

# Strategies for sustainable competitive advantage in real estate industry

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## ABSTRACT

In order to differentiate from other companies, the real estate developers should understand and accept the fact that the industry is not facing a cyclical problem but it has fundamentally changed and in the following years the industry will remain less attractive.

The paper focuses on the strategies a real estate developer could implement in order to develop a long term sustainable competitive advantage. On one hand a competitive advantage can be obtained by having a lower cost than the competitors and consequently obtaining higher margins when selling at the market prices. On the other hand a competitive advantage can be created by differentiation, by the ability to use the company's unique skills and resources (better utilization of land and human capital, more appealing design, innovation) in order to obtain higher revenues by requesting a higher price.

Knowledge is the key competitive advantage in real estate industry, the element which creates and sustains the competitive advantage on the long run. A developer may have a great knowledge of particular customer needs, a specific area, of the market in which operates or it can be better than the competitors in terms of economic intelligence.

However, implementing a proper human resource strategy is at least as important as exploiting knowledge. Consequently, by achieving an efficient human resource management, real estate developers can take advantage of future innovation, better customer relationship or complementary growth strategies. In addition, the human resource strategy should facilitate the knowledge transfer within firm, as to fully exploit the knowledge competitive advantage and to support the knowledge creation.

This paper is an exploratory research, based on secondary sources about strategies for developing competitive advantage on the long run, in real estate industry.

## KEYWORDS

competitive advantage, differentiation, human capital, learning organization

## JEL Classification

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## Introduction

The real estate economic sector was maybe the most profitable business in Romania for the past 15 years. The ones who bought buildings 10-15 years ago might have noticed that their value increase even by over than 1000%. Lucrative investments could have been made also on short term where large amounts of money and proper knowledge about the market existed.

However, the year 2009, influenced by the negative effects of the financial crisis, brought dark previsions for both the real estate sector and industry, for our country and the entire world.

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Consequently, in order to fight against the crisis effects real estate developers must find unique ways to differentiate from the other competitors on the market.

Nevertheless, the globalization of touristic activities has increases the flows of tourists from and to emerging and developing countries. Consequently, the investments in infrastructure have created significant opportunities for any real estate developer. In order to exploit the potential opportunities, a company should first gain a proper knowledge about a certain location but also to understand the profiles of the future customers. Investing in creating a learning organization enhance the chances of creating a sustainable advantage through innovation.

### **Creating competitive advantage through differentiation**

A product or a service is said to be differentiated if customers perceive it to have properties which make it distinct from rival products and services or even distinct in certain areas (Thompson and Mark, 2005). Differentiation is most effective when the customers are willing to pay a premium price to obtain the product, where competition is unable to imitate it and when the consumers appreciate the cause of the difference. Basically, differentiation recognizes that customers are very numerous and scattered in order to all have the same preferences regarding a product or service. Where specific groups of customers with broadly similar needs can be identified and targeted they are called market segments. The segmentation can be based on ages, socio-groups, lifestyle, income, size of the buyer. The segments also must be identifiable and separated from others so that a company can differentiate products, prices and advertising accordingly to them.

It is a well-known fact that one of the most important factors for success in residential real estate was the location, as a bad emplacement leads to unsuccessful results, but after the fundamental changes in the industry not even a good location insures performance. Thus the capacity to obtain above average return will be driven by different factors.

In terms of target customers and property types, in the real estate industry there are many types of projects and diverse customers. Each of them has different needs and there are a lot of options for them to make. Consequently, in order to perform above average, the developer should identify the factors which lead to success and bring something distinctive as compared to the competition.

In order to find key success factors, a company should make a historical analysis to see the areas of success and the factors which determined it. Valuable lessons can also be failed projects because they give a better insight of what should be changed.

In order to differentiate from the other companies, to have the incentive of thinking differently the real estate developer should understand and accept the fact that the industry is not facing a cyclical problem but it has fundamentally changed and in the following years the industry will remain less attractive.

