

THEORETICAL FRAMEWORK FOR TAXONOMIZING SOURCES OF COMPETITIVE ADVANTAGE

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Abstract

While talking about competitive advantage and use of this term in literature of business strategy much confusion prevails. There are series of questions pertaining to its origin, types, sources, factors and period of elongation which need to be further investigated through better ontological and epistemological perspectives of competitive advantage. This increased confusion in the definition and clarity of the ideas pertaining to its sources of competitive has enhanced the difficulty level of strategy managers to define their competitive advantage. In this article we have tried to make it easier for the strategy managers to define, refine and retain competitive advantage of their firms. In this article we have made an attempt to make a taxonomy of sources of competitive advantage. The proposed taxonomy divides sources of competitive advantage into location, product, socio-economic environment, raw material access, process and efficiency and organizational structure based. The articles provide useful hints for strategy managers to delineate their competitive advantage and devise strategies for its sustainability.

Keywords: competitive advantage, RBV, IO, Strategy manager, taxonomy, sustainability

1. INTRODUCTION

The literature of business strategy would be incomplete without discussion about competitive advantage and its sources (Barney, 1991; Porter, 1985). Discussion about firms' differential performance has been in the hearts of the strategy literature. Many theoretical frameworks has been presented in the last three decades which have tried to explain the phenomena of differential performance. These frameworks include Porter's five forces model, resource based view and transaction cost economies. Each of these views offer a different set of explanations for firms' differential performance. However despite their inherent differences in explanation of differential performance they share some common assumptions which suggest that competitive advantage is gained through earlier or more favorable access to resources, markets, or organizational opportunities and second assumption underpins the claim that managers exploit these opportunities in a way which yield better performance. (Cockburn et al 2000)

While talking about competitive advantage and use of this term in literature of business strategy we see lots of confusion ensue here. There are series of questions pertaining to its origin, types, sources, factors and period of elongation which need to be further investigated through better ontological and epistemological perspectives of

competitive advantage. Historically many authors like Porter, Barney, Wernerfelt, Peteraf, CK Prahalad and Hamel have discussed the concept in its details but still we feel there is need for more investigative writings highlighting the details about sources and factors which constitute competitive advantage and the limitations of the existing work done in the domain of competitive advantage particularly in lieu of strength and breadth of competitive advantage. The extensive review of the literature lead us nowhere but to a situation which yields further ambiguity. We find that competitive advantage concept is in use but with no clear understanding about its nature and position in various epoch, industries and regions. We do not have concrete knowledge whether the conditions and guidelines given in IO or RBV perspective for achieving competitive advantage are applicable to all industries and for all regions and for all times?

We see in the literature that each author has used the competitive advantage term in his/her own perspective fulfilling his/her own scholastic needs. A coherent approach toward understanding of the concept acceptable for all lacking. What is the origin of competitive advantage and when precisely can we say that certain organization has gained competitive advantage and what is the strength and breadth of the competitive advantage; these and many more other issues are the main focus of this article. We want that the concept of competitive advantage should be presented in a way which will help future managers to strategize for building it. The so far available literature creates more confusion and lacks ability to lead a corporate manager to decide about the path which will ensure competitive advantage.

We found much literature on the sources of competitive advantage but still the general feelings about competitive advantage and the level of ease to understand the interplay between these sources is mired with confusions. A common manager feels it difficult to decide on the strategies to maintain the acquired competitive advantage of the firms. In the pursuit of understanding long term competitive advantage by different firms we see development of new terms in the literature like sustainable competitive advantage which gives an implied meaning of existence of competitive advantage for a longer period. We assume that unless a strategy manager cannot identify the source of competitive advantage, he will face much difficulty to sustain it. Surprisingly the conditions suggested in the literature for competitive advantage are similar to the one which are described for sustainable competitive advantage. So what is the significant difference between the two terms and what are those conditions which separate mere competitive advantage with the sustainable one.

Much of the academic writers like Porter, Peteraf, Rumelt, Penrose, and Barney are the most cited writers in the discussion of competitive advantage. After having careful study of these writers we have developed certain set of questions regarding the debate of competitive advantage. This article has focus to find answers of these questions and would attempt at the end to develop a taxonomy of sources of competitive advantage. In this article we would like to identify manifestations and sources of CA and on the basis of which developing a taxonomy for the sources

of CA. At first we like to discuss the important issues which still needs further explanation by the strategy experts are highlighted below.

