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Systems sales as a competitive response to the Asian challenge: Case of a global ship power supplier

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Abstract

Cost-based competition from East Asia has forced western companies to reassess their competitive strategies. It is difficult for western companies to attain cost leadership because of high domestic labor costs. Thus it is crucial to pursue differentiation. One way to do this is to shift the market from products to systems. To examine the role of systems as an enhancer of competitive advantage, this study synthesizes the literature concerning competitive advantage and systems. The emerging theoretical framework is then tested against an in-depth case study of a Finland-based ship power supplier. The findings suggest that systems can be a value-enhancing strategy whereby the seller takes over the buyer's value activities related to systems integration. Such forward integration results in enhanced systems performance at a lower total cost. This strategy, based on the seller's rare and valuable resources, is difficult for cost-based competitors to imitate or substitute.

Keywords: Competitive advantage; Systems; Systems sales; Competitiveness; Cost-competition; Product strategy

1. Introduction

Competitive advantage is one of the most fundamental concepts in international business because it ultimately determines a firm's success and even survival. Its importance is only growing as globalization tightens its hold. In particular, competition from newly industrialized countries in East Asia is challenging established players. Countries such as China with low labor costs and a high learning curve are forcing western firms to reassess their competitive position in the global market place (e.g. McKinsey & Company, 2005).

It is difficult for western companies to enhance their competitiveness through cost leadership strategies because of high domestic labor costs. Thus it is crucial to pursue differentiation successfully and companies, particularly those operating in mature industries need to take an innovative approach to product strategy. For many companies, this means high technology product innovation and such a strategy has generated numerous success stories. In Finland the most notable example would be Nokia Corporation. However, this article argues that innovation through skillful business process reengineering may be equally effective in strengthening a firm's competitive advantage through differentiation. One way to do this is to shift the market offering from products to systems—a product strategy that combines physical products, know-how, and system-specific services (Kosonen, 1991). Systems may enhance the seller's differentiation by both offering a better end product and by lowering the customer's total (though not initial) costs.

The findings of this study are based on a review of literature and past studies resulting in a process model, which is validated by examining a revelatory case from the shipbuilding industry. The shipbuilding industry provides a good case because it is a mature industry where the effects of globalization have been drastic. In fact, Cho and Porter (1986) call the shipbuilding industry "an extreme case of a global industry" where industry leadership has shifted repeatedly. Starting with the rise of Japanese shipbuilding in the 1950s and 1960s, competitive advantage, especially in the low and medium complex ship categories, has gradually

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shifted to Asia. European shipyards are still market leaders in highly complex ship categories such as cruise vessels, but the Asian shipyards are pushing to enter this segment as well (see for example Clarkson Research Studies, 2003; Drewry Shipping Consultants, 2002). The shift in competitive advantage has been so dramatic that the Finnish financial press has singled out shipbuilding as a symbol of declining Finnish competitiveness (Ahosniemi, 2004).

Thus the central objective of the study was, through a thorough review of earlier research and an in depth case study of a ship power systems supplier, to explore the following question:

How can international systems sales be used to achieve competitive advantage against cost-based competition derived from East Asia and other low cost countries?

2. Literature review

This section reviews existing research on competitive advantage and systems. The aim is first to explain what is meant by competitive advantage and then to examine what factors contribute to building it. Secondly, the concept of systems is examined to analyze how systems could contribute to building competitive advantage. A process model for enhancing competitive advantage through systems sales (Fig. 2) is presented at the end of the section.

2.1. Competitive advantage

Michel Porter is among the most widely quoted authors on competitive advantage. In the Porterian world, a firm's profitability depends on industry attractiveness and on the firm's relative position in that industry. The firm that is favourably positioned within its industry can earn above average profits regardless of the industry's overall profitability. However, to do this the firm must enjoy a sustainable competitive advantage that results from being able to create value for its buyers. This value may take the form of "prices lower than competitors' for equivalent benefits or the provision of unique benefits that more than offset a premium price" (Porter, 1985, 1991).

The main focus of this study is on containing the *competitive pressures from lower cost producers.* Their cost advantage is mainly based on the locational driver that affects the costs of labor, management, scientific personnel, raw materials, energy, etc (Porter, 1985). What makes this driver so challenging for western companies is its geographic specificity. It cannot be emulated without relocation, which is not a desirable strategy from the point of view of the western economies. Thus it is desirable that the *value propositions* of western companies are based on differentiation to offset their higher labor costs. This differentiating effect can occur through two ways—either the seller offers *lowered total costs* or *enhanced performance for the buyer.* At the same time, the differentiator must exercise strict *cost control*, so that it does not price itself out of the market (Porter, 1985).

Chen (1996) notes that competition is a function of firms' market profiles and resource endowments. Thus a firm that competes with lower cost producers could relieve competitive pressure either by changing its market profile or resource base in comparison with its competitors. For a global supplier to an industrial market the market profile may be difficult to change without giving up market share. However, by choosing to build on specific *resources* that cost-based competitors generally lack, the differentiator would deter the ability of cost-based competitors to respond to competitive moves. According to the resource based view (RBV) this resource heterogeneity is at the heart of competitive advantage (Barney, 1991; Peteraf, 1993). Resources are defined as "all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc., controlled by a firm that enables the firm to conceive of and implement strategies that improve its efficiency and effectiveness" (Barney, 1991). A differentiator could mitigate its labor cost disadvantage by strengthening and utilizing unique and valuable resources that are difficult for cost-based competitors to imitate.

An analysis of the firm's resource base needs to be combined with a market orientation. A firm pursuing a strategy of differentiation needs to identify customer segments that appreciate lowered total costs or enhanced performance—that is the value proposition needs to fulfil *buyer needs*. The seller also needs to be able to protect its value proposition through *entry barriers*. Entry barriers refer to difficulties encountered by new entrants to the market (Porter, 1985). The concept of entry barriers can be further complemented by the RBV's concepts of *unique and valuable resources*. Accordingly, firms must base their strategy on resources that are rare and difficult for competitors to imitate. Firm resources can be imperfectly imitable because their development has been dependent on unique historical conditions; the link between the resources and ensuing sustained competitive advantage is casually ambiguous; or the resources contributing to competitive advantage are socially complex (Barney, 1991).

Lastly, a competitive and imperfectly imitable value proposition needs *effective communication* to result in enhanced competitive advantage (Ronchetto, Hutt, & Reingen, 1989). The more difficult it is to measure the exact buyer value, the more rigorous the seller's signalling must be. Anderson and Narus (1998) propose that the seller builds a value model through input from its customers. Customer value models help to operationalize the seller's value proposition by demonstrating the "worth in monetary terms of the technical, economic, service, and social benefits" the customer receives in exchange for the price it pays (Anderson & Narus, 1998). As such value models are negotiated with customers, they also help to eliminate value drains—services that cost the supplier more than they are worth to the customers receiving them and that have no strategic significance.