

# II

## **| CHAPTER TWO**

### **INNOVATION, ENTREPRENEURSHIP, AND COMPETITIVE ADVANTAGE IN THE AI ECONOMY**

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## Innovation, Entrepreneurship, and Competitive Advantage in the AI Economy

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### Abstract

Artificial intelligence (AI) is reshaping the way firms create value, innovate, and compete, and transforming the future sources of firm-level competitive advantage. Recent research indicates that AI represents a general-purpose technology that will transform productivity, entrepreneurial opportunity, and competition (Crafts, 2021; Cockburn et al., 2018). This chapter shows how AI is changing the underlying drivers of innovation and competitive advantage in the 21(st) Century economy. Its objective is to explain how AI-enabled capabilities, specifically data accumulation, algorithmic learning, and digital ecosystems, transform strategic resources and then firm behavior. It develops a theory-driven analysis, building on rich literature in invention and strategy, and incorporating elements of Schumpeterian creative destruction, Resource-Based View, and dynamic capabilities theory, platform and ecosystem theory, and transaction cost economics, and establishes a conceptual framework called the Algorithmic Competitive Advantage Architecture. Drawing on the literature in these areas and empirical insights from AI-intensive firms, it seeks to answer how the interaction among data assets, machine learning models, digital infrastructure, and platform ecosystems can lead to sustained competitive advantage in the AI economy. It establishes AI as a source of structural economic transformation, reshaping the mechanisms that drive value creation, entrepreneurial opportunity, and competition. It further discusses the implications for scholars, executives, and policy-makers interested in exploring the dramatic ways that AI-enabled capabilities will change the future architecture of technology and of economic organization.

**Keywords:** *Artificial Intelligence; Innovation Economics; Competitive Advantage; Digital Ecosystems; AI Strategy; Entrepreneurial Dynamics*

## INTRODUCTION

### *AI as a Structural Economic Discontinuity*

Technological change has always been a key catalyst for investment opportunities and economic growth (Babina et al., 2024). Breakthroughs from the steam engine to electrification and digital computing have periodically reshaped production, competition, and economic organization. Artificial intelligence (AI) is now seen as a similar game-changing technology that influences how we produce knowledge, how companies innovate, and how economic value is created and captured. Unlike simple digital tools, AI systems provide capabilities that change decision-making processes, prediction methods, and innovation dynamics in organizations and markets (Agrawal et al., 2018; Brynjolfsson & McAfee, 2014). Recent research suggests that AI should be viewed as a general-purpose technology with broad economic impacts, much like electricity or computing infrastructure (Crafts, 2021). General-purpose technologies improve productivity not only through direct technological advancements but also by driving widespread complementary innovations, organizational changes, and new business models. AI demonstrates these traits by allowing automated predictions, adaptive learning systems, and data-driven decision-making across various industries. As AI systems become part of production processes, decision-making, and product development, they create structural changes in economic coordination and competitive behavior.

One of the most important ways AI disrupts the economy is by changing the innovation process itself. Traditional systems relied heavily on human experimentation, trial-and-error learning, and gradual knowledge building. In contrast, AI-driven research environments enable organizations to analyze large datasets, generate predictive insights, and accelerate discovery. Studies show that firms investing heavily in AI technologies see higher rates of product innovation and growth, suggesting that AI capabilities can redefine the connection between technological knowledge and economic performance (Babina et al., 2024). Similarly, Cockburn, Henderson, and Stern (2018) argue that AI acts as an “invention of a method of invention,” enabling organizations to find new solutions and create innovations faster than ever.

AI-driven change also affects labor markets and production systems. Automation technologies are increasingly taking over tasks that once needed human input, changing how labor is allocated and how organizations operate. At the same time, technological change creates new economic tasks and opportunities, leading to ongoing job displacement and task creation (Acemoglu & Restrepo, 2019). These changes indicate that AI is not merely replacing human labor; it is restructuring the foundation of economic activity.

Beyond productivity and labor markets, AI also changes competitive dynamics in today’s markets. Access to large datasets, scalable computing resources, and machine learning capabilities allows some firms to gain significant strategic advantages. As AI systems improve through data-driven feedback, firms that successfully use these technologies may see increasing returns to scale, which strengthens market concentration and dominance (OECD, 2024). Therefore, the economic importance of AI lies not just in its technical abilities but also in its capacity to reshape the foundations of innovation, competition, and entrepreneurship.

Together, these developments suggest that AI represents a major shift in how innovation and competition work in the economy. Instead of offering a slight technological boost, AI changes how knowledge is created, how resources are used, and how companies maintain competitive advantages. Grasping these structural changes requires reevaluating established theories of innovation and strategic management in light of the new realities brought by AI.

## ***Research Question***

As AI becomes more significant economically, it raises essential questions about the future of innovation and competitive strategy. Traditional theories of technological change focus on research investments, human expertise, and organizational capabilities as drivers of innovation. However, AI introduces new ways to create value through algorithmic learning, large-scale data collection, and automated knowledge discovery. These changes challenge existing beliefs about how firms gain and maintain competitive advantages.

This chapter addresses the central research question: *How does artificial intelligence change the logic of innovation, entrepreneurship, and lasting competitive advantage in modern economies?* Answering this requires examining how AI capabilities affect interconnected aspects of economic activity.

AI changes innovation processes by enabling faster experimentation, predictive discovery, and large-scale knowledge recombination. AI reshapes entrepreneurial opportunities by lowering market analysis costs, facilitating new digital business models, and creating platform-based ecosystems for rapid firm growth. AI-driven systems redefine sources of competitive advantage by allowing firms to build proprietary data assets and develop constantly improving algorithmic capabilities. These shifts prompt broader theoretical questions regarding the evolution of innovation economics and strategic management. Existing theories, including Schumpeterian creative destruction, the

## ***Resource-Based View of the firm, and dynamic***

Capabilities theory offers valuable insights into technological competition and firm performance. However, the rise of AI-driven innovation systems suggests that these frameworks may need reinterpretation to account for algorithmic learning, data resources, and ecosystem-based competition. Examining how these theoretical views interact with AI transformation is a vital step in understanding the changing economic landscape.

