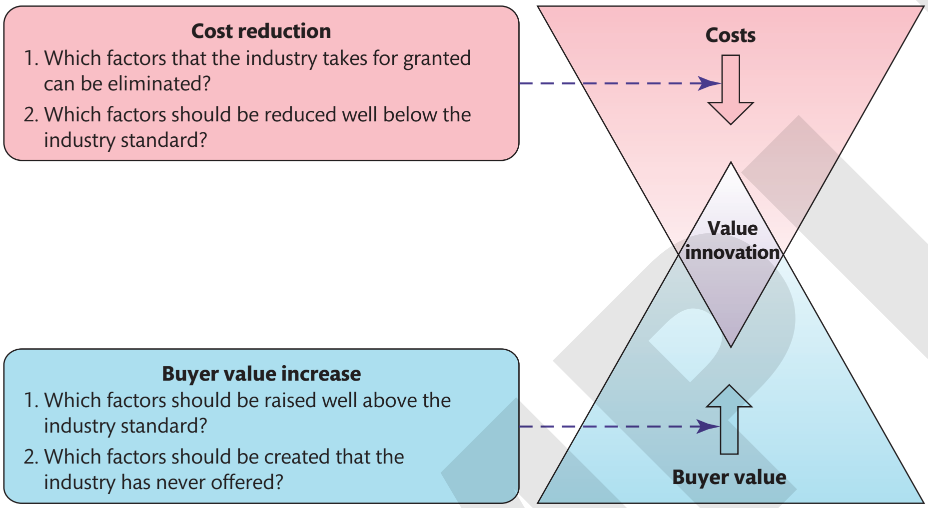


FIGURE 3.8 *Blue ocean strategy framework*

Source: Hollensen, S. (2014). *Global Marketing*, 6th ed, Financial Times Prentice Hall, p. 128, © Pearson Education Limited 2014.

The resulting new value curve should then determine if the firm is on its way into the 'blue ocean'.

## 3.8 THE SHARING ECONOMY

The main principles behind the sharing economy are neither new nor revolutionary. Sharing has always been practiced within societies and even businesses have a long history of sharing resources with other businesses and with their consumers. While traditionally individuals have been sharing within their private social networks, nowadays an extension has occurred towards exchanges with strangers. This kind of "stranger sharing" is what makes the construct of the **sharing economy** new (Bozek, 2018).

**Sharing economy:** A business model in which customers are able to make short-term rentals of assets (products or services) owned by service providers, typically through an online marketplace. The sharing economy model is most likely to be used when the price of a particular asset is high and the asset is not fully utilised all the time

Instead of buying and owning products, customers are increasingly interested in leasing and sharing them. Companies can benefit from the trend toward "collaborative consumption" through creative new approaches to defining and distributing their offerings (Stein, 2015).

This so-called 'sharing economy' is growing rapidly. PriceWaterhouseCoopers has estimated that the global revenues of 'sharing economy' would increase from USD 15 billion in 2015 to USD 335 billion in 2015 (Cusumano, 2018). Well-known examples of startups built on collaborative consumption systems include Uber, a transportation (taxi) network company headquartered in San Francisco; Airbnb

## EXHIBIT 3.1

# Value innovation at hotel chain Formule 1

When Accor launched Formule 1 (a line of French budget hotels) in 1985, the budget hotel industry was suffering from stagnation and overcapacity. The top management urged the managers to forget everything they knew of the existing rules, practices and traditions of the industry. There were two distinct market segments in the industry. One segment consisted of no-star and one-star hotels (very cheap, around €20 per room per night) and the other segment comprised two-star hotels, with an average price of €40 per room. These more expensive two-star hotels attracted customers by offering better sleeping facilities than the cheap segment. Accor's management undertook market research and found out what most customers of all budget hotels wanted: a good night's sleep at a low price. Then they asked themselves (and answered) the four fundamental questions:

1. Which of the factors that the budget hotel industry took for granted should be eliminated?

The Accor management eliminated such standard hotel features as costly restaurants and appealing lounges.

