CHAPTER IV

MODEL AND HYPOTHESIS

Much of what we hear and the little that has got accepted as authentic progress in the field of strategic management, might be seen as having the character of what Eccles & Nohria (1993) call the "language games" Far from moving towards a holistic theory of strategy, most of the concepts in recent times are in fact, seen from a rhetorical stance, historical nuances modelled as new perspectives The 1950's employed the language of long-range planning; in the 1960's & 1970's, strategic portfolio planning and diversification became the dominant rhetoric, in the early 1980's, competitive analysis and generic strategies came to the fore and diversification was out of currency, by the mid 1980s, the emphasis had turned to sources of competitive advantage and restructuring, and by the end of the 1980's, the new slogans were strategic thinking, core competencies, global strategy and strategic alliances Inevitably, whenever a new perspective on strategy is introduced, it comes with a matching new managerial rhetoric.

Spanning 4 decades of development and theory building, the field of strategic management is, today more than ever, characterized by contrasting and sometimes competing paradigms. While each new theoretical construct (experience curves growth-share matrices, the PIMS research, industry structure analysis, game theory, transaction cost theory, agency theory, etc.) has attracted both applause and criticism, the strategy field seems to be as far away as ever from a grand unified theory of competitiveness

There is still much divergence of opinion within the strategy field as to what should a theory of strategic management be about While this researcher acknowledges the contribution of new perspectives, it appears to be the acceptance of an unusually broad resonance within the practicing community of managers of an improved strategic rhetoric. We find little consensus when we ask questions such as whether strategy is created or emerges ? Is the process of strategy formulation top-down, bottom-up or middle-out ? Is it content that matters in strategy making, or should the emphasis be put on the 'process' by which strategies are built ? Is strategy prospective or retrospective ? Is it about 'positioning' within an extant industry structure or about redefining industry boundaries for one's own advantage ? Does industry 'attractiveness' set the boundary conditions for firm profitability or is managerial capability the critical determinant ? Is development and decentralization the key to strategic vitality or does vitality stem from the clarity of strategic direction emanating from the top of the organisation ? Are corporate winners the product of Darwinian selection or purposeful action ? Is strategic wisdom dictated by the leverage of a 'portfolio' of product-market combinations or by a basket of critical competencies ?

What we do have are not answers, or well rounded-off models of firm behavior, but rhetoric postulations. Total quality, benchmarking, customer focused, micromarketing, core competence, downsizing, restructuring, the network organisation, flexi-manufacturing, value migration, reengineering, the virtual organisation, outsoursing, - the list is endless. This amounts to a telling sign of the continuing quest for a holistic veiw of strategy The task of coming to an agreement on what strategy is, or should be, is

complicated by the fact that the phenomena under study are changing faster than they can be captured and measured As much time needs to be devoted to the development of new paradigms as to the testing of existing ones. If there is a shortage of any thing in the strategy field, it is not of a well tested theory but of administratively sophisticated, contingency, sensitive and operationally subtle theory

If we have learnt anything about strategic management it is that strategy is about contingencies, trade-offs, paradoxes and uncertainty Why should we then expect to find a grand unified theory of competitiveness ? Diversity and variety in paradigms is less a sign of confusion than of multifaceted phenomena of corporate success and failure and the limited usefulness of any single strategy dictum The problem arises when strategy choices and perspectives are posed as opposing dichotomies rather than complementary components For example, the concept of internal competence has always existed alongside a market based view of the firm. In the resource based model, strategy is seen through the lens of the internal resources of the firm In the market based model, the firm itself is treated as a black box, and strategic advantage is seen to lie in the positioning of the firm in various factor and product markets. Thoughtful scholars have argued that this duality doesn't necessarily require an either/or decision on the part of the strategist (Eccles & Nohria, 1993) In fact, taken together, the resource- and market-based perspectives are more insightful than if treated as separate paradigms (Robert M Grant, 1991) Porter (1991), being critical of extant versions of resource based theory says: At worst, the resource-based view is circular For him, discussions of core competencies are inward looking and most troubling and stress on resources must complement, not substitute for,

stress on marketplace positions. But such realisations not withstanding, the strategy discourse has tended to cycle back and forth from one perspective to the other What is required is an integral understanding of the phenomenon of competition

1.0 The Phenomenon Of Competitive Dynamics

Managers are often judged on the brilliance of their strategies The brilliance of a corporate strategy is typically measured in terms of the extent to which it gives the firm competitive advantage relative to its competition This is then to say that strategy is about creating competitive advantage. And this may very well be true. But the main question for the strategist is exactly what leads to sustainable competitive advantage As Porter (1985) pointed out, the concept of sustainability can be interpreted in both a static and a dynamic way. Approaching 'sustainability' from a static point of view means determining a necessary (portfolio of) competitive advantage(s) (given the objectives, the environment and the available resources of the company) and then deploying a course of decisions and actions to defend that competitive advantage against the competitor's moves (imitation, alienation and substitution being the most important categories) One of the major problems with this approach, it appears, is that not a single competitive advantage can be sustained in this way in the longrun. Sooner or later, all competitive advantages will be eroded through competition and reduced to competitive pre-requisites or 'competitive conditions', which in turn, will lead to a reduction in the company's profitability to the level of the 'average' profitability within its industry Some competitive advantages may

be more 'sustainable' than others, meaning it will take more time and effort to neutralise the same Thus, the quest is to establish a competitive advantage that is more defensible over time before it falls victim to imitation or substitution

Thinking about the competitive advantage as never being 'defensible' in the long run compels one to look at 'sustainability' from a different, more dynamic point of view In a static approach, (strategic) decisions and deployment of resources are primarily aimed at defending an existing competitive advantage whereas with the dynamic approach sustainability is accomplished through the continuous renewal of the competitive advantage itself and the sources of that advantage

Under the dynamic approach, sustainability means substitution, a continuous process covering the replacement of previously defined advantages and sources in order to keep ahead of the competition. 'Sustainability' means 'keeping ahead' of the competition through processes of 'challenging' and 'changing' the rules of the competition and through deliberately creating misfit The essence of strategy is the creation as well as the continuous discovery of new sources of advantages as old advantages lose their potency. Thus, this dynamic view of strategy perhaps offers a theory that can account for differences among companies in their capacity for dynamic advantage creation Strategic management from this point of view has less to do with the search for 'defensible' sources of competitive advantage than with the search for sources that allow for a continuous renewal of the competitive position Once again it can be seen that competitive advantage like competition, is a continuously moving target.

Investigators like Porter (1980, 1985) have explained differential performance among competitors as a function of each firm's success in harnessing the 'drivers of competitive advantage' in a particular industry so as to place themselves in a more advantageous position relative to 'industry forces' compared with rivals Porter (1980) contends that competition in an industry continually works to drive down the rate of return on invested capital toward the competitive floor rate of return, or the return that would be earned by the economist's perfectly competitive industry As mentioned earlier, the resource-based perspective may also run lateral attributing the differences to key commitments made by a firm that lead to an accumulation of a bundle of unique resources and competencies not possessed by rivals (Prahlad & Hamel 1990) It can be yet again seen that the heart of the problem lies in possessing an elusive distinct comparative advantage. Note the change of a rhetorical stance The proposition of competitive advantage is akin to the concept of comparative advantage in International Economics. What is being argued is that a theory of strategic management can never be regarded as 'grown-up' unless it can justifiably explain extant competitive syndromes and offer pragmatic answers to important corporate strategy problems. Further and more important, any proposed model must be empirically testable

The comparative advantage theory of competition (Hunt & Morgan, 1995), is offered as a well-articulated rival to the neoclassical theory of perfect competition Hunt & Morgan maintain that, the notion of normal profits, that is, the average firm's profits in a purely competitive industry in long-run equilibrium is an empirically meaningless and arguably pernicious abstraction Long-run equilibrium is neither something that exists nor

something that groups of rivals are tending toward nor something that, if achieved, would be desirable. Rather, markets are never in equilibrium It is their contention that competitive activities that produce turmoil in markets, on the contrary, are the true engines of growth. A theory of competition, they argue, should satisfactorily explain the micro phenomenon of firm diversity. They point out that, competition consists of a perpetual struggle among firms for a comparative advantage in resources (financial, physical, legal, human, organizational, informational, and relational) that will yield a market place position of competitive advantage and thereby, superior financial performance They differentiate between comparative advantage and competitive advantage. They say that a comparative advantage (resources tangible and intangible) is the source of a competitive advantage, which essentially is the 'Marketplace Position' captured by the firm in some market segment(s). Competitors then attempt to neutralize the advantage and some may prove victorious and leapfrog the advantaged firm through acquisition, imitation, substitution, or major innovation. The comparative advantage theory of competition is, therefore, inherently dynamic Disequilibrium, not equilibrium, then becomes the norm.