2. ONTOLOGY OF COMPETITIVE ADVANTAGE

What exactly is competitive advantage? Is it an organizational capability, a state of performance, a performance indicator, a phenomena, a process or a standing in the competitive market? Is it qualitative or quantitative term? When exactly we say a firm has competitive advantage? Barney (1991) and Porter (1980) explain competitive advantage as superior performance of the firm. The question is directly concerned with the ontology of the competitive advantage. However we feel little attention has been paid to make final judgment on the ontological and epistemological dimensions of the strategic research. We must understand whether competitive advantage is a reality or merely a notion in business analytics. From the literature we find the ontology of competitive advantage in four epistemological frames namely positivist advantage, constructionist advantage, realist advantage and pragmatist advantage (Durand and Vaara 2006). Talking about the philosophical stance of competitive advantage the strategy research is usually taken in positivist frame where the strategy researcher always talk about measuring the performance of any firm through certain empirical tools. Most of the time various authors use epistemological frames like positivism and constructionism in the strategy research (Mir and Watson 2000). However we see the other epistemological frames like scientific realism and pragmatism has not been so often connected to strategy research. Nonetheless after consulting the literature we came to the conclusion that apart from any epistemological and ontological definition of competitive advantage, it is however a name of “capacity” of the firm to successfully compete in the business arena which means existence of competition is must condition for it. Barney (1991) and Porter (1980) explain competitive advantage as superior performance of the firm. We view in this article that competitive advantage is a capacity of the firm to compete and generate superior economic performance. The superior performance is an outcome of prevailing competitive advantage. In the absence of any competition or competitive environment superior performance cannot be attributed to a competitive advantage. We recommend that any superior performance emanating through best strategies and acquisition of best resources while working in perfect competitive environment should be regarded as result of competitive advantage of the firm and all those superior economic performances which do not take place in a competitive environment should not be attached to competitive advantage per se.

There might be many sources of competitive advantage of the firm. The nature and existence of these resources can vary firm to firm. The sources of competitive advantage may be categorized as many however generally we can see competitive advantage arises through some controllable and non-controllable factors. Controllable means labor, skills set, part of geographical location and uncontrollable means political and geographical situation, history and the competitive rivalry (Porter 1985).

Competitive advantage ensues through one or all of these reasons like available resources, capabilities geographic location, and time. Resources here we mean tangible resources of all types and capabilities in terms of Teece definition means appropriately adapting, integrating, and re-configuring internal and external organizational skills, resources, and functional competencies toward changing environment in your own favor (Teece et al 1996).

Durand and Varaa in their article of 2006 has given details about various epistemological frames to define competitive advantage and their use but they have not made any final judgement to the adoption of any epistemological frame to define competitive advantage. They have asserted on the fact that adoption of epistemological definition is total discretion of a researcher and it depends upon the research ambitions they are pursuing. However for the strategy managers and executives pursuing to identify competitive advantage for their firm, they need to choose positivist frame for defining competitive advantage otherwise it would be difficult for them to make clear strategies. They argue that the studies which follow positivist frame portray CA as outcome of mixture of several conditions that help organizations to ascertain extra-revenues from the idiosyncratic resources in comparison to rivals. We conclude that competitive advantage leads towards better economic performance which can be quantified and hence making it quantitative term.

Michael Porter (1980) explains the notion of competitive advantage through industrial organization paradigm. In his book *Competitive Strategy* he suggests that performance of a firm in competitive environment is due to its unmatched competitive advantage in that particular environment. In his famous book *Competitive Strategy* he gives model to show how a firm can actually create and sustain a competitive advantage in an industry. He suggested three distinct strategies for gaining competitive advantage namely low cost, differentiation advantage and a successful focus strategy. In addition to that Porter makes a point for value a firms produces for its customers which is absolutely higher than the cost firms need to bear to produce that value. Porter suggested that firm's competitive advantage grows out of these value creation activities of the firm.

John Kay (1993) explains the concept of competitive advantage through distinctive capabilities. He says that distinct capabilities are those which others lack and which create a value addition to the firms' performance. The distinct capabilities due to its uniqueness and scarcity in the market give a competitive advantage to the firms who possess it.

Peteraf (1993) gives definition of competitive advantage by using the term "sustained above normal returns". Her definition also revolves around certain distinct resources of firms which are scarce in nature and which are imperfectly mobile. According to her, those resources which have the capacity to generate above normal profits, can only generate competitive advantage if they are immobile and scarce. Because any Ricardian or monopoly rents which are being generated by such assets will not be offset completely by accounting for the opportunity cost of such assets.

