THE STRATEGIC MANAGEMENT PROCESS REQUIRES COMPETITIVE STATUS ASSESSMENT

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ABSTRACT

This paper contains a step-by-step analytical roadmap for students who are using, and professors who are teaching, the Strategic Management Process as the methodology to drive the development of strategies producing competitive advantage. We introduce the term competitive status to capture the competitive state of the firm: advantage, disadvantage, or parity.

INTRODUCTION

Porter (1985) played a big role in initiating the search for *competitive advantage;* then came a search for *sustained competitive advantage* (e.g., Barney, 1986; Barney, 1991). Warren Buffett now seeks *durable competitive advantage* (Buffett & Clark, 2008). Strategic management instructors can easily explain the concept of *competitive advantage* by using *economic value added* (Porter, 1985; Barney, 1986); however, EVA, a concept, not a calculation, leaves students with no definitive assessment method.

In this paper, we seek to demonstrate a systematic analytical method for assessing *competitive status,* the state of advantage, disadvantage, or parity. Strategic management textbooks (Barney & Hesterly, 2012; Barney, 2011; Hitt, Ireland, & Hoskisson, 2009; etc.) utilize the *strategic management process* (SMP) to craft business strategy. These texts assert that creating/improving *competitive advantage* is the purpose of the SMP (e.g., Barney & Hesterly, 2012). However, none of these textbooks contain explanations as to how students are supposed to craft a strategy designed to improve some vague immeasurable concept. This is not a criticism; it instead highlights the complex nature of the concept. As shown in Figure 1, the SMP is a linear process that begins with mission definition and concludes with a strategy that produces or enhances competitive advantage (Barney, 2011). Setting of objectives, defining the measures of effectiveness and efficiency, follows mission definition; next is the concurrent external & internal analysis; then strategic choice, followed by strategic implementation, which should then lead to *competitive advantage*.

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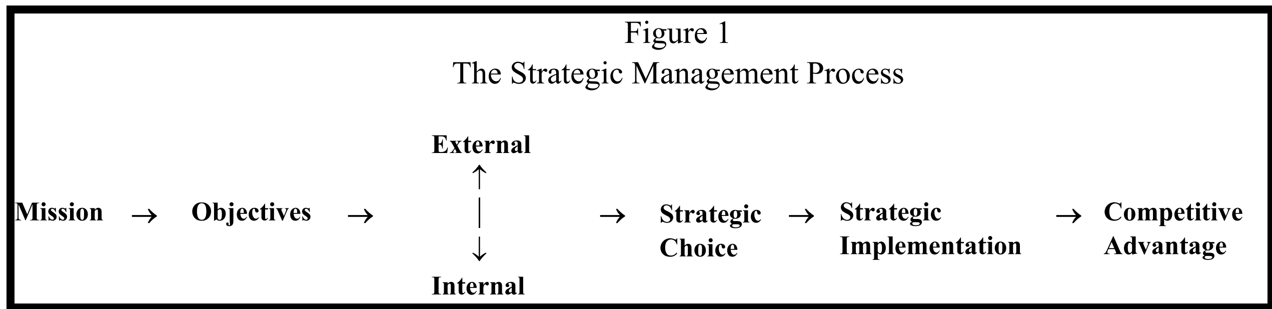

Source: adapted from J.B. Barney. (2011). *Gaining and Sustaining Competitive Advantage, 4ed*. Upper Saddle River, NJ: Prentice-Hall. p. 5

