Understanding Competitive Advantage Through a Strategic Retail Typology

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Abstract

The authors present a retail typology of strategies and performance outcomes based on a combination of Porter's (1985) concept of competitive advantage and Miles and Snow's (1978) classification of strategic groups. Application of the above theoretical concepts is accomplished through an empirical examination of 159 retail drugstores. The tactics used in product, promotion, and service differentiation are examined along with location and pricing. The costs of goods, advertising expense, and rent expense of each retailer are also examined. Various combinations of these tactics result in classification into one of four strategic categories with differing sales and profit margins.

Introduction

Intensifying competition and a rapidly changing environment have left many retailers searching for avenues of survival. The turbulence in retailing is manifested by going-out-of-business sales, bankruptcies and predictions of more large scale failure (Zinn 1990). American retailers are wondering about their raison d'etre and their ultimate fate (Sack 1990). A concept which has been adopted by the disciplines of marketing and strategic management as central to long-term survival and success of the firm is that of competitive advantage (Day and Wensley 1988). Most of the literature addressing competitive advantage to date has been descriptive and/or theoretical (e.g., South 1980; Miller 1981; Porter 1985; Day and Wesley 1988). Also much of the work has been described in the context of large manufacturing firms and rarely has it been examined from a retail management perspective.

In response to marketplace pressures, retailers often attempt a variety of tactics. All too often, these tactics are knee-jerk reactions to stimuli rather than a cohesive strategy designed to reach their goals. Inevitably, the tactics converge and a strategy emerges. A methodological concept which can help explain how tactics merge to form strategies and the resulting performance outcomes is strategic group analysis.

The development of the concept of strategic groups has increased researchers' understanding of firm behavior (Hawes and Crittenden 1984). A strategic group consists of firms within an industry that are clustered by virtue of following similar strategies on key decision variables (Porter 1979). Research into strategic groups typically focuses on business level strategies such as product and market decisions (Hawes and Crittendum 1984).

Miller and Friesen (1978) have put forth the notion of archetypes as a set of relationships in an industry group of competitors which appear in balance for some period of time. To a degree this may appear as some variant of the familiar Miles and Snow typology where specific roles are assumed by competitors according to a variety of underlying resource availabilities as well as in response to the environmental constraints on each firm.

Oftentimes these combinations of resource availabilities, organization structures, value chain strategies, environmental conditions and competitive dynamics do not converge in a neatly drawn configuration. An empirical solution is to observe the multivariate matching of firms (i.e. the degree of competitive and structural conformity) and describe these as the gestalts of the competitive array. That is, clusters of firms competing in similar ways each define a gestalt. Each of these can then be tested for descriptive validity based on behaviors, performances, etc. Miller (1981), Miller and Friesen (1984), and Hambrick (1984) have all suggested variations on this theme - but the basic appeal is that a competitive space, which may be defined by dozens of constructs, and thousands of combinations, is better observed by similarities in firm behavior and then

decoded as to gestalts rather than by simply logically deducing which few combinations (of thousands of possible combinations) of foundation constructs should be hypothesized, a priori.

The Miles and Snow (1978) method suggests that different strategic approaches are utilized by firms in the same industry. These four types of strategies may be categorized as: (1) defenders, (2) prospectors, (3) analyzers, and (4) reactors. Defenders attempt to maintain a relatively secure niche through a limited range of products while competing primarily on the basis of service. Prospectors operate within broad product/market domains. They seek out and stimulate new opportunities in a market that undergoes periodic redefinition. Analyzers make fewer and slower product/market changes than prospectors but are less committed to stability than defenders. This strategy is often accomplished by maintaining a stable, limited line of products. A reactor does not have a well-defined strategy and is not as willing as competitors to assume risks.

The purpose of this study is to provide a typological examination of Porter's (1985) concept of competitive advantage along with Miles and Snow's (1978) strategic groups within a retailing environment. Specifically, the objectives of the study are: (1) to identify and analyze clusters of retailers using similar strategies, (2) to place these clusters of retailers in a strategic typology in order to better understand their position in the marketplace, (3) to analyze these strategies in terms of performance outcomes, (4) to provide theoretical support for the position and advantages of each cluster, (5) to provide support for the use of typological analysis on business levels rather than on the product level as in most marketing studies, and (6) to identify differences and similarities among chain and independent drugstores. This study empirically examines 159 retail drugstores in order to accomplish the above objectives.

