

COMPETITIVE ADVANTAGE IN THE CONTEXT OF THE CORPORATE LIFE CYCLE

KEY TAKEAWAYS

- Durable competitive advantage is key to corporate financial success and we believe an essential component to successful investment approaches.
- Combining Michael Porter's external, structural lens with David Teece's internal, dynamic lens offers a more complete and differentiated view of competitive advantage.
- While Porter's model captures industry forces at a point in time, Teece's framework reveals how firms actively evolve through deliberate, forward-looking decisions by capable management. This dual view highlights both the environment a firm operates in and the leadership driving its trajectory.
- Competitive advantage must also be interpreted through the lens of a company's stage in the corporate life cycle. What drives success in early growth differs fundamentally from what sustains it in maturity. Crucially, high-quality management enables firms to transition successfully between stages.
- Cash Flow Return on Investment (CFROI), when viewed dynamically across the life cycle, becomes a powerful indicator of management quality and sustainable value creation – and therefore, of durable competitive advantage.
- Firms that combine favorable market positioning with management-led adaptability are best positioned to sustain high CFROI and outperform over the long term. This integrated lens helps investors distinguish between temporary success and enduring strategic advantage.
- In an era of rapid disruption, firms that align external opportunity with internal adaptability are best positioned to lead. This dual-lens, life cycle-aware model is designed to uncover those firms.



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INTRODUCTION

Active investment management is a pari-mutuel market, where all participants have access to the same data and are evaluated against identical benchmarks and factor exposures. However, it is also true that viewing the same data through different lenses allows one to see different things and ultimately create differentiated portfolios.

This explains how two analysts can look at the same company but draw very different investment conclusions. The implication is that the competitive advantage of asset managers – especially experienced ones – resides in the specific institutional lenses and processes deployed to evaluate that undifferentiated data.

Similarly, understanding the source of a given company's competitive advantage is one of the essential ingredients in identifying attractive investment candidates. First, we'll show how different ways of thinking about competitive advantage can lead to very different conclusions about a company's position.

Next, we'll argue that competitive position and corporate financial results are best understood in the context of a company's entire life cycle, rather than at a single point in time. We believe this provides a more fulsome view of a company's financial health and prospects.

Finally, we'll show financial metrics essential to identifying and validating management quality and enduring competitive advantage. The punchline is that evaluating competitive advantage by looking at the right data in the right way in the context of the corporate life cycle is crucial to identifying investment opportunities.

CONTRASTING – YET COMPLEMENTARY – VIEWS OF COMPETITIVE ADVANTAGE

Institutional asset managers have given a great deal of thought as to what creates durable competitive advantages. Observation suggests that durable competitive advantage is a function of management quality, business processes and execution. Long-term investors often prize management's orientation toward future growth and future challenges, conditional upon the stage of development of the business.

Naturally, the processes, plans and capital allocation decisions vital to succeed at one stage of business development are necessarily different than those at a different stage. As a result, less emphasis should be placed on quarter-to-quarter data points and instead be oriented toward the long-term trajectory and growth thesis.

Because of the importance of competitive advantage and its durability over time, this topic has understandably captivated researchers for decades.

Here we will contrast two leading methodologies for understanding competitive advantage, Michael Porter's "Five Forces" framework and David Teece's dynamic capabilities model.

We will go on to assert that both frameworks are well-established individually. However, their combined application is essential for identifying companies poised to outperform over the medium and long term.

Attention changes the world. If you attend to it in a certain way, you see certain things. If you attend to it in a different way, you see different things.

– Iain McGilchrist

By viewing competitive advantage through both a static, exogenously focused lens and a dynamic, endogenously focused lens, we can gain deeper insights. Indeed, we will argue that these contrasting views are actually highly complementary.

PORTER'S FIVE FORCES

Porter's Five Forces provide a structured way to analyze the competitive forces shaping an industry. Rather than focusing on internal capabilities, it broadens the lens to take in competitors, suppliers, buyers, substitutes and potential entrants.

The model helps firms assess industry attractiveness, identify strategic threats, and uncover differentiation or cost leadership opportunities. It remains a foundational tool in strategic management, widely used by corporations, consultants and investors to inform decision-making and long-term planning.