In order to be a superior performer, a company should think in different terms than opportunistic ones: it should create a sustainable competitive advantage and this can be obtained, according to researches, by two means. On one hand a competitive advantage can be obtained by having a lower cost than the competitors and consequently obtaining higher margins when selling at the market prices. On the other hand a competitive advantage can be created by differentiation, by the ability to use the company's unique skills and resources (better utilization of land, more appealing design, new concept of project) in order to obtain higher revenues by requesting a higher price. This approach is closely correlated to costs, because the success of this strategy depends to an important extent to the ability of a developer to keep the costs as low as possible (Porter, 1989).

But these strategies would make no difference for a company if they are applied to all potential customers. Eventually it is a question of choice, because a developer can either adopt a cost-leadership strategy and thus compete on many areas and developing many different types of projects, or it can try to choose a narrow scope and specialize in a particular direction: to address to a specific type of tenant, to a particular geographical area or to build only several types of projects and try to get a premium by creating differentiation for the buyer.

In order to obtain performance and above average profitability, a real estate developer should choose the most appropriate strategy: focus on efficiency or on the mix of skills and resources making possible the obtaining of a premium.

Imitating the successful players in the real estate industry is not a solution because the same project cannot be duplicated, applied to different geographic areas without marketing researches and other analyses in order to find out if that is the right location, the right project or there are interested tenants.

These are some of the factors which lead to a good investment. On the other hand the developer must make sure that the buildings are constructed on time according to the planned standards of quality and cost levels. All these decisions are related to strategy because basically the ability to find good deals and execute them is a function of it.

### **Knowledge as competitive advantage**

A developer may have a great knowledge of a particular customer needs, a particular area or it can be better than the competitors in terms of market or economic intelligence. All these competencies come from experience, resources and knowledge and whether the rights decisions are taken, regarding the location, the profitability of the projects, are influenced to a large extent by the company's strategy.

Competing in a fragmented industry, the real estate developer can specialize in certain areas in order to differentiate from the competitors:

- *Specialization by Customer Type.* As the competition is intense due to the fragmented industry, the company can benefit by specialization on a particular category of customer in the real estate industry (ideally the ones with the least bargaining power). Or the firm might specialize in the customers who are the least price sensitive or who need the value added the firm can provide. This strategy may limit growth prospects for the firm, but it offers a higher profitability.

- *A Focused Geographic Area.* By adopting this strategy a firm can obtain substantial economies because it will concentrate its marketing, sales and facilities on a given geographic area. This policy can economize on the use of the sales force and allow more efficient advertising.

In order to develop the products and strategies which can enhance the company's revenues, a real estate business must have local market knowledge. The challenge for a successful developer is to create the systems to allow them to incorporate local market knowledge, while still paying attention to capital costs, operating and overhead costs. In addition a good strategy should be able to change the customer expectation in a net-positive way, to affect the prices or cost structure of that industry or to change the assets or competencies required for success (Hamel 2002).

Consequently, one of the key knowledge advantages relates to the relationships of the real estate developers with clients and the knowledge of their needs. Any competitor in this industry should focus on understanding the customers and their needs, and should use that knowledge to deliver products that satisfy those needs. In addition, in order to create a long-term competitive advantage, a company should emphasize on maintaining the relationship with its clients and on analyzing the factors that build trust between the two parties.

On the other hand, knowledge of the business is also a significant source of competitive advantage. A real estate developer should have a solid grasp of the market in which operates, manage properly the relationship with its clients and above all these have the knowledge and the means to produce the product required. A significant amount of this knowledge is deeply embodied in the firm's personnel in the form of tacit knowledge, making difficult to transfer it to another person by formal means. Tacit knowledge represents the most important part of the human capital in an organization, as it sums up the whole experience of an employee. Consequently, the company's competitive advantage is not sustainable on the long run as an employee might leave the company at any moment, unless the firm develops programs to facilitate the transformation of tacit knowledge into explicit knowledge, as explicit knowledge can be aggregated at organizational level and used in different situations. A firm can reduce the vulnerability of the competitive advantage by implementing a proactive human resource strategy: work in teams, encouraging the employees to share information, all these reduce the

dependency of a company to key personnel. Last but not least, the effective knowledge transfer within the firm plays a significant role on its ability to fully use its knowledge competitive advantage.

