

# Competitive Dynamics and Creating Sustainable Advantage

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Firms that earn persistently higher levels of profit than competitors have a competitive advantage (Grant, 2008; Porter, 1985). A variety of theories within the strategy domain address competitive advantage as a way of explaining how management decisions or market factors lead to superior economic performance. According to Michael Porter (1985), to have a competitive advantage a firm must create superior value for buyers by offering lower prices than competitors for equivalent services or by providing unique services that a buyer is willing to pay for at a premium price. Using this definition, a given firm must devise a competitive strategy that is able to establish a profitable and sustainable position relative to competitors. Porter (1985) argues that a firm's profitability is also determined by the attractiveness of the industry. He offers a framework of competitive forces that are a function of industry structure or the underlying economic and technical characteristics of an industry. The positioning paradigm associated with Porter (1980) and grounded in industrial organization (10) argues that market structure drives firm level positional strategies (Mintzberg, 1994). This 10 foundation serves as the conceptual home for Chapter 15 by Kim and Canina, which notes that the nature of the market affects a firm's ability to compete. The chapter explores the complexity of market definition in the hospitality industry by examining clusters of competitive relationships. Using data from U.S. hotels, this chapter raises important questions about how best to define market boundaries and the implications of these definitions for determining appropriate competitors for strategic analysis.

A different conceptual foundation that focuses less on industry structure and more on the internal capabilities of the firm argues that a firm's ability to achieve and sustain a competitive advantage is directly related to its firm-specific resources (Barney, 1991; Mahoney & Pandian, 1992; Peteraf, 1993; Rumelt, 1984; Wernerfelt, 1984). This view, called the resource-based theory of the firm, emphasizes the role of building unique and valued know-how and capabilities that rivals cannot easily imitate (Barney, 1991; Grant, 2008). This task is difficult and requires a firm to select the appropriate strategy based on the development of resources and capabilities. In this part of the book, three chapters (Chapters 16, 18, and 19) explored issues that revolve around firm-specific knowledge resources to achieve competitive advantage in restaurants and hotels. A final chapter (Chapter 17) in this grouping

focused on contingency theory to help understand the role of both environmental and internal factors on performance. Three of the chapters offer empirical support for their views, while one is a conceptual chapter and the other relies on a case study. While three dominant paradigms inform the chapters in Part III, all of them seek to clarify our understanding of the competitive dynamics that shape the performance of firms in the hospitality industry.

## **Understanding Competitive Dynamics**

### *Identifying Relevant Markets*

One of the major challenges for hospitality managers is accurately defining the competitive situation. In Chapter 15—the featured chapter "On the Importance of Market Identification"—the question of how to define the competitive arena is explored. Kim and Canina, the authors, argued that the boundary for competitive analysis is often defined as broadly as the industry worldwide or as narrowly as the specific players within a given geographic scope. It seems evident that the same definition of market or industry should not be used when making strategic decisions around price or past performance in contrast to decisions about unserved markets and future opportunities. In the former case, narrow definitions may be far more useful than in exploring competitive questions that address future competitors.

Kim and Canina began by arguing that one of the limitations of market boundary definitions is that they are treated as classification schemes but are not considered to be an important element of determining overall competitive advantage. The authors explored the complexity of determining market boundaries by first reviewing the strategy literature on market identification. Market, when not defined as the entire industry, is defined by resources or strategies, product type, and/or consumer needs. The authors elaborated on the resource-based view (RBV) that suggests that firms with similar resources (e.g., physical, technological, managerial, or organizational) pose a competitive threat. In contrast, the strategic group approach clusters firms with similar strategies together arguing that they compete more intensely with each other. The last framework they explore in detail is the customer- or demand-side approach, which suggests that customers define the market according to competitors who fulfill similar needs. The review concluded that managers are more inclined to define their competition on supply side attributes linked to competitive advantage (e.g., resources and strategies), while customers judge substitutes in what can be considered a demand-based approach. Elaborating on hotel markets, the authors show that complex layers of structure allow us to define competition from global to local, by

product type, at corporate and property level, by brands, and any combination of these factors. The authors suggested that drawing boundaries around industries and markets must be given more Chapter 20 Commentary: Competitive Dynamics and Creating Sustainable Advantage 299 attention and that identifying the relevant market in the hotel industry is essential if we are to fully understand the nature of competition among firms within the industry.