## ***Contribution Statement and Chapter Structure***

This chapter adds to the growing body of work on artificial intelligence and economic transformation by providing a theory-driven analysis of how AI reshapes innovation, entrepreneurship, and competitive advantage. While existing studies have looked at specific applications of AI, fewer have offered an integrated understanding of how AI interacts with traditional theories of strategy and innovation. This chapter aims to fill that gap by combining insights from various theoretical perspectives to explain the economic processes behind AI-driven competitive advantage.

The chapter has three main contributions. First, it offers a theoretical contribution. The analysis combines Schumpeterian innovation theories, the Resource-Based View, dynamic capabilities theory, platform and ecosystem theory, and transaction cost economics to explore how AI changes traditional sources of firm advantages. By connecting these perspectives, the chapter shows how data-driven capabilities and algorithmic learning systems reshape the strategic resources available to firms and how competitive advantages arise.

Second, the chapter provides a conceptual contribution. It introduces the Algorithmic Competitive Advantage Architecture as a framework explaining how interactions between data assets, machine learning algorithms, digital infrastructure, and platform ecosystems create lasting competitive advantages in the AI economy. This framework emphasizes the feedback

loops between data collection and model improvement, illustrating how AI-enabled firms can achieve increasing returns to scale and market power.

Third, it highlights managerial and policy implications. By analyzing how AI alters innovation dynamics and market competition, the chapter offers insights for leaders looking to build AI-focused strategies and for policymakers addressing the broader economic impacts of AI adoption.

Finally, the chapter will summarize its findings and discuss their implications for future research, managerial strategies, and economic policy.

### ***Theoretical Foundations***

To understand how artificial intelligence changes innovation, entrepreneurship, and competitive advantage, we need to base our analysis on established theories of economic change and strategic management. AI-driven economic systems do not emerge in isolation but connect with long-standing frameworks that explain how companies innovate, compete, and organize economic activities. Classic and contemporary theories, such as Schumpeter's creative destruction, the Resource-Based View (RBV), dynamic capabilities theory, platform and ecosystem theory, and transaction cost economics, provide crucial tools for analyzing these changes. Although these frameworks were created before AI became widespread, they still offer valuable insights into how algorithmic technologies affect innovation and business strategy. This section reviews these theoretical perspectives and lays the groundwork for examining AI-driven economic change.

### ***Schumpeter: Creative Destruction and Recombination***

Joseph Schumpeter's theory of creative destruction is one of the most important frameworks for understanding technological change and economic development. In 1942, Schumpeter argued that capitalist economies evolve through waves of innovation. New technologies and entrepreneurial ventures disrupt established industries and replace outdated production methods. Economic progress arises from constantly destroying existing structures and creating new combinations of resources, technologies, and organizational forms.

Central to Schumpeter's view is the role of entrepreneurs as agents of change.

They introduce new combinations that redefine markets and change competitive dynamics. In this framework, innovation is not just about making small improvements. It involves introducing fundamentally new products, production methods, or organizational structures that alter industry dynamics. These innovations create cycles of competition, in which companies that successfully adopt new technologies gain an advantage over those stuck with outdated practices.

The idea of recombination is key to understanding technological progress. Schumpeter noted that innovation often comes from new combinations of existing knowledge and resources, rather than completely new discoveries. Today, digital technologies have sped up this recombination process. They allow for rapid integration of information and technological capabilities across different fields.

Artificial intelligence enhances these dynamics by increasing the potential for knowledge recombination and speeding up innovation cycles. Machine learning systems can analyze large amounts of data and find patterns that help discover new solutions, effectively boosting technological experimentation. From a Schumpeterian perspective, AI acts as a catalyst. It intensifies creative destruction by enabling faster technological discovery and allowing new entrepreneurs to challenge established players.

## ***Resource-Based View (RBV): VRIN Resources***

The Resource-Based View of the firm is another key framework for understanding competitive advantage. According to Barney (1991), firms achieve a sustained competitive edge when they have resources that are valuable, rare, inimitable, and non-substitutable, often referred to as VRIN resources. These resources can include physical assets, intangible knowledge, organizational skills, or proprietary technologies that competitors cannot easily copy.

The RBV shifts the focus from industry structure to the internal characteristics of firms. Instead of believing that competitive advantage comes mainly from market positioning, the RBV highlights that unique firm-level resources shape performance outcomes. Companies with distinctive capabilities can generate economic profits by using resources that others cannot easily obtain or replicate.

In today's digital economies, data and algorithmic capabilities increasingly resemble strategic resources in line with RBV logic. Large datasets can give companies insights into customer behavior, operational efficiency, and market trends that others cannot easily replicate. Similarly, machine learning models trained on proprietary data can generate predictive capabilities that improve decision-making and operational performance.

These changes raise significant questions about how traditional resource-based logic evolves with AI-driven capabilities. Unlike many traditional resources, data assets often show traits like scalability, cumulative learning, and network effects. As firms gather more data and refine their machine learning models, their predictive accuracy and operational effectiveness may improve over time. This might strengthen their competitive edge. Thus, AI-driven resources could change how VRIN conditions arise in modern economic settings.

## ***Dynamic Capabilities: Sensing, Seizing, and Transforming***

While the RBV focuses on valuable resources, the dynamic capabilities theory looks at how companies adapt to changing technologies and competitive environments. Teece, Pisano, and Shuen argued (1997) that companies need higher-order capabilities to integrate, build, and reorganize resources in response to environmental changes. These dynamic capabilities enable firms to maintain a competitive advantage in rapidly changing technological landscapes. Dynamic capabilities are often seen as three interconnected processes: sensing, seizing, and transforming. Sensing is the ability of firms to spot new opportunities and technological trends. Seizing involves mobilizing resources and investments to capitalize on these opportunities.

Transforming means ongoing reconfiguration of organizational structures, processes, and capabilities to keep up with changing environments. AI-driven technologies can significantly impact each of these processes. Advanced analytics and machine learning systems help organizations process large volumes of information and identify emerging patterns in markets and technologies. These capabilities enhance sensing, helping firms detect opportunities and risks that might otherwise go unnoticed. AI-supported decision-making systems can also help companies evaluate strategic options and allocate resources more effectively, thus strengthening the seizing aspect of dynamic capabilities.

