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Improving firm performance through Competitive Advantage, differentiation strategy and cost leadership: A Literature Review

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ABSTRACT

This study aims to examine previous research in order to determine the role of competitive advantage as a variable that mediates the effect of differentiation strategy and cost leadership strategy on firm performance. This study applies various theories, namely resource-based-view (RBV) theory, and Market-based-view (MBV) theory to explain the relationship between variables. As a literature study article, this article contributes to developing a conceptual framework on how to combine the two perspectives of generic strategy and competitive different advantages. This article has importance for management and further research considering that not many previous studies have used the theoretical framework to test similar research models. This study has limitations in obtaining research that examines competitive advantage in research with firm performance. This research introduces a new framework that illustrates the contribution of competitive advantage to company performance through the implementation of a differentiation strategy and cost leadership strategy.

I. Introduction

Industry 4.0 is no longer the same as the previous industrial era. The role of information technology is no longer just as an additional tool but has become a mandatory tool to ensure smooth operations.

Performance reflects the extent to which the firm manages its business successfully [1]. The definition of firm performance in principle focuses on the firm's capability to utilize available resources efficiently to achieve results that are consistent with the goals set by the firm, and consider its relevance to its users [2]. The ability to achieve company goals efficiently is an achievement of firm performance [3]. [4] stated that performance is a certain result obtained in management, economics, and marketing that gives the characteristics of competitiveness, efficiency, and effectiveness to the organization and its structural and procedural components.

[5] provide a set of definitions to describe the concept of firm performance; (1) Performance is a set of financial and non-financial indicators that offer information about the level of achievement of objectives and results. (2) Performance is dynamic, requiring assessment and interpretation. (3) Performance can be illustrated using a causal model that explains how future outcomes may be affected by current actions. (4) Performance can be understood differently depending on the people involved in the company's performance appraisal. (5) To define the concept of performance, it is necessary to know the fundamental characteristics for each area of responsibility. (6) To report the level of company performance, it is necessary to be able to measure the results. [4] considers the word “performance” as a bag-word because it includes a variety of different meanings such as growth, profitability, returns, productivity, efficiency, and competitiveness. [6] believe that the definition of performance should be achieved through items such as testing, evaluation, efficiency, effectiveness, and quality.

Meanwhile [7] firm performance is a measure of performance that may depend not only on the efficiency of the firm itself but also on the market in which it operates. firm performance needs to be measured to ensure that resources are used effectively and efficiently in order to realize the firm's goals. Performance measurement can provide invaluable information for management to use to monitor performance, report progress, improve motivation and communication, and pinpoint problems [3]. In addition, the firm's performance is not only seen from its financial performance, but also more comprehensively in order to meet the needs of stakeholders and organizations for it to survive [8]. A performance measurement system is a set of concise and clear measures (financial or non-financial) that support the decision-making process of an organization by collecting, processing, and analyzing measurable data from performance information [9].

One of the tools used to describe, elaborate, and implement the firm's vision and strategy into a fixed target and a set of clear financial and non-financial performance indicators is the Balanced Scorecard (BSC) Model. The Balanced Scorecard (BSC) model was developed in the early 1990s by [10]. The Balanced Scorecard (BSC) model shows firm performance through four perspectives: financial, customer, innovation and learning, and internal processes. (1) Financial Perspective; Controlling financial resources is critical to the success of the company. Most organizations focus on financial results and ignore other perspectives. (2) Customer Perspective: Knowing what customers want in terms of quality, cost and distribution, and most importantly, what they want in the future from the organization. (3) Internal Process Perspective: Understanding how internal processes work is essential for an organization to achieve its goals and to know how to add the expected value to the products or services that customers buy. (4) Innovation and Learning Perspective: All achievements from the customer, internal process, and financial perspectives are closely related to the organization's ability to train and develop its human resources and innovation systems [10]..

According to [11], [12] to assess the firm performance, viewed in general from the perspective of financial performance, its products and markets can be measured through profitability, return on investment, product reliability, number of products with unique characteristics, market share and customer satisfaction. The attention of experts is a factor that affects the firm's performance [13], [14]. [15], [16] proves that Competitive Advantage affects the firm's performance. In line with the Market Based View (MBV) theory, market competition has an influence on companies in determining strategies to maintain and improve firm's performance [17], [18]. The Market Based View (MBV) theory approach illustrates that market competition (external) is the main factor that influences the firm to determine strategy in an effort to achieve firm goals, maintain and improve firm's performance.