Evaluating the performance of hotels differs depending on how market boundaries are drawn. To illustrate this idea, Kim and Canina spent the remainder of their chapter exploring two different approaches to defining a specific hotel market's boundary. Using product type (e.g., luxury, upscale, economy, etc.) and a minimum variance clustering method around average daily rate (ADR), the authors show that the characteristics of a given market differ depending on the techniques used to define competitive groupings. What is fascinating about their findings is that hotels do not easily fit within the conventional product type classification when the starting point is customer choice based on the clustering method of ADR. The results they detailed offer a more micro view of the external environment and competitive strategy than that associated with the industry analysis offered by Porter (1980) and commonly used in the lodging industry. Further, the chapter is the first of its kind to question our traditional definitions of market identity in hotels and to suggest that an alternative approach that incorporates both manager and customer perspectives (ADR clusters) will lead to a more compelling articulation of real substitutes and hence facilitate a more meaningful property-level competitive analysis.

Much work remains to be done in this interesting area of emerging research. Most promising future endeavors should consider other factors for identifying market similarity beyond price. Nevertheless, in Chapter 15, Kim and Canina showed empirically that product type does not effectively capture the competitive dynamics of hotels in microlevel local markets. The illustrative market used in the data analysis showed that luxury hotels could be grouped into three different and distinct groups while one cluster group accommodated all midprice and economy hotels along with one upscale hotel. Since hotels in the same property type did not group in the same ADR clusters, performance gaps due to physical conditions, service quality, resource capabilities, or senior management skill may be the cause of the problem. Hence, the redefinition of local markets using an ADR cluster approach, such as the one introduced by Kim and Canina in Chapter 15, may prove to be a valuable tool for recognizing shifts in a firm's competitive market and enable improvement in cases where a hotel's performance is below its property level. We now turn to the remaining chapters in Part III of the book, which focus on the role of internal resources in building and sustaining competitive advantage.

## Resource-Based Advantage

### *Failure Rates and Elements of Success in Restaurants*

According to the Parsa et al. chapter (Chapter 16), only 26% of independent restaurants fail in their first year of operation, when mortality data are operationalized using operating license permits. The Dun & Bradstreet Corporation's (2000) *Business Failure Record* reports that eating and drinking places have more business failures than any other industry. Experts, executives, and the investment community estimate that failure rates are as high as 90% in the United States and west European cities (Hubbard, 2003). Still, exact figures are difficult to obtain, and failure rates are not tracked by the National Restaurant Association. The lack of reliable statistics and the fact that the failure rates that are available appear to vary by the source makes this chapter a valuable contribution. By using the operating license permits approach to gathering data, this study provides a new and useful operationalization of restaurant failure. The literature has relied on everything from bankruptcy rates, which understate failure, to change of ownership (i.e., turnover rates), which overstates failure rates because of its inclusion of a broad definition of closures. Moving forward it would be desirable to see this study replicated in cities with larger restaurant communities. The finding that Mexican restaurants had the highest failure rate may be a function of the popularity of this cuisine in Columbus, Ohio. It is likely that different restaurant segments will have a greater probability of success depending on the customer needs in a given city.

The finding that smaller independent restaurants have higher failure rates than larger franchised restaurants is consistent with industry perceptions. However, the U.S. Federal Trade Commission's consumer protection director notes, "The most widespread myth is that franchises are a safe investment because they have a much lower failure rate than independent business. In fact, there may be much less of a difference than is commonly thought" (Oleck, 1993). It is useful to note that the 3-year cumulative restaurant failure rate for franchised chains was 57% in contrast to 61% for independent restaurants in this study. So while smaller independent restaurants fail more than franchise chains, the differences in failure rates are not huge.