AI systems can support continuous organizational change by allowing real-time monitoring of processes and performance indicators. Companies with these capabilities can adjust strategies, optimize operations, and reorganize resources more quickly and accurately. From a dynamic capability perspective, AI is not just a technological tool; it also serves as an infrastructure that enhances an organization's adaptability in complex, fast-changing environments.

## *Platform and Ecosystem Theory*

Beyond changing firm-level capabilities, digital technologies have reshaped the overall structure of markets and competitive ecosystems. Platform and ecosystem theories offer frameworks for understanding how firms create value by managing networks of users, complementors, and partners. Rochet and Tirole (2003) defined platforms as intermediaries facilitating interactions between different groups of users in two-sided or multi-sided markets. By reducing transaction barriers and enabling coordinated exchanges, platforms generate powerful network effects. These effects increase the value of participation as more users join the system.

Recent research further explores this idea by focusing on ecosystems, complex networks of interdependent actors that collectively create and capture value around a technological platform. Jacobides, Cennamo, and Gawer (2018) describe ecosystems as structures where multiple organizations contribute complementary innovations and skills that enhance the overall functionality of the system. In such settings, competitive advantage can come not just from internal resources but also from managing relationships among ecosystem participants.

Artificial intelligence introduces new aspects to platform and ecosystem competition. AI systems rely heavily on large datasets generated from user interactions, transactions, and other digital activities. As more users engage with a platform, the resulting data can improve machine learning models, thereby increasing the platform's value for both users and complementors. This creates data network effects, where the accumulation of user-generated data enhances algorithmic capabilities and solidifies the platform's competitive position.

The interaction between AI and digital ecosystems creates strong feedback loops between data collection, algorithmic improvement, and user value creation. Platforms that effectively manage these interactions may gain considerable competitive advantages, as their ecosystems become harder for competitors to duplicate.

## *Transaction Cost Economics*

Transaction cost economics offers a different view on how technological change affects economic activity. Williamson (1985) suggests that firms and markets are two ways to manage transactions. Choosing between these options relies mainly on the costs tied to negotiating, monitoring, and enforcing agreements between economic actors.

According to this framework, firms arise when internal coordination can lower transaction costs compared to market exchanges. Factors like asset specificity, uncertainty, and opportunism affect whether economic activities occur within firms or through market relationships. Technological innovations that change coordination costs can reshape the boundaries of firms and the structure of industries.

Digital technologies, including AI, can significantly affect transaction costs by improving information processing, monitoring abilities, and contract enforcement. AI-driven analytics systems can analyze large datasets to assess risks, predict outcomes, and enhance supply chain coordination. These abilities can decrease the costs linked to information gaps and uncertainty, making transactions between economic actors more efficient.

At the same time, AI technologies may enable firms to take on certain activities they previously outsourced. For example, automated decision systems and predictive analytics might allow organizations to handle complex analytical tasks internally instead of depending on external service providers. These changes suggest that AI technologies could shift the boundaries of firms by altering the balance between hierarchical coordination and market exchange.

Overall, the concepts discussed in this section create a foundation for understanding

how artificial intelligence changes innovation, entrepreneurship, and competitive advantage. While each perspective highlights different aspects of economic change, combining them provides a clear view of the strategic and organizational effects of AI.

### ***Algorithmic Recombination***

Schumpeter's idea of creative destruction explains how economic growth comes from the constant mixing of knowledge, technologies, and organizational structures that disrupt current market setups (Schumpeter, 1942). Historically, this mixing relied on human trial and error, gradual scientific discoveries, and ongoing learning within companies and research organizations. Artificial intelligence changes this process by allowing large-scale algorithmic mixing, where computer systems recognize patterns and connections across vast datasets and produce new technological combinations.

AI systems serve as strong tools for computational searches in complex innovation fields. Machine learning algorithms can evaluate scientific articles, patent databases, consumer behavior records, and operational data all at once. They can spot potential technological connections that human researchers might miss. This ability greatly increases the range of mixing for innovation. Cockburn, Henderson, and Stern (2018) describe AI as a method of invention, highlighting its role in changing how new ideas and discoveries happen. Instead of relying solely on human experimentation, companies are increasingly using algorithmic systems to assist in discovery and design.

The economic effects of algorithmic mixing go beyond labs. Companies that use AI technologies can combine existing technologies and datasets to develop new products, services, and processes. Evidence shows that organizations investing in AI capabilities have higher rates of product innovation and quicker growth, suggesting that algorithmic systems improve the ability to turn mixed knowledge into economic benefits (Babina et al., 2024). In simple terms, AI-driven mixing enables companies to test multiple technological setups simultaneously, broadening their innovation potential.

From a Schumpeterian viewpoint, AI intensifies the mechanisms that drive creative destruction. By dramatically expanding the range of knowledge mixing that can be explored, algorithmic recombination pushes the limits of innovation and speeds technological change. As businesses increasingly incorporate AI into their research and development efforts, the innovation process itself becomes partially automated, altering the classic relationship among human expertise, experimentation, and technological progress (Agrawal et al., 2019).

### ***Speed Asymmetry***

Besides broadening the mixing possibilities, artificial intelligence also changes the timing of innovation. AI-powered analytics reduce the time needed to generate insights, assess alternatives, and implement new technologies. This speed creates disparities where firms with advanced AI capabilities can innovate and react to market signals faster than their rivals.

General-purpose technologies frequently alter economic systems by reorganizing production and decision-making rather than by quickly replacing existing technologies (Crafts, 2021). AI follows this trend by allowing automated analysis of large datasets, predictive modeling of technological results, and quick evaluation of strategic choices.

As organizations adopt machine learning in their decision-making processes, the time from idea generation to execution is significantly reduced.

These timing advantages have strategic implications for companies in competitive mar-

kets. Organizations that can use AI-driven analytics may gain first-mover advantages by introducing new products, optimizing production, or spotting new market opportunities before competitors. Companies lacking similar capabilities might struggle to keep up with the pace of technological change, leading to widening competitive gaps.

The shortening of innovation cycles also interacts with broader changes in labor and production systems. Automation technologies allow companies to shift tasks between human workers and machine systems, focusing human expertise on creative and strategic functions while leaving routine analytical processes to algorithms (Acemoglu & Restrepo, 2019). Evidence suggests that adopting AI is linked to greater innovation intensity and better productivity results, highlighting the role of technological acceleration in shaping firm performance (Dam-ioli et al., 2025).