Hunt & Morgan (1996), thus describe competition as the disequilibrating, ongoing process that consists of the constant struggle among firms to seize the comparative advantage initiative in resources. It is also about, more importantly they say, firms learning by competing as a result of feedback from relative financial performance 'signaling' relative market position, which in turn signals relative resources. Empirical evidence (Ceccarelli & Clayton 1992) substantiates this proposition by revealing that there

is far greater variation in profit performance within industries than there is between them. This evidence implies that different firms belonging to the same industry, facing the same market environment, demand and cost constraints, are behaving differently Some of them manage to subvert legitimate market forces and disturb the competitive balance and in doing so may be earning above par profits

The value of strategy in competition comes from developing the potential to intervene in an intricate system with only a limited input and thereby produce a predictable and desired change in the system's equilibrium to one's advantage (Henderson, Bruce 1983). Strategic competition requires an ability to manouver within the dynamics of the complex web of natural competition. Henderson points out that, there is no reason to expect a change in competitive equilibrium without an intention to cause it to happen This aggression, inherent in strategic competition, is perceived as generating an outcome that may seem potentially valuable enough to at least one party to justify the initiative He argues that perfect competition was meant to describe an idealized situation in which all competitors were so small that no one individual competitor could have any perceptible effect on supply or demand and therefore, on price; no situation of this kind has ever existed. Competition is inherently unstable The existence of firm diversity itself demonstrates that every competitor is uniquely superior and influences his related competitive segment. The ability to use strategy is the ability to manage the natural competitive system by calculated intervention in order to produce predictable shifts in competitive equilibrium. The meticulous conservatism of strategic competition leads to time compression and revolutionary change because strategy is itself the management of

natural competition. Visible conflict is only a symptom of a continuing effort on the part of participating adversaries to manage a dynamic equilibrium. Hax & Majluf (1991, pg 163) reiterate the same view, "the true objective of a strategy is to break the economic equilibrium law It is to search for windows of opportunity that might position a firm in a unique competitive advantage which can legitimately allow it to claim economic rents beyond those resulting from perfect competition. Rather than living in this long-term equilibrium condition, the central purpose of strategy is, first, to identify opportunities to create disequilibrium, and then to protect and sustain these conditions as long as possible This is the essence of a long-term sustainable competitive advantage".

That equilibria do not exist or are not possible, is not being argued. Equilibria do happen but for very short periods As mentioned earlier, the presence of firm diversity implies that all firms participating in a market are not equipped with homogeneous competitive capabilities. This means that the access to and control of the required resources (capital, supplies, markets, talent, etc.) is also not equal amongst a given set of competing firms. Further, no single firm or group of firms can eternally possess a competitive advantage. Competition, then is certainly imperfect. And as a consequence we have variation in firm performances. Obviously, each firm's quest then is to seize the initiative by leveraging a comparative advantage to gain a competitive advantage (Hunt & Morgan 1995, 1996, 1997) and this surely leads to a disruption of existing equilibriums. This phenomenon of fluctuating equilibria attributable to changing asymmetries in a market's competitive conditions is called competitive dynamics. For a diagrammatic depiction of the same, refer Fig. 1.0, chp. I.

2.0 Firm Proactivity And Competitive Dynamics

The prime purpose of this research endeavour is to propose a model that will explain the firm's competitive behaviour in imperfect markets It has been shown that the strategic behaviour of firms is the cause of the competitive dynamics phenomenon The proposed model is based upon the Resource Advantage Theory forwarded by Hunt & Morgan (1995) also representative of the Resource-Based perseptive [Refer Fig 4.1] As stated earlier, the Resource Advantage Theory proposes that competitive advantage (leading to superior financial performance) results from a comparative advantage in resources which they define as the tangible and intangible entities available to firms that enable them to produce efficiently and/or effectively market offerings that have value for some markets Imbedded in these resources also lie entrepreneurial skills and capabilities that have a decisive role to play

In Resource Advantage Theory, innovation occupies a central place It is in this context, that they introduce the all important notion of proactive innovation (i.e., innovation by firms in the absence of specific competitive pressures) and 'reactive' innovation (i.e., innovation directly prompted by competition) Evolutionary and Austrian approaches to explaining the dynamism of market-based economics have placed great emphasis on the proactive, innovative activities of entrepreneurs in spotting and subsequently developing market offerings (Jacobson 1990, Kirzner 1973, Nelson & Winter 1982, Schumpeter 1950). Similarly, Resource Advantage Theory recognizes people's entrepreneurial skills and organisation's entrepreneurial capabilities as

organisational resources. In addition, however, it explicates the competitive process whereby such resources lead to economic change Specifically, entrepreneurial capabilities produce economic dynamism when they produce proactive innovations that contribute to efficiency and/or effectiveness and when they result in marketplace positions of competitive advantage and, thereby, superior performance Furthermore, Resource Advantage Theory shows how, even in the absence of entrepreneurially oriented firms engaging in proactive innovation, competition ensures that market-based economic systems will still be dynamic. Moreover, such proactive innovations are also the genesis of entirely new Business Ecosystems The creation of new economic communities of interdependent members who co-evolve in an eternal reciprocal cycle to foster the growth of a radical innovation (Moore, 1993). This again is reflective of how proactivity redefines industrial structures.

Recall that Resource Advantage Theory proposes that all firms seek superior financial performance and because all of them cannot have it simultaneously, firms occupying positions of competitive disadvantage must attempt to neutralise and/or leapfrog that advantaged competitor through reactive innovation . by better managing existing resources, obtaining the same or equivalent value-producing resources , and/or seeking a new resource that is less costly or produces superior value The time required for reactive innovation to succeed depends on, among other things, the extent to which an advantaged firm's resources are protected by such societal institutions as patents and/or they are causally ambiguous, socially complex, tacit, or have time compression

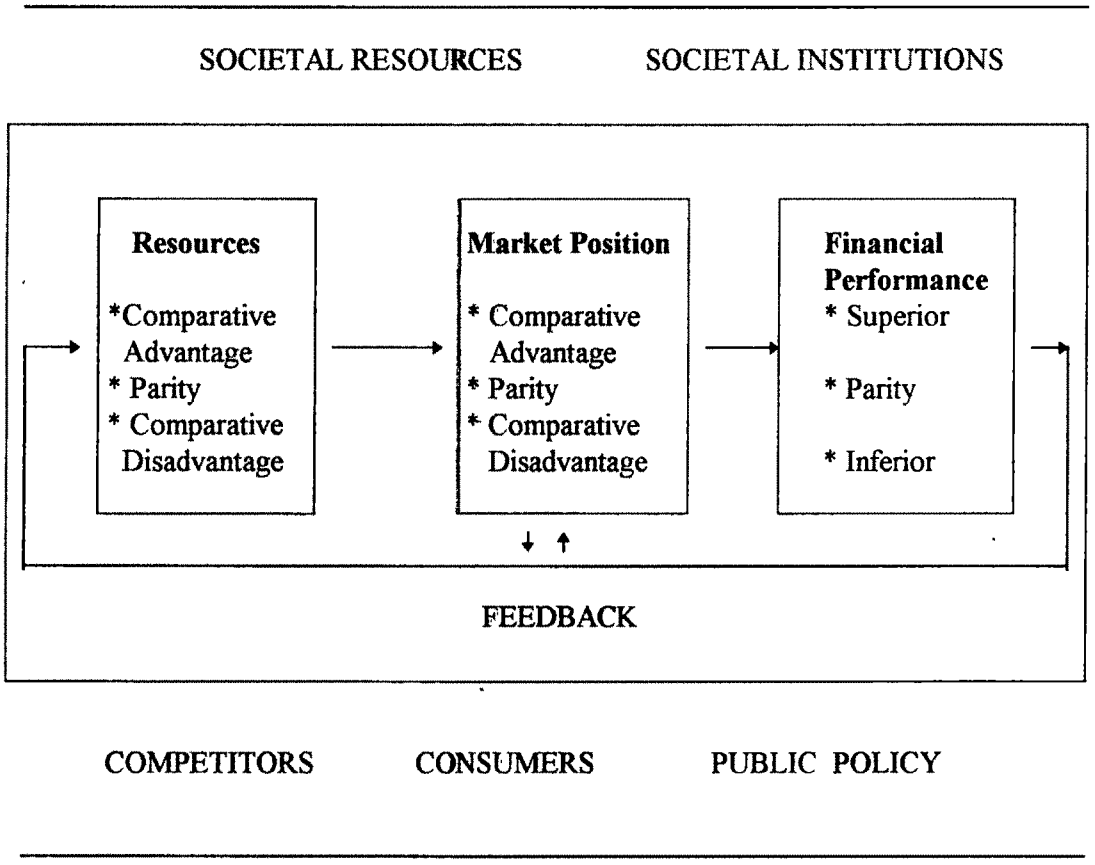
diseconomies (Conner 1991, Dierickx & Cool 1989, Nelson & Winter 1982, Peteraf 1993, Reed & Defillippi 1990, Wernerfelt 1984)

Note that both reactive and proactive innovation depend on higher-order, complex resources Note also that unlike those dynamic theories that just assume there is exogenous heterogeneity in the change (or rates of change) of some variables or theories that require proactive innovation, Resource Advantage Theory explicates the process that ensures endogenous competitive dynamism even in the absence of such proactive innovation.