Another finding of interest in Chapter 16 was the result that showed higher failure rates in areas of the city with higher restaurant concentration. This finding is contradictory to previous research on positive effects from agglomeration or clustering of competitors in the hospitality industry (Canina, Enz, & Harrison, 2005; Kalnins & Chung, 2004). Agglomeration economics argues that geographic areas with a large selection of competing services are more attractive because they reduce search costs for the

consumer (Marshall, 1920). Attraction to the location is simply due to the wider variety of restaurants from which to choose. From the restaurant owner's perspective, colocation should allow closer monitoring of competitors and the ability to respond to specific competitor moves (Canina et al., 2005). Previous research has found that the greater the difference in product segments represented in a local market the more likely that both the positive and negative benefits of colocation will accrue for firms that are experiencing uniqueness from others in their clusters (Canina et al., 2005; Enz, Canina, & Liu, 2008). In light of the research findings for hotels, it is possible that future research in restaurant failure could explore more fully the question of cluster composition. In hotels, positive colocation effects are caused by benefits from higher segmented properties (e.g., luxury hotels). With further research, it could be discovered whether these findings are also true for casual restaurants that colocate next to fine dining establishments and negative effects of colocation with firms in lower segments such as quick service restaurants (QSRs). Future work should more fully explore failure rates, and a logical starting point is the expansion of the investigation to a larger sample of cities and incorporate more sophisticated metrics for measuring concentration, such as those used in the agglomeration research.

Turning to the qualitative results of Chapter 16, the authors interviewed 20 successful and 20 unsuccessful independent restaurant owners to determine the key factors that contributed to failure. The most important finding, according to the authors, was that a successful restaurant requires focus on a clear concept that drives all activities. The authors argued that concept is distinct from strategy and that having a well-defined strategy did not contribute to success. As proof of this conclusion, the authors noted that some of the failed restaurants had elaborate strategic plans. The discussion of strategy seems to suggest that the creation of a plan may actually drive out strategic thinking. The term *strategy* is used in many different ways, and in this chapter, it is difficult to determine what the authors actually mean. It appears that the term may be used interchangeably with the term *planning*. It may be possible that the strategy process experienced by the restaurant owners was too rigid and drove out creative thinking, a concern often expressed when discussing strategic planning as an analytical process (Enz, 2010; Mintzberg, 1994). Nevertheless, focus on a clear concept is part of the strategic management process (SMP), which begins with the formulation of a strategic direction. The authors reported that maintaining a clear vision, mission, and operating strategies were essential but that owners needed to amend their strategies as the situation changed. This qualifier is consistent with strategy scholars, who would argue that firms should engage in deliberate strategic planning processes, but they should also be willing to make mistakes and learn from them as they chart a strategic course (Enz, 2010). In other

words, strategy is both deliberate and emergent, and firms should both adapt to and enact their environments, with the situation determining which option to choose.

Overall, the results from the qualitative interview with restaurant owners revealed that in addition to a well-defined business concept, focus, positive organizational culture, managerial flexibility, location, and various personal characteristics were elements of success. Broadly speaking, the results of this study suggest that a wide range of skills and resources influence competitive performance. In their efforts to answer the question of why some restaurants succeed and others fail, these authors lead us to an RBV of the firm. While they do not explicitly use this perspective on strategy development, Chapter 19 on restaurants does. We now turn to this chapter.

### *Resource-Based Competencies in Restaurant Franchising*

The distinctive competency literature and the RBV of the firm argue that organizational success can be explained in terms of the resources and capabilities possessed by an organization (Barney, 1991; Mahoney & Pandian, 1992; Wernerfelt, 1984). According to this view, an organization is a bundle of resources, and thus, a single resource does not create competitive advantage. In Chapter 19, Enz used Outback Steakhouse in Korea to illustrate how careful attention to developing and applying resources and capabilities in five categories can build sustainable competitive advantage.

In Chapter 19, Enz showed how Outback has gained competitive advantage by possessing superior resources in the five categories described in a general framework that includes (1) financial resources, including all of the monetary resources from which a firm can draw; (2) physical resources, such as land, buildings, equipment, locations, and access to raw materials; (3) human resources (HR), which pertains to the skills, background, and training of managers and employees, as well as the way they are organized; (4) organizational knowledge and learning; and (5) general organizational resources, including the firm's reputation, brand names, patents, contracts, and relationships with external stakeholders. Each resource category is described and an example from Outback is provided to illustrate. The case suggests that Outback Steakhouse Korea's differentiation rests most heavily on intangibles, such as HR and operational processes. Emphasis was placed on how the full bundle of interdependent resources is essential to giving this restaurant chain competitive advantage. The ability of a resource or capability to lead to sustainable competitive advantage depends on whether it is valued in the market, unique, costly to imitate, readily substitutable, and is built with the existence of organizational systems.