Competitive Advantage

The emergence of the term competitive advantage came in the 1970s (South 1980). South described the process of strategic management and the management of competitive advantage as specifically identifying, developing, and taking advantage of the enclaves through which a tangible and sustainable business edge can be achieved. However, the concept of competitive advantage truly became popular with Porter's works (1980, 1985) in the strategic management discipline. According to Porter (1985), competitive advantage grows from the value a firm is able to create for its buyers that exceeds the firm's cost of creating the product or service. Analytical support for this concept is provided by a model developed by Karnani (1984) who concluded competitive advantage results from a combination of

cost and differentiation.

Day and Wensley (1988) stated that competitive advantage is not a single entity, but a complex construct consisting of the sum of many parts, and "there is no common meaning for the term competitive advantage" (p. 2). They stressed that a complete definition must describe not only the state of the advantage but also how that advantage was gained as well. Competitive advantage, in their eyes, consists of positional and performance superiority (outcomes of competitive advantage) as a result of relative (to the competition) superiority in the skills and resources a business deploys. These skills and resources make up the positional advantages of cost and differentiation. Thus, a competitive advantage is defined as a significant edge over one's rivals in the marketplace in cost, differentiation, and/or the outcomes that result from these positional strategies.

Cost

A cost advantage is achieved by performing important activities at a lower cost than competitors. This practice can lead to a superior competitive position if the firm provides an acceptable level of value to the buyer if that edge is not nullified by charging a low price (Day and Wensley 1988). A study by Hall (1980) showed that achievement of the lowest delivered cost position together with acceptable quality and a pricing policy to gain volume and market share is one of two success strategies (the other being differentiation) held in common by sixteen leading companies.

Retail costs may be broken down into two broad categories: cost of goods sold and operating expenses (Fees and Niswonger 1981). Cost of goods sold refers to the invoice cost for the amount of merchandise sold in a given time period (Mason and Mayer 1987). Operating expenses are those costs that are incurred in the selling of merchandise such as salesforce salaries, advertising, depreciation of store equipment, and general expenses such as rent, office salaries, and office equipment (Fees and Niswonger 1981).

Differentiation

Differentiation is a multivariate concept, and there are many ways to achieve it; therefore, identifying a single measure is troublesome (White 1986). Porter (1985) stated, "A firm differentiates itself from its competitors if it can be unique at something that is valuable to buyers" (p. 119). This research is primarily concerned with retail store differentiation. Wortzel (1987) offered three basic positioning strategies for store differentiation, each of which is supported by advertising and promotion:

First, a product differentiation strategy is based on offering

products that are intrinsically different (e.g., different brands or different styles) from those in the same product category offered by other stores. Second, in a service and personality augmentation, a retailer offers products that are intrinsically similar to those offered by competitors, but adds specific services and personality to differentiate the store. Third, a price leadership strategy means offering the same products as the competition, at lower prices. (p. 50)

Additionally, Wortzel (1987) stated that often a retailer's differentiation strategy comes from a combination of two or possibly all three of the above strategies.

Conceptually, retail differentiation at the store level concerns significant variance as compared to the competition with respect to the retailer's physical facilities, products, services, promotions, and/or prices that are perceived as valuable by the buyer. Operationally, for a retail drugstore, differentiation should be measured relative to the competition to be meaningful in the assessment of competitive advantages as suggested by Day and Wensley (1988).

The components noted above relate closely to Lazer and Kelley's (1961) retailing mix and were operationalized and measured for retail differentiation. The product component concerns the variety and assortment of goods carried by the retailer (Lazer and Kelley 1961). Variety is the number of merchandise lines carried by a store (e.g., over-the-counter goods, health and beauty aids, auto parts, stationery, etc.). Assortment refers to the choice of products within each line such as brands, sizes, or hard-to-find products (Mason and Mayer 1987). The promotion element is concerned with advertising and sales promotion. Interviews with a chain store vice president and independent druggists revealed that the forms of advertising most prevalent in the retail drugstore industry are newspaper, television, and direct mail. Although most promotions involve coupons of one form or another (Mason and Mayer 1987), point-of-purchase displays and health promotions are also popular in retail drugstores. With respect to each, the effectiveness (amount and quality) of reaching the customer is the key issue in differentiation.

Outcomes of Competitive Advantage

The key question to be addressed in this section is which outcomes of competitive advantage are most applicable to retailing and can be most precisely defined and measured within the parameters of this study. Based upon a review of relevant literature, numerous interviews with independent store managers, and two panel discussions with four chain managers, three measures were chosen for this study: (1) sales volume, (2) net profits, and (3) inventory turnover. Sales volume is a base figure for most key business ratios and is used in almost all measures of productivity. The sales

measure consists of revenues received in exchange of merchandise and/or services. This measure includes quantities of products, services, or some combination of both (Bucklin 1978). Sales volume is measured in terms of total sales for the most recent fiscal year in the study period.