From an innovation economics perspective, speed asymmetry represents a major change in the competitive logic of technological growth. Firms that integrate AI into their innovation processes can shorten development cycles and respond to market shifts more quickly, thus improving their strategic position in fast-changing industries.

### ***AI-Native Entrants vs. Incumbents***

The shift in innovation processes through algorithmic mixing and faster experimentation also changes competitive dynamics between new entrants and established companies. Traditional firms often have advantages from their size, accumulated knowledge, and position in the market. However, the rise of AI-driven economic systems has allowed AI-native companies, businesses built around data infrastructure and algorithmic abilities, to challenge these established firms.

AI-native companies usually build their business models around ongoing data collection, machine learning development, and digital platform structures. They view data as a key strategic asset and organize their operations for continuous algorithmic improvement. As a result, AI-native firms often show greater flexibility in responding to market changes and tech opportunities (Iansiti & Lakhani, 2020). Evidence suggests that companies adopting AI technologies often experience higher rates of innovation and product development, indicating that algorithmic capabilities can lead to measurable competitive advantages (Babina et al., 2024). In many sectors, new entrants have used AI-powered analytics and digital platforms to compete with incumbents that rely on outdated information systems and organizational setups.

The competitive implications of these changes are increasingly acknowledged in discussions about digital markets. Firms that gather extensive datasets and advanced machine learning skills may gain structural advantages that are hard for competitors to replicate. These advantages can drive market concentration and create barriers to entry in AI-driven sectors (OECD, 2024). Therefore, the interaction between AI-native entrants and established firms plays a key role in how creative destruction is reshaped in the AI economy.

### ***Data Network Effects***

The Resource-Based View sees competitive advantage as coming from valuable, rare, hard-to-copy, and non-substitutable resources. In AI-driven economies, data has become a vital resource that affects firm performance and competitive positioning. However, data have different economic characteristics compared to traditional assets, mainly due to data network effects.

Data network effects occur when user interactions create data that enhances the performance of machine learning systems. This, in turn, boosts the value of the platform or service

for new users. Gregory et al. (2021) argue that these feedback loops are key to how AI-enabled firms create value for users. As more people interact with a digital system, the data generated allows algorithms to make better predictions, recommendations, or operational insights. Better performance attracts more users, which then generates even more data for algorithmic learning.

These dynamics are vital in digital transformation strategies. Firms that can collect and analyze large amounts of user-generated data can improve the accuracy of their AI systems and enhance service quality. Wu et al. (2024) show that organizations leveraging data network effects often accelerate digital transformation by integrating AI into product development, customer engagement, and operational decision-making.

From a competitive perspective, data network effects lead to increasing returns to scale in AI-driven markets. Firms with large user bases gain richer datasets that improve algorithmic performance and strengthen competitive advantages. These cumulative dynamics may create concentrated market structures where leading firms keep technological superiority by continually accumulating data (OECD, 2024).

### ***Non-Rivalrous but Path-Dependent Assets***

Data has unique economic characteristics that set it apart from traditional physical resources. One major feature is its non-rivalrous nature. The same dataset can be used simultaneously by multiple algorithms or departments without being diminished. This allows firms to expand AI-driven capabilities across various applications without depleting the underlying resource.

While data is non-rivalrous, its value is greatly influenced by its historical context. The usefulness of a dataset often relies on the past processes used to create and gather it. Organizations that collect data over long periods develop unique informational resources that competitors cannot easily replicate. These historical datasets often capture detailed patterns of user behavior, performance, and market interactions that contribute to creating effective machine learning models.

From the Resource-Based View, these characteristics challenge old-style ideas about VRIN resources (Barney, 1991). While data may be replicable in theory, proprietary datasets often have qualities that make them hard to imitate in practice.

Firms with exclusive data sources may develop resources that are both valuable and rare.

Economic studies of artificial intelligence highlight that predictive systems rely heavily on having high-quality training data (Agrawal et al., 2018). Without such data, machine learning algorithms struggle to make accurate predictions or insightful recommendations. Therefore, firms that gather large amounts of proprietary data may gain strategic advantages that support ongoing innovation and competitive differentiation (Babina et al., 2024).

### ***Model Training as Capability Accumulation***

In addition to having raw data assets, competitive advantage in AI-driven markets increasingly relies on model training and refinement. Machine learning systems enhance their performance through repeated training cycles where algorithms analyze data, make predictions, and adjust their internal settings based on results (Cockburn et al., 2018). Over time, this leads to increasingly advanced models that can handle complex decision-making tasks.

This iterative learning process can be viewed as a way of accumulating capability. Each

training cycle embeds more knowledge into the algorithmic system, gradually boosting its predictive performance and operational value. Cockburn et al. (2018) argue that AI technologies change the innovation process by enabling ongoing computational learning, which enhances firms' abilities to create new technological insights.

The accumulation of trained models also interacts with broader organizational capabilities. Firms that invest in machine learning infrastructure usually develop complementary skills in data governance, technical architecture, and AI integration across business areas (Hanelt et al., 2025; Iansiti & Lakhani, 2020). These capabilities shape how organizations deploy AI systems in strategic decision-making processes.

Recent research suggests that AI technologies can act as boundary resources that facilitate coordination among organizational units and ecosystem partners (Hanelt et al., 2025). By integrating predictive capabilities into digital infrastructures, firms can weave AI-driven insights into product development, supply chain management, and customer engagement strategies. Thus, model training is not just a technical task but a strategic activity that helps organizations build capabilities supporting long-term competitive advantage.

### ***Continuous Sensing via Machine Learning***

Dynamic capabilities theory highlights the significance of organizational processes that allow companies to recognize and react to shifts in technology and market conditions (Teece et al., 1997). In this context, sensing means the ability of firms to spot new opportunities, technological trends, and changes in the competitive landscape. Artificial intelligence greatly improves this ability by facilitating continuous analysis of large amounts of data generated through digital interactions, operational systems, and outside information sources.

Machine learning systems can monitor complex environments and identify patterns that indicate new market opportunities or possible disruptions. By examining real-time data on consumer behavior, technological progress, and industry trends, AI systems help firms discover strategic opportunities sooner than traditional analytical methods would allow. Engelmann, Audretsch, and Lehmann (2024) argue that AI-enhanced analytics changes sensing capabilities by turning strategic awareness into an ongoing computational process instead of a periodic managerial task.

