Tim Kastelle, Nilofer Merchant, and Martie-Louise Verreynne

What Creates Advantage in the "Social Era"?

The prominent and influential management theorist Peter Drucker wrote presciently in the 1950s that "today, knowledge has power...it controls opportunity and advantage."[1] Drucker explained that, as the economy becomes knowledge-based, much of what we assume about its functioning will change. The question isn't *if* change would occur, but *how*.

Though, the definition of "knowledge work" has itself been subject to continuous redefinition. Computers can perform any algorithmically specified task far more efficiently than humans, thus the definition of 'work' has shifted away from information-centered jobs that can now be more efficiently performed by a machine, and more toward specialities requiring creativity and independent judgment. Knowledge work involving creativity and independent judgment isn't about how much information you hold but rather about the inherent ability power of ideas to connect with one another.

The ideas of greatest value to any given organization aren't the ones in the interior, but rather those that reside outside, or on the boundaries. Individuals, teams, and firms innovate by tapping into open reservoirs of knowledge that exist either outside of organizations, or on boundaries between them, to create distributed innovation systems and new business models.[2] The value that can be derived from tapping into such open reservoirs puts pressure on organizationsstill using closed approaches.[3]

Tim Kastelle is Associate Professor of Innovation Management at the University of Queensland Business School. He researches, teaches, consults, speaks and blogs about innovation.

Nilofer Merchant is Adjunct Professor of Collaborative Innovation at Santa Clara University, and with two published books on the topic, an expert on how collaborative work drives performance.

Martie-Louise Verreynne is Associate Professor of Innovation at the University of Queensland Business School. She is deeply engaged in building innovation capability in organizations.

Differences in the ways companies take advantage of the free flow of ideas have led to a decline in the expected lifespan of competitive advantage, as demonstrated by McKinsey researchers Richard Foster and Sarah Kaplan, and further confirmed by research from The Deloitte Center for the Edge.[4] Deloitte's research shows that the average lifespan of a firm on the S&P 500 has declined from more than 70 years in the 1930s to fewer than 12 years today. The default management literature offers two approaches to helping a firm succeed in such an environment: (1) more innovation and (2) a better strategy. However, the literature does not address a more fundamental opportunity: using the abundance of open and boundary-spanning information as a driver of organizational change. Recent data makes it clear what creates advantage now: being open to new ideas from non-obvious places.[5] Realizing the potential of openness introduces a third-dimension into the creation of advantage. In this paper, we describe this particular dimension of inspiration, and how it interacts with both innovation and strategy, as they are conventionally understood.

METHODOLOGY

We seek a better understanding of the sources that offer advantage to individual performers during what one of the author's (Nilofer Merchant) calls the "Social Era[6]," the contemporary era of the Internet and its 21st century evolution. For this exloration, we used the questionnaire and interview methodology developed in 1991 by a research team at the Centre of Business Research at Cambridge University, a strategy that has since been used and improved by researchers around the world.

For this paper, we surveyed 2,097 firms in Australia, ranging across economic sectors, and varying in size from single-person firms to more than 45,000 employees. The questions we asked referenced such issues as firm performance, strategy, innovation, collaboration, and other factors that are important in evaluating how well a firm is performing. We studied these data to ascertain what drives growth and, more specifically, what successful firms do to drive their growth in the midst of a technology driven world.[7]

KEY QUESTIONS

To answer the question of what creates sustained market advantage, we first had to answer two other questions:

- **Innovation:** What are companies doing today in terms of innovation?
- **Strategy:** What categories of strategic action are firms taking?

We correlated the responses to these questions with each firm's performance metrics in order to identify the sources of advantage among those surveyed.

Research shows that strategy and innovation are important drivers of performance abounds, but we hypothesized that interactions between the two are more critical than either factor individually. It is this interaction that constitutes the third dimension involved in accessing open information.

As we began our study, our first step was to divide up the firms along these two dimensions: strategy and innovation as depicted in Figure 1 below.