Despite critiques of its static nature, the framework's clarity and versatility mean it remains relevant today. The Five Forces include:

1. **Threat of New Entrants:** New competitors can erode market share and profits, so there's a focus on erecting barriers to new entrants, such as securing new patents, emphasizing economies of scale or locking in customers.
2. **Bargaining Power of Suppliers:** Fewer, powerful suppliers can raise input costs, so companies emphasize vertical integration, supplier diversity and alternative inputs.
3. **Bargaining Power of Buyers:** Fewer, more powerful buyers can demand lower prices or higher quality, so companies might favor customer loyalty programs or bundling, as well as long-term customer contracts and relationship management.
4. **Threat of Substitute Products or Services:** Alternative products can reduce demand and pricing power, so the threat is high when substitutes are cheaper, better or more convenient. Companies must innovate, improve customer experience or otherwise add value and differentiate products.
5. **Rivalry Among Existing Competitors:** Intense competition reduces profitability, while industries with few players and strong brands typically enjoy more stable results.

While Porter's framework remains a foundational tool in strategic analysis, critics argue that it is too static for today's dynamic, technology-driven markets. It assumes relatively stable industry structures and overlooks rapid innovation, digital disruption and globalization.

Perhaps the strongest criticism is that it emphasizes external industry forces while de-emphasizing internal capabilities. As industries evolve, many strategists advocate for more adaptive, integrative models that reflect complexity and change.

EXAMPLES OF PORTER'S FIVE FORCES AT WORK

A good example of Porter's Five Forces at work might be the business of access to space before the early-2000s entry of several new commercial launch providers. Incumbents might have looked around and found a competitive landscape that had been fairly stable for a decade or more, dominated by a handful of commercial providers and quasi-governmental international players.

It would also have been evident to them that space presented an incredibly difficult and unforgiving reality, which created high barriers to entry and a wide competitive moat. Big U.S. launch providers spent time lobbying the government for more support, less regulation and lucrative government contracts.

With respect to the “threat of new entrants,” the incumbent providers must have felt very secure indeed. But they failed to account for a number of deep-pocketed investors familiar with disrupting large, stable markets.

So, in the early 2000s, visionaries such as Musk, Branson and Bezos, and highly motivated young entrepreneurs such as Sir Peter Beck, saw a staid industry with huge potential crying out for innovation.

The few existing players felt little need to innovate to defend their market positions because the barriers to entry were so high. Except for the space shuttle, launch capabilities were highly limited and modeled on Cold War-era systems.

Companies such as SpaceX and Rocket Lab introduced not only new technology and software but also a fundamentally different mindset. Their approach was rooted in private-sector efficiency, agility and cost discipline, which stood in contrast to the legacy cost-plus contracting model that had dominated previously.

Most notably, they challenged the long-standing assumption that rockets were single-use, pioneering the once-absurd idea of a circular economy through reusable launch systems. It is no coincidence that essentially all of today’s commercial launches are performed by rockets that entered service in 2006 or later, reflecting this wave of innovation.

In this view, Porter’s model’s limitations are the extent to which it captures or emphasizes a snapshot of an industry at a point in time. It is also more outwardly oriented than other models of strategic management.

As the space example shows, the model is less suited to accounting for technological change, innovation and disruption.

But arguably its greatest limitation is that it focuses less on companies’ own capabilities and how these interact with rapidly changing technological, economic and political conditions.

Think of it this way – profits today do not guarantee profits tomorrow. Experience and intuition tell us that companies must continually innovate and reinvest in the business or risk obsolescence. Consider two prominent historical examples, Kodak and BlackBerry maker Research in Motion.

Both preferred to protect their legacy business rather than change along with technology and customer preferences. Kodak resisted the transition to digital photography because of the fear it would cannibalize its golden goose – photographic film. Of course, the company resisted change, and digital media rendered its golden goose all but extinct.

Research in Motion tells a similar tale. In the early 2000s, its BlackBerry phones were nearly ubiquitous in government and corporate circles because of their famed keypad, secure email, messaging and trackball.

While Research in Motion sold its first phone in 1999, the company was out of the business entirely by 2016. So, the company went from product launch to market dominance to irrelevance in less than two decades.

The snapshot told the company profits were high and it held an advantageous competitive position, so it was better not to tinker with its products.

The BlackBerry example also shows why a firm's evolutionary path is so important. BlackBerry's maker was locked into its physical keyboard and the idea that its security features meant it held an unassailable position in key markets.

As a result, Research in Motion could not or would not change quickly enough to meet the challenge of the iPhone's new touchscreen, greater functionality and range of applications in the App Store. Years later, the company did launch a touchscreen product, but poor execution further damaged the firm's brand and reputation.

Conceptually, Kodak and Research in Motion failed to realize they were at the peak of their respective product life cycles – their products were fully mature and entering decline. The nature of competitive markets is that profits exist to be competed away.

Said differently, markets are dynamic, not static, and it's a profound management failure to rest on one's laurels, rather than continually reinvesting and reassessing threats to one's competitive position.