What isn't clear from the chapter is whether Outback Steakhouse in Korea has a sustainable competitive advantage. Distinctive competencies, or the subset of resources that help an organization perform well, are considered a source of enduring advantage because they have considerable ambiguity and tacit knowledge, making them difficult to imitate (Bryson, Ackermann, & Eden, 2007). When Outback stepped away from the traditional hierarchical organizational culture common in Korea, the firm may have developed a difficult to replicate, casually ambiguous resource that sets the company apart. In a franchise restaurant, competencies may be the result of linked competencies across organizational boundaries and hence not simply internal to the firm. In the case of Outback Steakhouse Korea, the chapter highlighted the importance of the cooperative relationship between the U.S. franchisor and the Korean franchisee. The development of cross-boundary competencies may be a major collaborative advantage for franchise restaurants.

### *Information as a Source of Competitive Advantage*

In Chapter 18, Piccoli argued that information technology (IT) can be used strategically to enable value creation and sustained differentiation. The benefit of this chapter is that it provides a more robust and sophisticated framework for the use of IT—one that moves beyond the development or purchase of a computer system or application that may create advantage for a brief period of time until others replicate the system and the IT loses its uniqueness. Instead, the author presented a view of IT as a bundle of strategic initiatives. Drawing a distinction between IT and information systems (IS), the chapter suggests that IT is a single resource, and IS is the configuration of interrelated and interlocking activities, which leads to IT-dependent strategic initiatives. In this systems view, IT is easily imitated by competitors, while an IT-dependent strategic initiative can enable a substantial delay in competitive response. The response lag drivers include IT resources and IT capabilities consistent with the broader RBV of the firm. Complementary resources, IT projects, and preemptive preferential relationships are also barriers to erosion of competitive advantage and extend the response time of competitors. In Chapter 18, Piccoli offered a detailed framework with an array of subcategories offering a tangle of jargon for many readers but in the end a comprehensive argument in support of the benefits of IT-dependent strategic initiatives. Unfortunately, the chapter offered few examples to help illustrate the framework but acknowledges the need for validation and testing of the proposed conceptual framework.

Some have argued that the interface with the customer is the "sole remaining frontier of competitive advantage" (Rayport & Jaworski, 2004, p. 48). Given the challenges of attracting and

retaining skilled service workers, technology may serve as a viable substitute (Enz, 2009). Further, customers are becoming more accustomed to service relationships and interactions being handled through interface technologies. A systems approach to effectively build an IT-dependent strategy is extremely important in light of this trend toward increasing use of IT to replace human interactions. While interface technology can assist frontline employees in customer-facing front-of-the-house roles, it can also replace phone and online services traditionally provided through human interaction. Aggressive moves from competitors who are early imitators or fast second movers can erode technology advantages. The risks of aggressive competition in the acquisition and appropriation of value from technology requires strategic decision makers to make significant investments in the technology system and carefully weigh how to delay competitor response. Chapter 18, while conceptual in nature and lacking in empirical substantiation, did offer advice for how to build a strategy to successfully tap into technology as a critical resource.

#### *Environment and the Role of Competitor Versus Customer Orientation*

The final chapter realizes that different situations give rise to different approaches to firm profitability. Dev and colleagues (in Chapter 17) deployed a contingency theory approach that includes environmental conditions such as stage of economic development and local market factors as moderators of the relationship between market orientation and firm performance. Under contingency theory, different environmental factors explain differences in organizations (Mintzberg, 1994), and managers choose strategies that are best suited to their environment. In this study, the authors focused on the circumstances under which a firm selects a customer orientation strategy that focuses on acquiring, satisfying, and retaining customers or deploys a competitor orientation that addresses monitoring, managing, and outflanking competitors. The distinction between a customer orientation and a competitor orientation rests on the degree to which a firm strives to understand its target customers versus its competitors' actions. The international context of this chapter allowed the authors to consider a country's stage of economic development as a critical environmental factor.