Our questionnaire first asked the participating firms about their primary intended sources of competitive advantage. They could choose any combination of 12 points of difference from competitors that we suggested to them. These included: low prices; product or service quality; creativity; and so on. We used factor analysis to reduce the many disparate variables into clusters of related variables. The results indicated that the most prevelant strategies for competitive advantage fell into one of the three categories below:

- **Low Cost**—The first group focuses on having lower production costs, and thus lower prices, than their competitors. Their business models are predicated on efficiency, which becomes the foremost priority for producers.
- **Customer Intimacy**—The second group strives to form close relationships with their customers. This gives them advantages in areas such as quality and service.
- **Best Product**—The third group takes a product leadership position. Their competitive advantage stems from their creative skills, emphasizing and pursuing quality design of products that satisfy customers' unmet needs. They distinguish themselves from the aforementioned groups by going to greater lengths to meet customers' needs.
- **No point of difference**—The fourth category consists of firms that make no significant distinction from their competitors. These firms either scored low on all the points of difference, or they had a combination of points that didn't match the three other categories.[8]

The clusters defined above summarize the *strategic/innovation intent of firms*.

In addition to the questions we asked these firms about how they distinguish themselves in their market spaces, we also asked them to evaluate their realized innovation outcomes against their initial innovation intentions.

In seeking these answers, we defined innovation outcomes in six different ways: producing new or significantly improved products; offering new or significantly improved services; developing new production, distribution, or supply-chain methods; developing new ways to deliver existing services; and developing new business or management models. We used the results from this set of questions related to innovation outcomes to cluster the firms anew into three groups:

- **No Innovation**—One end of the spectrum, this group of firms did not generate any ideas that were new to the industry and thus were not innovative at all.
- **Some** the next group consisted of those in the middle, which innovated in one to four of the categories specified above.
- **High Innovation**—At the other end of the spectrum were the firms that innovated in five or all six categories, indicating they were highly innovative.

These clusters represent *innovation outcomes*.

In order to define how the combination of innovation and strategy drives suc-

High Innovation	0%	2%	3%
Some Innovation	5%	10%	10%
No Innovation	12%	17%	9%
	Low Cost	Customer Intimacy	Best Product
	No Point of Difference	32%	

Figure 1. The interaction of strategic/innovation intent and innovation outcomes of surveyed firms

cess, our research involved a third stage, for which we interacted the clusters defined by *strategic/innovation intent* with the clusters defined by *realized innovation outcomes*. We used the third stage to create what we call an Advantage Map. Figure 1 below shows how the firms in the sample were distributed across the clusters. The bottom row lists the three clusters of strategic/innovation intent: low cost, customer intimacy, and product leadership. The left hand column shows the three levels of innovation: none, some, and high. Firms with no clearly defined point of difference are at the bottom.

In addition to exploring the relationship between firm innovation/strategy intent and innovation outcome, we predicted how a firm's performance would increase using the Advantage Map. We rated the relationship between strategic/innovation intent and the innovation outcomes using a 0 to 9 rating scale, with 9 being the greatest expected increase in performance. The results are illustrated in Figure 2 below. Readers can find the elaboration on the process we used to determine these findings in the next section.

KEY FINDINGS

Classification Predicts the Firm Performance

To apply the Advantage Map, we had to first demonstrate how firms in the different groups performed in relation to other firms. We investigated each firm's performance using our questionnaire. Each firm was asked to indicate how satisfied they were with four indicators of their performance: finances, growth, market share, and customer satisfaction.

High Innovation	7	8	9
Some Innovation	4	5	6
No Innovation	1	2	3
	Low Cost	Customer Intimacy	Best Product
	No Point of Difference	0	

Figure 2. The Advantage Map classification of firms and expected performance

Each indicator also had sub-categories such as financial performance, which was measured by return on assets, gross profit margin, and profit per employee. Growth had four sub-categories, and each of the other indicators had two. All of these added up to one variable for performance.

To understand the relationship between performance and these indicators, we used regression analysis to test what factors correlated with the observed performance difference. We included variables like firm age, size, industry; several types of collaboration; and the firm's location on the Advantage Map. We found that this set of variables offered relatively substantial explanation for the variation in firm performance. We also concluded that the strongest driver of high performance is the firm's position on the Advantage Map (i.e. the interaction between strategic/innovation intent and the innovation outcomes).