COMPETITIVE ADVANTAGE ASSESSMENT IMPERATIVE

From goal setting theory (Locke & Latham, 1990), we know that goals must be achievable and measurable. Therefore, demonstrating successful competitive improvement plan implementation remains elusive as long as the strategist cannot actually measure the firm's *competitive status*. The previously cited textbooks (e.g., Barney & Hesterly, 2012; Barney, 2011; Hitt et al., 2009; etc.) define competitive advantage within the context of Porter's (1980) competitive dichotomy (i.e., low cost & differentiated supplier). By using EVA (the difference between cost and customer perceived value) and Porter's dichotomy, Barney and Hesterly (2012, pp. 13 – 19) utilize the ideogram in Figure 2 to illustrate EVA, a concept that takes on one of the two forms shown. Then they suggest the use of numerous accounting and economic measures as indicators of *competitive advantage* while conceding that there is no direct measure of EVA and by extension, no direct measure of *competitive advantage*. Given the imperative that *goals must be measurable*, the strategic planner's ability to establish a firm's *competitive status* constitutes a prerequisite competency for the effective use of the SMP. Further, the inability to determine the firm's *competitive status* degrades the strategist's ability to utilize other industry level analytical models, such as Porter's Five Forces Model (Porter, 2008) as a source of threats or Life-cycle Models (Porter, 1980; Potts, 1988) as a source of opportunities. Even further, the decision as to whether market implementation of the business unit's strategic plan will focus on growth in market share, grow in profitability or some combination of the two becomes little more than a shot in the dark if the strategist does not know the firm's *competitive status*.

BUSINESS LEVEL STRATEGY RECONSTRUCTED

As previously defined, EVA involves a buyer's perception of value relative to the perceived value of competing alternatives. Only when we acknowledge that calculating EVA requires the estimation of a potential buyer's perceptions, where actions were not taken and where the buyers perceptions were never articulated, can we appreciate the complexity underlying this simple concept.

In markets, the seller quotes a price and the prospective buyer accepts, declines, or makes a counter offer. In retailing, the concept of the consumer's counter offer takes on the form of

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waiting for the sale price. In a market driven economy, companies strive to maximize profits while concurrently building market share. On the surface, this seemingly encompasses two distinctly different strategic orientations, but the way the company goes about achieving one will ultimately affect the other in either a positive or negative manner. It is axiomatic that a firm can always increase market share by cutting the price (e.g., AOL in the nineties, GM leading up to bankruptcy) or conversely increase profits by raising prices at the expense of market share. In other words, profit (i.e., return on sales – ROS) coupled with market penetration (i.e., market share) captures both outcomes for both the low cost competitors and differentiated competitors in a competitive marketplace. Therefore, to determine if a company has built and/or has sustained *competitive advantage,* one must assess *both* relative profitability and market share.

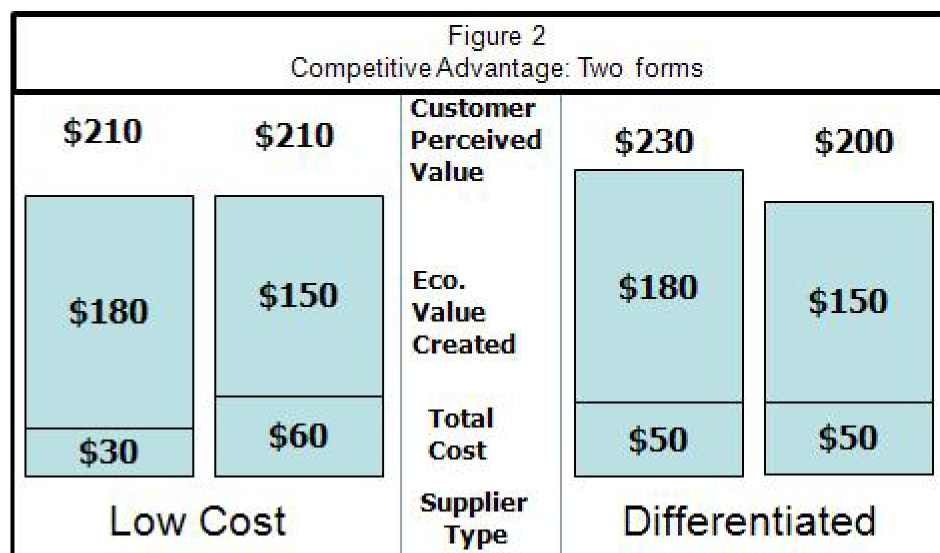

Figure 2
Competitive Advantage: Two forms

Source: adapted from J.B. Barney. (2011). *Gaining and Sustaining Competitive Advantage, 4ed.* Upper Saddle River, NJ: Prentice-Hall. p. 11.