In addition to external factors in the form of market competition conditions, some literature states that internal factors in the form of firm capabilities have an influence on firm in determining firm strategies in maintaining and improving firm performance [19]. This internal factor approach is better known as Resource based theory (RBV) which explains the influence of internal capabilities on the determination and implementation of strategy and implications for firm performance. Capabilities in the form of resources owned, managed and controlled by the company can make the firm have high competitiveness and create good firm performance. [20] in the theory of generic strategy states that to be able to create strong competitiveness, the firm must determine a strategy with two main aspects namely: 1) a comprehensive cost advantage strategy or also called a low-cost strategy, 2) a differentiation strategy. If the market segmentation is relatively narrow, then the two data strategies are developed into a focus strategy, where the strategy is directed at specific target markets only. In line with the findings of [21]–[25] which mentions differentiation strategy has a significant effect on competitive advantage. Likewise, the differentiation strategy affects the firm performance [26]–[28].

Based on the RBV and MBV which describe internal and external factors that influence the company in determining the company's strategy to maintain and improve firm performance [29]. [23], [25], [30] prove that cost leadership strategy has an effect on competitive advantage. Likewise, the cost leadership strategy has an effect on firm performance [31]–[34]. Previous research has examined the relationship between differentiation strategy, cost leadership strategy, competitive advantage, and firm performance [22], [27], [35]. However, some researchers consider that the relationship is still unclear [31]. Meanwhile, several studies have developed a theoretical review of differentiation strategy, cost leadership strategy and competitive advantage on firm performance.

This article fills the gap and establish a framework for competitive advantage as a mediating variable that reflects the business circumstances in which managers successfully combine strategies. The author intends to examine theoretically, first, how the differentiation strategy determines the firm performance either directly or indirectly through competitive advantage?. Second, how the Strategy cost leadership identifies firm performance retention either directly or indirectly through competitive advantage?. Third, how do competitive advantages contribute to firm performance?. The authors leave further study to answer the question by applying the appropriate data. The introduction is the first part of the article structure. In the second part, the author discusses the methods used in this literature review. The third section describes the results, including the Differentiation Strategy, Cost leadership strategy, competitive advantage, and firm performance, discusses the propositions derived from the relationship between these variables, and provides a discourse on the relationship between the four variables in a developing country context. The authors point out the limitations of the role and measurement of competitive advantage and suggest further studies to address this issue in the next section. The last section states the conclusion

II. Method

This section focused on discussing the methodology of the research. This study aims to see if there is a theoretical reason to explain the effect of differentiation strategy and cost leadership strategy, either directly or indirectly, on firm performance. In line with this goal, the author provides an overview of several empirical studies on the relationship between variables. The author sets two stages in the writing method. First, the authors selected material for review, including extensive articles available in the form of research papers and literature review papers, as well as books, and proceedings on differentiation strategies, cost leadership strategies, competitive advantage, and firm performance. In the selection process, such as Academy of Management, Emerald Group Publishing, Elsevier BV, JSTOR, Sage Publication, and Wiley Online.