Organizations that integrate machine learning into their decision-making processes gain better situational awareness and a stronger ability to foresee technological changes. These sensing capabilities enable firms to shift strategic priorities, manage resources more efficiently, and pursue new opportunities with greater accuracy. In the AI economy, continuous sensing serves as a critical foundation for staying competitive in fast-changing markets.

### ***Real-Time Adaptation***

In addition to improving sensing capabilities, artificial intelligence also boosts the seizing and transforming aspects of dynamic capabilities by allowing real-time organizational adaptation. AI-driven analytics enable firms to quickly assess strategic options, improve operational decisions, and modify business processes based on changing market conditions.

Empirical studies indicate that organizations using AI technologies often show enhanced performance in innovation and product development. This suggests that algorithmic systems improve the ability to convert insights into strategic action (Babina et al., 2024). Machine learning models can examine operational data to find inefficiencies, anticipate market

demand, and optimize resource use, allowing organizations to respond more effectively to new opportunities.

AI-supported decision systems also aid organizational transformation by merging predictive insights across business functions. Cockburn et al. (2018) note that AI systems promote continuous learning within organizations, enabling firms to refine strategies and operations as new data comes in. These capabilities encourage adaptive behavior in environments marked by uncertainty and rapid technological change.

Recent research indicates that AI-enabled organizational structures may even reshape traditional company boundaries by automating certain coordination tasks and lowering managerial overhead (Klein & Wieczorek, 2026). In this way, AI-driven realtime adaptation not only boosts operational efficiency but also changes the governance structures through which firms coordinate economic activities.

### ***Compressed Innovation Cycles***

The final impact of algorithmic acceleration is the shortening of innovation cycles. In traditional innovation systems, developing products and experimenting with technologies typically took a long time for research, testing, and market evaluation. AI-driven analytics significantly reduces these timelines by enabling automated experimentation, predictive modeling, and rapid evaluation of different strategies.

Economic studies on artificial intelligence emphasize that machine learning systems greatly reduce the cost of prediction and information processing (Agrawal et al., 2019). As prediction costs drop, firms can quickly test multiple hypotheses and examine technological options. This ability enables organizations to refine product designs, operational strategies, and business models at an unmatched pace.

Historical analyses of technological change suggest that general-purpose technologies often generate productivity gains by reorganizing production systems and accelerating innovation (Crafts, 2021). AI seems to follow a similar pattern. By promoting continuous experimentation and data-driven decision-making, AI systems decrease the time it takes for firms to transition from technological discovery to market implementation.

The strategic implications of shorter innovation cycles are significant. Firms capable of leveraging AI-driven innovation systems can launch new products and services more frequently, adjust strategies more swiftly, and respond to competitive threats more nimbly. Meanwhile, organizations that do not adopt AI capabilities may find it hard to keep up with the fast pace of technological change. Therefore, integrating AI into organizational processes contributes to a structural shift in the speed and intensity of competitive dynamics within modern economies (OECD, 2024).

### **API Economies**

Digital platform markets increasingly rely on application programming interfaces (APIs). These allow external developers, partners, and others to connect their services to a core technology framework. In platform economics, APIs act as resources that enable interactions among users, developers, and companies within a digital ecosystem (Rochet & Tirole, 2003). By reducing integration costs and enabling modular innovation, APIs help platform owners manage complex networks of participants who work together to create value.

The growth of artificial intelligence enhances the strategic role of API-based ecosystems. AI services such as natural language processing, predictive analytics, and recommenda-

tion systems are often delivered via programmable interfaces. These let third-party developers integrate algorithmic features into their applications. In this setup, APIs serve as a means to distribute AI functions across ecosystems, enabling firms to add machine learning capabilities to a range of digital products and services.

From an ecosystem viewpoint, API designs enable platform leaders to coordinate networks of complementary innovations. Jacobides, Cennamo, and Gawer (2018) note that ecosystems generate value through the coordinated efforts of multiple actors who provide specialized skills for a shared technology framework. AI-driven APIs build on this model by enabling developers to create new applications using machine learning infrastructure provided by platform firms.

Recent studies show how AI technologies aid in coordinating ecosystem business models by automating interactions among platform participants (Chin et al., 2024). With APIs, firms can distribute algorithmic abilities across networks of partners and collaborators. This approach broadens the ecosystem's functional capabilities while keeping control over essential technology assets. Therefore, API economies serve as a key way for AI platforms to promote innovation and enhance their strategic influence in digital markets.

### ***Model-as-a-Service***

A second major development in AI ecosystems is model-as-a-service (MaaS) business models. In this setup, organizations access machine learning models as cloud-based services through subscription or usage-based pricing. Instead of creating proprietary AI systems, companies increasingly depend on external providers that offer scalable algorithmic capabilities via digital infrastructures.

This model reflects a wider shift in how technological capabilities are organized in digital economies. AI models require considerable investments in computing infrastructure, data management systems, and specialized knowledge. By offering models as cloud-based services, leading tech firms allow other organizations to tap into advanced AI capabilities without bearing the full costs of internal development (Iansiti & Lakhani, 2020).

From a strategic angle, model-as-a-service setups create new chances for platform growth. Companies providing AI models through cloud platforms can attract many developers and businesses that depend on their infrastructure for essential technology functions. As more users adopt these platforms, they gather data, refine algorithms, and broaden the range of services offered to ecosystem participants.

Research on AI-enabled business models shows that service-based models can yield significant competitive advantages by enabling firms to expand their technological capabilities across multiple markets simultaneously (Climent & Haftor, 2024). Additionally, the concentration of AI infrastructure among a limited number of technology providers raises critical questions about market power and competition policy, especially as AI models become fundamental to digital economies (OECD, 2024).

### ***AI-Driven Ecosystem Lock-In***

The integration of AI into digital ecosystems also creates forces that reinforce ecosystem lock-in. As organizations adopt AI services and integrate them into their operations, switching to other platforms becomes more expensive. This situation arises because AI systems depend on proprietary data structures, training environments, and computing infrastructures that are often unique to specific platforms.