Profit is the key objective of retail management, and traditionally the most common method used to describe profit is net profit after taxes as a percentage of sales (Mason and Mayer 1987). Respondents were asked to indicate profit after taxes for the most recent fiscal year. The inventory turnover measure used was the number of times average inventory was sold annually.

Methodology

The study population consisted of (1) a chain of drugstores with approximately 75 units in 56 cities in 3 states and (2) independent drugstores located in the same cities as the chain outlets. The development of the independent sampling frame was a two-stage process. Since the majority of the independents were located in one state, a list of retail drugstores from the state pharmaceutical association was also obtained. Thus, a list of all independents located in the same cities as the chain stores was compiled. In the second stage, a list of independents in the other states was developed by searching the Yellow Pages directory in each relevant city. These two processes yielded a total sampling frame of 248.

The primary chain store management contact was the corporate senior vice president who approved the project. He provided a cover letter endorsing the survey and assuring confidentiality. The field survey of independents followed guidelines suggested by Lee (1984) to improve the response rate. Each independent store was first contacted by telephone to (1) identify the manager, (2) verify the address, and (3) call attention to the forthcoming mail survey. All interested respondents were promised an executive summary of the results and were assured complete confidentiality. Of the 248 stores in the sampling frame, 57 either declined to participate or could not be reached by telephone number. Thus, 191 surveys were mailed to independents; 96 surveys were returned within six weeks for a response rate of 50.3 percent. Sixty-three of 73 chain respondents (86 percent) returned the surveys within the same six-week period.

Cost of goods sold is the largest element of cost in the retail drugstore industry averaging approximately 72 percent of sales (*Retail Industry Statistical Compendium* 1980). Three categories of goods (pharmaceutical, health and beauty aids, and over-the-counter drugs) account for the majority of sales in the retail drugstore industry (Sack 1990). Cost of goods sold in this study

was measured by a market basket of 14 top selling items as determined by trade literature surveys (American Druggist 1988; Rosendahl and Italiano 1989). Retailers were asked to indicate their invoice cost for items in each category and these costs were summed to create a market basket cost. These same items were also used as a measure of retail price. Additionally, retailers indicated their advertising expenses as a percentage of sales.

Several summary scales of differentiation competitiveness were tested for reliability. These scales included promotion expenditures, promotion effectiveness, service differentiation and product differentiation. These variables were measured on a five point Likert-type scale and compared to competition. The relative to competition measure was devised for this study based on Day and Wensley's (1988) suggestion. The scale points were derived from the aforementioned interviews and panel discussions with managers. The alpha coefficients for each scale are reported in Table 1.

Table 1 Reliability of Differentiation Scales		
Scale	Alpha	Items
Promotion Amount	.95	6
Promotion Effectiveness	.92	6
Service	.63	5
Product	.93	4

The promotion measures for amount and effectiveness consisted of: (1) newspaper advertising, (2) television advertising, (3) direct mail, (4) health promotions, (5) store coupons and (6) cooperative promotions. The service component incorporates four pharmaceutical services. Product differention was measured by the number of: (1) product lines carried, (2) brands offered, (3) sizes available, and (4) private label brands provided. Service differentiation consisted of (1) speed of pharmacy services, (2) prescription record keeping, (3) prescription interaction, (4) personal pharmacy service, and (5) delivery services. Managers were asked to consider if these variables were much better or much worse than the competition. Price was measured through the same market basket of goods used for the cost measure. See Table 2 for sample questions of cost and differentiation measures. These four scales were used as a basis for developing empirical typologies of competitive styles along with several other measures suggested in panel discussions with chain store managers and personal interviews with independent druggists. These variables were: (1) store size, (2) nearness to a discounter, (3) location, (4) inventory, and (5) years in business. Store size was measured with a single question asking for total square footage of the store. This variable largely defines

the variety and assortment of products carried and directly affects operating expenses. The variable distance to a discounter measures the distance in tenths of miles to the nearest discount department store (e.g., K Mart, Wal-Mart). Discounters were identified by practitioners in interviews as the greatest competitive threat.

Location is considered the most important criterion in consumer selection of a drugstore (Nickel and Wertheimer 1979). In this study, location is measured on a five point Likert-type scale relative to the nearest chain or independent competitor. Breadth and depth of inventory is necessary for product service and differentiation; however, it is costly to carry a large amount of inventory. Respondents were asked to indicate their average annual inventory in thousands of dollars. Chain store managers and executives identified the number of years the store has been open as a critical variable since most stores were expected to lose money during their first three years of operation.