The following method employs the metaphor of the lever and fulcrum (a see-saw) to illustrate the relationship between market share, ROS, and competitive advantage. By viewing the fulcrum height as equivalent to EVA, thereby depicting competitive advantage, we beg the question, “If EVA cannot be measured, then how do we measure the height of the fulcrum?” We do not directly measure the height of the fulcrum; instead, we derive the height of the fulcrum by concurrently measuring the direction of travel of both ends of the see-saw – we measure change in market share over time and change in ROS over time. Only when a firm holds competitive advantage can it concurrently grow market share and profitability. In the absence of competitive advantage, when increased market share is accompanied by reduced ROS or increased ROS is accompanied by reduced market share; the firm is simply rocking the see-saw.

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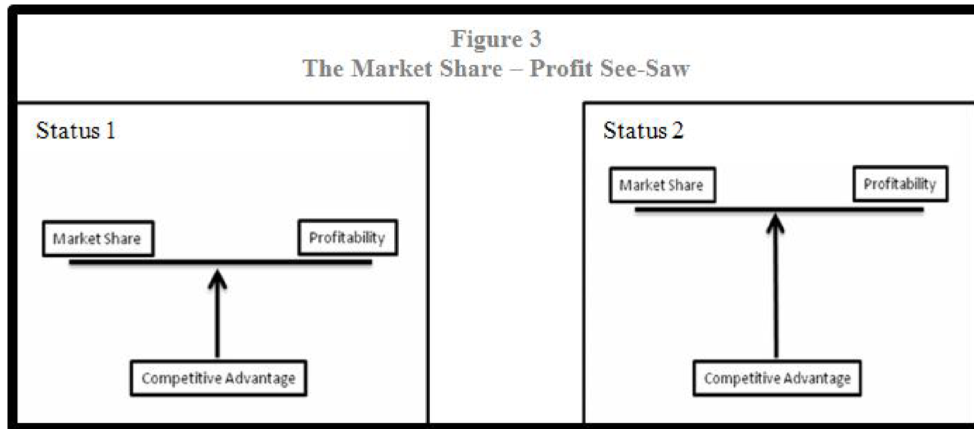
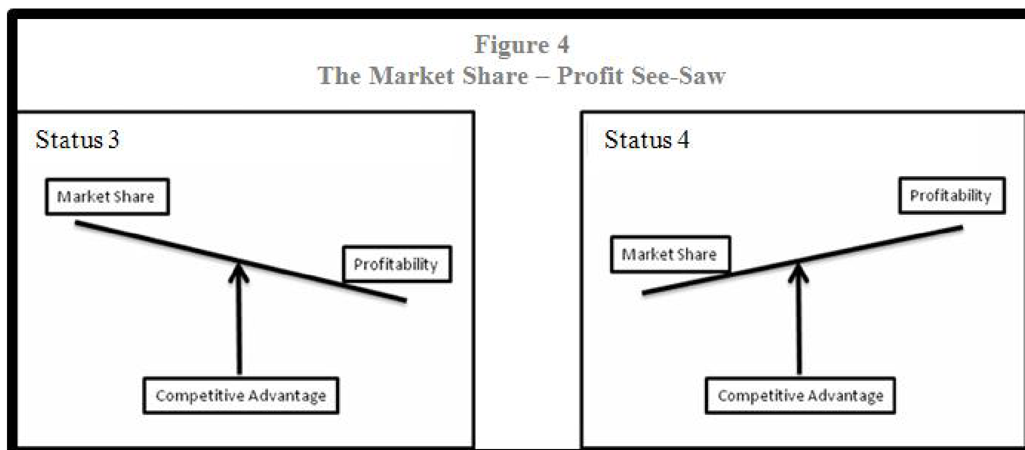


Increased ROS, achieved at the expense of lost market share, or vice versa, can be the result of an orientation shift or it could be the result of a failure of strategic implementation in the marketing link of the firm's value chain; but the important point is that rocking the see-saw does not alter *competitive status.* In Figure 3, if we view status 1 as time-1 and status 2 as time-2, then this example demonstrates concurrent increases in ROS and market share. This allows us to derive that an increase in the height of the fulcrum has occurred – *competitive advantage*.