Firms (attempt to) learn in many ways - by conducting formal marketing research, seeking out competitive intelligence, dissecting competitor's products, benchmarking, and test marketing What Resource Advantage Theory adds to extant work is how the process of competition itself contributes to organisational learning, as feedback loops in Fig. 4.1 show. Firms learn by competing as a result of feedback from relative financial performance signalling relative market position, which, in turn, signals relative resources Through competition, firms come to know their relative resources and marketplace positions Integrating the metaphor of 'The Learning Organisation' into a theory of strategic management, then, becomes mandatory. The continuous renewal and 're-sourcing' of comparative advantages can most probably be fulfilled by a learning organization that maintains a degree of strategic and operational flexibility (Hamel, 1994). A theory must provide for higher-order learning processes as complex resources that can yield market place positions of competitive advantage (Dickson, 1996) Hunt & Morgan's

Figure 4.1

A Schematic of the Resource-Advantage Theory of Competition



Source : Hunt & Morgan (1996)

(1996) Resource Advantage theory not only incorporates this dimension, but it also shows precisely how firms learn from the very process of competition itself - even in the absence of having mastered higher-order learning processes The Resource Advantage Theory, thus, shows explicitly how the process of competition motivates proactive and reactive innovation, thereby ensuring that competition continues to be dynamic

Competition as a proactive process is not an entirely novel concept Downie (1958, in Devine *et al* 1979) has expressed the spirit of this approach 'The most fundamental characteristic of a capitalistic economy is growth and change (it) is characterised by a restless urge to do better, to change the conditions lest, through inactivity they are changed against you'. He contends that competitive process proceeds by way of a dialectical thrust and counter thrust as oligopolists seek to defend their positions in the face of change and to seize new opportunities for dominating their rivals

While the proposed theory does seem to resolve many issues, much conceptual and empirical work must be done to test, explore, and further explicate the structure and implications of the theory. Are there additional foundational premises that should be included ? What other resources can distinctively provide a comparative advantage ? Can and should the theory be mathematized ? Much of these issues lie beyond the immediate scope of this research endeavor. However, the primal effort is to make a reasonable attempt to operationalize the model of proactivity and competitive dynamics, so that capturing the phenomenon becomes empirically possible

3.0 Proactive Firm Behaviour : A Pragmatic Perspective

Although the attempt is to offer a theory of competition, this research work forges the quest for the same with the general determinants of the market economic behaviour of private manufacturing firms Largely, researchers have attempted to explain firm performance by emphasising the role of industry structure in the competitive process and the analysis of the main decision variables within the firm's control. Both reflect on a firm's behaviour in markets as opposed to wider questions concerning the performance of the industry as a whole This study adopts a similar view

The operational framework for illustrating the proactivity of firms, to a great extent, has its roots in industrial economics. This section is inspired by the work of Hay & Morris (1991)

First is represented the more traditional approach, as in Figure 4 2(A) In the top left hand corner are shown the central issues stemming from the theory of the firm, namely the determination of price and output in markets by demand and supply Price and output determine gross receipts out of which current costs are paid, leaving profit. Current costs depend on the actual output level, and the supply conditions facing the firm. The latter depend on the capital stock of the firm, built up by successive investment expenditures The history of this approach is the study of price/output decisions in the light of market supply and demand conditions, their consequences for profit and cost levels, and (usually quiet separately) the level of investment in the light of its marginal efficiency and interest rates. The later advent of the concept of monopolistic competition brought in the possibility of market investment (advertising, etc) as a means of influencing the demand

conditions faced, and this has subsequently been examined in considerable depth, so this may be added to the diagram

Almost entirely separate from this, and until recently generally part of the empirical school, was work concerned with the financial decisions and behaviour of individual firms and the systematic aspects of these across firms This can be shown as in Fig 4 2(B) Here a main concern was to analyse firm's dividend policies in the light of a firm's needs for funds itself and its concern for the value of it's shares The dividends paid out of profits are an important determinant of the firm's stock market valuation, though the relationship naturally requires an examination of the behaviour of financial markets and is open to debate High stock market valuation may represent an aim in itself, but is also necessary in order to attract new funds from existing or new share holders The supply of both internal funds from retentions and external funds will therefore depend on the financial policy adopted by the firm.

Besides the market model and the financial model, an additional expenditure model may be postulated, which forms a linkage between them This describes the expenditure on market investment, research and development, and physical capital out of funds available Expenditure on research and development may be process research and development, influencing the supply conditions of the firm, or product research and development, which alters the nature of the goods and services sold Acquisition of other firms through takeover or merger may be added as another type of expenditure Fig 4.2(C) shows the different types of expenditure and illustrates a largely ignored aspect of

Fig. 4.2(A) : Market Model

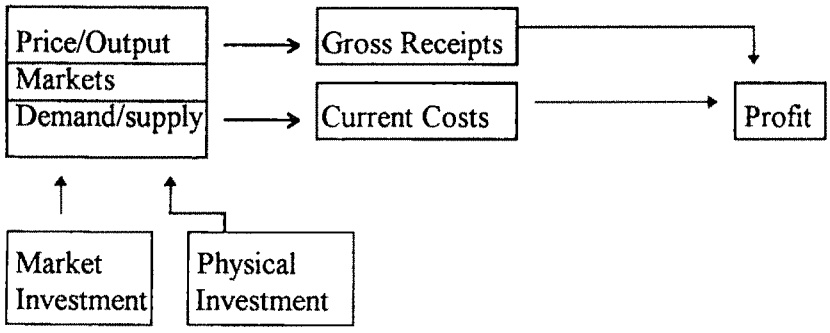


Fig. 4.2(B) : Financial Model

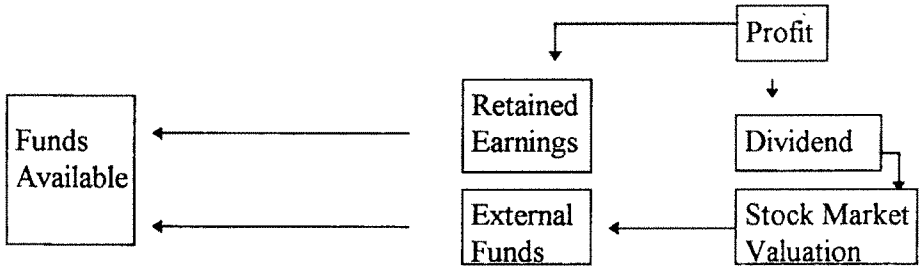
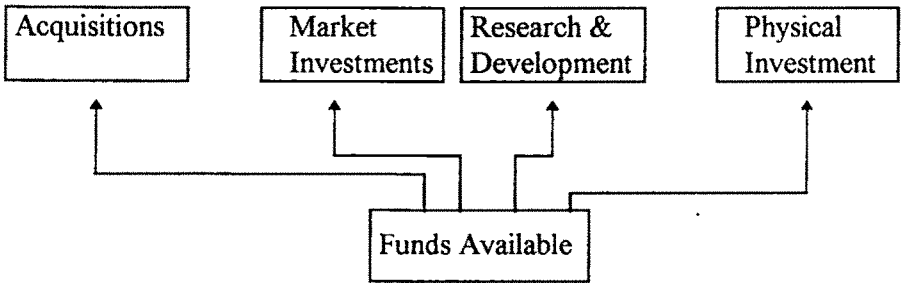


Fig. 4.2(C) : Expenditure Model



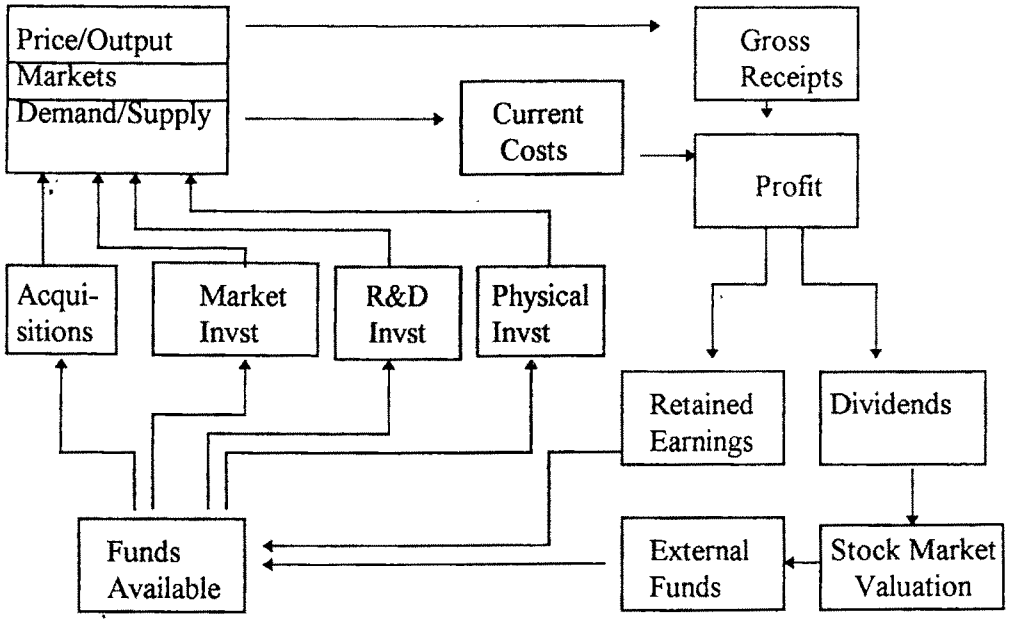
Source · Hay & Morris (1991)

the firm's expenditure decisions, namely that there are alternative and competing uses of a firm's funds