As tempting as it must be to rest having reached the metaphorical mountaintop, this is also a moment of extreme competitive peril. That's because such a profitable market will inevitably attract competitors eager for a share of the profits.

TEECE'S DYNAMIC CAPABILITIES

In contrast, Teece's seminal 1997 paper introduces the "dynamic capabilities" framework, which has dominated academic and boardroom thinking in recent decades. Its popularity reflects its utility in capturing the enduring factors underlying corporate competitive advantage. It recognizes the dynamism and competitive nature of global markets and seeks to explain how companies can endure and thrive under such conditions.

Paraphrasing a key section and footnote from the original paper:

"Competitive advantage of firms lies with their management and organizational processes. ... By management and organizational processes, we refer to the way things are done in the firm, or what might be referred to as its routines. ... We are implicitly saying that fixed assets, like plant and equipment which can be purchased off the shelf by all industry participants, cannot be the source of a firm's competitive advantage."

Unlike traditional strategy models focused on market positioning or static resources, dynamic capabilities emphasize a firm's ability to integrate, build and reconfigure internal and external competencies.

These capabilities are rooted in organizational processes, shaped by asset positions and constrained by evolutionary paths.

The framework highlights the importance of learning, innovation and adaptation, arguing that long-term success depends more on internal transformation and responsiveness than on strategic manipulation of market forces.

In the academic literature, this is considered a “resource-based” approach. That is, it focuses on a firm’s unique resources and capabilities. One well-known example is the human capital management process described in “No Rules Rules: Netflix and the Culture of Reinvention,” a book by Netflix CEO Reed Hastings.

The text outlines how the company’s early challenges and crises shaped its culture, which is built on the belief that rules and processes can hinder innovation.

By emphasizing trust, transparency and “talent density,” Netflix management’s goal is to foster an environment where creativity and agility can thrive. Hastings argues that in fast-moving industries, flexibility and empowerment are more valuable than stability and control.

Consider that Netflix launched its physical DVD rental service in 1998, just one year before the BlackBerry. Yet within a decade, Netflix had transitioned to streaming content on demand over the internet. This evolution highlights how Netflix’s management and organizational processes served as a clear competitive advantage.

Rather than five forces, Teece gives us three broad determinants of corporate competitive advantage:

1. **Processes:** The organizational and managerial routines that shape how a firm operates and evolves. Under this rubric, coordination, learning and transformation appear. This captures a firm’s ability to evolve and adapt to new challenges and opportunities.
2. **Positions:** This reflects a firm’s current assets and strategic positioning, including brand equity, intellectual property and proprietary technology, customer relationships, etc.
3. **Path dependency:** Historical investments in technology and other unique capabilities constrain a firm’s future strategic actions. Network effects and scale advantages also fall under this heading.

Again, the primary distinction with Porter’s framework is that Teece emphasizes a company’s core internal competencies and characteristics, and how these can be deployed to address rapidly changing environments. A classic example of dynamic capabilities in action is the development of Amazon Web Services (AWS).

The entire genesis of AWS was Amazon reconfiguring *its own* business processes and IT infrastructure to support its rapid growth and expansion into diverse markets. This necessitated a corporate culture that fervently champions external empathy, starting with the customer first.

Indeed, the process was enabled by deep customer relationships, understanding their clients’ needs and providing completely new and innovative solutions to challenges that

they and their clients were facing.

Amazon management recognized that other fast-growing companies must be struggling with these same issues. Its internal processes, evolutionary path and capabilities led it to a solution, which it was able to monetize and package for its customers.

For future AWS customers, there was no better validation of the service and its economic potential than Amazon having undergone its own transformation.

Now, consider that as we write this in the early months of the Trump administration, the economics of global trade are changing by the tweet. This is an extreme example of the pace of change companies face and highlights the many dimensions touching on their day-to-day operations.

Dynamic capabilities speak to the different resources at companies' disposal to navigate changing business conditions. In summary, this is the rationale for the dynamic capabilities approach, which emphasizes dynamism and adaptation as strengths.

In contrast, rigid processes and approaches would be relatively disadvantaged. This perhaps explains the enduring appeal of Teece's dynamic capabilities paper, which emphasizes fluidity and adaptation.

COMPETITIVE ADVANTAGE AND THE CORPORATE LIFE CYCLE

During the growth phase of a company's life cycle, demand accelerates significantly, prompting rapid scaling of operations. This expansion, while indicative of market validation, inevitably attracts heightened competition. New entrants begin to vie for market share. Simultaneously, incumbent players intensify their efforts to consolidate their positions.