### **Human capital as competitive advantage**

Implementing a proper human resource strategy is at least as important as exploiting knowledge as a competitive advantage. Peteraf and Barney (2003) define the competitive advantage as “the ability of an enterprise to create more economic value than the marginal competitor in its product market”. By extrapolation, a company gains competitive advantage through use of its human capital, when it creates economic value by exploiting the employee knowledge and skills.

Human capital is rare especially if we discuss about highly trained professionals. A person with a high level of skills and knowledge is not common. In some cases, a company may spend months looking for a skilled and experienced manager or technician.

Human resources are valuable for the unique experience and skills a person has. Highly-qualified employees perform many essential functions, inside companies.

Human capital is hard to be imitated, as it is not easy to find individuals with similar abilities. In order to imitate human resources of a performing competitor, a company should first identify the key employees who create the competitive advantage, and the ways they do it. Afterwards, a company should recruit persons with the same skills and implement policies in order to enable the new employees to imitate the performing competitors. In practice these mechanisms are quite hard to be implemented, as not all companies have access to information regarding their competitors.

Last but not least, human resources don't have any good substitute, especially if highly trained employees. As the standardized labor can be replaced by highly-performing machineries, the creativity and experience of valuable staff cannot be substituted. When people are trained properly, and motivated, they have the incentives to learn, develop their abilities and most importantly to care about customers. No other resource can match the talent, skills and commitment of the human capital. (Putnam and Krone, 2006).

Consequently, a company can create sustainable competitive advantage through human capital, if it develops mechanism to retain and motivate its key employees. All these traits of the human resources highlight the enormous potential they have. In order to exploit the potential, a company should implement HRM policies in accordance with the organizational culture and the goals of the organization.

However the amount of time that the human resource management function devotes to administrative tasks should decrease as technology is used for many administrative purposes, while its strategic role has increased. The focus has changed from current operations to developing strategies for the future and implementing practices to stimulate innovation and knowledge transfer within the enterprise.

Consequently, by achieving an efficient human resource management, real estate developers can take advantage of future innovation, better customer relationship or complementary growth strategies. In addition, the human resource strategy should facilitate the knowledge transfer within firm, as to fully exploit the knowledge competitive advantage and to support the knowledge creation.

HR strategy should be aligned at the general strategy, and coherent with it. Consequently, there should be a strong linkage between the overall vision of the organization that is held in the minds of the senior executives and the aims, objectives, and underlying philosophy of the organization's approach to managing people (Leopold et al. 2005). Additionally, a real estate developer has to achieve a coherent and consistent approach to managing people that spreads among the entire activities of the HR function and other organizational functional areas, talking here at the policy level, not the practice level. In other words, there should be a positive combination of strong vertical alignment, strong horizontal alignment and strong action. This combination occurs when the HR team has strong business or strategic skills and excellent HR process skills, coupled with the capability to translate these skills into practice (McKenna and Beech, 2001).

Motivating employees plays an essential role in keeping key personnel and in stimulating them to outperform themselves, by coming up innovative ideas and creative solutions. One suggestion related

to rewarding performance would be the initiation of a share-based compensation plan. Under the terms of a performance share program, conditional awards of company shares could be made to employees, judging by some sort of business performance factor. There has been exponential growth in the quality and quantity of information that is needed by all functions of the business in order to survive in and respond to the dynamics of change that are features of modern organizations (Pilbeam and Corbridge, 2002).

People are the most complex resource to manage, therefore the companies need sophisticated HR information systems. A real estate developer, which operates projects in many locations, should develop an intranet, which allows different departments to provide information to all members of the organization. This is a useful means of communication for the HR function and provides easy access to HR policies and procedures as well as internal vacancies, the availability of training courses and so on. In addition, computerized job evaluation packages, including competence based or points rating schemes can accelerate the process of job evaluation and dispense with the need for individual calculation of job scores. It also help the process of negotiations as it identifies a wide range of options and a variety of combinations of pay, hours and benefits to make the basis of the negotiating position.

There are two types of rewards: intrinsic rewards appeal to a person's desire for self-actualization, curiosity, joy and interest in the work. Extrinsic rewards appeal to a person's desire for attainment: money stock options, days off. Intrinsic rewards are intangible, whereas extrinsic rewards are quite tangible.