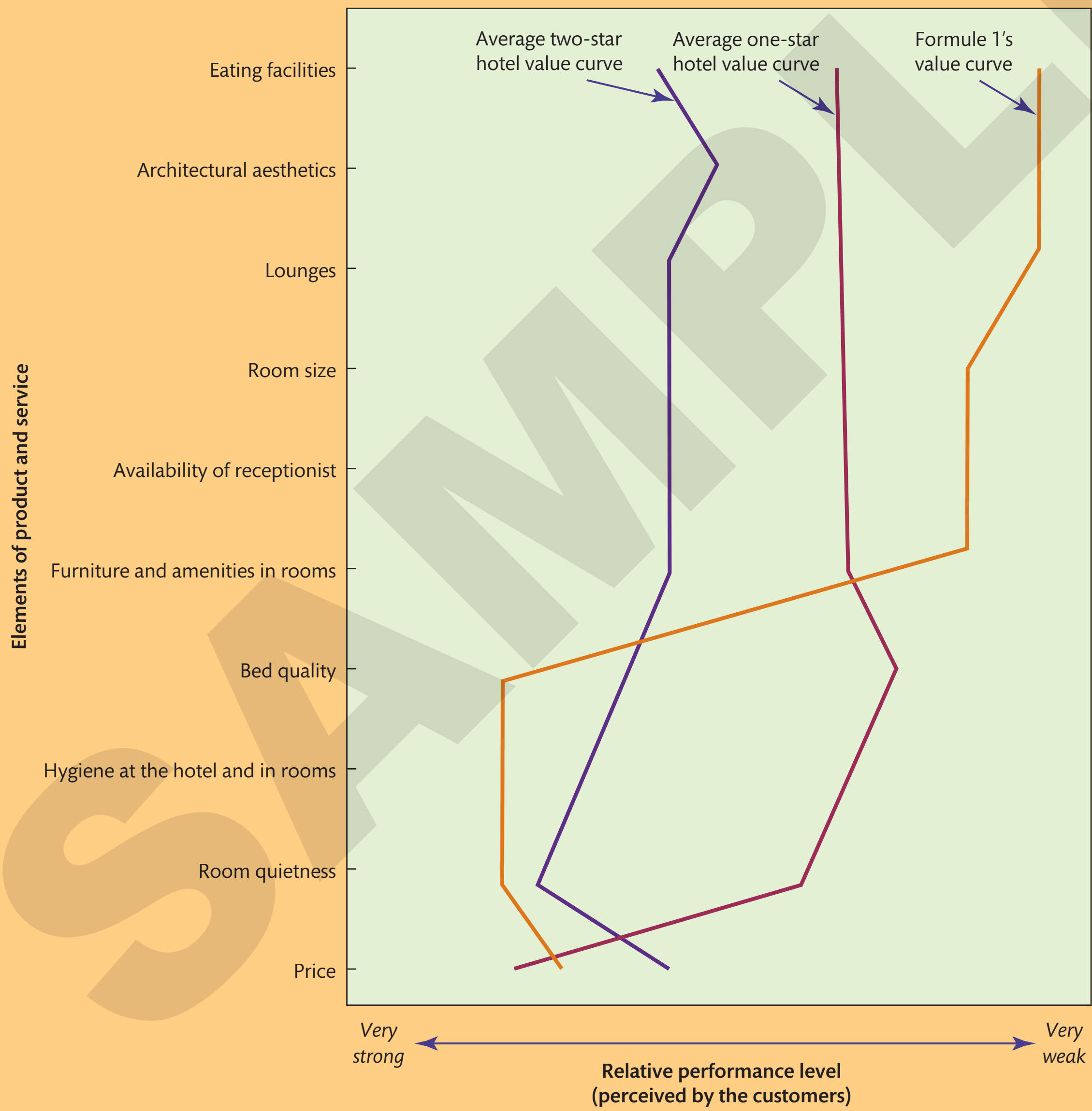


**FIGURE 3.9** *Formule 1's value curve*

Source: Kim, W.C. and Mauborgne, R. (2005) *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant*, Harvard Business School Publishing, Boston, MA. Copyright © 2005 by the Harvard Business School Publishing Corporation. All rights reserved. Reproduced with permission.

Accor reckoned that they might lose some customers by this, but they also knew that most customers could live without these features.

2. Which factors should be reduced well below the industry standard?

Accor also believed that budget hotels were overperforming along other dimensions. For example, at Formule 1 receptionists are on hand only during peak check-in and check-out hours. At all other times, customers use an automated teller. The rooms at Formule 1 are small and equipped only with a bed and bare necessities – no desks or decorations. Instead of closets there are a few shelves for clothing.

3. Which factors should be raised well above the industry standard?

As seen in Formule 1's value curve Figure 3.9, the following factors:

- the bed quality
- hygiene
- room quietness

were raised above the relative level of the low-budget hotels (the one-star and two-star hotels). The price-performance was perceived as being at the same level as the average one-star hotels.

4. Which new factors (that the industry had never offered) should be developed?

These covered cost-minimising factors such as the availability of room keys via an automated teller. The rooms themselves are modular blocks manufactured in a factory. That is a method that may not result in the nicest architectural aesthetics but gives economies of scale in production and considerable cost advantages. Formule 1 has cut in half the average cost of building a room, and its staff costs (in relation to total sales) dropped below the industry average (approximately 30 per cent) to between 20 per cent and 23 per cent. These cost savings have allowed Accor to improve the features that customers value most ('a good night's sleep at a low price').

Note that in Figure 3.9, if the price is perceived as relatively low, it is regarded as a strong performance.

**What has happened with Accor and Formule 1?**

Today, Accor is owner of several hotel chains (besides Formule 1) – for example, Mercure, Sofitel, Novotel, Ibis and Motel 6. Most of the Formule 1 hotels have been rebranded into Ibis Budget hotels. However, there are still 160 Formule 1 hotels in France, which has the biggest number of the remaining Formule 1 hotels.

Sources: Accor (www.accor.com); Hotel Formule 1 (www.hotelformule1.com); Kim and Mauborgne (1997).

Inc., a San Francisco-based online accommodations marketplace; and Zipcar, a car-sharing brand that is now part of the vehicle rental services company Avis Budget Group Inc., based in New Jersey.

With car sharing companies (like Zipcar), for example, participating car owners are able to charge a fee to rent out their vehicles when they are not using them. Participating renters can access nearby and affordable vehicles and pay only for the time they need to use them. These two-sided platforms offer many advantages by unlocking the value inherent in sharing spare resources with people who want them.

There are opposing viewpoints as to whether or not the sharing economy is really concerned about sharing practices. There are vast differences between companies like Uber or Airbnb and voluntary giving services like CouchSurfing. The second is a hospitality and social networking service accessible via a website and mobile app. Members can use the service to arrange homestays and offer lodging and hospitality. The platform is based on a gift economy; hosts are not allowed to charge for the service.

But where, then, does sharing end and commerce begin? In order to categorise respective activities based on specific attributes, Habibi et al. (2017) have constructed a sharing/ exchange continuum in which businesses can be placed into three different categories. This is graphically illustrated in Figure 3.10, where the gift-economy CouchSurfing service would also be located to the left, with no money involved as a matter of principle.