Barney (1991) when explaining the concept of competitive advantage through value creating strategy of firm which is not being copied by any current or potential competitors. Barney gives his famous VRIO model which suggests that firms having resources which are Valuable, Rare, Inimitable and Organization has the capacity to exploit those resources can enjoy competitive advantage. Barney has the opinion that a firm gains competitive advantage when it follows a certain strategic path which create economic value and difficult for competitors to follow that path due to certain constraints in the acquisition of valuable resources. Another view namely the knowledge based view (KBV) is also taken as an important extension to RBV which is now being researched heavily (Arbi, K. et al 2017).

Dierickx and Cool (1989) also explain the same reasons and conditions as Barney has given by focusing on the critical assets of firm and their imitability and mobility. This views competitive advantage as characteristics emanating from scarce resource bundles used in the making of that products rather than the products markets itself. This actually explains the resource based view. They have the view that the critical assets stocks are accumulated by the firms over the years and by constant streams of investments in specific area rather it can easily be bought from markets.

3. AREAS OF CONFUSIONS

How much literature help managers to devise strategies which will help them to run their organizations successfully, is big challenge for strategic management theorists. This is just like the case that if a man wants to eat fish and his friend suggests him to go to the river side. Now there is lots between eating a fish and going to the river side. When the strategy literature suggests the manager if you want to be successful then gain the competitive advantage or develop VRIO resources or develop dynamic capabilities. This premises leave us nowhere but to a crossroad of strategy and conjecture.

In the historic debate of competitive advantage we however found two clear distinctions in the approaches of explaining and defining competitive advantage i.e. I/O perspective and RBV. The most recent authors like Barney, DG Sirmon, MA Hitt, RD Ireland, DJ Ketchen, M Wright, BA Campbell, R Coff, and D Kryscynski have again and again presented the competitive advantage in the framework of I/O and RBV. Literature suggests that competitive advantage (CA) lies in the resources differentiation (Barney 1991). We feel that this is not sufficient to claim that CA is due to differentiation of firms' resources, as it is ubiquitous that no two firms in the world possess same resources. Then does it mean that all firms have CA? Priem and Buttler (2001) has made a critique on the Barney's article by naming its argument a tautological statement.

In economics the perfect competition theory claims that all competing firms will have same characteristics and are homogeneous. So the RBV argument does not fit well with the perfect competition theory as well. The differentiation in the resources which RBV claims will eventually lead towards the differentiation in products and services which thus pull the firm out of the competition. If the success of the firm in terms of superior economic

performance is attributed to the differentiation of the resources then failure of the firms may also be attributed to the differentiation in resources. The famous VRIO model by Barney (1991) claims that the resources which yield CA must possess the VRIO properties (Barney 1991). This framework explains the sources of competitive advantage. However all the theories presented to define competitive advantage and to generate competitive advantage are generic in nature and cannot be used by managers to utilize them to acquire or maintain competitive advantage. Relative advantage in technology and human factors have impact on the sustainable competitive advantage of firms (PĂCESILĂ et al 2017).

Authors like Porter (1992) and Barney (2001) define competitive advantage through the notion of superior performance by firms which lead towards the question of whether competitive advantage is zero sum game and a competitive advantage is gained by only one firm. In the mobile technology market which is very competitive and fragile firms like Samsung, Apple, Motorola, RIM, LG and Nokia compete furiously. Following graph shows the profit share rankings of the industry. For us it is strange that as per definition in terms of “superior performance” only one firm which has the highest profit share in the industry should be regarded as firm with competitive advantage. From the definitional view we can infer following results from the graph:

- In the start of 2007 Nokia has competitive advantage which is exhibited through its highest profit share in the industry and until middle of 2008 it loses its profitability and at the end of 2012 it is pushed down to number 4.
- Similarly for Apple it has no competitive advantage since the start of 2007/08 and then from the fourth quarter onward it has gained competitive advantage and it has maintained its position till the given time frame of graph.



Source: Courtesy of US technology expert Horace Dediu from www.asymco.com
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- In the graph above we see Samsung has number 2 position in the start of 2007 and its position plunged into lowest in the end of the year 2008 and then again gradually moves up and at the end of year 2012 it regain its second position. How can we explain this fluctuating situation through competitive advantage theories discussed in the earlier pages?
- Similarly if we look at the performance graph of RIM, it has 6th position in the year 2007 which in later years faces many ups and downs and ends up at number 3 in the start of 2012.