All of the foregoing variables were used with the QUICKCLUSTER (default settings) routine in SPSSX and several clustering solutions were examined. A six group solution that included all cases was the most parsimonious and still provided the level of richness of explanation as higher level solutions, while also maintaining a good level of statistical separability between groups, which was lacking in solutions of five groups or less. Variable selection was not a function of the algorithm used, but was a priori inclusive. The study is inductive in nature searching for typological structure and mapping to theoretical structure. Thus, many variables were used for cluster testing that were not used for cluster deviation.

Results and Discussion

The six groups solution was analyzed by means of ANOVAS with multiple range tests, crosstabulations and t-tests. Several dominant factors which did a good job of explaining group differences in a meaningful way emerged. The first two aspects are presented graphically in Figure 1, which was constructed by plotting the mean values of cost of goods sold and advertising expenditures for each group. This figure shows that clusters 1 & 3 are significantly high on advertising expense while low on cost-of-goods sold relative to the other four groups. This result is consistent with the makeup of the groups since both clusters consist of stores from the same chain. However, group 3 has a significantly higher amount of promotion relative to its competitors than group 1, but spends less on advertising as a percentage of sales. Group 1 also has the highest sales volume of all clusters which is perhaps a function of their being the largest stores with the highest level of product differentiation. Thus differences in strategy can

TABLE 2

Sample Questions of Cost and Differentiation Measures

Please indicate below the current invoice cost for each item below and its current original retail sales price.

	Cost	Price
Tylenol #3, 20	____	____
Dimetapp Extentabbs 24	____	____
Crest 4.6 oz.	____	____

Please circle the number below on the scale that reflects the extent to which your store is better or worse than the chain drugstores in your trading area on each of the following items.

	Much Worse	Worse	About Equal	Better	Much Better
Store layout	1	2	3	4	5
Store location	1	2	3	4	5
Store ambiance	1	2	3	4	5
Speed of pharmacy services	1	2	3	4	5
Personal pharmacy service	1	2	3	4	5

Please circle the number below on the scale that reflects the extent to which your store offers a higher or lower amount than chain drugstores on each of the following items.

	Much Lower	Lower	About Equal	Higher	Much Higher
Number of product lines carried	1	2	3	4	5
Annual amount of newpaper advertising	1	2	3	4	5
Effectiveness of newspaper advertising	1	2	3	4	5

be observed which are attendant to a cost-leadership strategy accompanied by high advertising that supports price promotion. Additionally, among the non-low cost groups, group 4 had the lowest cost-of-goods (significant) as well as the lowest advertising expenses.

Figures 2 & 3 address the degree of differentiation present in the market. In Figure 2 both amounts spent on promotions and the effectiveness of promotions are observed. As expected, these results are consistent with advertising expense presented in Figure 1. The strategies of clusters 1 & 3 are apparent. They spend more and are more effective at promotions than the others. Although from the other "pack", one can observe that cluster 2 with the lowest promotion expenditure amount is significantly better than its higher spending cohorts on the effectiveness dimension. This result is somewhat counter-intuitive as normally economies of scale are
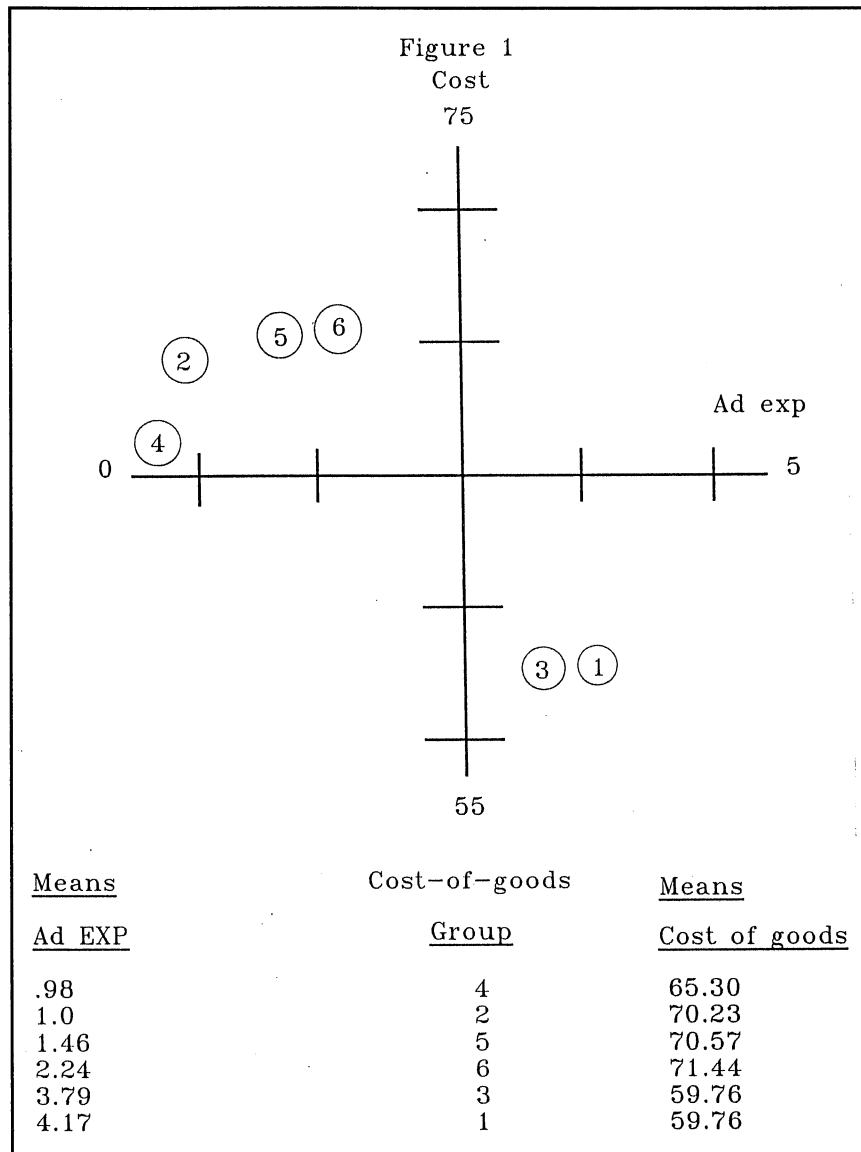
realized in increased advertising and effectiveness.

