DEVELOPMENT OF THE FIRM’S INTERNATIONAL COMPETITIVENESS

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Abstract:

Development of a firm’s international competitiveness takes place interactively with the environment. The firm must be able to adjust to customers, competitors and public authorities. To be able to participate in the international competitive arena the firm must be established a competitive basis consisting of resources, competences and relations to others in the international arena.

Keywords: development, national competitiveness, competition analysis, competitive triangle, benchmarking

To enable an understanding of the development of a firm’s international competitiveness in a broader perspective, a model in three stages (fig. 1) will be presented:

1. analysis of national competitiveness (the Porter diamond);
2. competition analysis in an industry (Porter's five forces);
3. value chain analysis:
   - competitive triangle;
   - benchmarking.

The analysis starts at the macro level and the moves into the firm’s competitive arena through Porter’s five forces framework. Based on the firm 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 fig. 1 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.
Fig. 1. Development of a firm's international competitiveness
1. Analysis of national competitiveness (the Porter diamond)

Analysis of national competitiveness represents the highest level in the entire model (fig. 1). Porter called his work „The Competitive Advantage of Nations“ – 1990, but as a starting point it is important to say that it is the firms which 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 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 national 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 weakness relative to foreign rivals.

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

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, 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: 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.

Let us now take a closer look at the different elements in „Porter’s diamond“, beginning with the factor conditions.

a) factor conditions: in this connection it is important to mention that the most enduring competitive advantages for nations are created by those factors that have the least degree of mobility. Table 1 lists the various factors of production and indicates the mobility of each.
Table 1. Factor conditions and their degree of mobility

<table>
<thead>
<tr>
<th>Factor</th>
<th>Degree of mobility</th>
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<tbody>
<tr>
<td>Climate</td>
<td>Low</td>
</tr>
<tr>
<td>Physical infrastructure (transport etc.)</td>
<td></td>
</tr>
<tr>
<td>Natural resources (minerals, oil)</td>
<td></td>
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<tr>
<td>Educational system</td>
<td></td>
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<tr>
<td>Human resources</td>
<td></td>
</tr>
<tr>
<td>Technological infrastructure</td>
<td></td>
</tr>
<tr>
<td>(software, communication network)</td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>High</td>
</tr>
</tbody>
</table>

At one extreme, we have climate with no mobility. At the other end of the mobility scale we have capital, probably the most mobile of the factors of production.

b) demand conditions: the nature and size of home demand is represented in the right-hand box of „Porter’s diamond“ (fig. 1). 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.

c) related and supporting industries: in part, the advantages of clustering come from a reduction in the transportation costs for intermediate goods. In many other cases 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 industries. Coordination of technology is also eased by geographic proximity.

d) firm strategy, structure and rivalry: one of the most compelling results of Porter’s study of successful industries in 10 different nations is the powerful and positive effect that domestic competition has on the ability to compete in the global marketplace. 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.

e) chance: 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 having 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.
f) **gouvernment**: governments play a powerful role in encouraging the development of industries within their own borders that will assume global positions. One way governments do this is through their effect on other elements of the „national diamond“. Governments finance and construct infrastructure, providing roads, airports, education and health care, and can support use of alternative energy or other environmental systems that affect factors of production.

From the firm’s point of view the last two variables, change and government, can be regarded as exogenous variables which the firm must adjust to. Alternatively, the government may be considered susceptible through lobbying, interest organizations and mass-media.

In summary, we have identified six factors that influence the location of global industries: factors of protection, home demand, the location of supporting industries, the internal structure of the domestic industry, change and governoement. We have also suggested that these factors are interconnected.

2. **Competition analysis in an industry**

The next step in understanding the form’s competitiveness is to look at the competitive arena in an industry, which is the top box in the „diamond model” (see fig. 1).

One of the most useful frameworks for analysing the competitive structure has been developed by Michael Porter. Porter (1980) suggest 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 fig. 1. 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.

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 which are close substitutes for each other. A **market** is a set of actual and potential buyers of a product and 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 other box in fig. 1 is designated „industry level“ and the inner box „market level“.

The „industry level“ consists of all types of actors (new entrants, suppliers, substitutes etc.) 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).

Each of the five forces in the Porter model is now discussed:

a) **market competitors**: the intensity of rivalry between existing competitors in the market depends on a number of factors:
   - the concentration of the industry;
   - rate of market growth;
   - structure of costs;
   - degree of differentiation;
switching costs;
exit barriers.

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 be 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.

b) 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;
their products are unique or differentiated;
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.

c) 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;
the industry’s product is unimportant to the quality of the buyer’s 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.

d) substitutes: the presence of substitute products can reduce industry attractiveness and profitability because they put a constraint on price levels.

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.
e) 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 forms customer loyalty;
- capital requirements in production;
- switching cost – 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 now competitors, the marketing planner should not take a passive approach but should actively pursue ways of raising barriers to new competitors.

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.

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, drawing upon the foundation and utilisation of both collaborative and competitive advantage.

3. Value chain analysis

Success in the marketplace is dependent not only 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. The immediate causes of differences in the performance of different firms, these writers argue, can be reduced to two basic factors: 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; the firm-related costs incurred in creating this perceived value.

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 (fig.1).

The perceived value created and the costs incurred will depend on the firms resources and its competences (fig. 2).

![Diagram of performance and competitive advantage]

Figure 2. The roots of performance and competitive advantage

The ultimate test of the efficiency of any marketing strategy has to be in terms of profit. 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.

The concept of the 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 out performing rivals. Firms also have to consider (or market) positioning, meaning the performance of different activities from rivals or performing similar activities in different ways.

References:
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