4. QUESTIONS ON COMPETITIVE ADVANTAGE THEORIES?

However certain fundamental questions listed below still need adequate attention to be explained further. A list of questions is given below which needs to be addressed:

- a) Does prevailing competitive advantage theories have the power to enable managers of today to identify, generate and sustain competitive advantage?
- b) Is competitive advantage zero sum game? It means only one firm in an industry can gain competitive advantage.
- c) Is competitive advantage manifested through profitability only? Can other indicators like market share, stock price and welfare of the stakeholders be used as business and performance strength of a firm?
- d) What are the preconditions for competitive advantage?
- e) Whether competitive advantage comes from only outside or inside of the firm or from both side?
- f) What is the length and breadth of competitive advantage?
- g) What is the general classification of competitive advantage?

The answers to these questions needs in depth analysis of existing literature. However in this article we just intend to explore taxonomy of sources of competitive advantage because until we do not have a clear understanding of the taxonomy of sources we cannot empower business managers to identify and sustain their business performance. Due to given constraints in the use of competitive advantage term makes it imperative to develop a taxonomical framework for competitive advantage which will help managers to understand the depth and breadth of competitive advantage. In the article we have attempted to develop a taxonomy of competitive advantage based on its sustainability and history.

5. TAXONOMIZING SOURCES OF COMPETITIVE ADVANTAGE

Our urge to develop and refine the notion of competitive advantage is to have practical use of this term which will be used by managers to devise strategies for their firms. We feel that unless we do not have a taxonomical framework for competitive advantage it will be a merely a theoretical concept and will be less helpful for managers to use it for their strategy making. We think that superior economic performance is not the result of any single source, strategy, capability and conditions rather it is outcome of amalgamation of all these. The notion of competitive advantage is vital for supreme economic performance and managers must have adequate knowledge about the past, present and future of all those factors and conditions which generate competitive advantage for their firm. No single strategy, competency and resource can guarantee competitive advantage. To devise a strategic path which will yield superior economic performance for the firm managers have to enlist those factors which have their highest share in the superior economic performance for their organization. To make the competitive advantage concept useful for the managers we feel it is imperative to develop taxonomy of competitive advantage. Prahalad and Hamel (1990) argue that sustainable competitive advantage is dependent upon building and exploiting "core competency"-those capabilities which are fundamental to a firm's competitive advantage and which can be deployed across multiple product markets. Again this is very generalized term and will not help any manager to create and sustain competitive advantage unless he could not clearly identify that core competency and its sources. The following figure shows the proposed taxonomies of competitive advantage. These taxonomies are conceptually defined and are subject to empirical testing. We have categorized competitive advantage on the basis of its origin. In general competitive advantage can be categorized into two broad categories market based competitive advantage and resource based competitive advantage.

The Figure 1 - Theoretical Framework; Taxonomy of sources Competitive Advantage starts at showing broad business categories of competitive and non-competitive environment. We believe that competitive advantage can only belong to competitive business environment. It would be illogical talking competitive advantage phenomena for monopolistic firm. A monopolist will be least interested to develop strategies for sustaining competitive advantage. The monopolist due to his given facilities enjoys higher profits returns and will have feeling of protection from a source outside market forces. We therefore exclude the monopolist from the debate of competitive advantage however nature of firms which come under the definition of monopolistic competition will remain in the competitive advantage debate.

The competitive environment firms are categorized into further two categories; revealed competitive advantage and unrevealed competitive advantage. We will include those firms in revealed competitive advantage category which have an "X-factor" advantage in the competition. These are top performers in their domain and their performance may oscillates due to their strategic path and the presence of that X-factor which have impact on their performance. Whereas the firms which have low profile and lack that "X-factor" advantage which can guarantee

them top performance will be included into the category of unrevealed competitive advantage. The term unrevealed competitive advantage means the firms included in this category are unable to exhibit any sort of competitive advantage and they are below average performer of the industry.