Figure 3 examines differentiation on product lines and service dimensions. Our cost leaders, groups 1 & 3 carry considerably more product lines than the other groups, while providing less service. Groups 2, 6 and groups 5 & 4 provide more service than the cost leaders although product lines width is significantly higher for groups 2 & 6 than for groups 5 & 4.

Figure 4 presents these emergent strategies in terms of the Miles & Snow strategic typology. This figure identifies all the variables used in the cluster analysis in addition to the key measures of cost and differentiation are included in Figures 1, 2, and 3. Group 2 is a "reactor" segment - high costs but frequently resorts to promotions. This group consists of small independent stores located in large cities. Both groups 5 & 4 are independent stores which can be classified as "defenders" based on their high commitment to service and low level of products carried. The key difference between these two group is the lower price and higher sales volume of group 4. Group 6 consists of "analyzers" due to its moderate level of inventory and product differentiation. This group is the only one which consists of a mix of chain and independents and is similar to the defender stores, but has more aggressive promotion. The "analyzers" also have higher cost of goods, price, and product differentiation than the defenders. The "prospectors" are groups 1 and 3, and consist entirely of chain drugstores. These groups utilize aggressive promotion and product differentiation analogous to the broad product/market domain in which opportunistic prospectors operate. The strategic behaviors that lead to these classifications are shown in Figure 4. The content evaluation of high, medium and low are accomplished through an examination of the multiple ranges tests in the significant one way ANOVAS.

Figure 5 presents the outcomes for each of the strategic groups in terms of net profit & sales volume. Groups 1 & 3 perform as well as we would expect based on a Porteresque cost-leadership strategy, and a prospector profile, net profits are the lowest, yet sales