The first step in establishing a comprehensive framework is to recognize that these are complementary models, focusing on different aspects of a firm's behaviour, and that we can provide an overall picture of firm's economic behaviour by putting the three together. Hay & Morris (1991) have integrated these models to present a complete model as shown in fig 4 3. The market model explains the profits generated, the financial model analyses the division of profit, and the expenditure model examines the use of the total funds made available to provide (1) Market investment and product research and development, both of which influence the demand conditions facing the firm, (2) plant expenditure and process research and development, both of which influence the cost and supply conditions facing the firm, (3) acquisitions, which directly change the nature of the market conditions facing the firm In addition, it is expectations of market conditions which determine the expenditure made and the finance which will be made available both internally and externally Fig 4.3 is a picture of a representative firm that has many interlocking facets. Hay & Morris explain that when viewed circularly as a whole, the model leads us to draw a distinction which helps interpret and reconcile many current controversies regarding firm behaviour This is the distinction between the concepts of the 'passive' firm and the 'active' firm This furnishes the missing links of the Resource Advantage Theory

Hay & Morris contend that at any point in time, firms will be pursuing one or more objectives in the face of several constraints Passive behaviour consists of attempting to

Fig. 4.3 : Complete Model



Source · Hay & Morris (1991)

maximise the achievements of objective(s) within given constraints In the original theory of the firm, the firm was faced with a set of cost conditions, one of which applied in the short run and any of which might apply in the long run Market structure was given, and with it the shape and position of the demand curve The firm then pursued profit maximisation, passively, accepting the constraints of costs and demand A totally passive policy would then involve acceptance of the consequences, which could include stable or deteriorating profit and even exit from the industry

In contrast, active behaviour involves the attempt over time to modify and/or remove the constraints, thus enabling a better achievement of the firm's objectives Advertising, Research and Development, product diversification, collusion, merger, and takeover are all forms of active behaviour that can be undertaken to relax constraints

Given this distinction, we can reappraise the approaches described earlier The first, more traditional approach, focusing more on the passive aspects, emphasizes the constraints placed on firm's economic behaviour by cost and demand structure, analysing the response to them in terms of a limited number of decision variables. It emphasizes profitability as an objective and as a performance measure because of its role as the outcome of the market model and as the input to the finance and expenditure models The second approach recognizes the discretion those profits provide for a firm to release itself from industry constraints, to pursue other goals, and to manipulate its environment, using a wider range of decision variables The third approach, while adopting the traditional stance of profit maximization and a limited number of variables, also focuses on the ability of firms to actively influence market structure and the constraints within which it will

operate Passive and active behaviour are complementary, ultimately being just different facets of a firm's overall behaviour The passive aspect determines the firm's ability to pursue an 'active' policy, the active aspect determines the context of the passive responses which the firm makes The model also explicates the ways in which a firm modifies, but is also modified by, the industrial structure it faces A satisfactory theory of competition can be adequately constructed only if this two-way interrelationship is recognized This facet is diagrammatically represented in Fig 1 0 of chapter I

Many of the debates in the discipline of strategy can be regarded as stemming from a difference of view about the relative importance of passive and active behaviour Scepticism about the impact of active decisions, proactivity of firms, will tend to be associated with the belief in the efficiency of competitive markets, while those who believe the reverse will tend to downgrade the importance of industrial structure, focusing more on the economic power that resides in the company sector and the lack of external constraints on it. Whether advertising and acquisition are seen as part of the competitive process or attempts to thwart it, with emotive overtones in each case, will depend whether the proactive or the passive perspective is adopted.

Hay & Morris (1991) tie-up their model to the super-environment and macro phenomena as well For example, in recessionary periods, competitive pressures will increase, profits will be greatly reduced, and the possibility of adopting a significant proactive posture will be reduced, leaving the firm's skill in optimizing under tight constraints as the main factor Active expenditure policies and mergers typically decline, the threat of new products or new firms appearing are much diminished, and consumer

emphasis on low prices may well be increased Cyclical upswings would, however, see the reverse of all of these In summary, the priority for research in strategic management will depend on choosing the proactive perspective

4.0 An Integral Conceptual Model Of Strategic Firm Behaviour

Thus far it has been established that, the dynamics of competition is more importantly about the quest of firms to wrest marketplace positions on the basis of some comparative advantage, which itself is a moving target. It has also been argued, at length, that strategic behaviour has to do with proactive postures adopted by firms Further, it has been explicated that viewing competition through the lens of economic behaviours adopted by firms presents external and internal analysis as complementary rather than as a conflicting dichotomy The mechanics underpinning these postulations have been demonstrated through the two models presented However, an integral model to make an empirical veracity of the proposition that differential performance among competitors is a function of proactive firm behaviour attributable to competitive dynamics, remains

It would be reasonable to start on the premise that firms are not born great but achieve great The firm, as a corporate entity certainly does not make its market debut as a proactive contestant, but over time matures from a passive participant to an assertive market activist. As a passive firm, the enterprise is almost always a price-taker and as explained in the Hay & Morris model, would seek to maximise achievement of objectives within industry structure constraints of costs and demand Firms at this stage could only depend on their production skills or, still better, what we may term as 'operational

effectiveness' for improving their profitability Thus, financial performance of a passive firm would be a function of its ability to improve its operational effectiveness (optimizing within constraints) This implies that the accent is on productivity improvements Porter (1996) defines operational effectiveness as the cost advantage generated by performing particular activities more efficiently than competitors He says, differences in operational effectiveness among companies are pervasive. Some companies are able to get more out of their inputs than others because they eliminate wasted effort, employ more advanced technology, motivate employees better, or have greater insight into managing particular activities or sets of activities Correctly pointed out by him, soon improved operational effectiveness results in rivals imitating one another's improvements that ultimately leads to mutually destructive competition. Eventually major productivity gains are captured by customers and equipment suppliers, and cease to be retained in superior profitability Operational effectiveness cannot be a substitute for strategy

The heart of the problem lies in the inability to consolidate dramatic gains in operational improvements and translate those gains into sustainable profitability How does one graduate from being a transitory top league passive player to a consistent proactive market contestant ? The journey from being a 'price-taker' to achieving the status of price-maker is the true essence of strategy Porter (1996) claims that strategy, by contrast, is not about attaining productivity gains in performing activities, but strategy means performing different activities from rivals or performing similar activities in different ways He describes competitive strategy as deliberately choosing a different set of activities to deliver a unique mix of value Incidentally, almost the same wisdom has

been earlier espoused by Drucker (1994) who pointed out that firms ought to focus on 'what to do' (doing the right thing) rather than waste efforts on 'How to do' (doing a thing rightly) tools Note, once again, the nuances remain the same Only the rhetoric changes

The transition to a proactive status lies in the discretion that profits (made available by productivity gains) provide to circumvent environmental constraints, by orchestrating a wider range of decision variables This has been illustrated in the Hay & Morris model. Decisions on deployment of these funds, for physical capital investments in technology and expansions, research and development in manufacturing processes and new product development, market investments in building brand equity, acquisitions and mergers for vertical/horizontal integration, diversification into fast growing markets, or the sustained funding required for building core competencies represent the scope and options to manoeuvre the legitimate market forces of competition These investments, strategic in nature, should result in a relatively superior position of comparative advantage This advantage proves to be the well-spring for a relatively superior marketplace position; which normally is expressed in terms of market share However, in the context of a proactive posture adopted by the firm the objective is slightly altered Here, the aim is: to become a firm that can behave in a manner different from the behaviour that a competitive market would otherwise enforce on a firm facing similar cost and demand considerations. This distinction is crucial, subtle, and certainly not rhetorical The stress is not on achieving market share dominance but to harness a critical mass of economic power whereby a firm becomes a price-maker Specifically, a competitive position which enables