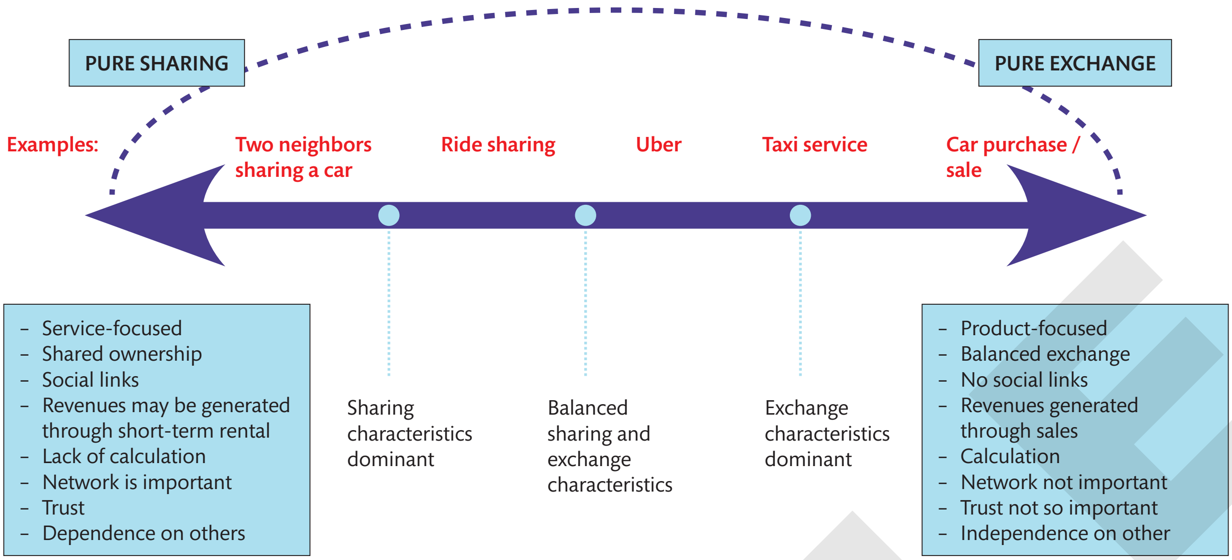


**FIGURE 3.10** *The Sharing / Exchange Continuum (in the transporting/mobility sector)*
Source: based on Habibi et al. (2017) and Kumar et al. (2018).

In the transport / mobility services, we have different examples to illustrate the sharing / exchange continuum – from left to the right.

- *Two neighbors sharing a car* (joint ownership) with no money involved would be an example of 'pure sharing'. The relationship between the two is based on trust and a high degree of 'social link'.
- *Ride-sharing services* often include long distance drives or frequent carpooling. Typically, they take place over a longer distance and a longer period of time, where social bonds are likely to be created. Consumption of the service depends on the other people in the car, but monetary exchange is still of relevance. There is no 'joint ownership.' Overall, ride-sharing services can be characterised as 'balanced sharing and exchange', slightly approaching 'sharing characteristics.'
- The *Uber taxi service* can be characterised as a 'balanced sharing and exchange.' Here ordinary drivers give a ride to passengers who have booked through an app. Money exchange is dominant and the interaction time is rather short. The driver shares his or her personal car as a resource, but there is no joint ownership.
- *Traditional taxi services* are classified as a form of 'pure exchange' with very few sharing characteristics. Personal contact with a taxi driver is existent but limited, and it is uncommon to establish social links. Instead, the service is a balanced exchange; a taxi ride is executed for a calculated price.
- *Car purchase from a car dealer*: The case of a single independent buyer of a car at the car dealer, has all the characteristics of 'pure exchange.'

Figure 3.10 distinguishes car sharing from ride sharing models like Uber and Lyft. But in the automated future, the distinction between those modes will likely disappear along with human driver.
Car manufacturers (selling cars) follow the conventional two-sided market model. Value is created in the process of the supply chain and increases with each step in the value chain, from supplier to customer. In the traditional B2B2C setting (e.g. Kellogg Company selling breakfast cereals to the retailer - Tesco (UK) - and finally to the end-consumer), there is a dyadic sales relationship between

the retailer and the final buyer, the end-consumer, but there is not normally a direct interaction between the supplier, Kellogg Company, and the final end-customer. Consequently, conventional two-sided markets have a product focus with a high variety of options, and the revenue is generated from sales. In the sharing economy, suppliers (service providers) are expected to deliver high service quality, as they offer their valuable assets (e.g. their cars) and are personally involved in the transaction.

Drivers in mobility services are traditional service providers. In connection with taxi mediation platforms, they serve as suppliers. Ride-sharing and taxi apps (like Uber) are always executed via the infrastructure of a platform where a minimum of two individuals is connected, with the service enabling platform in the middle (see Figure 3.11):

