Solution Manual for Modern Competitive Strategy 4th Edition Walker Madsen 1259181200 9781259181207

Teaching Note: Ch. 2 – Competitive Advantage

Learning Objectives

LO 02-01. Identify and describe the Value-Price-Cost Framework and its relationship to positioning a firm in a market.

LO 02-02. Explain the relationships between a firm's resources and capabilities and the firm's value and cost drivers.

LO 02-03. Apply the VPC framework.

LO 02-04. Explain the relationship between the generic strategies and the VPC framework.

LO 02-05. Articulate the relationships between isolating mechanisms and a firm's ability to sustain a superior market position over time.

LO 02-06. Analyze the strength of a firm's isolating mechanisms.

Topics Covered in this document:

1. Overview
2. Case Recommendations
3. Teaching tips
4. Exercises and links to Video resources

1. Overview

This chapter is very easy to teach and can be either the first or second class in the course. We prefer to teach this material in the first session, even though that goes somewhat against the grain of current practice in strategy teaching. Our rationale is that students should understand first that industry structure is a function of strategic behavior and second appreciate that structure can constrain behavior. Using the value-price-cost (VPC) framework to show this interaction is extremely useful, and it is logical to introduce this framework in the context of competitive advantage. However, there is no reason the framework could not be introduced through separate slides or discussion when industry analysis is taught in a first class. Obviously, VPC applies only to price maker industries, not commodities.

The VPC framework is now perhaps the most accepted way to teach the resource-based view of competitive advantage, as argued by Hoopes, Madsen and Walker in SMJ and Peteraf and Barney in MDE. The framework is not new, as the references in the text indicate, and is used in other strategy books. Our goal in this text has been to use VPC to tie together almost the complete range of strategy topics so that students have an integrated and robust perspective that is consistent with the economics of sustainable performance differences. VPC also subsumes generic strategies, so that this concept can be taught without distortion. Further, we have found that the framework works extremely well as a foundation for teaching almost any case, single or multibusiness. Finally, VPC is highly intuitive and easy to teach, either as background to the challenges in a case or in straight lecture/discussion format.

Our approach to teaching the VPC framework begins by locating it in a larger framework of competitive advantage (for instance, slides 3-5). Value and cost are determined in part by the firm's resources and capabilities, which must be defended from imitation. Otherwise, competitors will copy them and rivalry will drive the price down, reducing the firm's profit. We also include customer retention as a means of defending against competitors, since switching costs also increase the costs of competing against the firm.

We then introduce the list of generic value and cost drivers. Regarding the value drivers, one could decompose many of them into subcategories; quality, for example, has elements of durability and aesthetics. We emphasize that firms need to articulate effectively what determines demand for their products. The generic value drivers may be helpful in this task, but they should not be forced upon the firm's analysis of its customers' preferences.

Cost drivers are harder to decompose into elements. As a group they can be divided, importantly, into those that are dependent on high volume or scale (scale economies, scope economies and the learning curve) and those that are not (practices, low input costs). We call the former scale-driven cost drivers. Vertical integration is included since theoretically in-house transactions are more efficient for customized activities. The difference between scale and non-scale driven cost drivers comes up again in the Strategy Over Time chapter.

Defining value is very important. Students should understand that value is not price; rather, it is what a customer would be willing to pay in the absence of alternative products and given budget constraints. We, and others who teach this framework, use the phrase, "willingness to pay." Examples of the difference between value and price abound, such as gasoline, cell phone service, air transportation, a latte. In most cases there are clear substitutes with a lower V-P than the product, but in other cases there is no fundamental need for the product, and budget constraints become more salient. Once students understand what determines their purchases (V minus P) and can see that businesses make the same kinds of purchasing decisions, and also see that price in most cases does not equal cost because of differences in firm resources and capabilities, then almost everything else in the session is relatively clear. In the chapter, we briefly lay out the ways WTP has been estimated in the business-to-consumer context and the business-to-business context. We find that this content is critical to students' understanding of the differences between price and willingness-to-pay. The methods also allow instructor make links to content students have covered in prior course work (analytics, stats, marketing). In this edition, we introduce the results of the conjoint analysis used by Apple in its legal battle with Samsung over patents used for smartphones and tablets. Table 2.1 identifies differences in a customer's willingness to pay for particular product features.