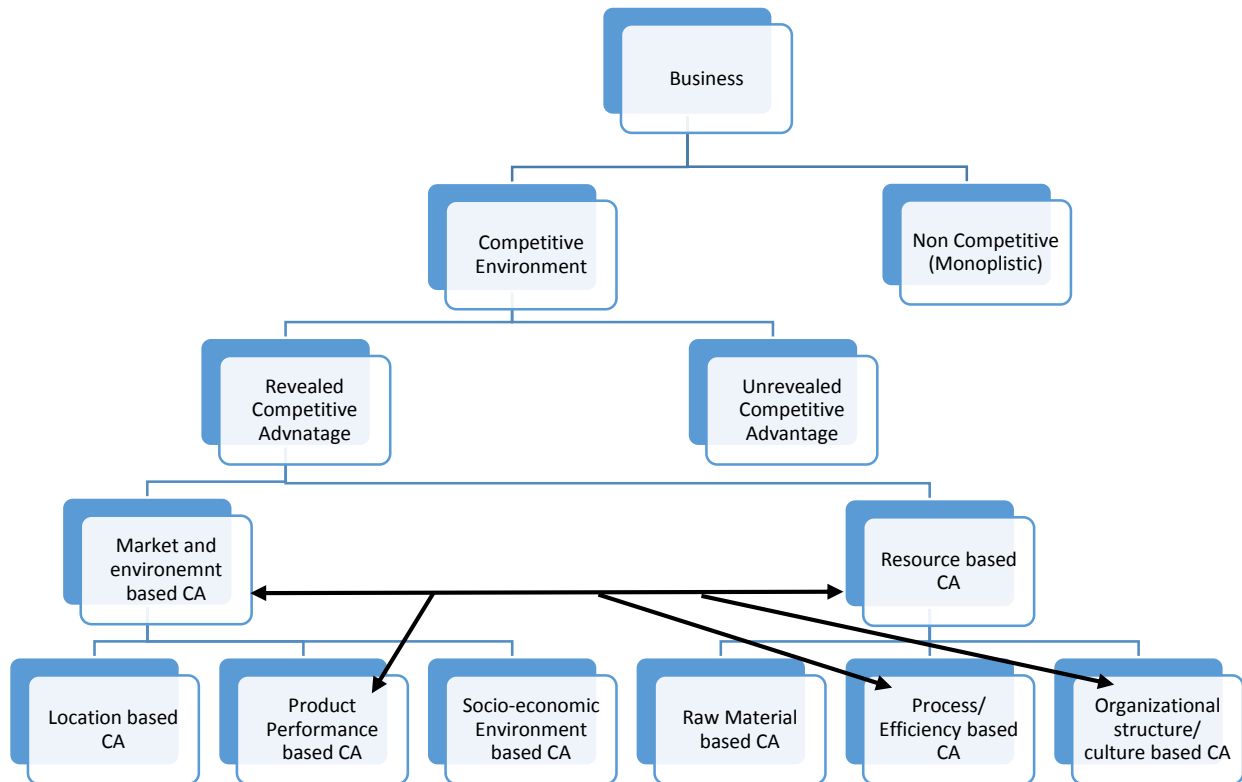


FIGURE 1 - THEORETICAL FRAMEWORK; TAXONOMY OF SOURCES COMPETITIVE ADVANTAGE

Revealed competitive advantage is further categorized into two broad categories; market based competitive advantage and resource based competitive advantage. Following the sense of I/O and RBV this categorization suggests that the origin of competitive advantage is mainly from two sources that is either from the market and environment or from the resources of the firm. We have actually clubbed the thinking of I/O and RBV and have strong belief that competitive advantage of a firm cannot be explained solely by any one of them.

Market and Environment based CA

When talking about roots of competitive advantage, firms when enjoy high performance due to the factors which are related to market and environment we categorize that sort of competitive advantage as market based competitive advantage. This sort of competitive advantage has further three roots; the location, product/service performance and socio-economic environment based CA. The origin of the market based CA is rooted in I/O perspective. Many firms depend heavily on their, location, political and economic environment, performance and acceptability of their product in the markets and changing market dynamics help firms to gain or maintain their competitive edge. Under this category of competitive advantage those factors have been included which are

relatively uncontrollable factors. It is the existence of favorable uncontrollable-factors which help managers to gain superior economic performance. The strategies adopted to capitalize such factors will be significantly different than the strategies to capitalize resource strengths of a firm. This is the point which raise the importance of taxonomy of competitive advantage and a clear identification of source of competitive advantage will help managers to devise more successful strategies for their firm.