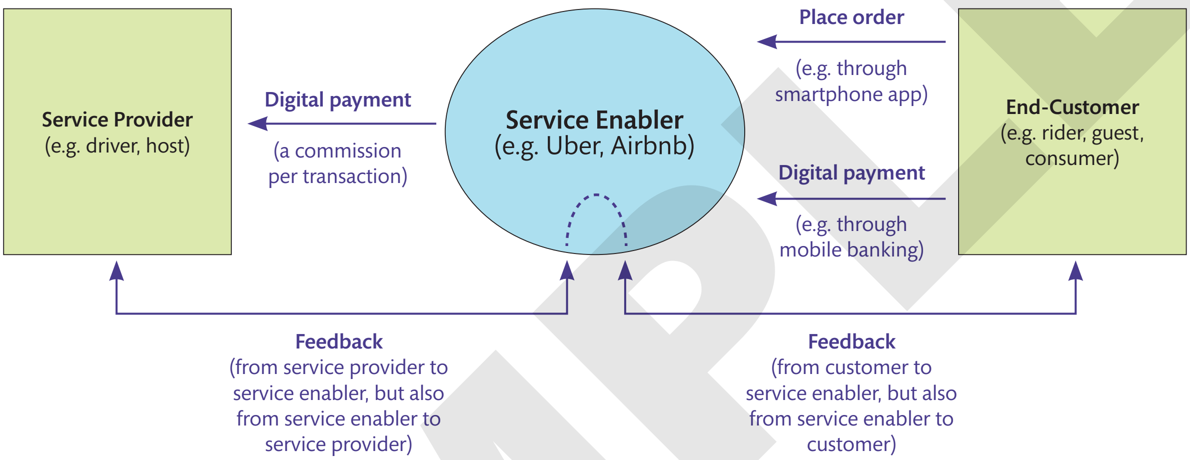


**FIGURE 3.11** *The sharing economy business model – the platform approach*
Source: based on Kumar et al. (2018).

For the end-customer, convenience and low cost are key motivators. The key aspects of convenience are enabled by the digital technologies integrated in the user interface, ease of payment (payment by smartphone), availability of the product or service, and the short response time. The convenience offered by digital technologies creates network effects by steering the end-customers toward the service enabler's platform. The demand for the service is primarily generated by the service enablers. These factors also draw the service providers to the platform. Ultimately, the sharing economy enables value exchange by successfully matching time and money. It saves time (also often cost) for customers through convenience, generates monetary value for service providers who offer their assets, and by doing that provides both time and money for customers.

Let us again move to the mobility/transport platform services. For all the newer mobility app services, the network community and the contributed resources create value for the overall service. They benefit from different types of network effects; this even applies to car-sharing providers that are classified as service providers. The success of the sharing economy platform depends on building a critical mass of service providers and end-consumers, as well as the service quality. First, every car-sharing provider needs to overcome the challenge of achieving both a critical mass of users as well as a critical mass of cars. More signed up members lead to extensions of the fleet and greater geographic saturation; thus, more cars are made available for the whole network. A bigger

fleet and a greater coverage in turn inspire more people to sign up. With an increasing number of both, the attractiveness of using the service increases. The mobility services can be used more extensively, more efficiently, and more precisely the more members are signed up. Positive direct network effects are present. However, negative direct network effects may also emerge; e.g. if too many members want to use a car during peak-hours or on the weekends leading to partial unavailability of the service, the loss of spontaneity and a decrease in perceived value.
In the traditional marketing model, the brand communicates directly to consumers and guides them into the sales funnel. In sharing economy, the consumers' decision is highly influenced by reviews and reputation among peers. Consequently, marketers should help people experience the brand and encourage word-of-mouth recommendations between users, also by allowing them to become co-creators in the branding journey.

## 3.9 SUMMARY

The main issue of this chapter is how the firm develops competitive advantage in the international marketplace. The sources of competitive advantage are:

- economies of scale (scale efficiencies);
- economies of scope (transfer of resources across products and markets);
- economies of speed (time-based competition advantages);
- exploitation of local advantages;
- ability to provide global services;
- ability to use 'human resources' (HR) (HR are especially important for RM and internal marketing).

A three-stage model allows us to understand the development of a firm's international competitiveness in a broader perspective.

### Analysis of national/regional competitiveness

The Porter diamond indicates that the home base plays a central role in the firm's international success.

### Competition analysis

Here the firm itself is the unit of analysis. Porter's five forces model suggests that competition in an industry is rooted in its underlying industry structure. The state of competition depends on five basic competitive forces, which determine profit potential in an industry.

### Value chain analysis

According to the competitive triangle, it can be concluded that firms have competitive advantage in a market if they offer products or services with the following characteristics:

- a higher perceived value to the customers;
- lower relative costs than the competing firms.

Influenced by core competency thinking, many companies have been attempting to reorganise their value chains and focus on a number of core activities in which they can achieve and maintain a long-term competitive advantage and outsource all other activities where they do not have high relative competence strength.

With the success of innovative ventures like Uber and Airbnb, it is no surprise that the sharing economy is turning into a booming business for B2C. The concept of sharing one's goods and services is perfectly suited to consumers who would rather handle business themselves at reasonable prices. Easy access to products and services is the foundation of the sharing economy. Thus, good websites are a must for the collaborative platforms' success. Companies can focus on offering an engaging experience to their users by including this kind of elements into our website: peer reviews, simplified navigation, maps, imagery, and video.

**CASE STUDY 3.1**

## Nintendo Switch: Is this the 'Blue Ocean' come-back

When Nintendo Wii was launched in 2006, very few analysts would have predicted that Nintendo Wii would one day be market leader in the games console market against the established PlayStation 3 (PS3) and Xbox 360 brands. But analysts can be wrong: in the week ending 23 August 2007 www.Vgchartz.com data, which is based on sample data from retailers all over the world, indicated that Nintendo's Wii (which was released in November 2006 – one year after the Xbox 360) had passed the Xbox 360's lifetime unit sales, making Nintendo the new world market leader in both the games and console businesses.

This had a big impact on third party publishers and also influenced the decisions that the three major players (Microsoft, Sony, and Nintendo) would make in the future. One factor that no doubt helped Nintendo's Wii to grow so quickly was the console's broad appeal across all age groups, demographics, and countries. However, Nintendo's first place in the world market came under massive attack from both Sony and Microsoft's new sensing devices (see below).