As a next step, we compared the performance of firms in each group within the Advantage Map against the performance of the firms that had no strategy. For example, we compared the results of the low-cost strategic/innovation intent and the no innovation outcome with the performance indicators outlined above. Simultaneously, we analyzed the relationships between the other clusters and groups. We set the baseline average of reported performance for the firms with no strategy as equal to 1, and then compared the performance of all the firms in all the other groups to the no strategy group. Figure 3 below shows the results.

Firms with low cost strategic/innovation intent combined with no innovation outcomes had performance levels about 10 percent better than the baseline, whereas the performance of those with best product strategic/innovation intent and high innovation outcomes were 37 percent better.

It is important to note that, overall, firms in all categories on the Advantage Map outperformed the firms with no clear strategic/innovation intentions.

High Innovation	0.84	1.20	1.37
Some Innovation	1.14	1.12	1.25
No Innovation	1.10	1.09	1.23
	Low Cost	Customer Intimacy	Best Product
	No Point of Difference	1.0	

Figure 3. The relationship between firm performance indicators and the Advantage Map groups

Unsurprisingly, firms with a well-developed and coherent strategy are more innovative using this methodology. Similarly, those with greater intent have better innovation outcomes and performance.

Categorizing firms according to their different approaches to strategy and innovation demonstrates that these differences among the millions of different producers in any economy are the primary drivers of market performance.

In sum, we found that this set of variables explains the majority of the variation in marketplace performance, and that the strongest indicator of high performance is where the firm is situated on the Advantage Map.

The Advantage Map in Context

These findings reinforce an important point: over time, the features or perks that provide advantage in one era become baseline requirements in the next. New forms of advantage do not replace the old, but rather accumulate through ideas. Traditional ways of understanding of advantage—capital intensity and economies of scale, for example—still matter. They alone, however, are no longer sufficient when it comes to achieving the highest performance levels. There is now a new source of advantage: the use of extended networks of ideas.

As the "what" of the economy changed over time, so has the "how" of organizational models[9]. Technological change consistently drives the development of new business models, and has made collaboration a crucial part of economic production.[10]

For each era, there has been an optimal business model that provides advantage. (See Table 1.)At each inflection point, including the existing economy, the basis for advantage has changed. In the colonial era, government played the larger

Time	Era	Business Form	Advantage	Finance
1600-1850	Colonial	Multi-national	State-granted monopoly	Government
1850-1900	Industrial	Robber barons	Land, labor, capital	Business banks
1900-1950	Production	Large Manufacturing	Efficiency and scale	Stock market
1950-1990	Competitive	Conglomerates	Differentiated Strategy	Institutional investors
1990-??	Social	Networks	Ideas	Angel, Venture, or Community Capital (IndieGogo, Kickstarter)

Table 1. The Evolving Relationship Between Business Form and Advantage

role by offering monopolies to those who created infrastructure. Then, the industrial era shifted the economy to advantage those who could get access to capital. The 20th century was divided into compatible strategies: first for firms who found efficiencies and next for those that focused on differentiation.

Today, three factors govern whether or not your organization succeeds: 1) how well you *manage* the performance of the firm given certain resources, 2) whether you provide the *best* products and/or services in the marketplace, and 3) at a framework level, whether you take advantage of the rules that frame how to create value in the marketplace. In other words, if you are playing by the old rules in a new context, no amount of good strategy and management will yield an optimal outcome.

As economist and historian of technology Carlota Perez observed: "An adequate set of institutions is needed to complement, shape and guide the transformations that take place in the economic sphere. Yet, it cannot be a blissful return to what worked in the previous paradigm; it must be the complex design of what will work with the new one … Each technological revolution does then indeed lead to a 'new economy'."[11]

The inevitable shift here has indeed happened—the basis of firm advantage has changed.

In previous eras, competitive advantage demanded that a firm lock up their resources, and position itself to create a unique ability to serve specific consumer needs. Today, in the Social Era, the advantage a firm can gain is its collaborative capacity to contribute to shared work. And, ultimately, this era's necessary collaboration between strategy and innovation is driven by the firm's community and purpose.

Community includes how a firm interacts within its institution and the way it engages its core stakeholders across its networks. Purpose is the main mission and existence of a firm.

