SMALL-FIRM COMPETITIVE STRATEGY

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ABSTRACT

This study examined the competitive strategies of 167 small firms in rural Kansas and Missouri. Fifty-eight firms were differentiators and forty-five were cost leaders. The remaining firms were unable to articulate a specific generic strategy and are what Porter described as “stuck in the middle.” We consider these results to be important because with fifty years of combined experience consulting with small firms, we strongly believe that the most successful generic strategy is focused differentiation.

INTRODUCTION

In 1980 Michael Porter published *Competitive Strategy: How to Analyze Industries and Competitors*. This book quickly became a New York Times best seller. Thirty-one years later, it remains in print in hardback only. Porter’s thesis was that there were only two ways to compete successfully: Cost Leadership and Differentiation. He called these “generic competitive strategies.” Cost Leadership means just what it says: achieving the lowest cost of goods or services sold in the firm’s competitive domain (industry or industry segment). The Cost Leader in discount retailing is Wal-Mart; through massive scale, the efficiency of its distribution system, and effective advertising, it has become the world’s largest retailer. The challenge for the cost leader in any domain is not to be so cost-focused that it fails to spot innovations which change the domain. Examples: Sears, independent booksellers.

In contrast, differentiation is about being different. Porter’s phrase is “perceived uniqueness.” Successful differentiators set themselves apart from the competition by offering something – features, options, customer service, image, etc. – for which customers are willing to pay more. Examples in department-store retailing are Nordstrom and Neiman Marcus. The danger for differentiators is not to allow the price gap between them and the cost leader to become so large that customers are no longer willing to pay the difference. Examples: Wanamakers (Philadelphia) and many other now-defunct upscale, local department stores. Common characteristics of cost leaders are large production facilities, long production runs, centralized decision-making, and tight control systems. Differentiators, on the other hand, rely heavily on surveys to keep them abreast of what their customers value and perceive in the differentiator’s product or service offerings. They are also characterized by decentralization, informality, higher gross margins, and significant investments in
R&D. They are ever-alert to complaints about price because those tell them that customers don’t perceive value.

Porter also offered a 2x2 matrix of these strategies. The “Y-axis” is for the scope of operations. “Wide” means a business that competes industry-wide, and “narrow” is for a company competing in an industry segment, which the strategy literature (Caves & Porter, 1977) calls a ‘strategic group.’ Marketers might think of such a group as a “niche.” The Porter strategy matrix, then, is a 2 x2 matrix with two choices for how to compete and two for scope.

Although numerous studies have attempted to relate these two basic strategies to firm performance, we are aware of none that address this research question: “What percentage of small, non-public companies employ which type of strategy with which breadth of scope?” The purpose of this study was to answer that question. We define “small non-public companies” as those employing fewer than one hundred people.

**METHODOLOGY**

MBA students and final-semester undergraduates conducted 167 onsite interviews with CEOs and sole practitioners in the Fall 2010 semester. Interviewees were from southwest Missouri and southeast Kansas. Each respondent was asked to complete a questionnaire – Appendix 1. All of the interviewers had been trained (in class) about generic strategies. That turned out to be important because, as we later learned, in most cases the interviewer had to explain what “generic strategies” are.

Respondents were also asked to check the appropriate block on the survey form indicating the generic strategy they employed, to indicate their type of business (service, retail, manufacturing or wholesale), and to disclose employment levels for 2009 and 2010.

**RESULTS**

All companies reported employing fewer than 100 people in 2010. Thirty-two (19%) reported an increase in employment last year, while the rest reported flat or declining headcount. These are consistent with trends in the U.S. economy at large.

Forty-five companies (27%) said cost leadership was their choice of strategy, while fifty-eight others (35%) chose differentiation. The remaining enterprises (38%) reported “both or none” as their strategy; Porter (1985) described this as “stuck in the middle” – a company tries to be all things to all people and refuses to commit to a strategy. We saw no obvious connection between the type of business or employment levels and the firm’s generic strategy.

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DISCUSSION

We can only speculate about why most interviewees needed a definition of ‘generic competitive strategy’ before they could answer that particular question, but we believe it derives from the use of ‘generic’ in that context. Had the questionnaire used the phrase ‘competitive strategy’ with the labels “low-cost” and “being different,” we suspect explanations would not have been necessary.

We are more concerned, however, about what we see as a strikingly self-destructive strategy choice by some companies: the choice to compete on cost. Though we didn’t ask for financial performance figures, we are confident that many of these ‘cost leaders’ are making subnormal rates of return and, thus, are in a slow state of liquidation, but don’t even know it. This creates a teaching opportunity for small colleges in rural areas: the market of small-business owners and senior managers. It seems to us that knowing the unsustainability of having a cost-leader strategy in a domain where the cost leader is a much larger company would be valuable for them to know.

Of course, they might well ask, ‘What then?’ Classes could instruct them about resources and about, as Penrose (1995) wrote, the importance of identifying additional services that can be provided by existing resources or combinations of resources. The second author of this paper, in fact, did that in his own consulting practice: he saw that the tools of strategic management lent themselves to easy and needed applications in valuing middle-market closely-held companies where the assumptions of traditional microeconomics (profit maximization, the firm-as-production-function, etc.) do not apply. He has carved out a lucrative niche which, 17 years later, only he occupies.

In addition, small-business owners and managers could be encouraged to develop their employees by, you guessed it, underwriting their attendance in evening classes. This could be done in conjunction with what Miller (2010) called “personal development programs.” These offer a way for owners, officers, and employees to take personal ownership of their careers and grow their skills and knowledge in order to support companies’ growth. It is much less risky to promote from within.

CONCLUSIONS

Of the 103 firms making a deliberate strategy choice, 58 chose differentiation. Because interviewers had to explain “generic strategy” to business representatives, we infer strategy, in general, and generic strategy in particular was not a “front burner” issues for them. This is a troubling because a consistent strategy has been demonstrated to correlate with performance in a large number of empirical studies.

In addition to picking the appropriate strategy, firms must decide how to implement the strategy. This means figuring out what to do in each of the functional areas of the business in support of the strategy and this requires transformational leadership (Parnell, 2008).
Based on a combined half-century executive and consulting experience, we have found that the strategy *du jour* for smaller non-public firms is differentiation with a narrow scope (Box, 2010; Miller, 2010). This reflects the fact that few middle-market companies have either the resources needed to be cost leaders or the footprint to compete across an entire industry (Peters, 2007). Working from Porter’s 2x2 matrix, Miller (2010) devised a typology of ‘strategy archetypes’:

![Diagram of strategy archetypes]

Note that each archetype begins with the letter ‘E’. The name of each label conveys a basic idea of what it’s about. Both alliteration and names make them much easier to remember. The ‘stuck in the middle’ Equivocator clearly conveys a mistaken strategy.

**REFERENCES**


*Academy of Strategic Management Journal, Volume 10, Number 2, 2011*
Appendix 1

Pittsburg State University Fall 2010 Strategy Survey

Interviewer:__________________________ Class:__________________
Name of the Firm Interviewed:__________________________
Name and Title of the person interviewed:_________________________
What is your primary line of business?________________________________
Number of full time employees (2010):________________
Number of full time employees (2009):________________

How does your firm compete? Please check ONLY ONE block that best describes your strategy.

[ ] Low Cost and Low Prices: We diligently control costs and prices. It is common to use long production runs or large batches. We have very tight control systems. We (generally) have lower costs and selling prices than our competitors.

[ ] Differentiation: Based on in depth knowledge of what our customers want, we have a wide variety of products and services. Our selling prices are "premium".

[ ] Neither of the above or both.