The big question is now – has the new Nintendo Switch the ability to repeat the 'Blue Ocean' strategy from 2006?


*The Nintendo Wii*

Source: Brandon Alms/123RF.

### Nintendo – key facts and financial data

Nintendo Co. was founded in 1889 as the Marufuku Company to make and sell 'hanafuda'. Japanese game cards. Abandoning previous ventures in favour of toys in the 1960s, Nintendo then developed into a video game company in the 1970s, ultimately becoming one of the most influential in the industry and Japan's third most valuable listed company with a market value of over US$85 billion.

Today Nintendo (www.nintendo.co.jp) is engaged in the creation of interactive entertainment products. It manufactures and markets hardware and software for its home video game systems. The company primarily operates in Japan, Europe, and America. It is headquartered in Kyoto, Japan. In total the whole Nintendo Group (including subsidiaries) employs about 5,200 people. Approximately 80 per cent of the company's revenue is generated from regions outside Japan.

Over the years Nintendo has managed to achieve higher returns on its investments, assets, and equity compared with the industry average. Nintendo has not raised any capital through debt in the past few years. The company's total debt to equity ratio at the beginning of 2015 was close to zero compared with industry average of 12 per cent. Debt-free status indicates the company's ability to finance its operations efficiently. Additionally, having no debt obligation provides the company with significant liquidity and financial flexibility.

### The video game console industry

The interactive entertainment software market is characterised by short product life cycles and frequent introductions of new products.

The game consoles are relatively expensive at the beginning of the product life cycle. Hard-core game freaks pay dearly to have a console early, but sales really jump in years two and three, as Moore's law and economies of scale drive prices down and third-party developers release must-have games. By year four, the buzz will have begun about the next generation, and the games consoles will often be found at the local grocery store at discount prices.

Nintendo has been operating in the video game console market since 1977 with the introduction of colour television games, and is considered the oldest company in this market. It is one of the largest console manufacturers in the world, and a leader in the hand-held console market. The company released six generations of consoles over the past two decades, including the Nintendo Entertainment System, Super Nintendo Entertainment System, Nintendo 64, GameCube, Wii, and Wii U. Nintendo has dominated the hand-held games market since its release of the original Game Boy hand-held system in 1989. Nintendo DS, the current hand-held console of Nintendo, had, by end of December 2014, already had a lifetime sales of more than150 million.

### Nintendo's launch of Wii

Nintendo launched the Wii in November 2006. Nintendo's arguments for using this brand name were:

- Wii sounds like 'we', which emphasises this console is for everyone.
- Wii can easily be remembered by people around the world, no matter what language they speak.
- Wii has a distinctive 'ii' spelling that symbolises both the unique controllers and the image of people gathering to play.

The genius of the Wii is that it has changed the rules and invented a type of gaming with massively enhanced interaction between player and game.

### Wii's first attack – the blue ocean strategy

Nintendo was attempting to create a blue ocean by creating a unique gaming experience and keeping the cost of its system lower than Sony's and Microsoft's. In a Forbes.com interview, Perrin Kaplan, vice president of marketing and corporate affairs for Nintendo of America, discussed its implementation of blue ocean:

> *Inside Nintendo, we call our strategy 'blue ocean.' This is in contrast to a 'red ocean.' Seeing a blue ocean is the notion of creating a market where there initially was none – going out where nobody has yet gone. Red ocean is what our competitors do – heated competition where sales are finite and the product is fairly predictable. We're making games that are expanding our base of consumers in Japan and America. Yes, those who've always played games are still playing, but we've got people who've never played to start loving it with titles like Nintendogs, Animal Crossing and Brain Games. These games are blue ocean in action* (Rosmarin, 2006).

Part of blue ocean strategy involves creating a strategy canvas that depicts the current marketspace and relative offering level for major attributes that companies compete on. It helps visualise which offerings cost more to compete on. It also helps companies to identify which values to eliminate, reduce, and/or raise and, finally, it helps to identify new values that aren't currently competed on.

Figure 1 shows a strategy canvas for the Nintedo Wii at the point of introduction in late 2006, compared with Microsoft's Xbox 360, and Sony's PlayStation 3. The *x*-axis of the graph lists the primary sources of Wii's competitive advantages, at the time of introduction (end of 2006):

- *Price*: Wii was 30–40 per cent cheaper than Xbox 360 and Sony Playstation 3.
- *CPU power*: Wii had a comparatively low processor speed and no Dolby 5.1 (sound system). Both PS3 and Xbox 360 had processors that were far more powerful than you would find in most PCs.
- *Storage (hard disk)*: in the basic model, Wii had no hard disk.
- *High-definition video*: both PS3 and Xbox 360 used high-end graphics chips that supported high-definition games and were prepared for high-definition TV. Wii's graphics were marginally better than the PS2 and the original Xbox, but Wii paled next to the PS3 and Xbox 360.
- *DVD*: both Sony and Microsoft provided the DVD opportunity. Sony even included a Blu-Ray DVD drive.
- *Connectivity (online)*: the Xbox especially had positioned itself as the online games console with multi-player functions.
- *Motion-controllable*: with its innovative motion control stick Wii added new value to game playing. The stick integrated the movements of a player directly into the video game (e.g. tennis, golf, sword fights).
- *Unique gameplay*: the new Wii gaming console sensed depth and motion from players, thus adding a whole new element to the play experience.
- *Family-oriented (large public)*: with the motion control stick Nintendo opened up the console world to a completely new public of untapped non-gamers