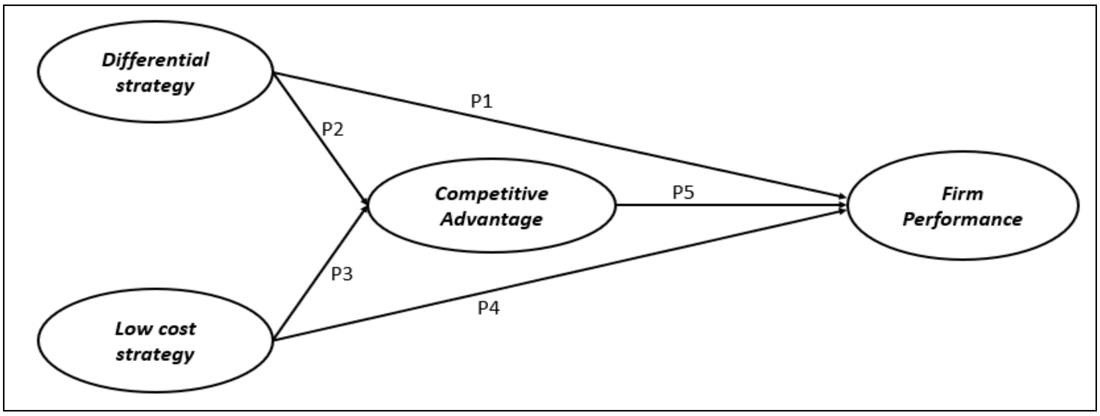

Fig. 1. Conceptual model

After that, the authors compiled relevant papers using certain keywords, such as "differentiation strategy and competitive advantage", "differentiation strategy and corporate performance", "cost leadership strategy and competitive advantage", "cost leadership strategy and firm performance", " competitive advantage and firm performance". "Market based-view (MBV) and competitive advantage theory", "Resource based-view (RBV) theory and firm performance", and "generic strategy". This study combines keywords and the forward snow-ball method as a search strategy. Throughout the selected papers, the authors examine the papers and summarize the main hypotheses and findings to ensure that all articles qualify. After going through the article selection stage, the authors obtained 150 titles consisting of 60 research papers, 25 empirical studies and 2 literature reviews

III. Result and Discussion

A. *Differential strategy and competitive advantage: Market Based-View (MBV) Perfective*

The differentiation strategy is one of Porter's main business strategies. Differentiation refers to the development of a unique product or service [36]. Differentiation strategy is a strategy in which an organization seeks to differentiate itself from competitors through the quality of its products or services [26]. According to [37], if customers perceive a product or service as unique, then this strategy provides high customer loyalty and is willing to pay a higher price for the product. According to [38], [39] product or service differentiation is an expression of individual and group creativity within the firm, which means that the risk of imitating differentiation depends on the capacity of creative companies to find methods that make products unique.

The differentiation strategy cannot last forever because of the possibility that the product can be imitated by competitors. [40] states that if the standard product in the industry is sufficient to meet customer needs or if the product is easy to imitate, differentiation does not guarantee a competitive advantage. Successful differentiation can mean greater product flexibility and compatibility, improved services, greater convenience, less or less maintenance, more perks or additional features. A successful differentiation strategy allows companies that are successful in implementing a differentiation strategy to have the opportunity to sell at a higher price and gain consumer loyalty. [40] states that to the extent that the distinguishing attribute is difficult for competitors to imitate, the differentiation strategy will be very effective. Sourcing for uniqueness must be time consuming, expensive, and too taxing for rivals to match. Therefore, companies should pay attention when deciding to pursue a differentiation strategy. Research by [41]has found that the implementation of a differentiation strategy in innovative manufacturing firms positively affects R&D and innovation collaboration agreements with other organizations.

According to [42] firm can increase differentiation based on the following: (1) Make product features and appearance attractive to many buyers; (2) Improve customer service or add additional services; (3) Invest in production-related R&D activities; (4) Innovation and technological progress. (5) Continuous quality improvement. (6) Improve marketing and brand building. (7) Seek high-quality input; (8) Development of human resource management by improving the skills, expertise, and knowledge of company personnel. According to [43] differentiation means that a product or service in addition to having differences with other products or services also makes the difference superior to other products or services.

According to [44] differentiation is the act of establishing a group of differences to differentiate the company's offering from its competition, including: (1) Product differentiation, namely physical differences such as consistency, durability, convenience of use, completeness of features; (2) Service differentiation that accompanies the product; (3) Differentiation of personnel by increasing the ability or expertise of employees; (4) channel differentiation, which is related to distribution channels, the wider the reach, the better; (5) Image differentiation, with a good image and product image, the product will receive more attention and be valued higher. Meanwhile, based on its dimensions, [45] divides it into: Content, which is about what (product) is offered to customers; context, which is about how the company offers to customers; infrastructure, is a factor that can realize content and context such as technology, implementation human resource capabilities, and supporting facilities.

[45] said that in order to be different or create differentiation, there are several conditions that must be met, namely: (1) Creating excellent product or service value; (2) The differentiation created is superior in industrial competition; (3) Has a unique distinguishing character, difficult to imitate and irreplaceable. Furthermore, [45] said that in order to make differentiation strong and sustainable, the company must carry out several stages, namely: (1) Segmentation, targeting and positioning, is the first stage, where the company maps the market, determines the target and then prepares a positioning strategy. products/services, brands and companies; (2) Differentiation analysis, analyzing possible sources, considering the advantages and disadvantages through content, context and infrastructure to make the product of differentiation superior in the competition; (3) Test of sustainable differentiation, measuring whether the product of differentiation can survive. Products that are unique, not easy to imitate and not easily replaced will be able to survive. (4) Communication, the fourth stage is to communicate to grow a good image.