Many of the motivation techniques used could be considered intrinsic rewards. Extrinsic rewards systems are more difficult to implement as there are usually budget considerations to deal with. In many companies, the methodology used to grant yearly raises can even be considered as counter motivational. Leopold et al. (2005) talk about the use of spot bonuses, team celebration and innovative employee benefits.

On the other hand ideas that work for the senior management should also work for employees who greatly contribute to the profitability and/or competitive advantage of the firm: stock option grants, restricted stock plan-bonus income deferred, cash based on accounting performance measures. Creating a workforce infused with innovation and creativity requires understanding how to work with people.

On the other hand, the profound changes which take place in the organization in order to improve the internal processes may affect the individual's jobs or place of work. Subsequently, changing the organizational culture can arouse deep psychological feelings related to self-esteem and achievement, which in turn affect the level of motivation and performance. There is overwhelming evidence that the best way to reduce resistance to change is to involve those whom it is going to affect, in the decision-making process. Individuals who have been involved in the diagnosis, planning, devising and implementation of change are far more likely to feel positively about it (Marchington and Wilkinson, 2005). Generally speaking, they will feel more committed and it should lead to speedier and improved implementation.

### **Creating a learning organization**

During the last years managers have been interested in creating an organizational culture which encourages people to improve their skills and knowledge, by learning continuously. This process starts with monitoring the business environment and using the information to take decisions and make changes in the organization, based on what they have learned. Building a performing information system plays a great role in creating the learning organization, as it captures knowledge and make it available at any given time and place to company's employees, even after the people who provided the knowledge have left the enterprise. Nevertheless, beside the information system, people are an essential component to create a learning organization, as they must be committed to learning and most importantly to be willing to share what they have learned.

On the other hand, continuous learning represents the individual and collective efforts of each employee to gather information and apply the information in the decision making process. In addition, a real estate company could use continuous learning to improve the overall quality of its products. By

exploiting the learning curve and implementing a learning culture, a real estate developer can develop a sustainable long term advantage as compared to its competitors. By improving the overall quality of the products and the efficiency of the chain management, a company will both differentiate but it will also decrease the production cost.

However, to sustain the competitive advantage on the long run, a company should develop mechanisms that encourage employees to share knowledge. Therefore, one of the main challenges when creating a learning organization is to focus on generating and sharing culture and not only on training.

Last but not least, managers should encourage flexibility and experimentation in the company. The organization should encourage employees to take risks and more importantly to innovate, that is why the management should implement a culture that don't punishes unsuccessful ideas.

### **Cost leadership as competitive advantage**

Investing in real estate is extremely capital intensive and consequently the cost of capital will influence to a great extent the success of a project. Basically, the cost of capital has three main elements: the cost of the debt, the cost of equity capital and the cost associated to raising capital (Linneman 1997).

The cost of debt is positively influenced by good history of financial performance and strong balance sheets.

The cost of equity capital has two main components: the annual dividends and the expected appreciation. The cost of equity is directly influenced by the risk of a specific project: the lower the risk of a business, the lower the cost of equity. Here it appears an issue because we have two types of companies: on one hand privately owned companies and on the other hand public companies. The latter have an important advantage, it provides verifiable financial information about the company's performance and it consequently builds trust for the investors. Thus there are many interested stock investors which eventually give to the public companies an important advantage: enhanced liquidity which can be translated by lower risk. In this way the public companies can attract capital at lower costs, which gives them a competitive advantage as compared to the rivals.

The third component of capital cost is the cost associated with raising the capital. Here the economies of scale exist because the cost of raising capital has an important fix cost dimension. Consequently the bigger a company is, the lower the cost will be for raising that capital.

According to several studies the capital costs (debt and equity) represent up to 90% of the total costs of a real estate company. Given the fact that the real estate industry is an intensive capital one, lower capital costs for a firm represents a huge opportunity in order to obtain long term sustained competitive advantage. Due to this efficiency in terms of cost, a company can afford to make other strategic moves in order to sustain its competitive position. It can either reduce the selling prices (or thus enlarge the array of potential buyers), purchase land at higher prices, hire the best managers and specialists in the industry or even start an aggressive advertising campaign. The operating advantage obtained from lower capital costs is especially useful for the transition periods with fundamental changes in the industry, like those which happened in Romania for the past months.