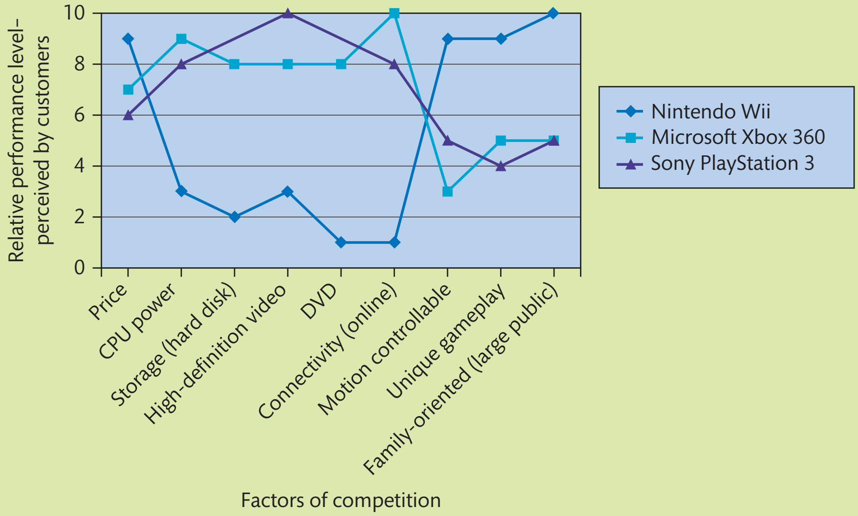


**FIGURE 1** *Value curves (strategy canvas) – original W versus Xbox and PS3*

from the age of around 30. Parents and even grandparents enjoyed playing the Wii.

**Wii's market shares compared with Microsoft (Xbox One ) and Sony (SP4) – and their earlier versions.**

Table 1 shows the worldwide sales of games consoles from 2005 to 2017, together with the corresponding market share.

Current Nintendo Switch sales are pretty evenly split between the three major markets – 30 per cent have been sold in Japan, the American market (including Canada and South America) accounts for 40 per cent, and other markets (including Europe and Australia and a few niche markets) for 30 per cent. The sales of Sony (PS4) and Microsoft (Xbox One) have been more unequally distributed: Microsoft sells in North America, whereas Sony's biggest markets are Japan, China, and the rest of Asia.

**TABLE 1** *World sales of game consoles (total number of units) and market share*

| YEAR | SONY PS4 + EARLIER VERSIONS (%) | MICROSOFT XBOX ONE + EARLIER VERSIONS (%) | NINTENDO SWITCH + EARLIER VERSIONS, E.G. WII (%) | TOTAL PERCENTAGE | TOTAL MARKET MILL. UNITS |
|---|---|---|---|---|---|
| 2005 | 69 | 20 | 11 | 100% | 24.3 |
| 2006 | 53 | 31 | 16 | 100% | 24.4 |
| 2007 | 40 | 20 | 40 | 100% | 39.1 |
| 2008 | 33 | 21 | 46 | 100% | 53.7 |
| 2009 | 35 | 21 | 44 | 100% | 49.5 |
| 2010 | 35 | 28 | 37 | 100% | 49.2 |
| 2011 | 36 | 35 | 29 | 100% | 39.5 |
| 2012 | 40 | 35 | 25 | 100% | 30.0 |
| 2013 | 47 | 34 | 19 | 100% | 27.1 |
| 2014 | 55 | 32 | 13 | 100% | 32.4 |
| 2015 | 58 | 30 | 12 | 100% | 32.9 |
| 2016 | 65 | 31 | 4 | 100% | 28.0 |
| 2017 | 49 | 19 | 32 | 100% | 41.1 |

Source: based on www.Vgchartz.com.

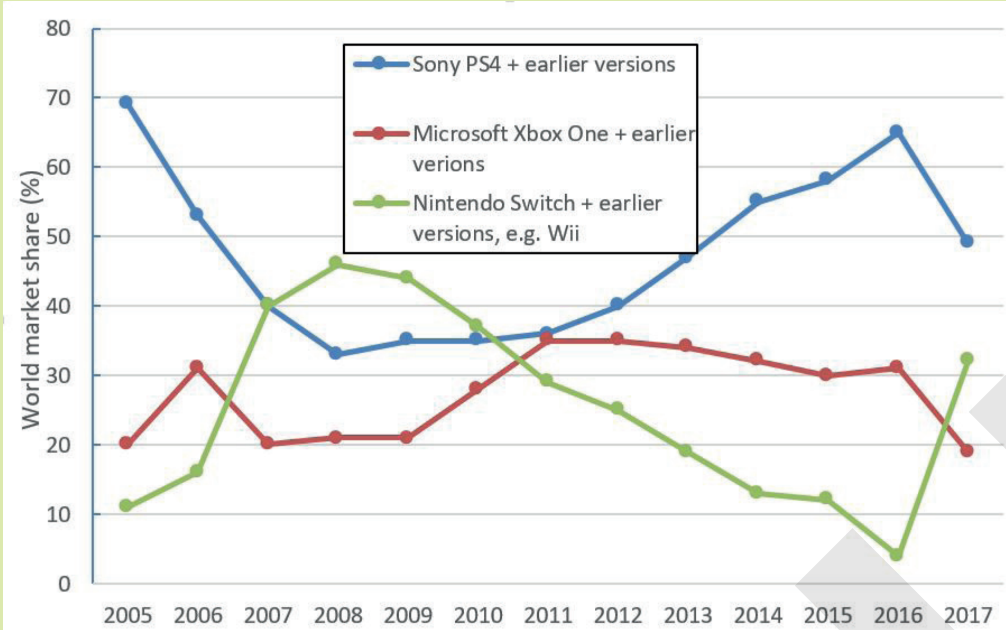


**FIGURE 2** *Development of world market shares of PS4, Xbox One and Nintendo Switch*

At the retail level, games consoles are sold through a variety of electronic and audio/video retailers, supermarkets, discount stores, department stores, and internet retail stores.