[18] shows the relationship between differentiation strategy and firm performance and profits obtained by the firm, namely by applying a differentiation strategy, the firm's revenue realization is higher than competitors because of the brand's trust, quality, and perceptions that clients have for the firm's products. Differentiation strategy affects competitive advantage [25], [46], [47]. [39] said that the company will excel in competition if the firm is able to carry out a strategy that creates value that is not done by other firms in the same industry. Competitive advantage arises when consumers

perceive the value obtained from transactions are greater than the costs incurred compared to competing firms. The differentiation strategy emphasizes the company's efforts to excel by using the different and unique capabilities of the company. This uniqueness and difference that has value for consumers then makes the company have a competitive advantage in its industrial market. Creating a striking difference or contrast, difficult to imitate and has value for consumers requires a large and complex effort in utilizing and maximizing resources. Differentiation strategy affects company performance [26], [48].

Broadly speaking, the approach to using a differentiation strategy is to emphasize superior quality and different from its competitors where the value of these differences can be seen, felt and enjoyed by consumers [49]. These advantages will last a long time if the products produced are irreplaceable or difficult to imitate by competitors. The Market Based View (MBV) theory states that the external environment has an influence on the firm performance, where the firm performance is determined by the firm's behavior as a result of the response to competitive market competition. Customer satisfaction will foster customer loyalty which will increase customer retention [40].

Based on the theory and empirical experts described earlier, the determination of the indicators used in this study uses the measuring tools proposed by [31] namely: (1) Development of new products or services; (2) The rate of release of new products or services on the market; (3) Increase the intensity of advertising and marketing; (4) Develop and train sales skills and excellence; (5) Creating a good name and impression; (6) Offer a product or service that is unique compared to other hotels in its class. Based on the description, it describes how the differentiation strategy mechanism directly or through the contribution of competitive advantage determines the achievement of firm performance. Competitive adventage can play an important role in the process of achieving optimal firm performance [50]. However, there are still limited researchers who examine the role of competitive advantage as a mediator in this context.

Proposition 1. Differential strategy creates firm performance.

Proposition 2. Differential strategy creates firm performance through competitive advantage.

B. Cost leadrship strategy and competitive advantage: Resource Based-View (RBV) Perfective

Costs are a certain number of sacrifices that have been incurred or are in the stage that are likely to occur to achieve goals and are measured in units of money [51]. Standard costs are production costs or operating costs that have been carefully determined in advance. Standard cost is the target cost that must be achieved [45]. In relation to the budget, standard costs are things that are needed in budgeting, because standard costs are a reference for determining the budget. The standard cost itself has two classifications, basic standard and current standard, the basic standard in principle is the basic (initial) benchmark attached to a product or service as long as the process or activity that produces the product or service does not change. While the current standard is a standard that applies at a certain time and depends on conditions that apply and affect [45].

The cost leadership strategy emphasizes on producing products at a very low cost for price sensitive consumers [33], [34]. According to [52] a cost leadership strategy is a strategy in which an organization tries to gain a competitive advantage by reducing costs below the costs of competing firms. Meanwhile, according to [53] in carrying out a cost leadership strategy, firms must be able to combine features and services that are the main considerations for buyers. Prioritizing improving firm performance which includes the ability to produce and distribute at a lower cost than competitors. The advantage of using a cost leadership strategy is that the product will be more in demand in the market than competing firms because with the same product the firm can present a cheaper price. However, apart from the advantages of implementing this strategy, there are also weaknesses as a result of implementing this strategy, where as a result of suppressing production costs such as using lower quality raw materials, the quality of the product also becomes lower even though the appearance of the product is similar. For consumers who are observant or pay attention to quality, lower quality products will be abandoned. Apart from this, the production efficiency process by reducing employee wages causes employees to work not wholeheartedly which can lead to potential errors [43].

Resources help firms take advantage of opportunities and anticipate threats, and in order for valuable resources to be rare, difficult to imitate, not easily replaced [39]. [54] states that through RBV the firm's insight into excellence competitive environment, makes an important contribution to strategic management. The basis of RBV is to increase the firm's ability to act, shape, and transform its environment. The goal is not to adapt to environmental forces but to choose a strategy that allows the best exploitation/return of resources and competencies with external opportunities, with the aim of creating value beyond existing market standards. Cost leadership strategy affects competitive advantage [25], [30], [46]. Likewise, cost leadership strategy has an effect on company performance [31].

