How to Prolong Competitive Advantage

The resources that take a company further.

When Swedish furniture giant IKEA established its first store outside of Scandinavia, it created an expansion strategy of researching new markets, then opening a flagship store with local customisations and then franchising. Its customisation model was different, allowing for quirky marketing like "Swedes go home" in Switzerland. IKEA used its competitive advantage of a systematic expansion model, in terms of where the stores are and how they are laid out, with the willingness to make important changes when necessary. For example, it adjusted product sizing in the United States, where traditional Swedish-designed drinking glasses had to be supersized to stop Americans from **buying flower vases** to use as tumblers.

Competitive advantage, i.e. those conditions that give a company its favourable position, had been thought to last only about five years on average, according to traditional measures. But as **IKEA** and other firms have shown, a much longer period of success is available to some companies. When evaluating their firms, executives – and the market – have a tendency to consider only the resources they can see, ones that directly affect profit, which we call operating resources. More central to a firm's long-term success, however, are what academics refer to as "higher-order resources", those intangible assets that improve a company and help drive long-term growth, such as strategic capabilities.

Long-term successful companies must be able to change the way they operate; this is the fundamental idea of higher-order resources, also sometimes called dynamic capabilities. Traditionally, strategy scholars focused on a firm's operating resources when analysing its competitive advantage, but these do not explain why some firms outperform others with the same or similar resources for a longer period of time.

In the article, **"Performance persistence in the presence of higher-order resources"** in *Strategic Management Journal*, I found that firms can make their resources go further when they are complemented with intangible but valuable higher-order resources, such as superior strategic planning, M&A capabilities and forecasts. With a model based on empirical data covering 4,000 firms over three decades, I found that when taking into account both operating and higher-order resources, firms enjoy a competitive advantage for 18 years on average.

The special sauce

Higher-order resources are not quantifiable the way that profits are. Fundamentally, both operating and higher-order resources are always idiosyncratic and unique. If there were a general prescription for better resource positions, every firm would have them and these resources would no longer grant any advantage. This makes empirically measuring them a challenge. To confirm the importance of higher-order resources for prolonging competitive advantage, I had to consider the patterns expected in profit and other large-scale observable data, like the persistence of profit growth. Then I used statistical procedures to find the data consistent with what we would expect in firms with higher-order resources – akin to how physicists use extensive computer models to detect the signal of otherwise undetectable new particles such as the Higgs boson.

This "special sauce" of higher-order resources gives a company a competitive advantage for a longer time than previously predicted, but it is finite and should be examined on a firm-by-firm basis. For example, Apple has used its superior tech design capabilities from the arena of desktop computers to transform personal music players and mobile phones.

Evaluate your firm's resource position

So, how can managers make sure their firms have these higher-order resources?

First, you must evaluate your firm's drivers of current profits; what are the operating resources that generate the majority of profit? Often there are a few markets, a few key customer segments or a few key products which are the linchpin to your firm's economic profit. What are the underlying resources that enable your firm to do much better than any competitor? Understanding exactly what it is about your core business that allows your firm to make more profit than your competitors is absolutely critical.

Second, consider how your firm's resource positions have evolved over time. How did your company acquire these capabilities in the first place? And how can they be improved? Are your competitors better able at improving resource positions? How have you done over the past ten years? Few firms consider their resources at the strategic level. And even fewer firms think about what the pattern has been and what the future holds in relation to their competition; in other words: how their higher-order resources stack up vs. those of their competitors.

Higher-order resources: The Danaher example

On their own, higher-order resources don't provide profits. The **Danaher Business System** (DBS) has made Danaher extremely successful for more than 20 years. The company, a diversified conglomerate, applies a modified version of the Toyota Production System to strong, niche industries which were not achieving their full potential, like precision tools or dental tools. Little about Toyota's system was specific to cars; it was a general philosophy of manufacturing applicable to other industries, a perfect example of higher-order resources. For years, Danaher has bought small, underperforming companies and used DBS to turn them around, adding them to its portfolio.

DBS, in itself, produces zero profits. Without a business to apply it to, it would yield nothing. But in combining DBS with other higher-order resources, such as a very skilled M&A and corporate development team, Danaher has been steadily growing and increasing profits over a very long time. The company's CEO Larry Culp has recently moved to General Electric. Over the 14 years with Culp at the helm, **Danaher's market capitalisation and revenues grew five-fold.**

As we have seen with IKEA, Apple and Danaher, higher-order resources help bolster operating resources. They produce persistently better resources over the long term, leading to a longer stretch of competitive advantage. Although broad, my findings show that acknowledging the importance of higher-order resources is a decidedly valuable insight. As an executive, you intimately understand how your firm's resources make a difference. Consider your higher-order resources, like the M&A team or technologies that can be used in multiple businesses, for example, and make an assessment of where your firm's profit drivers are and how your resources have adapted over time.

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