Implications in the Social Era

We have observed the economy move from one where centralized organizations initiated value creation to one where that same value creation develops with the help of multiple outside, contributing networks. This tectonic shift means that all modern industries now have a different source of advantage. We have seen this documented in examples starting in the 1990s, when influencers enabled innovation platforms as business models, and continued to what we see today in the Social Era with crowdsourcing, open innovation and business models.

The Social Era will reward those organizations that realize they shouldn't create value alone. If the industrial era was about *building* things, the social era is about *connecting* things, people, and ideas.

Platforms are one well-documented mode of connecting people, but they get an undue focus. The key is not to rely solely on techonlogy for idea connection, but to utilize the new efficiencies in creating connection. Those that understand the new "how to succeed in the new market conditions" can take advantage of shifting forms of advantage and thus maximize gains.

Advantage, not Competitive Advantage

We are explicit in using the language of advantage vs. competitive advantage. Advantage is the broader category, as "a condition or circumstance that puts one in a favorable or superior position." The factors that enable advantage in social times will in turn allow for success in the following areas as well:

- Get new ideas, which still fit the organizing principles.
- Gather based on need. Not everyone/every idea needs to be in, or stay in same construct.
- Galvanize ideas into reality without having to check back in.

These are inherent advantages that collaborative/social constructs produce, rather than some of the tensions that competitive/comparative ones create.

Which Community for You

The first consideration for every organization should consider is not *if* community matters, but *how it matters*. Community exists in many forms. Communities can be engagement, reciprocal, or participatory. The determination each corporation must make is which of those communities will be most applicable for its unique strategy.

Today, power can come from the way you work *with* others, such as one party offering a platform to the multitude of creators or when you ask others to co-create with you. It involves a recognition that there is a natural division and distribution of strengths, and that different platforms can make each other stronger.

Consumers, traditionally considered as value exchangers or extractors, are now seen as a source of value creation and advantage with the ability to give feedback on a number of different platforms.

Community constructs can share varying degrees of power between the participants but it's clearly no longer simply a one-way direction. It is an exchange. The key is really this: When community invests in an idea, it also co-owns its success.

Marginal Ideas Are Key

Anyone—without preapproval or vetting or criteria—can create and contribute. In fact, it is crucial that they do. Recent research[12] of 166 science challenges involving 12,000 scientists shows that novel ideas come from "marginality"—a source of different perspectives and heuristics, play an important role in performance. This idea inclusion— across ages, genders, geographies, cultures, sexual orientation, and all the other ways in which new ways of thinking can manifest —is essential for solving new problems as well as integral in finding new solutions to old problems.

The element starts with celebrating each human and, more specifically, something Nilofer Merchant recently termed "onlyness." Onlyness recognize that *each* of us stands in a spot that fits only them, and is a function of history and experiences, visions and hopes. That unique point of view is the genesis of new ideas, the ones that challenge the *status quo*, or improve upon the existing condition. The more traditional formulation of the source of ideas was considered "talent". Talent, however, was often credential-dependent. We relied on gates to determine just whose ideas were worth considering as valid contributions. The evaluation of the value of an individual's ideas was cost-effective method to sort. But, in time we have fount that this reliance on certain ideas and the exclusion of others often measured the wrong things. For example, research consistently shows that SAT scores are more a function of socioeconomic background than talent. Still, SAT scores often serve as qualifying factors to advanced education, and thus to the networks and credentials that students gained in those institutions. Now, it is more commonly accepted that actual capability can come from anywhere, because each of us is standing in a spot no one else stands in, a function of our history and experiences, visions and hopes. And from that place, we create: not because of our accolades but because "we" see something no one else can see. Thus onlyness is an advancement on the idea of talent. Oftentimes, talent is defined as those with a specific degree or experience conferred by others, when onlyness points to inherent capacity. Those can overlap, of course but if you are the one to enable onlyness in your efforts, through systems and leadership, then you draw on the fuller potential of what exists.

Community is not a free-for-all

Sometimes community leaders create constructs with chaos. They do so without understanding how to overlay these constructs to their "structure". Given the research, we confirm that community works when it is “controlled” by purpose. Community without purpose *is* chaos. Purpose without community is simply passion. Similar to the necessary combination of strategy and innovation for market success, the intersection of community and purpose allows scale to happen. This effective intersection is the net finding of this research.