At this stage, the market begins to recognize the intrinsic value of the product or service, shifting the strategic focus from validation to aggressive share capture. Smart companies prioritize long-term positioning over short-term profitability, allocating substantial resources toward product innovation, brand development and geographic expansion.

However, the sustainability of this phase hinges on the strength and defensibility of the firm's competitive advantage. Without a durable edge, the company risks an early transition into maturity or shakeout, driven by margin compression and intensified rivalry. Extending the growth phase requires continuous differentiation and strategic agility to maintain leadership in an increasingly crowded landscape.

To navigate this competitive landscape effectively, firms must understand the strategic levers available to extend growth or pivot toward renewal. This understanding only comes from knowing where the firm and its products are positioned within their life cycle.

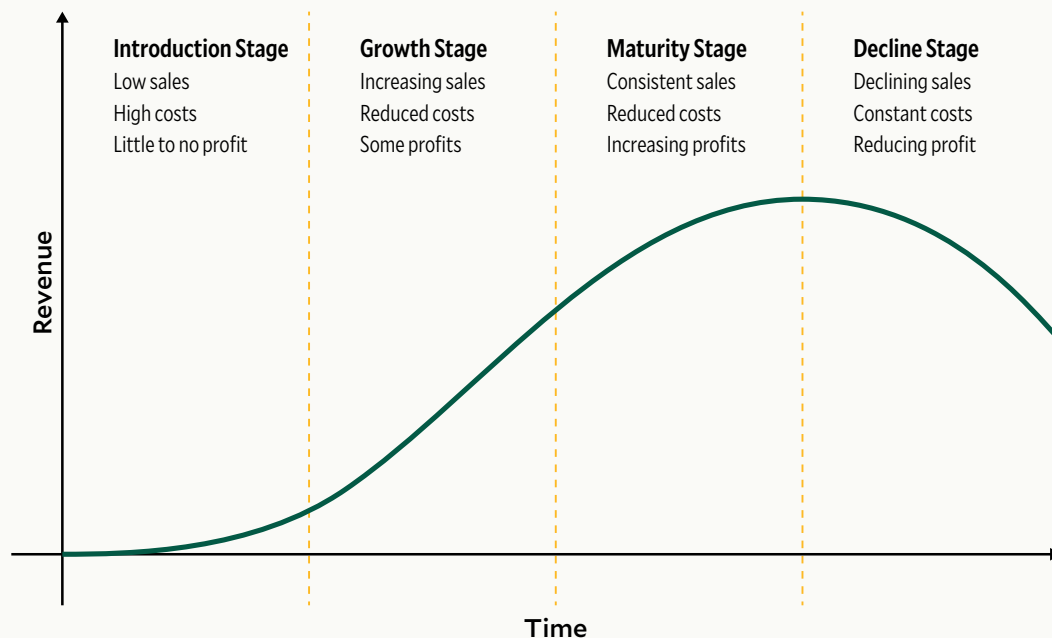
One reason to be sympathetic to Teece's approach in this framework is that it is by definition dynamic, not static. That comports with our own view that financial results must be contextualized by that firm's stage of development.

Consider **Figure 1**. This simple graphic has tremendous utility.

FIGURE 1

Corporate and Product Life Cycles Follow a Typical Growth Curve

Stages of a Company's Life Cycle



Source: American Century Investments.

On the one hand, it all but forces you to ask, “What’s next?” What’s the next evolution of the product, of the growth cycle, or the firm?

On the other hand, it also militates against using history as a lens, or at the very least, against using history as your only lens.

For example, if you looked at late-stage Research in Motion/BlackBerry based on historical valuations, you could make a case that it was a good value. But that would be to miss or deny the fact that the company was in a very different stage of development than the earlier growth stage.

Porter, Teece and a life-cycle approach would all lead to the conclusion that the competitive landscape had changed completely. That’s because smartphones with a different form factor, touch screen and apps revolutionized the market for mobile devices.

While historical valuation metrics may have suggested BlackBerry was undervalued, such analysis failed to account for its deteriorating competitive position and life-cycle stage. This would have revealed that the stock was not just cheap, but structurally impaired.

Better to recognize that historical valuation is a tool, yes, but it is a blunt one that must be contextualized by a firm’s competitive position and its stage in the business life cycle.

This question of competitive advantage is so important because it is key to corporate financial success. One of Teece’s insights is that capabilities rest on “organizational and managerial routines.” Our shorthand for this is “management quality.”

We've already given the Kodak and BlackBerry examples of management decisions at moments of peak profitability. Now, contrast that with Nvidia's remarkable recent decision to accelerate its product development cycle and launch cadence from every two years to every year.