Another area for cost reduction is represented by the overheads. Decreasing the costs for the employees involved in marketing, financial department and human resources can add value for the company, especially if the firm has intermediary capital costs or do not have a very clear market strategy.

There are also other cost drivers, but a real estate developer should appreciate which are the most significant. First of all, I can mention the cost reduction related to economies of scale, potential experience and learning curve benefits. All these factors are very relevant for this kind of activity and special focus should be put on every of them.

### **Tourism and real estate industry**

According to several studies, there is a causal relationship between tourism and real estate development and in addition, tourism can induce a positive promotion to real estate investment.

The last decades have witnessed a fast increase in travel and tourism, as the globalization process has facilitated the investment in emerging countries, enlarged the pool of potential international travelers and improved the access to information about less popular tourist attractions. Moreover, the emergence of new forms of tourism, such as ecotourism or agritourism, and the investment in infrastructure have increased the number of possible destinations. Lack of proper infrastructure can block the development of tourism, especially in developing and emerging countries, therefore governments must encourage this kind in investments, which in turn grow these areas from an economical point of view. However, infrastructure investments are not only about transportation, but also about safe water supplies, reliable energy sources and preserving the local values and heritage, by promoting the durable development.

Consequently, the real estate industry is strongly linked to tourism, as it represents its infrastructural basis. Therefore, much of the touristic infrastructure has been developed by real estate firms. However, as the tourism based companies expanded their activities abroad, they used vertical or horizontal integration in order to increase their efficiency, so that the distinction between real estate and tourism has become less clear. Nevertheless, the real estate industry is facing globalization as well, as many developers have started operations abroad by following their customers. There are many incentives for a real estate developer to go global, as instead of diversifying a range of offers around a single product, it could develop both office and residential buildings, as demand and prices vary with the global market and not according to geographic areas. Nevertheless, greater opportunities could be found in emerging regions, as the returns are higher, but this comes with a greater risk.

According to Dunning and McQueen (1981), the hotel industry can capture advantages of globalizing the business much quicker and a lower transition costs, as compared to manufacturing MNEs. This is possible because a foreign investment can be evaluated from the perspective of both country and company specific advantages.

As real estate represents the largest percent of the capital investment in tourism industry, the links between these two economic sectors are significant. The fast growth of tourism in emerging economies represents a potential opportunity for real estate developers in these countries. Although we cannot compare the GDP per capita in these regions to the one in developed countries, the rapid growth of the middle class make them attractive for investments in tourism.

Inskip (1988) describes a broad range of real estate elements related to touristic activities: commercial, cultural and conference centers, visitor centers, recreation centers, employee housing and accommodation. All these elements represent potential opportunities for real estate developers, but first they have to gain market knowledge related to these products.

Nevertheless, the connections between these two industries go beyond the contribution of the real estate companies to the touristic infrastructure. Therefore, a significant touristic activity, in a certain location, may attract potential investors willing to purchase holiday houses. Consequently, the opportunities for a real estate developer, created by touristic activities, are significant. Nevertheless, in order to be a performing competitor on this niche market segment, a real estate developer must gain first knowledge about the customer needs and tastes and afterwards to develop competitive products. Expanding the range of product in this area could imply higher profits and a larger market share, but also losses if the company doesn't have a great knowledge on that specific market.

### **Concluding remarks**

This paper has examined the concept of competitive advantage in the real estate sector. The experience of the real estate sector shows that competitive advantages can be also obtained by exploiting tacit and explicit knowledge and by implementing an efficient human resource strategy, not only by the traditional strategies of getting economies of scale and scope. In addition, the globalization of tourism has created a significant number of opportunities for real estate developers, especially in the developing and emerging countries. In these areas, the infrastructure, both basic and touristic, is poor,

so consequently once with the increase of tourist flows, the investments will create great opportunities for real estate developers.

For the largest extent of the firms in the real estate industry, human resources can become a key determinant of competitive advantage, but only by complementing a more conventional approach, such as focusing and gaining knowledge of clients and markets. Consequently, in order to develop and maintain on the long run a human resource based competitive advantage the firms should make a shift in their strategic thinking, by emphasizing on education and training of their employees.

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