Using data from 37 brands of hotels in 56 countries, in Chapter 17, Dev and colleagues found a competitor orientation was more effective in a developing economy while a customer orientation was more successful in more developed markets. The chapter does not provide the empirical results to the study; however, these data are available in the original research paper by Zhou, Brown, Dev, and Agarwal (2007). Examining the empirical results suggests that main effects of competitor orientation on performance are not significant in any of the models tested. In addition, customer orientation and



competitor orientation offer little explanatory variance (change in R-squared of 3%) in hotel performance beyond the control and environmental factors. While significant, the variance explained by these orientations is small.

The role of the local environment was operationalized to include customer demandingness, local business conditions, resource availability, and availability of local investors. The findings revealed that in markets with demanding customers, a customer orientation is preferable; in markets with poor local business conditions, a competitor orientation is preferable. In resource rich environments, a customer orientation provides stronger performance. The authors further note that a competitor orientation may be detrimental to a firm's performance in markets with high levels of investor availability.

Competitor orientation is argued to be more viable in leaner markets with poorer local business conditions and lower levels of resource availability. It is interesting that a customer orientation has no effect on performance in developing markets, which does suggest implications for how managers should direct their information-gathering efforts. The authors suggested that in these environments managers should orient themselves toward learning how key competitors operate. Other findings seem more intuitive, like the result that a customer orientation boosts performance in local markets where customers are highly demanding. Overall, the findings seem to suggest that different market strategies are more or less linked to hotel performance depending on the nature of the broad economy and local market conditions.

### **Building Competitive Advantage: The Future for Hospitality**

Why are some firms more profitable than others over an extended period of time? The RBV reflected in several chapters discussed in this chapter argues that the bundle of resources and capabilities that are built internally serve as the basis for competitiveness. Indeed, as the competitive environment in the hospitality industry becomes more uncertain, a focus on internal resources may be a more stabilizing and productive approach to strategy formulation. Recent studies have shown that pricing lower than competitors results in lower revenue per available room (RevPAR), clear support for the idea that in unstable times a firm is likely to secure an advantage by focusing on what Dev et al. (in Chapter 17) would refer to as a customer orientation and avoiding the trap of shifting strategy to fit competitor behavior (Enz, Canina, & Lomanno, 2009). The framework introduced by Enz (in Chapter 19) for Outback Steakhouse and the empirical findings by Parsa et al. (in Chapter 16), both speak to the importance of managers selecting a strategy that exploits the firm's core competencies. Piccoli further

argued in Chapter 18 that building IT-dependent strategic initiatives will enhance a firm's capabilities. Other studies have found that investing in intangibles like brand and customer contact, employees contribute to profitability (Walsh, Enz, & Canina, 2008). Resource development is not just about leveraging existing resources; it is also concerned with building new capabilities for the future. Hospitality practitioners would be advised to focus attention inward by building, renewing, and continually re-creating the resources necessary to provide competitive advantage.

While focusing on internal resources is advisable in periods of uncertainty, competitors are not to be ignored. To fully understand competitive behavior, the hospitality industry should complement our conventional definition of markets on the basis of property type with other more meaningful definitions of competitors. The featured chapter (Chapter 15) showed that a pricing-based approach to defining markets and a more sophisticated methodology for grouping competitors yields a new and different perspective on the question of who is your competition. Further research should extend the work begun by Kim and Canina (Chapter 15) with the hope that industry practitioners will be provided with new and more useful microlevel definitions of competitive groups.

## **Conclusion**

In highly competitive industries, such as lodging and restaurants, firms work vigorously to build and defend a competitive advantage. As the chapters in Part III have highlighted, intense rivalry necessitates careful selection of who to compete against as well as how to compete. Given the dynamic nature of strategy formulation, successful firms must begin by carefully defining their competitors to ensure that they are similar on relevant factors and thus clearly direct competitors. As conditions change, managers are required to rethink market boundaries and consider resource and pricing similarities as meaningful ways to determine the extent to which firms are still true competitors. While the chapters in Part III adopted diverse theoretical frameworks to ground their explorations of competitive dynamics, they ultimately showed that both competitor analysis and the extent to which the firms tangible and intangible resources are unique, valued, and difficult to imitate are key to building competitive advantage. Ultimately, firms commit to a definition of the competition, a customer or competitor orientation, a set of capabilities in the form of tangible and intangible resources, and an IT process all in the hopes of avoiding failure and producing above average rates of return.

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