Next, we walk though stylized examples to illustrate baseline approaches to positioning based on investments to increase Value or lower Costs, and to changes in price. Each example reinforces how value is distributed – how much value is created and how much is captured by the firm and the customer. The first animated example (Positioning on the Value slide, slide 14) begins with two competitors that have the same Value and the same Cost levels. Firm A invests in Value without changing price; this investment provides a larger surplus (V-P) to the customer. As a result, value sensitive customers from Firm B flock to Firm A's offering and Firm A's volume increases. Firm A will capture more value as long as $(P-C_2)Q2 > (P-C_1)Q1$ where "1" and "2" denote the firm's position before and after the investment, respectively.

In sum, starting with this very simple idea therefore makes teaching competitive advantage, and in fact strategy in general, quite straightforward. The course is different from marketing since the focus is on the business unit not the product. And the course differs from finance because the primary emphasis is not on valuation but on what drives the cash flows.

Once the overall framework has been presented, we like to move to the concept of tradeoffs between value and cost. Tradeoffs are central to strategy since they reflect the impact of resource constraints on the strategic choices firms make. The standard tradeoff between value and cost implies that higher value requires more investment and therefore higher cost, and less investment produces lower value. It is straightforward then to use tradeoffs to present Porter's concepts of generic strategy, viz. differentiation and cost leadership. Differentiation maps onto value or a value advantage. Cost leadership is associated with low cost or a cost advantage. Note that generic strategies are presented in terms of market position in the chapter rather than in terms of defending against the five forces. (The five forces are dealt with in the Industry analysis chapter and their relationship to value, price and cost is detailed there.) There are several advantages to framing generic strategies in terms of market position. First, it focuses the student on the customer and building demand; second, it shows how the pejorative term, stuck-in-the-middle, is not useful. There are many cases where firms in the middle do better than extreme differentiators or cost leaders. The extended example given in the chapter is Target Corporation.

How can stuck in the middle be successful? The key is to understand that superior positioning is better explained in terms of value over cost or value minus cost, rather than in terms of occupying one end or the other of the value-cost spectrum. Even firms competing in discount retailing are concerned about Value and not only Cost. In this way the VPC framework can be used to teach any business strategy case, no matter what market position the firm has achieved.

Having set up the importance of market position for competitive advantage, we shift attention to the significance of defending against competitors through developing or exploiting isolating mechanisms. Here it's important to emphasize that competition pushes prices down, increasing the buyer surplus (V-P) and lowering the firm's profits (P–C). Customers benefit, but firms do not. So a firm has an incentive to reduce competition by preventing the imitation of the resources and capabilities that underlie its value and cost drivers. In this light, it is straightforward to discuss switching costs that lead to high customer retention as well as the four ways firms attempt to prevent direct competition in their market positions (property rights, dedicated assets, causal ambiguity and sunk costs.

At the end of the session the students should have a clear idea of why some firms perform consistently better than others. Almost any single business case, from HTC or Hulu to Walmart or Southwest Airlines, works very well within this framework. In our experience, the framework does a better job in explaining sustainable advantage than generic strategies, primarily because it captures a wider range of phenomena and embeds generic strategies as a special case.

2. Recommended Cases (all materials available via HBS Online for Educators)
For additional cases, see the Case Chart that maps chapters and topics to cases and simulations.

Airborne Express, 798070
Apple in 2012, 712490
Crown, Cork & Seal in 1989, 793035
Coursera, 714412
Dogfight over Europe: Ryanair (A, B; and/or C)
eHarmony, 709424
Google, Inc., 910036
HTC Corp in 2012, 712423
Hulu: An Evil Plot to Destroy the World?,
510005 Husky Injection Molding Systems,
799157 Microsoft Search, 709461 Patagonia,
711020
Samsung Electronics, 705508
Sunrise Medical in 1999, 700031
Tesla Motors, 714413
Threadless: The Business of Community, 608707 (multimedia case)
Wal-Mart Stores, Inc., 794024
Zara: Fast Fashion, 703497

3. Teaching Tips

Walmart Stores Inc. Case and Relative Value:

In a case discussion, ask the students to identify the value drivers for customers in Walmart's rural markets and to the price differences for the rural location relative to the next largest discount retailed (this data is provided in the case). Next, shift to Walmart's urban locations, (where Walmart is located with 1-6 miles from rivals such as Target) and ask the students, which value drivers from the rural markets also exist in the urban markets and what price does Walmart typically charge, relative to rivals, when the firm is located within 4-6 miles of a rival (provided by the case). Walmart's tactics are more constrained in the urban markets (few points of differentiation relative to rivals selling relative comparable goods to the same customer). This simple illustration walks the students through a very simplistic V-P and can be used as a setup for discussing whether Walmart has any resources or capabilities that are protected from imitation.