Location based CA

Location plays significant role in the formation of competitive advantage. Firms which heavily rely on local source of raw material usually enjoy cost advantages and remain competitive in the long run. This location based competitive advantage is enjoyed by many agribusiness firms in Australia, IT firms based in Silicon Valley and many paper producers in Sweden. Clustering helps many firms to be more competitive and innovative. It is empirically tested that firms operating from a specific cluster have greater chances of success than a firm operating away from a cluster (Porter 2003).

Product Performance based CA

In this category we include competitive advantage which arises from branding efforts and as a result brand equity is established which ensures lasting performance by the product. Although the branding efforts can be attributed to the efforts of human resource of the firm under the marketing department but these efforts trigger the phenomena of words of mouth which releases the multiplied effect in shape of product positioning and liking by the customer. The fate of success and failure of the products is mainly decided in the markets where they operate. So market dynamics and subsequently product's behavior have heavy impact on the firm's performance.

Socio-Economic Environment based CA

This is the general environment for a firm where it operates. The given socio-economic conditions provide atmosphere for creating competitive advantage. The socio-economic environment includes rules and regulations by authorities, culture of the society towards new products acceptability and market competition conditions. All these three factors together make the conditions which make path for firm's competitive advantage.

Resource based CA

Many firms derive their competitive advantage from the resources they possess. Firms continuously strive to have control over those resources which provide basis for their competitive advantage. Usually they are access and control over raw material, efficiency of the firm in their processes and the organizational structure and culture.

Raw Material based CA

Among all sorts of reasons which give rise to competitive advantage the raw material based reasons contain heavy weight. Many firms gain competitive advantage by managing cheap and sustainable supply of raw materials. The uniqueness in gaining and maintaining raw material stocks is what most of the times turn into more strong competitive advantage. So it is imperative for the managers to develop such procurement strategies which provide in depth competitive advantage.

Process and Efficiency based CA

Efficiency in the systems and processes is another important reasons for generating competitive advantage. It goes without saying that firms with high efficiencies in their systems and processes earn long lasting competitive advantage. So firms' manager keep on improving their systems to keep their firms on competitive track.

Organizational Structure and Culture based CA

Organizational culture and structure is another reason which give better economic performance. This is somehow difficult to measure through validated empirical tests that the culture and structure of the organization play role to demonstrate competitive advantage. We have however strong believe that the culture and structure does have specific role in devising competitive advantage.

Apart from the conceptual taxonomy of competitive advantage we however emphasize that certain empirical instruments should be developed which can measure the strength and dimension of competitive advantage. This vectorization of competitive advantage will help managers to devise practical oriented strategies to generate and sustain competitive advantage.

6. CONCLUSIONS

The article discusses in length the existence of competitive advantage and the relevant interpretive theories. We have summarized in this article the main theorems pertaining to competitive advantage and their usage in strategic management and also the ontological and epistemological standing of competitive advantage. In this article we have discussed whether the CA is exclusively from the firm's internal resources or it is purely through the firm's outer environment or is there any mix of it. We highlighted that available literature creates lots of confusion about the competitive advantage. Even many authors like Rita McGrath (2013) and Steve Denning (2012) have raised questions about the usability of the concept competitive advantage.

The article narrates that competitive advantage is a state of performance in competitive environment. It means that when there are more than one firms, they compete with each other and the firm which has relative better performance than the other firms of similar product category will be termed as the firm with competitive advantage.

They claim that the competitive advantage concept and the interpretive theories do not help managers to develop strategies for the firm. Looking at this need we have presented the taxonomical conceptual map of competitive advantage.

The article provides managers a taxonomical structure for identifying sources of competitive advantage. It helps manager to make a check list for gaining and sustaining competitive advantage. The underlying taxonomy is based on conceptual mind map and based on the generalized logic on which all firms operate. We however do not claim that these taxonomies are final and no more further point can be added to the proposed taxonomies. We believe that these taxonomies are merely guiding check lists just like a pilot uses before he goes for flying. But availability and careful study of checklist does not mean that it will make you pilot. For a manager this taxonomical framework help to identify the main source of competitive advantage relevant to his /her firm. From this taxonomy managers will be able to devise competitive strategies to gain sustainable competitive advantage which is the ultimate goal of a managerial job.

Future Research Questions

1. Quantification of competitive advantage by empirically testing each category and analyzing the weight of CA on which dimension; market based CA or resource based CA.
2. Another important aspect of CA studies would be analyzing the strength and breadth of CA. Can we actually know how long a firm can enjoy CA in a given environment?

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