Figure 1

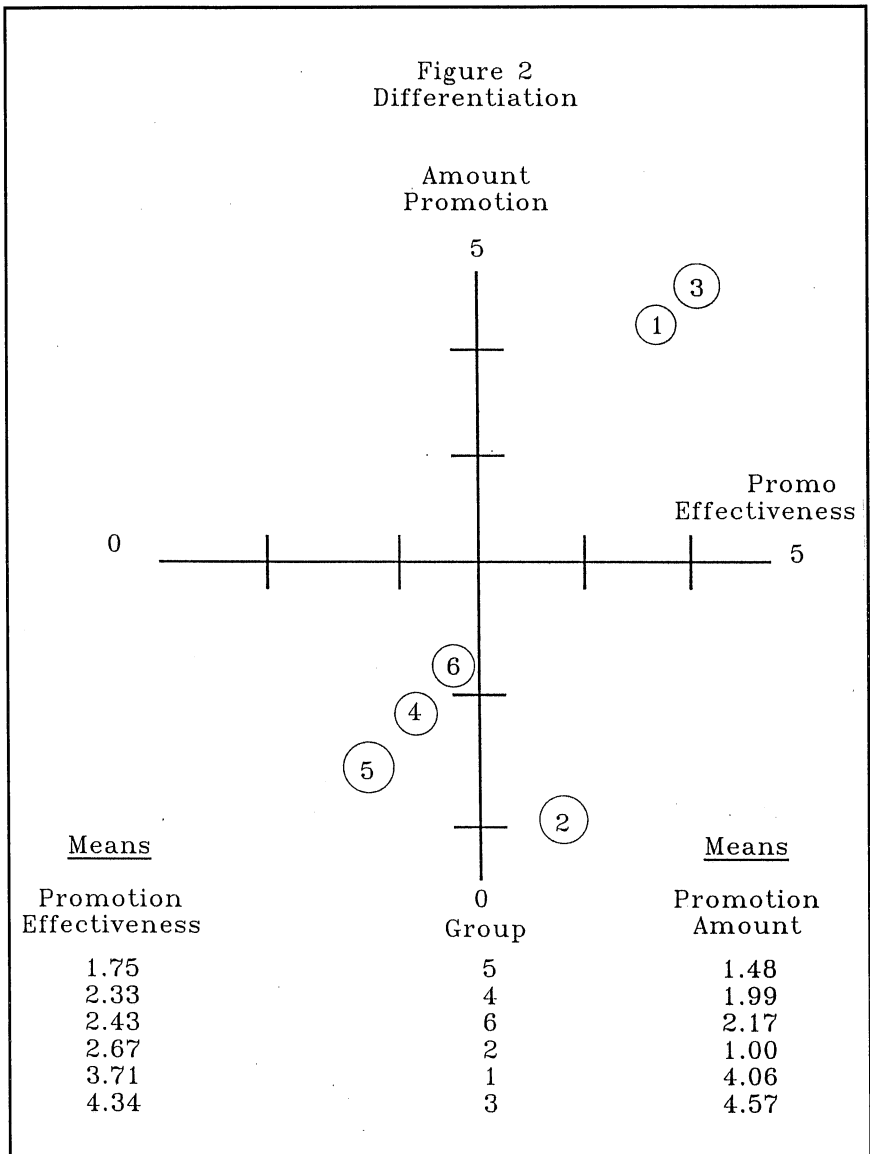| Means		Cost—of—goods	Means	
Ad EXP		Group	Cost of goods	
.98		4	65.30	
1.0		2	70.23	
1.46		5	70.57	
2.24		6	71.44	
3.79		3	59.76	
4.17		1	59.76	

larly aggressive in promotion nor product differentiation. They compete primarily with location and service and charge high prices, consequently, their sales are low, but they maintain a moderate profit level. This strategy would appear risky for new stores, and is not a popular strategy as it is employed by only a small number of firms.

The defender stores try to protect their market through moderate size and inventory levels. These independent firms offer high levels of service, little promotion, small stores and competitive pricing. This strategy yields moderate sales and high profits thus allowing the defenders to maintain their market position. The defender position is the most common strategy for independent drugstores and apparently the safest plan.

The apparent goals of a prospector are to achieve high sales volume and establish a broad product-market domain, as well as to stimulate new opportunities. However, these goals are not without their drawbacks. Although these stores are the sales volume leaders and have the lowest cost of goods, they also report negative profits. Advertising expenses of prospectors are greater than counterparts in other clusters. Additionally, being a product leader requires greater floor space and inventory. These costs coupled with a low-price strategy are likely contributors to negative profits. Also, the growth objectives of the prospectors are critical in their profitability performance, as they have been open the fewest years. Profitability should improve as these stores stabilize their operating expenses. Finally, these clusters of stores are located significantly closer to discount stores than their rivals, perhaps a function of locating in growth areas. Thus, a prospector must be prepared to meet direct competition and be able to absorb the costs incurred in obtaining market share.

Analyzers are more aggressive than reactors or defenders, while moving slower than the more aggressive prospectors. This cluster of stores is characterized by moderate product and service offerings, and higher advertising expenditures compared to all but the prospector stores. Basically, these stores fall between defenders and prospectors. They are somewhat aggres-

volumes are the highest. The profit sacrificing, sales maximizing strategy yielded exactly that outcome. Group 2, the service leader, with moderate product line width performs poorly on both sales volume and profitability.

Groups 4, 5 & 6 did very well on net profitability, but show varying results on sales volume. Both groups 4 & 6 are significantly higher than 5 on volume so using the dual criterion of sales volume and profiting, four and six - one defender and one analyzer, using the Miles & Snow typology have been extremely successful financially with their strategies.