Nvidia, too, was dominating its market and functioning at peak revenues and profits. The decision to rapidly obsolesce its own products by continually and rapidly innovating new generations of chips can only be understood in the context of product life cycles. It shows an intuitive understanding that once you've finally scaled the competitive mountain and reached product maturity, the next evolution is inevitable decline.

Measurability is certainly critical in terms of assessing these capabilities within a firm. In terms of quantitative measurability, management quality can perhaps best be encapsulated using traditional financial metrics, such as cash flow return on investment (CFROI).

CFROI helps us assess how effectively management has deployed capital in the past and whether it is succeeding on an ongoing basis. We monitor the "movie" of cash flows from invested capital to ensure the company is generating the returns on investment it has articulated to us in meetings and that these returns align with our expectations to drive above-average long-term growth.

PUTTING IT ALL TOGETHER: COMPETITIVE ADVANTAGE, THE CORPORATE LIFE CYCLE AND CFROI

We believe CFROI is a better proxy for corporate financial success than accounting earnings. Developed by HOLT Value Associates in the 1990s, CROI focuses on operating profits (cash flows), which are less easily distorted than net reported earnings.

CFROI is a function of operating cash flows and the capital employed to generate these flows. And because it eliminates the potential accounting distortions to financial results, CFROI provides a more accurate view of a company's performance and the value of its investments.

One implication of our discussion of the corporate life cycle is that CFROI cannot be viewed in the same way for companies at different stages of development. Financial metrics used to evaluate firms must be considered relative to that company's stage of business maturity.

As a company moves into its growth phase, its return on investment (ROI) tends to rapidly increase as the rate of fixed expense growth diminishes, particularly relative to the company's rate of revenue growth. Furthermore, operating expense leverage magnifies this scale effect.

Thus, a company can demonstrate high or accelerated levels of growth so long as its rate of CFROI *sustains* at high levels and/or continues to expand (assuming a zero dividend payout ratio).

Conversely, a decline in ROI may signal a shift in life cycle stage from growth to maturity, or maturity to a state of decline (a red flag for growth investors). As a result, we spend a disproportionate amount of time analyzing the sustainability and trajectory of ROI for companies in the growth phase.

Now, consider profitability in the context of a company in its initial investment stage. An early-stage company *should* exhibit zero (if not negative) to low profitability because revenue accumulation and business expansion have not reached equilibrium relative to the capital investment deployed.

Furthermore, the significant use of cash to build the business will likely result in a lower-quality balance sheet in the short term. We therefore need to resist being overly punitive and look further into the horizon during a company's rapid growth phase.

Similarly, a company in its growth phase *should* exhibit a level of profitability below maturation levels as capital investment in both fixed and operating expenses remains elevated relative to revenue.

At maturation, we finally should see target profitability achieved as the company reaches "critical mass," or a steady state of investment (i.e., variable-expense growth equals revenue growth, capital expenditures equal depreciation, and free cash flow equals net income).

It is only by appraising both static (Porterian) and dynamic (Teecean) competitive advantages, and viewing the whole in the context of where the firm and its products are in their life cycles, that we can hope to distinguish between companies with zero (if not negative) to low profitability that will remain so, and those on a more optimistic trajectory.

This is why the lens you deploy is so important, and why we emphasize the "movie" of the corporate life cycle rather than the "snapshot."

CONCLUSION

In summary, incorporating the considerations outlined in Teece's dynamic capabilities alongside the more traditional view of competitive advantage encapsulated in Porter's Five Forces framework provides a comprehensive view of how companies can sustain their market positions.

Porter's framework emphasizes the external forces shaping industry dynamics, while Teece's model focuses on internal capabilities and adaptability. By integrating these perspectives, we believe asset managers may better evaluate investment opportunities and anticipate market changes.

Moreover, it is crucial to consider a company's competitive advantage in the context of its life cycle. Historical examples such as Kodak and Research in Motion demonstrate that failure to innovate and adapt can lead to obsolescence.

Conversely, companies like Nvidia that continuously innovate and adapt their strategies can maintain their competitive edge.

Ultimately, we believe the key to identifying and validating management quality and enduring competitive advantage lies in evaluating the right data in the right way, within the context of the corporate life cycle. This holistic approach enables investors to make informed decisions and potentially capitalize on long-term growth opportunities.

These principles are particularly salient in today's environment of accelerated innovation, which is reshaping and disrupting industries across the board. The next generation of market leaders will be those firms that not only establish durable competitive advantages but also demonstrate the agility to deploy capital efficiently in response to rapidly evolving market dynamics and competitive pressures.

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