In previous eras, simply getting your strategy right created an advantage. In the Social Era, though, honing your strategy right only moves you from the ‘No Advantage’ region of the map into the first or second row. What causes the big jump in performance, that *extra 30% increase or more*, is combining community (ideas of many) and purpose (yet aligned to your mission). That’s the recipe for the giant leap to the top of the map.

Shared purpose aligns people together as a community to build something. As we’ve already described, networks and communities connect independent of, and outside, the boundaries of an organization. Purpose is important in the social era for several reasons. Where once an organization served as a necessary and vital structure, or architecture that gave people together effectively, purpose today appears to be a new scaling construct. The governing principle of purpose allows several constructs to shift:

- Authority shifts from *assigned* responsibility to *onlyness*. Purpose brings out the best people.
- Legitimacy, shifts from “officially” sanctioned, to be about shared commitment to a common goal. Purpose brings out the best *in* people and the best people.
- And, accountability is created by transparency, because peers can review and enforce guidelines so that the collective stays aligned by purpose.

These three shifts, all movements toward collaboration and utilizing networks outside immediate reach, show how purpose now becomes the organizing principle and the thing that creates focus and alignment. Combined, these key shifts are that community + purpose is the next generation way of creating advantage. Evidence proves that collaborative models are important to innovation or purpose, acting as a meaningful differentiator in the marketplace, what we’re seeing is that these two elements form together to strategically offer a new angle on advantage.

CONCLUSION

As in prior eras, new sources of advantage will build on the previous foundations of advantage, which are now uniform baseline requirements. While competitive advantage once was the crucial element to companies, achieving that goals no longer gives market participants the cutting edge in achieving their highest performance. Now, a competitive advantage is just the baseline. Community and purpose are the new sources of advantage in the Social Era.

[1] See Drucker (2006) *The Effective Executive,* New York, NY: Harperbusiness Essentials for the most recent edition of this book.

[2] See Karim Lakhani and Jill Panetta (2007) 'The Principles of Distributed Innovation,' *Innovations,* 2(3): 97-112 for a representative discussion of the issues involved; also see Chesbrough (2006) *Open Business Models*, Cambridge, MA: Harvard Business School Press.

[3] Forster and Kaplan (2001) *Creative Destruction,* New York, NY: Doubleday and Deloitte (2011) *Shift Index,* http://www2.deloitte.com/us/en/pages/center-for-the-edge/topics/deloitte-shift-index-series.html accessed on April 13, 2015.

[4] McGrath (2013) *The End of Competitive Advantage,* Cambridge, MA: Harvard Business Review Press.

[5] Merchant (2012) *11 Rules For Creating Value in the Social Era* Cambridge, MA: Harvard Business Review Press.

[6] Nilofer Merchant, *11 Rules for Creating Value in the Social Era*, Boston: Harvard Business School Press, 2012.

[7] The survey can be viewed at www.growingaustralianbusiness.com.au - other results have been reported in McCarthy, S., Oliver, B. & Verreynne, M. (online 6 August 2015). Credit rationing in SMEs by banks in Australia. *Australian Journal of Management.* DOI: 10.1177/0312896215587316. http://aum.sagepub.com/cgi/reprint/0312896215587316v1.pdf?ijkey=8leljoAURkrsXe0&key-type=finite

[8] For example, the three forms of difference outlined by Treacey and Wierdsma (1995) *The Discipline of Market Leaders* (low cost, customer intimacy and product leadership), or the generic strategies of Porter (1985) *Competitive Advantage* (low cost, niche, and differentiation).

[9] Erik Brynjolfsson and Andrew McAfee (2014) *The Second Machine Age,* New York, NY: WW Norton and Co.

[10] The table combines data and ideas from Perez (2003) *Technological Revolutions and Financial Capital*, McGrath (2013) *The End of Competitive Advantage* and Merchant (2012) *11 Rules for Success in the Social Era*.

[11] Carlota Perez, Technological Revolutions and Financial Capital: The Dynamics of Bubbles and Golden Ages, p. 145.

[12] Lakhani . http://dl.acm.org/citation.cfm?id=1862443