In Figure 4, if we view status 3 as time-1 and status 4 as time-2, the firm is rocking the see-saw – giving up market share to increase profitability without a change in competitive status. It could indicate a shift in market orientation or it could simple indicate a loss of competiveness. In the early stages of the industry life-cycle this shift in orientation could be utilized to favorably impact competitive advantage if the firm races down the experience curve resulting in a shift in the cost/volume relationship through the learning curve effect and thereby capitalize on an opportunity of the industry life cycle state.

If in Figure 4, we view status 4 as time-1 and status 3 as time-2 then the firm has rock the see-saw the other way, sacrificing profitability for increases in market share. This too reflects a change in market orientation without the benefit of an improvement in competitive status.

To illustrate retrenchment simple envision Figure 3, status 1 with a fulcrum height of zero. In this situation , the fulcrum is so low that leveraging of market share or profitability is not possible until a new set of core competencies have been developed. In the dot.com era, firms (AOL, for instance) famously burned capital (operated at a loss) in an attempt to gain



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market share. When firms lack strategic flexibility, an inability to engage in growth or profit maximization , rocking the see-saw doesn't create competitive advantage.

COMPETITIVE STATUS ASSESSMENT METHOD

The steps in the process are as follows:

1. Collect market share data on the target firms for the past 3 to 5 years and industry market share as a percentage.
2. Collect ROS data for the target firms for the past 3 to 5 years and graph the percentages.
3. Assess ***Competitive Status***
    a. **Competitive Advantage**
        i. Gains in market share and gains profitability
        ii. Gains in market share while ROS remains unchanged.
        iii. Gains in ROS while market share remains unchanged.
    b. **Competitive Disadvantage** (depending upon rival analysis)
        i. Losses in market share and ROS remains unchanged
        ii. Losses in ROS and market share remains unchanged
        iii. Losses in both ROS and market share
    c. **Competitive Parity** (depending upon rival analysis)
        i. No change in ROS and market share
        ii. Losses in ROS offset by increases in market share (Rocking)
        iii. Losses in market share offset by increases in ROS (Rocking)

Figures 5 & 6 shows two companies operating in a competitive market; Lowes is shown in Figure 5, Home Depot is shown in Figure 6. Over the past 10 to 12 years, Lowes has grown from a firm about 10% of the size of Home Depot to a firm about one third the size of Home Depot. In the three yeas charted, Lowes is concurrently growing ROS and market share. Home Depot in the meantime has managed a small increase in market share by giving up ROS; Home Depot is a firm rocking the see-saw in the absence of *competitive advantage*. Lowes illustrates a firm with *competitive advantage*.

Home Depot finally came to adopt mimetic strategy which could never produce competitive advantage because advantage can only be achieved through differences that play out in competitive markets. Why would Home Depot mimic Lowes? This illustrates a situation that parallels military strategy (the attacker must hold a 3 to 1 advantage in combat power to succeed) – more resources are required to attack than are required to defend.. Home Depot still has over 60% of the market so upon achieving competitive parity they can choose simple to defend their