### Nintendo's strategy

Wii managed to become a market leader by emphasising its simplicity and lower price (than Sony and Microsoft) to break down barriers for new customers.
Nintendo has attracted non-traditional users, such as women and those over 60 years old, with easy-to-play titles such as *Brain Training* and *Wii Fit* (launched in April/May 2008).
Nintendo is highly dependent on subsuppliers for both hardware and software. The company commissions a number of subsuppliers and contract manufacturers to produce the key components of game consoles and assemble finished products. The company was not able to meet the growing demand for its new Wii console after its November 2006 launch, because its suppliers were not able to ramp up their production in time. A shortage of key components or the finished products had a negative effect on the company's revenues.
Nintendo is also very much dependent on its software suppliers, who all develop new games based on a licensing agreement with Nintendo.
While the hardware (consoles) market is dominated by three players, the software market is more open and fragmented, with several regional players and local developers. However, the games software industry is undergoing a period of consolidation.

### Wii's second attack – The Wii U

After the two competitors, Sony and Microsoft had launched their new Playstation Move and Xbox Kinect in 2010, Nintendo came out with what they thought should be the new Blue Ocean Strategy:
In November 2012, Nintendo's new Wii U was released for worldwide sale. The Wii U console and controller prototypes were first revealed at the E3 2011 exhibition. The Wii U GamePad is the main controller for the Wii U. It features a built-in touchscreen, which can either supplement or replicate the game play shown on the main display. When using the 'Off TV Play' function, the controller can act as a standalone screen without the use of a TV.
Table 1 shows the worldwide sales of games consoles (in millions units) from 2005 to 2017, together with the corresponding market shares, which are illustrated in Figure 2.
The Wii U was available at two prices: basic (US$300 in US) and deluxe ($350).
In 2013, the new *Super Mario Bros. U* was one of the best-selling Wii U games. Also released in 2013 was the popular *LEGO City: Undercover*. In this original LEGO game, exclusive to Wii U, players assume the role of Chase McCain, a tough police officer who is a master of disguise.
When the plans for Wii U were announced at the end of 2011, the stock market was a bit disappointed. The question now was whether Nintendo could create another 'blue ocean'. These concerns about Nintendo's Wii U also came at a time when smartphones and tablet PCs are taking shares away from games consoles.


*The Nintendo 'Wii U'*

Source: Tixti/123RF.

**The competitors' response to Nintendo's Wii U**

The two main Wii competitors have both undergone some dramatic changes since the first console was introduced, as discussed in the following.

***Sony PlayStation PS4***

In 2008, cumulative sales of the PlayStation 2 (PS2) reached 130 million units, making it the world's best-selling game platform. However, the 2006–07 launch of Sony's new-generation PS3 did not translate into the immediate success that the company had hoped for. It was not as successful as the Nintendo Wii. Sony suffered from a perception that it was a complex console only to be used in a darkened room by qualified young men. The core age group used to be a tight demographic group of 14–30 year-old men.

In September/October 2010 Sony launched the PlayStation Move, a motion-sensing game controller platform for the PlayStation 3 (PS3) video game console. Based on a handheld motion controller wand, PlayStation Move uses the PlayStation Eye camera to track the wand's position and inertial sensors in the wand to detect its motion.

In November 2013 Sony launched its new Sony Playstation 4 (PS 4), which is now the world market leader.

***Microsoft Xbox One***

The original Xbox was introduced in 2001 – six years after the first Sony PlayStation 1 (PS 1). Microsoft continues to target the 'serious' gamer segment with the Xbox 360. The Xbox graphics, games, and Xbox Live internet gaming have proven popular with the core user segment, primarily young males. The US market remains the most important so far, accounting for nearly 50 per cent of the overall Xbox sales.

Xbox is the console with the highest 'game attach' rate. This is defined as the average number of games each console owner buys. For the Xbox 360, Microsoft managed a 'games per console' average of 8 to 1 in 2008, the highest in the industry.

The strength of Microsoft's software distribution network has also kept the company alive in the busi-


Source: Leonardo255/123RF.

Source: Robert Klein/123RF.

ness, allowing Microsoft to have a presence in more worldwide markets than Nintendo. Microsoft is strongly positioned in countries like China, India, Malaysia, and South Africa, all of which are growth markets, and this is promising for future sales of Xbox.

In November 2010, Kinect for Xbox 360, or simply Kinect, was introduced worldwide. It is a motion-sensing input device for the Xbox 360 video game console. Unlike its rivals, Microsoft's Kinect does not use a controller. Instead, a series of sensors allow the gamer to control the action using gestures, movement, and speech. Based around a webcam-style add-on peripheral for the Xbox 360 console, it enables users to control and interact with the Xbox 360 without the need to touch a game controller, through a natural user interface using gestures and spoken commands.
The new Xbox One was launched in November 2013. Prior to its official release, the Xbox One received mixed reviews; the entertainment-oriented features were praised, but there was controversy surrounding a mandate for Kinect to be used at all times.
Overall the 'rough' comparison between the three competitors looks like this:

**TABLE 2** *Comparison of Wii U, PS 4 and Xbox One*

| BRAND | NINTENDO SWITCH | PLAYSTATION 4 (PS4) | XBOX ONE |
|---|---|---|---|
| Manufacturer | Nintendo | Sony | Microsoft |
| Launch dates | March 2018 | November 2013<br>(upgraded and more powerful PS4 Pro was introduced in 2016) | November 2013<br>(Upgraded and more powerful Xbox One X was introduced in 2016) |
| Prices | USD 300 | USD 400 | USD 500 |

Source: different public sources.