Managerial Implications

The reactor organizations in this study are small and well-established independent stores and are not particu-

Figure 2
Differentiation

Amount
Promotion

Means	Group	Means
Promotion Effectiveness	0	Promotion Amount
1.75	5	1.48
2.33	4	1.99
2.43	6	2.17
2.67	2	1.00
3.71	1	4.06
4.34	3	4.57

framework for a typology and a better understanding of how strategies emerge and how these strategies ultimately affect performance and survival. This approach also identifies an organization's consistencies and inconsistencies in strategy development. The use of the typology develops a record of past strategies and outcomes which can be used to help shape future decisions. Each strategic cluster thus has identifiable advantages/disadvantages relative to competing clusters. Finally, through classification of strategies, an individual can see how tactics are intertwined and affect not only performance outcomes but also consumer perceptions and the ultimate fate of the store.

Suggestions for Future Research

Several implications for researchers in marketing, and particularly in retailing can be derived from this work. First, the study is a snapshot of one year of information. As environments and strategies change, so do positions and advantages; thus, a longitudinal study tracking stores over an extended period of time is needed. This type of analysis can also help discover how both poorly performing and successful organizations change their strategies over time. Second, the retail drugstore industry may contain unique characteristics (e.g. personal customer relationships with pharmacists) and other types of retail stores and service firms should be studied to see if similar strategic clusters exist. Third, the typology could be extended to examine strategies across different types of stores (e.g., drugstores, discount stores, supermarkets) which are in competition with each other. Additionally, quantified induction can be rigorously tested, and results in flexible, useful knowledge about competitive structure. Thus, the use of gestalts permits analysis beyond mere descriptions of value chain strategies and performance outcomes, and allows observation of points in their evolution. Additional variables not utilized in this study can also be tested for inclusion. Finally, this study is strengthened by the utilization of both objective (cost, profits, sales) and subjective (relative differentiation) data. Researchers should continue to collect as much hard information as possible rather than simply asking firms if they follow a cost or differentiation strategy. This type of data also allows for more detailed compari-

sive in all strategic areas, yet price high. This strategy leads to high profits while maintaining a moderate level of sales. A key implication is that prices may not have to be reduced if differentiation is high enough.
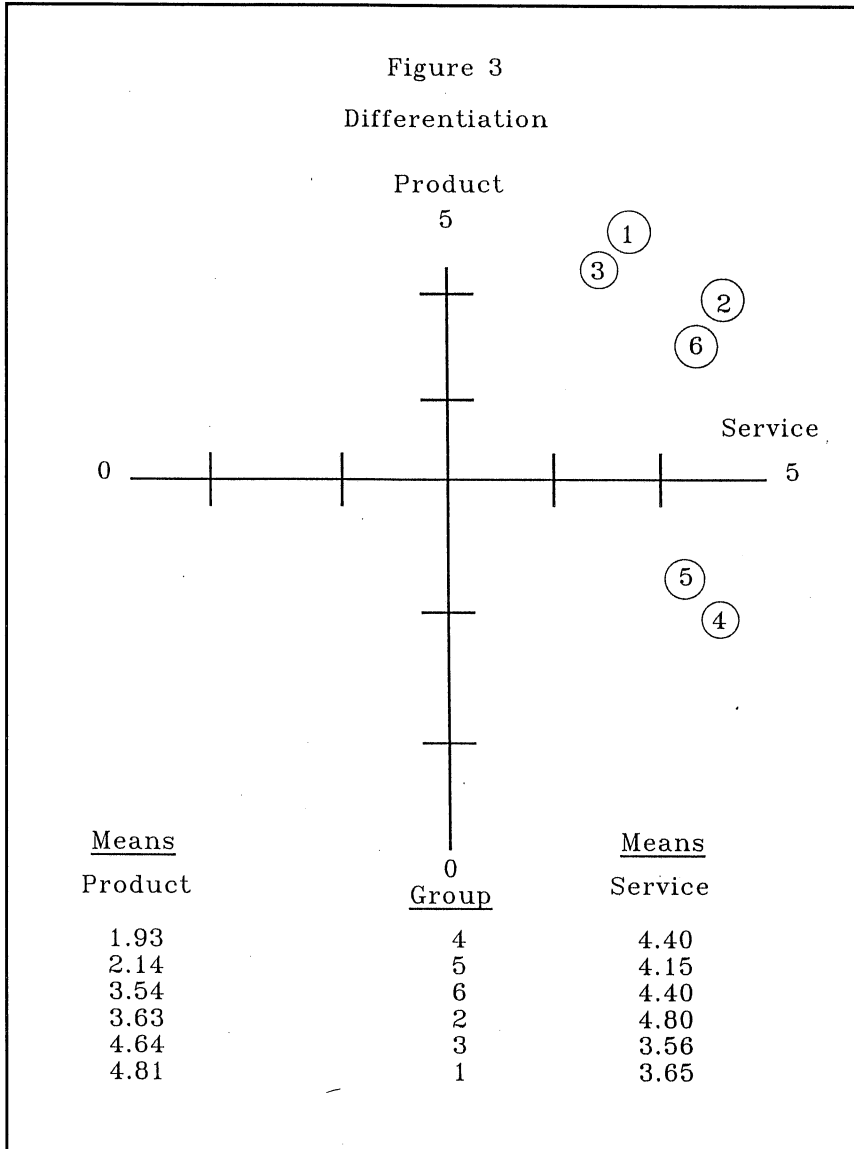
Conclusion