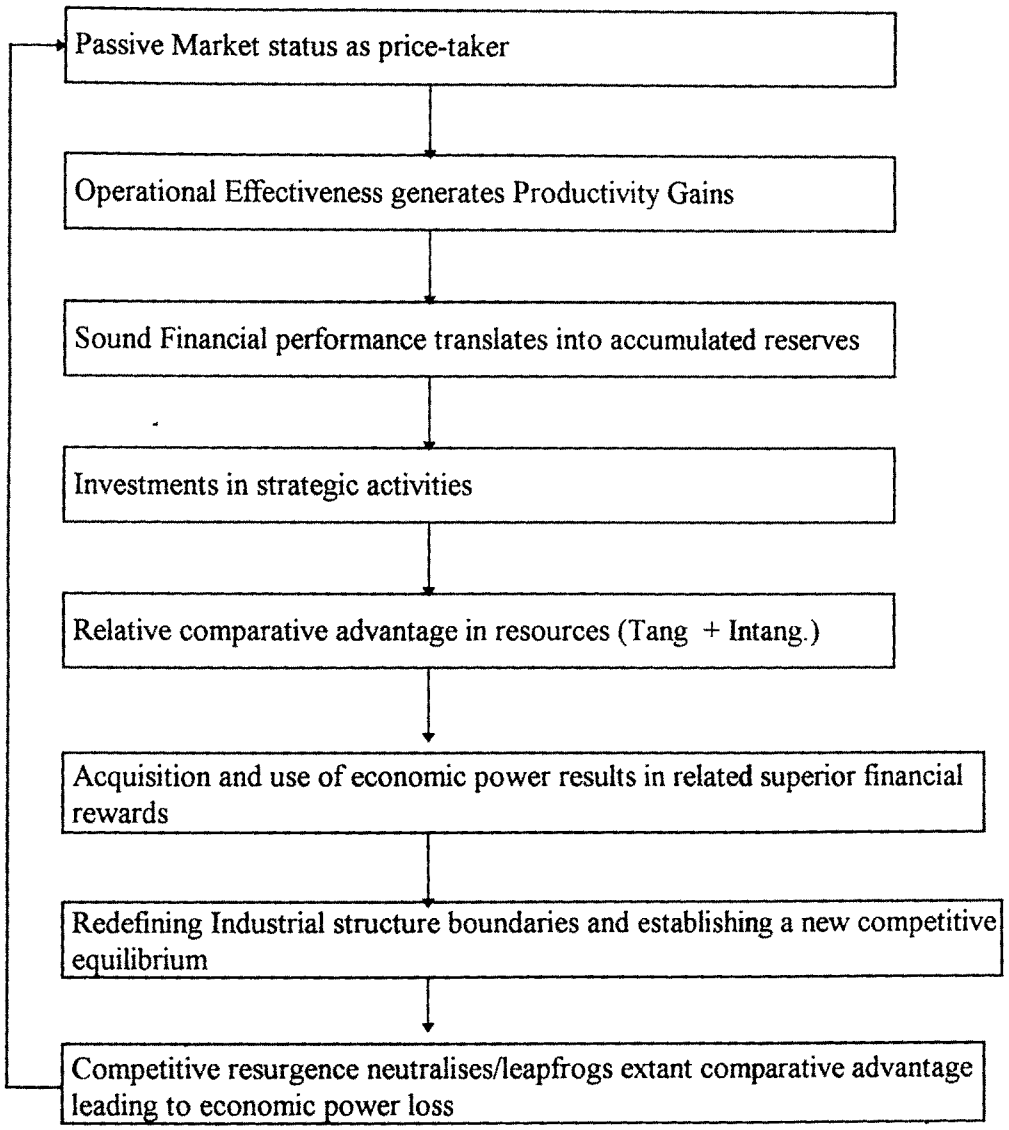
the firm to change the rules of competition to it's advantage The journey of a firm from passivity to proactivity, may be compared to the metamorphosis of a larva into a butterfly

It is worthwhile, to reiterate the fact that the passive aspect determines the firm's scope and ability to pursue a proactive policy, the proactive aspect determines the context of the passive responses The two are interdependent It will not be before long that an adversary would either neutralize or leapfrog the existing competitive advantage rocking the competitive balance The turmoil would gradually become stable, until one of the contestants again foresees a substantial gain in upsetting the established equilibrium Thus, it can be seen that the aspiration of firms for the acquisition, use, and subsequent probable loss of economic power, is the substance that competitive dynamics is made of And this may be accepted as a reasonably holistic theory of strategic competition The framework is represented diagrammatically in fig 4 4

5.0 An Integral Empirical Model Of Strategic Firm Behaviour

This thesis consistent with the resource based view, stresses the importance of proactive firm behaviour attributable to competitive dynamics as determinants of business performance However, unlike the position advanced by some resource based theorists it views the examination of firm proactivity as complimenting rather than conflicting industry structure and competitive strategy variables as determinants of business performance. The integral approach, presented in preceeding sec 4 0, in this study, interprets the situation as follows . the proactive strategic thrusts of a firm result in a comparative advantage in

Fig. 4.4 : An Integral Conceptual Model of Strategic Firm Behaviour



designing, manufacturing and marketing products relatively superior to the competition leading to the acquisition and use of economic power is the determinant of its superior financial performance In brief, this viewpoint is in line with

1 The resource based view which emphasises the importance of idiosyncratic firm competencies elicited from managerial volition, organisational assets, reputation and culture as potential sources of competitive advantage (Rumelt 1984, Coyne 1985, Dierickx & Cool 1989). It is in keeping with Jacobson's empirical research (1988, 1990) which in turn was largely inspired by the Austrian school of economics supporting of the Efficiency school which argues that it is the more efficient firms which win approval from customers and thereby achieve market share gains. It is also in line with the notions of core competencies espoused by Hamel & Prahlad (1990)

2 Porter's (1991), Amit & Schoemaker's (1993) view that the resource based view is complimentary to, rather than, an alternative to the role of industry structure and competitive strategy as determinants of firm performance

3 The position of Conner (1991) & Mahoney & Pandian (1992) that the resource based stream of research has the ability to coalesce extant literature on industry structure and competitive strategy with literature that emphasizes idiosyncratic firm specific assets and skills

4 Hunt & Morgan's (1995,1996, 1997) position that to achieve more accurate estimates of firm strategic behaviour, a model that incorporates industry structure

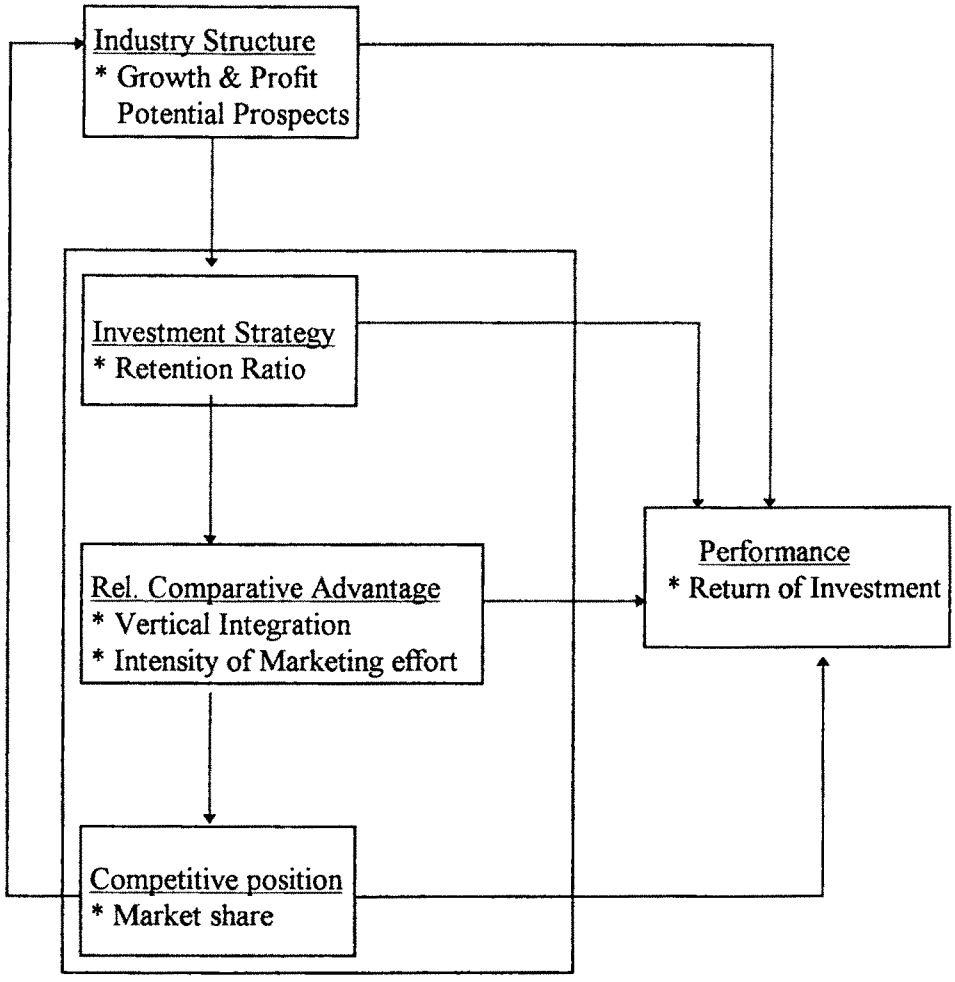
competitive strategy, and firm resources (tangible and intangible) is necessary, viz the Resource-Advantage Theory of competition