Data network effects further strengthen these lock-in forces. As users and organizations engage with AI-enabled platforms, they produce data that improves algorithm performance and increases the ecosystem's value. Gregory et al. (2021) point out that these feedback loops strengthen platform dominance by enhancing the technological edge of established firms.

Within ecosystem theory, these forces can be seen as a form of cumulative advantage in which early leaders solidify their position by controlling technological standards and data flows (Jacobides et al., 2018). Firms that effectively manage AI ecosystems can create conditions where collaborators, developers, and users become deeply integrated into the platform's structure.

Evidence shows that AI-driven firms frequently use these dynamics to maintain a competitive advantage. Organizations that can combine large datasets, advanced algorithms, and ecosystem coordination often achieve lasting innovation advantages that reinforce their market leadership (Babina et al., 2024). As a result, ecosystem lockin is a key method through which AI platforms influence long-term competitive dynamics in digital markets.

### ***Automation of Coordination***

Transaction cost economics highlights that firms and markets are different ways to organize economic activity. According to Williamson (1985), organizations take on transactions when using the market becomes expensive due to uncertainty, asset specificity, or information imbalances. Artificial intelligence changes this scenario by allowing automated coordination across complex economic systems.

AI-driven analytics can handle large volumes of data on supply chains, customer interactions, and operational performance. By lowering the costs tied to processing information and making decisions, AI systems make it easier for organizations to coordinate economic activities. Prediction technologies help firms forecast market demand, improve logistics, and allocate resources more accurately (Agrawal et al., 2018).

Recent studies indicate that digital technologies reduce transaction costs by enabling real-time information sharing and automated contract monitoring. Chan, Chen, and Zhao (2025) contend that AI-driven digital systems promote better coordination in economic networks, letting organizations manage complex interactions with less administrative burden.

These changes imply that AI could reshape the ways economic coordination happens. By automating analysis and decreasing uncertainty, AI systems enable firms to handle complex transactions more effectively than older coordination methods did.

### ***Boundary Shifts: Firm vs. Market***

Technological changes that affect coordination costs often lead to shifts in the lines between firms and markets. When market transactions become easier and cheaper, firms might outsource activities they once did internally. Conversely, if internal coordination becomes more effective, organizations might decide to bring activities back in that they previously managed through outside contracts. Artificial intelligence adds new factors to this boundary decision. Digital platforms and AI-driven coordination systems help firms work with external partners more effectively, which could increase the use of market-based relationships. At the same time, AI-driven analytics and automation may let organizations handle complex functions on their own without depending on outside service providers.

Emerging research suggests that organizations using AI might adopt mixed governance structures that blend aspects of hierarchical control with platform-based coordination. Klein

and Wieczorek (2026) describe the rise of the headless firm, where algorithmic systems take on many coordination roles that management manually handled. In such places, decision-making is more spread out among algorithmic systems that manage workflows, allocate resources, and oversee operational tasks.

Policy analyses also discuss how these changes could affect competition and market structure. As AI systems let firms take on complex analytical tasks, leading tech companies may combine abilities that were once spread across many firms (OECD, 2024). Thus, AI-driven technologies might redefine industry boundaries and change how economic activities are organized.

### ***AI as an Internalized Market Mechanism***

Another important effect of AI on transaction cost economics is its potential role as an internalized market system within firms. Conventional markets manage economic activity through price signals that reflect supply and demand. Inside firms, management usually replaces these market signals with administrative decision-making processes.

Artificial intelligence brings the chance that algorithmic systems can mimic some of the functions of market coordination within company boundaries. By continually analyzing data on demand, production capacity, and resource availability, AI systems can allocate resources and optimize decisions in ways similar to market-based coordination.

Cockburn, Henderson, and Stern (2018) argue that AI technologies change innovation processes by allowing computational search and predictive decision-making across complex economic systems. In firms, these abilities enable algorithmic systems to assess different strategies, allocate resources, and coordinate activities among organizational units.

From a strategic viewpoint, AI-driven decision systems blur the lines between markets and hierarchies. Iansiti and Lakhani (2020) argue that organizations centered on AI infrastructure increasingly depend on algorithmic coordination rather than traditional management structures. In these settings, decision-making is woven into digital systems that constantly process information and enhance organizational performance. These changes suggest that artificial intelligence may function as an internalized market system, reducing the need for hierarchical coordination while maintaining the advantages of centralized organizational control. As firms incorporate AI into their operational frameworks, the distinctions between markets, platforms, and hierarchies could become more flexible, changing the foundational structures of modern economic organization (Gregory et al., 2021).

### ***Conceptual Model***

The preceding analysis shows that artificial intelligence is not just a technological improvement but a fundamental change that reshapes innovation processes, competitive dynamics, and organizational abilities. While existing theories, including the Resource-Based View, dynamic capabilities theory, and platform ecosystem frameworks, offer valuable insights, the rise of AI-driven economic systems needs a more integrated approach. This chapter presents an analytical framework called Algorithmic Competitive Advantage Architecture.

The purpose of this framework is to explain how companies gain and maintain a competitive edge in environments where algorithmic technologies, large data resources, and digital ecosystems interact to influence economic results. Traditional models of competitive advantage often focus on fixed resource endowments or market positioning. In contrast, competition driven by AI involves ongoing feedback loops between data generation, algorithmic learning,

and platform expansion. These dynamics introduce new ways for companies to build capabilities and strengthen their strategic positions.

Recent research shows that organizations are increasingly depending on algorithmic structures that combine machine learning, digital platforms, and data analytics into essential business processes (Iansiti & Lakhani, 2020). In these settings, competitive advantage comes not just from individual technological tools but from the connections among data resources, computational models, and ecosystem relationships. This view aligns with new scholarship that highlights the role of AI-enabled business models in generating new types of value and competitive differences (Climent & Haftor, 2024).

The Algorithmic Competitive Advantage Architecture thus describes AI-driven companies as systems, where various technological and organizational pieces work together to create ongoing innovation and economic success. By identifying the basic elements behind this architecture, the framework offers a way to analyze how AI changes the sources of competitive advantage in today's economy.

### ***Framework Components: Data, Models, Infrastructure, and Ecosystems***

The proposed framework identifies four interconnected components that together constitute algorithmic competitive advantage: data assets, machine learning models, digital infrastructure, and platform ecosystems. These elements work together through feedback loops that strengthen technological capabilities and strategic positioning.