Microsoft has been aggressive in price cuts since the launch. In June 2014, they cut the price from USD 500 to USD 400, by taking the Kinect out of the standard package. In February 2015, they further cut the price to USD 350. The increase in sales volume has been quite strong in beginning of 2015, so industry experts thought it would only be a question of time before Sony had to react.

### *Nielsen market study*

In early 2015 Retail monitor Nielsen (Pike, 2015) released the results of its gaming study, this one examining the top factors shoppers considered when buying their new-generation console. The study, called *Nielsen 360 Gaming Report* asked 4,400 respondents in USA what were the driving factors behind the purchase of their consoles. For gamers aged 13 and up, "better resolution" was a top driving factor for PlayStation 4, while "brand" was the leading quality for Xbox One. Meanwhile, people gravitated most toward the Wii for its "fun-factor", which may also be the reason why the Wii was mostly popular among kids. Besides the fun factor, the Wii owners also bought their console because of the competitive price, and the kid-friendly game library that Nintendo is known for. Mario Kart 8 and Smash Bros. are both examples of exclusive titles aimed at kids.
Technically the Wii was not perceived as strong in processing power or in screen resolution as the two other consoles, but besides the fun factor and competitive price, Wii did have further selling points. Nintendo takes their time with development of new games through flagship franchises and puts a lot of time and energy into new game ventures.
In the first year of the PS4 and Xbox One lifecycle, a major talking point was resolution. Some multiplatform games were able to achieve higher resolution on PS4 than on their Xbox One counterparts.
Nielsen's gaming study also showed that the vast majority of new-generation system owners had owned a home console before. In fact, between 80% and 90% had earlier owned a PlayStation 3, Xbox 360, or Wii.

However, the PS4 showed that it was successful in capturing not only previous PS3 owners (66 percent), but also Xbox 360 (59 percent) and Wii (72 percent). This might explain why the PS4 got off so well in sales.

### Launch of Nintendo Switch in March 2018

Source: Niphon subsri/123RF.

The Switch is a hybrid of home (plug into the TV) and handheld consoles. Nintendo developed the product based on the growth of mobile gaming and the success of Sony's PlayStation4 console.
The Nintendo Switch is a unique system that can be used either as a portable or a home console, and it turns out Nintendo can track which mode you're using when you play games. The information was broken out during the company's six month financial report for the end of 2018. And the data shows that Nintendo is onto something with its dual-purpose design. The data break-down shows how players are using their systems based on registered Nintendo Accounts. The majority of players, a little over 50 per cent, use both the TV mode and handheld mode. This is followed by around 30 per cent of players who primarily use the tabletop or handheld mode, with under 20 per cent of players primarily using the Switch in TV mode.
Nintendo defines 'primary' as players who spend over 80 per cent of their time in a particular mode.
This flexibility and versatility of the hardware is a key USP for the Switch — combined with Nintendo's unmatched games. Neither Sony nor Microsoft will ever be able to release Mario or Zelda games on its console, nor are they likely to offer a similar product that operates in two different ways. Nintendo Switch players are not ignoring one mode for another. Nintendo bet that players wanted to use both modes, and now it has real-world usage data showing that players are in fact taking full advantage of that choice.
In conclusion, right now Switch does not have much competition. Neither Sony nor Microsoft has much appetite for portable gaming devices. The question is if Nintendo is likely to keep this very lucrative market completely to itself.
The Nintendo Switch sold for $299.99 at launch, lower than the PlayStation 4's $399.99 launch price and certainly lower than the $499.99 launch price of the Xbox One. The accessories, however, are relatively expensive. Additionally, games are typically more expensive on the Switch relative to other consoles. The games on the Switch are typically priced right at the $60 USD price range, which is quite expensive when compared to other games consoles platforms.
It can be played at home or on the go, adding value to the already appealing price point.
It is not exactly an impulse buy at that price, but the Switch is priced well enough that people feel comfortable picking it up as a second system, or even as their first new console in a long time. Price is not everything, but a lower price is better. And the Switch seems to be priced just about perfectly for many buyers.
At these prices Nintendo will probably make a loss on selling the hardware, but from the moment the consumer buys one piece of software, that entire customer relationship becomes positive, in terms of profits for Nintendo. The purpose of the business model is to drive the installation base for the hardware, and then to drive a strong tie-in ratio with all the software (games).
Parents feel safe letting even younger kids play with the Switch, and the system's biggest games appeal to many different age groups. Plenty of parents use these as excuses to get a toy they want to play with. Nintendo has mastered the art of making hardware and games that work with your family. Nintendo builds in easier modes so that kids and parents can play together and have fun, from *Super Mario Odyssey* to the racing assists available in *Mario Kart 8 Deluxe*.

### Questions

1. What were Microsoft's motives in entering the games console market with Xbox?
2. What are the competitive advantages of Microsoft's Xbox One and Sony's PlayStation 4?
3. What are the competitive advantages of the original Wii and the new Nitendo Switch?
4. What do you think Nintendo's chances are of creating a 'blue ocean' come-back with their Switch?

Source: based on different public sources.

## QUESTIONS FOR DISCUSSION

1. Which sources of competitive advantage are the most important?
2. How can analysis of national competitiveness explain the competitive advantage of a single firm?
3. Is it possible to identify not only national competitiveness, but also regional competitiveness? (A region is here defined as more than one country.)
4. In which situations should a firm consider outsourcing its value chain activities?
5. What are the key drivers of the sharing economy?

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