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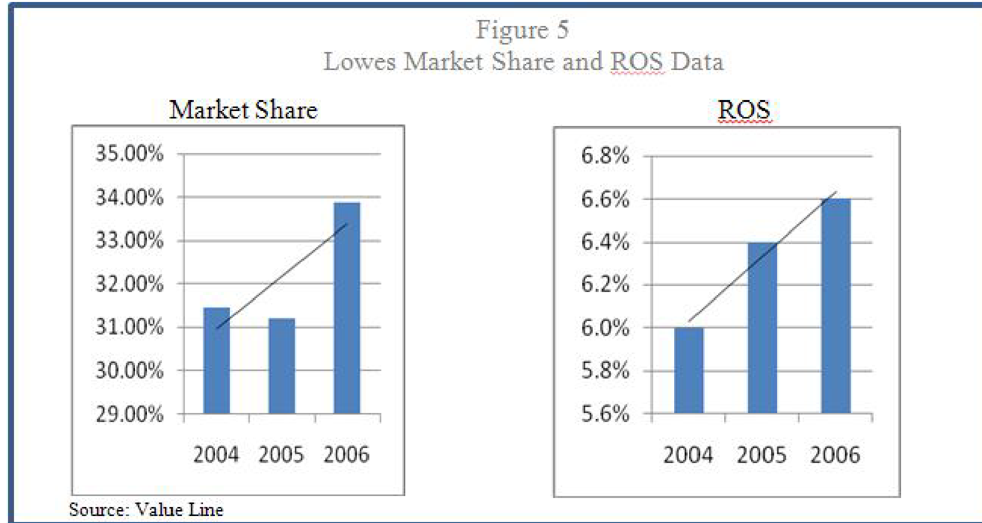
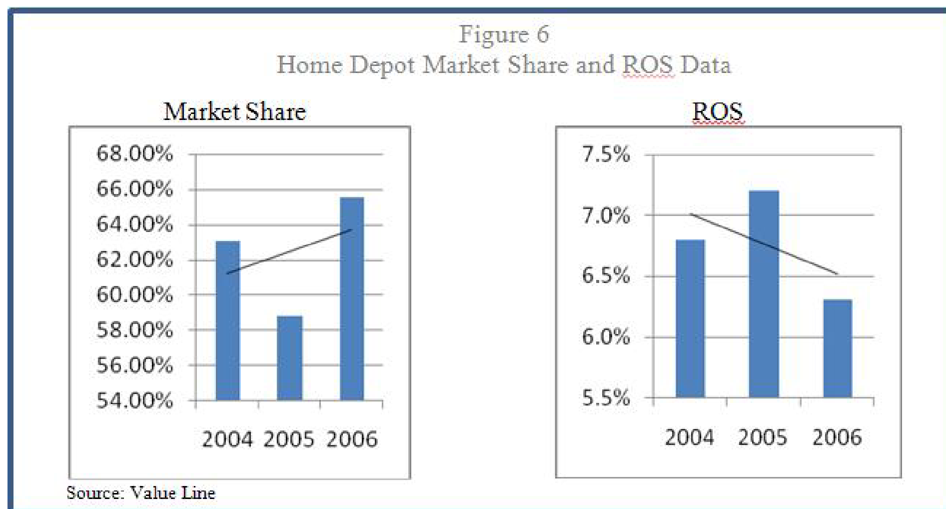


existing dominate market position.

This illustrated the concept of a tenable competitive position, one that can be defended by achieving competitive parity. This realization moderates the assertion on page one of Barney & Hesterly's (2012) text that strategy is designed to produce *competitive advantage*. Instead, we argue that business level strategy must address *competitive status* and an effective strategy designed to defend may not need to expend the resources necessary to create *competitive advantage*, creating competitive parity may be the most effective use of capital. This also suggests that given a *competitive advantage*, use it to improve competitive tenability though growth in market share.

CONCLUSION



The *competitive status assessment method* outlined above facilitates the case analysis activities of strategic management students as they attempt to apply the strategic management

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process to the task of crafting or assessing strategy. We used the term *competitive status assessment* rather than competitive advantage assessment to avoid the confusion and perhaps controversy that might be generated if one were to apply this method to assess competitive advantage when it defined in ways other than the definition implied by the citations in the introduction.

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