First, data assets act as the crucial input for AI-driven systems. Machine learning algorithms depend on large amounts of structured and unstructured data to find patterns, make predictions, and aid decision-making. Companies that can gather extensive data through digital interactions, operational processes, and platform involvement gain access to informational resources that their competitors may struggle to replicate. Therefore, accumulating data serves as a strategic resource for developing powerful algorithmic capabilities (Gregory et al., 2021).

Second, machine learning models convert raw data into predictive insights and operational intelligence. Through repeated training, these models continually improve their performance as new data arrives. The cumulative nature of training enables companies to build algorithmic capabilities that grow over time, creating a dynamic type of technological learning. Research on AI-driven innovation suggests that these capabilities can significantly boost product development, operational efficiency, and strategic decision-making (Cockburn et al., 2018).

Third, digital infrastructure provides the computing and organizational foundations needed to deploy AI technologies at scale. Cloud computing platforms, data pipelines, and distributed computing setups allow firms to process vast datasets and train complex machine learning models. These infrastructures also help integrate AI capabilities across various organizational functions, including research and development, marketing, supply chain management, and customer engagement (Iansiti & Lakhani, 2020).

Fourth, platform ecosystems broaden the reach of algorithmic capabilities by connecting firms with a network of users, developers, and complementary service providers. Ecosystem theory highlights that value creation increasingly happens through coordinated interactions among various actors rather than through isolated company activities (Jacobides et al., 2018). Within AI-driven ecosystems, user interactions generate data that improve algorithmic models, while developers and partners contribute innovations that enhance the platform's functionality.

These four components function within reinforcing feedback loops. Data produced by ecosystem participants enhances machine learning models; better models improve service quality and draw in more users; increased user engagement generates additional data that strength-

ens the algorithms. Evidence shows that firms that can leverage these feedback mechanisms often experience higher rates of innovation and growth (Babina et al., 2024). Thus, algorithmic competitive advantage arises from the systemic interplay of data, models, infrastructure, and ecosystem relationships.

### ***Integration with Existing Theories***

The Algorithmic Competitive Advantage Architecture incorporates insights from several theoretical traditions and adapts them to address AI-driven economic changes.

First, the framework builds on the Resource-Based View, which stresses that lasting competitive advantage arises from valuable, hard-to-replicate resources. In AI-driven markets, proprietary datasets and trained machine learning models are strategic resources that meet many criteria outlined in RBV research. However, the framework extends RBV by focusing on the dynamic interaction between data accumulation and algorithmic learning, rather than treating resources as fixed assets.

Second, the framework draws on dynamic capabilities theory, which emphasizes the role of organizational processes in helping firms identify opportunities, acquire resources, and adapt operations to technological change. AI-enhanced analytics support these processes by providing ongoing access to real-time data and predictive insights. As companies weave machine learning systems into their strategic decision-making, their dynamic capabilities increasingly rely on algorithmic infrastructures.

Third, the framework draws on platform and ecosystem theory, emphasizing the role of digital ecosystems in scaling AI-driven innovation. Platforms that organize networks of users and partners create environments where data generation and algorithmic learning bolster each other. In these ecosystems, competitive advantage arises not just from internal strengths but from a company's ability to coordinate interactions among various actors.

The framework reflects emerging views on AI as a general-purpose technology that can transform innovation processes and economic structures (Cockburn et al., 2018). By integrating multiple theoretical perspectives into a single model, the Algorithmic Competitive Advantage Architecture provides a conceptual framework for analyzing how firms achieve lasting advantages in the AI economy.

### ***Implications Entrepreneurship***

Artificial intelligence changes the world of entrepreneurial opportunity. It lowers entry barriers in some tech areas while making data-driven skills more important. AI platforms and cloud services let entrepreneurs use machine learning tools without building their own systems. This allows startups to test new business ideas, digital services, and data-focused products faster than before. Recent research indicates that generative AI platforms act as catalysts for digital entrepreneurship. They help individuals and small businesses create applications that leverage algorithmic capabilities once available only to larger firms (Nzembayie et al., 2025). This shift opens up more opportunities for entrepreneurs in fields like healthcare, finance, logistics, and the creative industries.

However, large tech companies are accumulating proprietary datasets and computational resources. This could create barriers that limit competition in AI-focused markets. Consequently, policymakers and entrepreneurs face a complex landscape in which AI broadens opportunities but also strengthens the advantages of established tech giants (OECD, 2024).

For established companies, artificial intelligence brings new strategic demands related

to developing technological skills, managing data, and participating in ecosystems. Companies that want to stay competitive must incorporate AI analytics into key business areas such as product development, supply chain management, and customer relations. This integration requires both investment in technology and organizational changes.

Research in strategic management shows that firms that build AI capabilities often see gains in productivity, innovation, and operational efficiency (Babina et al., 2024). These advantages hinge on the ability to merge technological resources with complementary processes. Leaders must connect AI use with broader strategic goals and ensure that algorithmic systems help maintain a competitive edge.

Additionally, the growth of AI ecosystems means companies must participate in networks of partners, developers, and data providers. Success may rely on effectively managing these ecosystem relationships and using innovations from outside the company. As digital platforms become vital for the AI economy, corporate strategy increasingly involves decisions about how to engage with platforms, set technological standards, and share data.

The rapid spread of AI technologies poses significant challenges for policymakers seeking to balance innovation, competition, and the public good. AI markets often display strong network effects and increasing returns to scale, which can lead to concentrated market structures controlled by a few tech firms (OECD, 2024).

Policymakers need to assess if current competition policies can adequately handle the specific dynamics of AI-driven industries.

The impacts on the labor market are also a key concern. Automation can eliminate certain tasks while creating new economic activities that require different skills (Acemoglu & Restrepo, 2019). Governments may need to invest in education, training programs, and reforms that help the workforce adapt to these technological changes.

In addition, AI governance must tackle issues of data privacy, algorithm transparency, and responsible innovation. As AI systems become essential to economic infrastructure, regulatory bodies need to create policies that promote technological advancement while protecting public interests.

### ***Organizational Design***

Incorporating AI into business operations alters organizational structures and management processes. Traditional decision-making hierarchies may lose importance as algorithmic systems take on more operational coordination and strategic analysis tasks. AI-driven organizations often depend on data-informed decision-making, where predictive analytics guide resource distribution, product development, and market strategies.