5 Hay & Morris' complete model of firm behaviour (1991) which relates the all important role of reserves and investments in liberating a firm from legitimate market forces of competition, to amass economic power which is the source of superior financial performance, and in turn influence the existing industry structure

A conceptual model grounded in the theoretical and philosophical underpinnings stated earlier was presented in fig 4 4. Fig 4.5 presents the integrated empirical model tested in this study The model incorporates four major determinants of business performance - industry structure, dictating growth and profit avenues open to a firm, the retention ratio reflecting a commitment to fund strategic ventures, building relative comparative advantage in critical success factors, and the role of a price-maker competitive position The model is integral in that the conceptualization of the same, approaches a holistic dimension of competitive dynamics However, it is not comprehensive since it does not explicitly model organization structure, viewed by many organization theorists as a crucial determinant of performance Likewise, nor does it model firm-specific intangibles as described by the propounders of the resource based theory. The main objective in this study is to capture proactive firm behaviour as a major determinant of business performance in a specific industry

The directional flows in fig. 4.5 demonstrates industry structure impacting the firm's financial performance as well as it's investment decisions These two boxes

Fig. 4.5 : An Integral Empirical Model of Strategic Firm Behaviour



represent the transition phase of the firm Investments in strategic options yields relative comparative advantages in decisive distinctive competencies shown in the third box This gives a firm access to a dominant competitive position. The dotted line encompassing the three sets of variables captures the proactivity of the firm All the three sets have their individual impact on the firm's financial performance The directional flow from the competitive position box to industry structure box reflects the eventual impact of the firm's proactive behaviour The degree of this influence also functions as the feedback signal for "new learning" functions which may be required

The model also represents a circular flow i e, industry structure impacting investment strategy which influences relative comparative advantage which in turn affects the firm's competitive position which finally impacts industry structure again However, empirically testing a recursive circular model is beyond the immediate scope of this study A search for more exhaustive instrumental variables (shown in the Hay & Morris Model) can solve the circular model in a simultaneous equations context The path associations are presented to highlight theoretical completeness only.

The main focus is on determining the extent to which each of these representing firm proactivity explain variance in profitability. Hence, the circular paths were not tested in this study. The major components discussed in detail and the concerned propositions espousing the relationships between the proactivity constructs and firm performance follow Justification of the choice of variables is also simultaneously taken up

6.0 Research Propositions

6.1 Industry Structure And Performance

The traditional structure - conduct - performance (SCP) paradigm developed by Bain (1951) posits that industry structure variables influence the firm's strategy (conduct), to eventually effect business performance. Schmalensee (1985, 1989) argues that measures of industry structure used in traditional research are imperfect Moreover, since many of the classical industry - level variables are endogenous in the long run, it is difficult to formulate enough non-controversial exclusion restrictions for all parameters of interest Schmalensee (1985) in an empirical study, using such a measure found that accounting rates of return at the business-unit level are strongly influenced by industry effects, not influenced by firm effects and only unimportantly by market share effects. Using an approach similar to that of Schmalensee (1985), Wernerfelt & Montgomery (1988) found that industry effects explained a majority of the variance in Tobins q However, Rumelt (1991) criticized Schmalensee's (1985) study on methodological grounds Using the same database, but extending it to four-year averages, Rumelt (1991) found startlingly different results · while business unit effects were the most important (explaining 46% of the variance), industry effects in contrast, explained only 8% of the variance in performance In spite of the seeming controversy about the relevance of industry effects (albeit unresolved), its validity in explicating a theory of strategic firm behaviour remains irrefutable. Although popularly there are many variables like industry concentration, barriers to market entry, capital intensity, etc for the purpose of this study only market growth rate was considered.

For achieving the objectives in this section, this study has opted to use the term 'market structure' rather than industry structure, as firms of a specific industry viz the Indian pharmaceutical sector is being examined The term 'market structure' refers to a selected number of organisational characteristics of a market that establish inter-relationships between the buyers and sellers of a particular product. Market structure analysis is, therefore, a study of the organisational features of a specific market that are believed to have significance for the conduct and performance of firms comprising that market. However, in practice the definition of a market presents many problems Statistical analyses of market structures are normally based upon industrial classifications at various levels of disaggregation, which do not necessarily equate to markets as defined above. Received price theory hypothesises certain relations between market structure, firm behaviour, and market performance Therefore, if it is possible to demonstrate that particular types of market structure are consistently associated with particular types of performances, public policies may be framed to achieve predetermined performance targets through the manipulation of market structure (Devine *et al.*, 1979) The logic of this concept is imported as it is especially relevant and critical to the Indian Pharmaceutical markets. Once we begin to examine the 'black box' assumption that firms are one-product, profit-maximizing, single decision taking units, we find in practice a very complex world Much productive activity is carried out by very large highly-diversified companies. The term 'Market structure' signifies that the market-forces and the super-environment prevalent in the pharma industry would be different from those existing in other industries Thus, the behaviour of firms, too, will be industry specific The industry

may be thought of firms whose techniques (not necessarily a particular manufacturing process) of production are sufficiently alike for it to make sense to conceive of one as being able to do the business of another. In the pharma industry especially, it is possible to leverage a single manufacturing set-up and a set of common raw-materials to make a variety of products With more than 77 therapeutic segment classifications, the typical growth oriented pharma company is a diversified one Refer chp. II, sec 5 0, for details

Role of market evolution and growth: One of the most widely-accepted postulations about strategic management is that the evolution of markets over time follows a common general pattern or 'life cycle' Markets in the early stages of their evolution display an erratic pattern of growth and instability in technology, market structure, and methods of competition. For those that survive this turbulent period, there follows a stage of rapid growth still later markets mature and stabilise Maturity may persist for many years, but ultimately almost all markets are fated to decline, either because a new and superior technology emerges or because of changing customer needs However, there are many departures from the typical sequence of stages and frequent cross-currents of more or less rapid growth within a given stage of development Important exceptions not withstanding, this concept is well accepted in extant literature and the related fields of marketing and economics

The impact of market growth on profitability and ultimately on strategic behaviour is decisive Rapidly expanding markets, particularly, represent maximum promise for gainful opportunities High growth rates are characterised by Buzzell & Gale 1987

* High gross margins.

* High marketing costs (but not enough higher to offset the improved margins)

* Low rates of inflation, both for selling prices and for materials and wages In rapidly-growing markets, prices typically rise at a rate below that of costs, creating a 'cost squeeze'

* Rising productivity (apparently this is usually more than enough to offset the differential between the rates of change in prices and costs)

* A need to increase investments to keep pace with growth (Interestingly, the investment base tends to grow, although at a slower pace, even in declining markets)

* Low or negative cash flow, even though ROI is rising

The net effect of all of these differences is that profits are highest in fast-growing markets and lowest in declining ones This also forms the cornerstone of the product portfolio concept, which is importantly used to arrive at priorities for strategic investment, depending on the business potential for growth and profitability All popular portfolio matrices; the BCG growth-share matrix, GE's industry attractiveness-business strength matrix, Arthur D. Littles life-cycle matrix, Marakons profitability matrix, incorporate this variable as a standard feature Thus, for the multi-product diversified firm, consisting of cash-generating and cash-absorbing divisions, the relationship between market growth rates and profitability assumes paramount significance

A realistic assumption would be that firms tend to be profit satisficing and not 'maximising' This has also been reflected in using the term 'superior' financial

performance in this study Thus, it would be reasonable to assume that a firm can alternatively pursue growth, maximising sales revenue, for its long-run survival in a dynamic context (Baumol 1959) Further, once the concept of an optimum size for the firm is abandoned, size becomes hereby a byproduct of growth Penrose (1963) argues that since total profits will increase with every increment of investment that yields a positive return, regardless of what happens to the marginal rate of return on investment, firms will want to expand as fast as they can take advantage of opportunities for expansion that they consider profitable She spells out that a firm is said to diversify whenever, without entirely abandoning it's old lines of product, it embarks upon the production of new products, including intermediate products, which are sufficiently different from the other products it produces to imply some significant difference in the firm's production or distribution programme. This could not be more true of pharmaceutical firms, which characteristically venture into related 'therapeutic segments' rather than into non-pharma markets. Once again this feature resonates the concept of market structure Hunt & Morgan (1995) have also pointed out that few industry markets exist; there are only market segments within industries. They say that an industry does not face a single downward sloping curve - such an industry demand curve would imply homogeneous demand and this is not possible. To summarise, it is argued that pharma firms do pursue growth through diversification in related market segments which in turn exists because of the heterogeneity in industry demand. Such diversifications will be dictated by the collective managerial experience and the productive resources existing within the firm, i e , internal restraints (Penrose 1963). This implies the development of comparative

advantage, and the reliance on available competitive strengths in the context of operative effectiveness as espoused earlier