Many retail firms are at the crossroad of extinction or survival. As retailers search for ways to travel the road of survival toward success, many utilize a variety of tactics without realizing that these tactics converge to form their strategy and in turn their ultimate fate. Cluster analysis can provide a useful method to classify strategies and their outcomes effectively. The Miles and Snow (1978) typology and Porter's components of competitive advantage can be operationalized and combined for explanatory purposes. Together, the analytic method and the strategic concepts provide a

Figure 3

Differentiation

Means Product	0 Group	Means Service
1.93	4	4.40
2.14	5	4.15
3.54	6	4.40
3.63	2	4.80
4.64	3	3.56
4.81	1	3.65

sons among competitors.   ?&

❋❋❋References❋❋❋

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### Miles—Snow Classification of Strategic Clusters
Figure 4

	Reactor 2	Defender 4,5	Analyzer 6	Prospector 1,3
Ad exp	L	L	M	H
CGS	H	M	H	L
Promo eff	M	L	M	H
Promo amt	L	L	M	H
Product diff	M	L	M	H
Service	H	H	H	M
Price	H	M	H	L
Store size	L	M	M	H
Distance to Disc	M	H	M	L
Inventory	L	M	M	H
Inventory Turnover	H	M	M	L
Sales	L	M	M	H
Profits	M	H	H	L
Yrs open	H	M	M	L

L = Low   M = Medium   H = High

Note: Only Those strategies which exhibited a significant (.05) difference between groups in the cluster analysis are used in the exhibit. Thus, expenses such as rent/mortgage expense as a percent of sales are not included. The categories low, medium, and high are determined relative to each of the six.

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Figure 5
Performance Outcomes

Net Profit
Margin

10

⑤   ④

⑥

Sales
Volume

0   ②   1500
                    ①
              ③

0
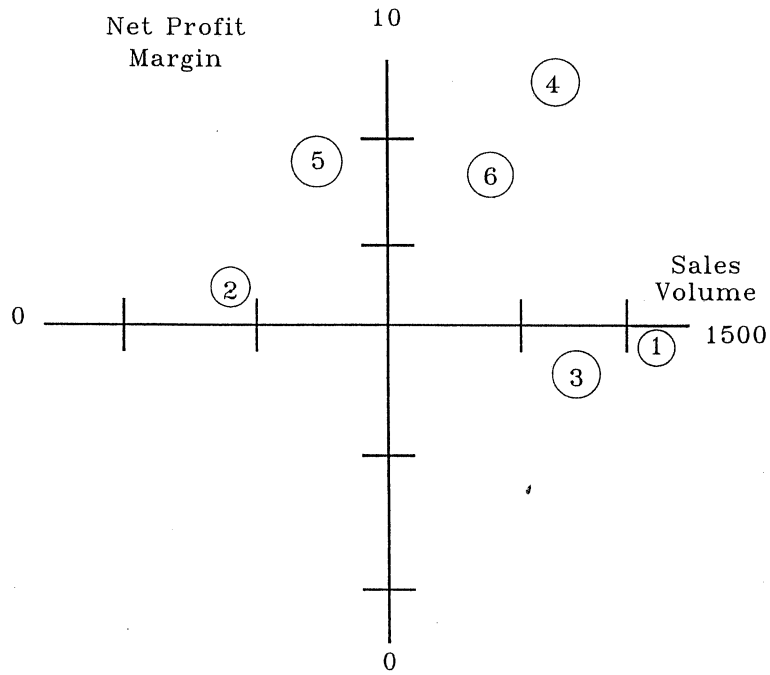
Sales Volume (000)	Group	Net Profit Margin
479	2	1.0
591	5	5.86
959	6	5.35
1027	4	7.4
1114	3	−1.02
1340	1	−.57