Research on dynamic capabilities indicates that organizations must continually adapt their structures and processes to keep pace with technological changes (Engelmann et al., 2024). AI technologies allow firms to monitor performance indicators and market conditions in real time, letting them react faster than traditional models allow.

Digital technologies can change firm boundaries by lowering transaction costs and enabling new forms of distributed coordination. AI platforms enable companies to work with external partners while keeping centralized control over critical data and algorithmic resources (Chan et al., 2025). Therefore, the organizational design of firms in the AI economy increasingly features hybrid structures that blend hierarchical coordination with platform-based ecosystems.

Overall, these implications underscore the extensive impact of artificial intelligence on entrepreneurship, corporate strategy, public policy, and organizational design. Grasping these changes is crucial for scholars, executives, and policymakers who aim to navigate the evolving economic landscape shaped by AI-driven innovation.

## *Case Studies and Illustrative Examples*

Uses of artificial intelligence show how the concepts discussed above translate into competitive advantage across industries. Instead of narrative accounts, the following cases demonstrate how firms put data advantages, learning effects, and ecosystem strategies into action.

Amazon's recommendation systems are a well-known example of AI-driven competitive advantage leveraging data and learning effects. Amazon examines large amounts of customer data, such as browsing history, purchasing patterns, and product ratings, to create personalized product recommendations. These systems use machine learning algorithms that improve as more users interact with the platform. Research shows that recommendation algorithms significantly affect purchasing behavior by reducing information search costs and improving product discovery (Zhou et al., 2024). In theoretical terms, Amazon's advantage comes from a mix of exclusive data assets and algorithmic learning processes that enhance customer engagement and loyalty to the platform.

Google DeepMind's AlphaFold system shows how AI can revolutionize innovation through algorithmic discovery. AlphaFold uses machine learning to predict protein structures based on genetic sequences, tackling a long-standing challenge in biological science. This system has greatly sped up scientific discovery by allowing researchers to analyze protein structures that would have taken years of lab work (Jumper et al., 2021). The AlphaFold protein database has broadened the structural coverage of protein-sequence space and is widely utilized in biomedical research (Varadi et al., 2022). This case illustrates how algorithmic capabilities can lead to breakthroughs in knowledge-intensive areas, supporting the idea that AI accelerates innovation.

Another example is OpenAI's model ecosystem, which illustrates the importance of platform-based AI infrastructures. OpenAI provides extensive language and generative models through APIs that let developers integrate AI features into their applications. By offering models as cloud services, the company has created an ecosystem where developers build additional innovations on shared algorithmic frameworks. This setup highlights the strategic importance of ecosystem orchestration and shows how AI platforms create value through user participation and data feedback loops.

NVIDIA's AI infrastructure is another example of competitive advantage rooted in technological specialization. NVIDIA's graphics processing units (GPUs) are key components of modern AI systems because they enable the parallel computation necessary for training large machine learning models. By designing hardware tailored for AI tasks, Nvidia has established itself as a critical supplier in the global AI ecosystem. The company's advantage illustrates how specialized infrastructure can serve as a strategic resource that fosters algorithmic innovation across different industries.

Netflix's recommendation algorithms show how AI-driven personalization can influence competitive advantage in digital media markets. Netflix analyzes viewer behavior to suggest content tailored to individual tastes. These algorithms use collaborative filtering and machine learning techniques to identify patterns across millions of interactions (Gomez-Uribe & Hunt, 2015). The resulting recommendations boost user engagement and reduce subscriber churn by ensuring that viewers frequently encounter relevant content. Theoretically, Netflix's advantage arises from the synergy of proprietary data, algorithmic learning, and platform network effects.

Together, these examples demonstrate how AI-driven firms apply theoretical mechanisms—data advantages, learning effects, and ecosystem strategies—into practical sources of competitive advantage.

## CONCLUSION

### *Summary*

This chapter explored how artificial intelligence changes innovation, entrepreneurship, and competitive advantage in today's economies. The analysis shows that AI is not just a technological tool; it represents a major shift in how innovation and competition work. AI systems allow for large-scale knowledge sharing, speed up innovation cycles, and create new ways to generate value based on data-driven learning. As companies incorporate machine learning into their strategies, their competitive edge increasingly comes from the interplay of data assets, algorithmic models, digital infrastructures, and ecosystem relationships.

The chapter also highlighted how AI changes the dynamics of creative destruction, resource accumulation, and organizational adaptation. Data network effects, ongoing model training, and platform-based ecosystems create feedback loops that help leading firms maintain their technological and competitive advantages over time.

### *Theoretical Contributions*

From a theoretical viewpoint, this chapter adds to the literature on innovation economics and strategic management by combining various theoretical frameworks, such as Schumpeterian innovation theory, the Resource-Based View, dynamic capabilities, and ecosystem theory, to explain how algorithmic competitive advantage develops. The proposed Algorithmic Competitive Advantage Architecture offers a conceptual model that connects data accumulation, machine learning capabilities, digital infrastructure, and ecosystem coordination into a comprehensive explanation of firm performance in the AI economy.

This integrative perspective builds on existing theories by stressing the role of algorithmic learning systems as dynamic strategic assets. Instead of viewing resources as fixed advantages, the framework argues that ongoing data creation and model improvements develop changing technological capabilities that influence long-term competitive outcomes (Cockburn et al., 2018; Climent & Haftor, 2024).

### *Future Research Directions*

While significant progress has been made in understanding the economic effects of AI, several important research questions still exist. Future studies could look into how AI-driven ecosystems affect market structures, innovation spread, and global competition among tech firms. More research is needed to explore how AI reshapes organizational boundaries and governance structures in digital economies (Klein & Wiczorek, 2026).

Policymakers and scholars must consider the wider societal effects of AI adoption, including its impact on job markets, competition policy, and economic inequality (OECD, 2024). Tackling these challenges will require cross-disciplinary research that brings together insights from economics, management, and technology studies.

As AI continues to develop as a general-purpose technology, understanding its role in shaping innovation and competitive advantage will remain a key priority for both researchers and practitioners (Agrawal et al., 2019; Damioli et al., 2025).

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