Thus, this research endeavour proposed that. The "choice" of participating in rapidly expanding nascent markets, where the firm has relative efficiency advantages, has a positive impact on financial performance. This is in keeping with strategy and standard economic theory. It also represents the dominance of market structures influencing firm behaviour. The passive aspect of the proposed model in this study

6.2 Investment Strategy And Performance

The previous section introduced growth as one of the more important objectives pursued by firms, reflecting inherently the endeavor of increasing total revenues through tapping rapidly growing markets. The prospect of entering and securing such markets to achieve growth, however, raises the question as to whether their is an upper limit to its rate of growth. The general answer provided by growth theorists is that growth will be subjected to various 'dynamic constraints' (Devine *et al.*, 1979). The interaction between these constraints - essentially between the means for growth and the costs of growth - sets an effective upper limit to the rate at which the firm *can* grow Of course, the rate at which it *will* grow may also depend on the objectives of those running it. This also symbolises the proactive attitude and aspirations of the firm. The major constraints that have been isolated are · demand, managerial and financial

The demand constraints are represented by our first proposition The managerial constraints have also been touched upon citing the work of Penrose & Porter's concept of operational effectiveness elucidated earlier. Here, the researcher seeks to argue for the

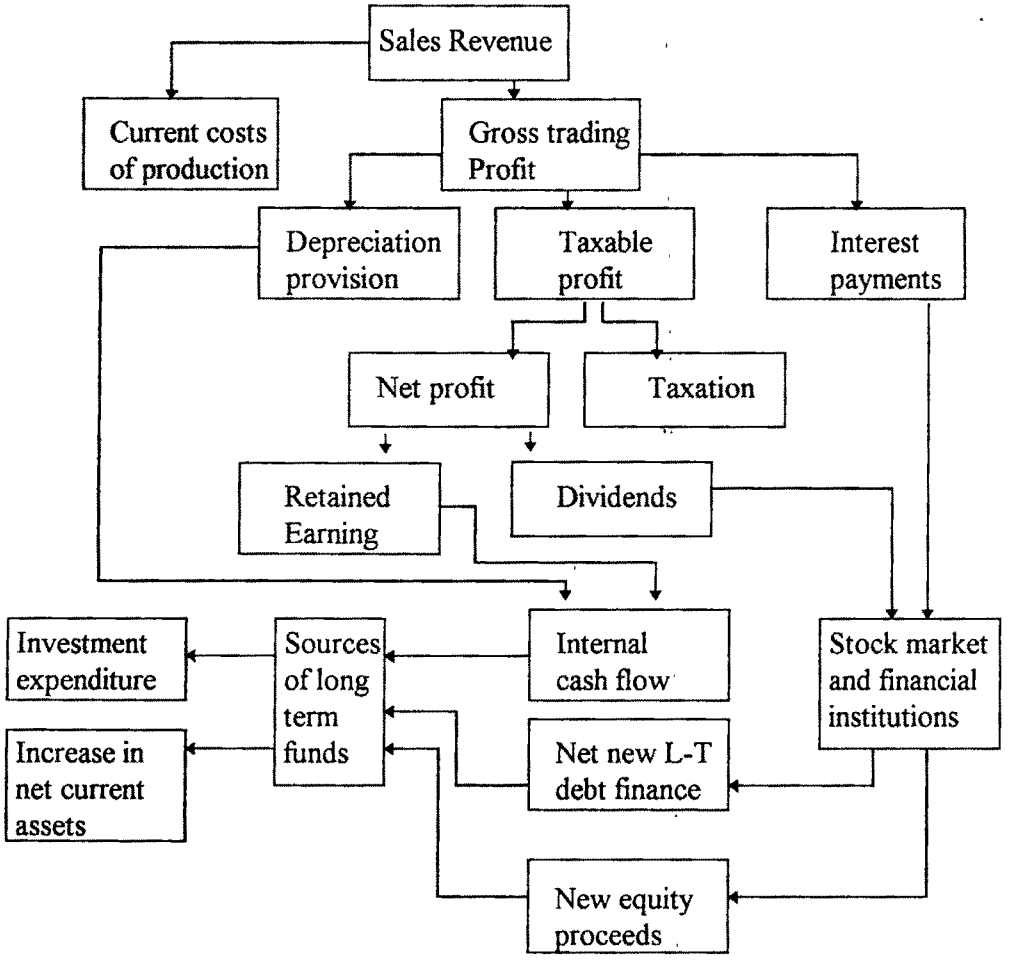
justification of the inclusion of investment strategy as an important variable in a model reflecting strategic firm behaviour and proactivity This requires an examination of the financial policy of firms This embodies the spirit of this study to thwart legitimate market forces ; forays into new strategic markets, expenses in research and development, investments in technology and the building of core competencies to acquire a critical mass of economic power will require a consistent stream of funding From a strictly financial point of view and without going into the elaborate arguments of industrial economics, it may be reasonably stated that this aspect mainly revolves around the following two decisions

* The retention ratio, the proportion of earnings retained for investments
* The gearing ratio; the proportion of debt finance to the total of debt plus equity finance

In taking decisions on the retention ratio, the company effectively determines its supply of internal finance, and indirectly therefore the proportion of its funds coming from external and internal sources In taking decisions on the gearing ratio, the company determines the proportion of its external funds coming, respectively, from borrowing and equity. These two decisions have traditionally been thought important as they together determine the valuation ratio of the company and the cost to the firm of obtaining funds A related framework was outlined in fig. 4 2 (C) and 4 3 of this chapter - a more detailed diagram is presented in fig 4.6, demonstrating the flow of funds

Two of the most accepted measures of corporate performance are growth and profitability Although there are strong interactions between these two concepts, very often growth and profitability goals are setup almost completely independently of one

Fig. 4.6 : Flow of Funds



Source . Hay & Morris (1991).

another This is a major logical flaw (Hax & Majluf 1991) There is a close association between profitability and growth as measured by spread (i e , the economic profitability is achieved when the return on equity enjoyed by the firm exceeds its cost of equity capital), market-to-book value, and net present value The relationships are further extended by Hax & Majluf (1991) in the form of the 'maximum-sustainable growth' concept which eventually impacts the market value of the firm's stock/shares They express growth as

$$g = p\ ROE$$

where, g = growth in equity,
p = profit reinvestment rate, alternatively, the retention ratio,
ROE = Return of equity, which inherently represents the gearing ratio

It is quite evident that growth is indeed a function of retained earnings.

Controversies about the growth-profitability relationship (not the objective of this study) not withstanding, from the preceding discussions it may be concluded that retained earnings have a pivotal role to play in asserting a proactive behaviour The second proposition thus made was.

A conservative dividend policy, resulting in an improved retention ratio, will have a favourable impact on financial performance

6.3 Vertical Integration and Performance

Central to the research theme of this study, i e , the acquisition of economic power, to achieve superior financial performance by adopting a proactive stance; is growing through autonomy in the supply function or the value creation chain Viewed as a strategy to be pursued vertical integration involves a set of decisions that by the nature of their scope reside at the corporate level of the firm These decisions are threefold (1)

defining the boundaries a firm should establish over its generic activities on the value chain, (2) establishing the relationship of the firm with it's constituencies outside it's boundaries, and (3) identifying the circumstances under which those boundaries and relationships should be changed to enhance and protect the firm's competitive advantage This set of decisions is of critical importance in defining what the firm is and is not, what critical assets and capabilities should reside irrevocably within the firm, and what type of contracts the firm should establish to deal with it's external constituencies It would be reasonable to claim that this factor should prove to be a suitable proxy to capture any technical competencies and leverage of the same in a firm's value chain, and also contain higher order firm specific intangibles. In other words, it is in keeping with the resource advantage theory proposed by this study.

The major the benefits of vertical integration (Hax & Majluf, 1991) are (1) *Cost* to internalize economies of scale and scope, and avoid transaction costs from imperfect markets (2) *defensive market power* which provides autonomy of supply or demand, and protection of valuable assets and services; (3) *offensive market power* which allows access to new business opportunities; new forms of technology, and differentiation strategies; and (4) *administrative and managerial advantages* rising from a more simplified managerial infrastructure when basic tasks are brought inside as opposed to outside the firm. These benefits merely demonstrate the vital qualifications required for adopting a proactive stance.