Stylized Exercise: Starbucks vs. Dunkin Donuts

For instructors who do not have sufficient time on the first day of class to cover a case, a stylized VPC exercise can be used to help students begin to think about the VPC framework. Using Starbucks and Dunkin Donuts, list each firm's prices for an expresso, high maintenance latte, and a large mocha on the board.

Ask: who are the coffee drinkers in class today?

State: Assume that you cannot purchase coffee from campus but that there is a new Starbucks within walking distance from the business school; located next to the Starbucks is a Dunkin Donuts. These are the only two locations where you can buy coffee. What drives you to purchase coffee from one firm vs. the other?

List the students' answers as "value drivers" on the board. Some student will state they will go wherever price is lowest – reiterate that price is not a value driver.

Step back and ask: Is our sample biased? How might we do this more accurately? What methods might we use to collect data on Value? And so on.

4. Exercises and links to Video resources

Exercises

A) Putting Together the Strategy Puzzle

Source: http://carpenterstrategytoolbox.com/category/differentiation-advantage/

Description: This exercise illustrates the importance of understanding the resources a firm holds and the importance of identifying and using overlooked resources or expertise within the firm. The exercise requires 2x 25 piece puzzle pieces. Before the exercise, two pieces from each puzzle should be blacked-out with an indelible market. You may also strategically place a few pieces in the room (at a few students' desks) prior to class. We assign a group to the exercise and their task is to put all of the puzzle pieces together using all of the resources available in the room. They are given three minutes.

What happens: The group eventually determines that there are two puzzles and they typically set the black pieces aside as "not belonging to the puzzle"; or leave these pieces to add after the puzzle is almost complete. Rarely does the group solicit anyone in the class for puzzle pieces.

Debrief: Refer to the link above for learning objectives, discussion questions, and key lecture points.

Alternative formats: The exercise may be modified in a variety of ways: 1) One approach is to have 2 teams or groups compete to complete puzzles (this requires a second set of 2 x 25 piece puzzles; each team's resources include two puzzles). 2) In another scenario, we run the exercise in two rounds. In the first round, both teams compete to finish the puzzle; prior to round two, one team is provided with additional resources (extra puzzle pieces) and the teams, again, compete to complete the puzzle. In this case, the abundance of resources may not help. 3) In a third variation, controls are set on ways the team members may communicate with each other. In one team, everyone may talk freely; in the other, team members cannot speak with each other and may only take instructions from the team leader. This scenario can be used to show communication and control may affect execution.

B) Is your advantage sustainable? Connecting Resources & Capabilities to Isolating Mechanisms
Using the case assigned for the day and after a brief lecture on isolating mechanisms, have students work in teams of 2 to identify 3-5 of the focal firm's resources or capabilities and to evaluate whether and how each resource or capability contributes to a disadvantage, parity position, temporary advantage or more sustainable advantage. Ask the students to identify any isolating mechanisms protecting a resource from imitation. Give the students about 7-10 minutes in their teams of two develop their analysis; then, discuss the results in the class as a whole.

Three points of confusion are surfaced by this exercise. First, even though they are familiar with the definitions for resources or capabilities, students often identify a strategy or a tactic as a resource or capability. The exercise provides an opportunity for reinforcing the differences in these concepts. Second, students often confuse describing a resource or capability with identifying the factors that prevent its imitation. Thus, the exercise provides an opportunity to reinforce the isolating mechanism concept. Second, some students confound the outcome of a resource or capability with its description (creating a tautology, for example, "an efficient manufacturing capability" rather than a "manufacturing capability"); the exercise provides an opportunity to emphasize that the sources of advantage (inputs) are distinct from the outcomes they produce.

Videos

A) Clip from Southpark - Underpants Episode

In this clip, the boys from Southpark are visiting gnomes who have stolen underwear. The gnomes plan to profit from the underwear but how they will do so is a question mark. The brief clip includes their plan (a chart that shows "Collect Underwear" (resources) on one end, and "Profits" on the other end; the middle is a "?"). At the time of this writing, several links to the clips from the episode are available on Youtube (the full episodes are available at Southpark's website).

B) Differentiating Uber: Seize the day

Source: Carpenter Strategy Toolbox,
http://carpenterstrategytoolbox.com/category/differentiation-advantage/
Description: This short clip from the Onion can be used to illustrate customer willingness to pay & differentiation.