Based on the theory and research results described earlier, the cost leadership strategy in this study is defined as a strategy that emphasizes efforts to produce products or services at a lower cost than its competitors, thus the company is able to sell its products or services cheaper than its competitors and win the competition. To determine the indicators used in this study, the authors use the parameters proposed by [26] which consist of the following indicators: (1) Consistency and certainty of raw materials and negotiations to get lower prices from suppliers; (2) Standardization on products or services; (3) Efficiency in products or services; (4) The maximum use of the company's capacity and capability; (5) Offering lower product and service prices than other competitors in its class; (6) Controlling all company expenses. Based on this description, it describes how the cost leadership strategy mechanism directly or through the contribution of competitive advantage determines the achievement of company performance. Competitive advantage can play an important role in the process of achieving optimal company performance. However, there are still limited researchers who examine the role of competitive advantage as a mediator in this context.

Proposition 3. Cost leadership strategy creates firm performance.

Proposition4. Cost leadership strategy creates firm performance through competitive advantage.

C. Creating Firm Performance through Competitive Advantage

Competitive advantage created by both the implementation of differentiation strategy and cost leadership [22]. The greater the benefits that will be obtained by consumers, both for the costs incurred or the benefits felt and obtained by consumers, the stronger the competitive advantage of a company. The stronger the competitive advantage, the higher the potential to win market competition. This can be seen from the increase in sales of the firm's products or services to firms that have a high competitive advantage. The higher the firm's sales, the greater the firm's income which reflects the performance of the firm concerned, the better.

[20] argues that the essence of strategy formulation is actually to overcome competition. Firms that excel in the competition will win in the competition. Five main aspects that determine the nature and degree of competition in the industry that must be highlighted include:

1. Threats from new entrants; A business that provides good profits and bright prospects will encourage new investors to join in trying their luck in the business. New entrants with potentially greater capacities and resources will enter the industry. This of course will threaten companies that are already established in an industry. However, to enter an industry, there are entry barriers that prevent new entrants from entering an industry, namely: Economic value, product differentiation, capital, distribution channels, government regulations.
2. Strong supplier; A strong supplier will have a high bargaining position, and under certain conditions will affect the level of competition and the level of profit of the buying firm.
3. Strong buyer: Monopoly market position, the firm's position is very strong and the buyer's position is relatively weak. However, in a market situation where there are many producers, under certain conditions the bargaining power of consumers is relatively strong, and they show it through demands for lower prices and high quality.
4. Substitute products; With new discoveries in industrial technology, various new products have emerged as substitute products. Not infrequently the new product has better characteristics than the main product.
5. Competition among industries; The competitive business in the industry is very dynamic, the intensity of competition is determined by various factors, including: (1) The number of competition participants is large with relatively comparable

resources/capabilities; (2) The sluggish industrial growth that causes market struggles; (3) Products that tend not to change; (4) The occurrence of a trend of price reductions; (5) Capacity building must be on a large scale; (6) The resulting product is not durable; (7) Competing companies have different strategic backgrounds, cultures and characteristics. The five main aspects above can be identified carefully by the company, then the firm will be able to formulate a reliable strategy to anticipate competition in the industry.

According to [44] Competitive advantage is an advantage over competitors that is obtained by delivering greater customer value, through lower prices or by providing more benefits that match higher prices. Competitive advantage is an organization's ability to differentiate itself from other competitors. In addition, competitive advantage is also an important foundation for designing business strategies to achieve sustainable growth [55], [56]. Competitive Advantage affects the firm's performance [15], [57], [58]. Based on the theory and empirical described earlier, the operational definition of competitive advantage in this research is the firm's ability to be superior to its competitors through the characteristics and resources of the company that are managed optimally so that the company can win the competition. The measurement of the competitive advantage variable in this paper uses the parameters proposed by [59] using three indicators, including: (1) The firm's ability to produce real options that are specific and flexible to meet and follow superior consumer needs; (2) the firm's ability to respond quickly to consumer needs and desires; (3) Having cost efficiency in the process of producing a product or service.

IV. Conclusion

This study prioritizes the role of competitive advantage as a mediating variable in the effect of differentiation strategy and cost leadership strategy on firm performance, which has never been done by previous research. Based on the literature review, competitive advantage has great potential in determining the achievement of firm performance which is driven by the implementation of differentiation strategies and cost leadership strategies. Explanation of research variables through resource-based-theory (RBV) and Market-based-view (MBV) perspectives. The use of theory in this research is intended to provide a comprehensive explanation, although some theories have not been widely used by many studies. However, these theories are able to explain the effects that arise between variables significantly. The research model and supporting arguments used in this study can contribute to advancing current discussion efforts in the field of strategic management and business in general. Therefore, this research is very relevant to be applied to further studies using quantitative, qualitative, and mixed methods.

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