Capital cost increases, flexibility losses, balance requirements and administration managerial penalties notwithstanding, the main lessons to be learned are that (1) critical

complementary assets must be owned (mainly when they are specialized for the needs of the firm), unless there is a cash constraint (2) when critical complementary assets are not owned, the firm should secure early access to them, mainly when its product is not protected by a tight regime of appropriability (it is an easy matter to copy it), and when the capacity of complementary assets is in short supply and may become a bottleneck. These lessons once again bring out the importance of this variable not only in the acquisition of competitive positions but more importantly, its relevance in sustaining the comparative advantage already built and possessed by the firm

Further in keeping with growth as a major motive, vertical integration represents an important link. Vertical integration, achieved either by forward or backward merger or investment, is the most complete form of vertical linkage Levy (1984, in Hay & Morris, pg. 346) suggests four possible determinants of vertical integration · (1) he conjectures that vertical integration is a feature of young industries, early in the product cycle. The technology is relatively new, and the growth of the market is uncertain, (2) as the industry grows in size, so the supply of specialist inputs is likely to become more competitive, as a greater number of outside specialist suppliers can be supported in the market So downstream firms are more willing to go to an outside supplier, knowing that there are alternative sources should a particular supplier prove unsatisfactory, (3) As demand grows, an outside supplier can gain economies of scale in producing for several downstream firms, which more than offsets the costs of transacting, (4) As firms expand they will encounter managerial diseconomies and will simplify their operations by

spinning-off specialist functions In this attempt Levy found that vertical integration was negatively related to firm size, but positively related to growth of the industry

Another perspective is to look at trends in vertical integration within one industry and to consider their relationship to behaviour and performance, which is what this study has done In one such study (Mcbride 1983 in Morris, pg 346) it was found that such strategic acquisitions lead to the following anti-competitive consequences· (1) They provide opportunities for indirect price discrimination; (2) Integrated firms can squeeze non-integrated ones, by cutting the price of the final product without reducing the price.of the necessary intermediate product; (3) Vertical acquisitions remove firms with counter-veiling power, (4) It raises the capital requirements entry barrier by requiring any new entrant also to be vertically integrated from the start While these findings do spell causes of concern for the anti-trust authorities; it is a vindication of our proposed model for acquisition and use of economic power for manipulation of legitimate competitive market forces.

Finally, the findings of Aaker & Jacobson (1987), Ravenscraft (1983), Buzzell (1983), & Williamson (1975) impeled this study to propose that · Financial performance will be positively impacted by the level of vertical integration.

6.4 Marketing Intensity and Performance

One of the major three critical capabilities required in the pharmaceutical industry is promoting the product in the market or as called in the industry circles 'blockbuster' marketing competencies (Garvin 1995, Murphy *et al* 1995, Lidstone 1989, Business World 1996, Bogner & Thomas in Hamel 1994) The other two being manufacturing

process technologies and product research and development The former was dealt with in sufficient detail in proposition three, while the latter is not valid in India upto 1995 as the country hitherto had adopted a 'process' patent regime Refer sec 9 0, chp II. Thus, as a major source of relative comparative advantage we focus on marketing intensity This variable contains and is representative of the following firm-specific intangibles

Market Orientation This refers to the implementation of the marketing concept (Mc Carthy & Perreault 1984; Kohli & Jaworski 1990) The marketing concept, proposed by Drucker (1954) and popularized by Levitt (1960) and accepted as a general framework in the field of marketing, refers to the market forms and customer orientation of an organisation which through co-ordinated marketing achieves its profit objectives Market orientation in turn has been defined as our organisational generation of market intelligence pertaining to current and future customer needs, dissemination of the intelligence across departments, and organisation wide responsiveness to it (Kohli & Jaworski 1990) Others view market orientation as sort of organisation culture that effectively and efficiently creates necessary behaviours for the creation of superior value for buyers (Aaker 1989, Peters & Austin 1985; Peters & Waterman 1982; Narver & Slater 1990).

Against this backdrop, the effect of market orientation on competitive position and thereby on financial performance is evident Organisations that are market oriented generate a number of benefits for their customers, which could lead to increased a sales and improved profitability Specifically, a market oriented organisation is better able to .

(a) track and respond to customer's current and future needs through market intelligence

generation and dissemination within the organisation, and (b) better satisfy customers by creating superior value for them (Kohli & Jaworiski 1990, Narver & Slater 1990)

Additionally because of a competitor focus, a market oriented organisation is able to identify and preempt competitive actions, identify potential new technologies to patent and prevent competition from adopting them Further more, from an organisational view point, a market oriented organisation has high levels of interfunctional co-ordination which helps in achieving a concerted action towards organisational goals (Webster 1988; Narver & Slater 1990) Therefore, by meeting present and future customer needs better and preempting competition it is expected that a firm's competitive position and financial performance will be positively impacted by extent of its market orientation.

Reputation: This may be defined as a set of attributes ascribed to a firm, inferred from the firm's past actions (Weigelt & Camerer 1988), is a firm resource that leads to superior financial performance since it is developed/earned over time it takes time to replicate or copy by competition and thus becomes a source of comparative advantage (Ghemavat 1986; Milgrom & Roberts 1986; Weigelt & Camerer 1988). Furthermore, its development is socially complex (Reed & Defillipe 1990), and it is in the form of a stock (Dierkx & Cool 1989), and hence, it is imperfectly imitable Since it is also intangible, corporate reputation is not tradeable, and for all these reasons it is likely to be a source of competitive advantage.

Reputation may signal to stake holders of an organisation about its products, about its work, environment, strategies and prospects relative to its competition (Forbum &

Shanley 1990) Relatively more favourable reputations (a) help generate excess returns for firms by inhibiting the mobility of rivals in an industry (Caves & Porter 1977, Wilson 1985, Weigelt & Camerer 1988), (b) signal consumers about product quality (Oster 1990, Klein & Leffler 1981 and Dowling 1988), (c) lower costs of information collection for consumers, (d) help charge premium prices (Klein & Leffler 1981, Milgrom & Roberts 1986), (e) aid in attracting and retaining better quality personnel in the organisation, (f) enhance access to capital markets (Bealty & Ritter 1986) and (g) act as a source for related diversification (Forbum & Shanley 1990) Empirical research supports a strong positive relationship between a reputation and performance and for the listed reasons corporate reputation may be accepted as an important source of comparative advantage

Brand Equity Brand equity has been defined as a set of brand assets and liabilities linked to a brand, its name and symbol, that add or subtract from the value provided by a product to a firm and/or that firm's customers (Aaker 1991) Brand Equity for an organisation is a valuable intangible resource which is invariable, rare, and hard to copy It is built over time (Porter 1991) and hence time compression diseconomies act as a barrier to imitation (Dierickx & Cool 1989) They provide value to both consumers and the organisation (Aaker 1991) and therefore offer an invaluable asset to achieve superior performance

Firms owning brands with strong equity are expected to achieve larger market share because of a variety of reasons : (a) brand equity helps differentiate the product from competitor's offerings (Park, Jaworski & MacInnes 1986), (b) serves as a proxy for quality and creates positive images in consumers minds (Oster 1990), (c) helps prevent

market share erosion during price and promotional wars (Aaker 1991), (d) prevents market share erosion by giving a firm time to respond to competitive threats (Aaker 1991), (e) helps gain trade leverage (Aaker 1991, Keller & Aaker 1992) and (f) enhances overall prospects for success (Aaker 1991, Keller & Aaker 1992, Smith & Park 1992, Tauber 1991). Therefore, it is expected that the firm's competitive position will be positively impacted by the equity invested in the firm's brands

Finally, and more important brand equity also leads to superior profitability, by (a) lowering current and future marketing expenditure (Porter 1991, Keller & Aaker 1992, Tauber 1988, Smith & Park 1992), (b) enhancing the efficacy of marketing expenditure (Porter 1991, Keller & Aaker 1992), (c) making premium prices possible without fear of market share erosion (Aaker 1991), and (d) being a source of growth and product diversification (Tauber 1988, Springer & Miller 1990, Aaker & Keller 1990, Bousch & Loken 1991; Park, Milberg & Lawson 1990) Therefore, the firm's financial performance will be positively impacted by the equity invested in the firm's brands

The marketing intensity construct, as consisting of a market orientation, firm reputation, and the equity of its brands, is also a concept which is in keeping with standard industry economic theories' postulations about imperfectly competitive markets Some controversies not withstanding, it is argued that this variable is a decisive competency for a firm to graduate from a 'price-taker' to a 'price-maker' Therefore, this study also proposed that: A firm's financial performance will be positively influenced by marketing intensity

6.5 Competitive Position and Performance

A number of arguments were presented in chapter III to support and oppose the case for a positive relation between competitive position, as represented by market share, and profitability To briefly reiterate, according to the efficiency theory, firm's with large market shares are more cost efficient due to experience curve effects and scale effects which in turn could lead to greater profits (Day & Montgomerry 1983, Buzzell & Gale 1987) An alternative argument provided by the market power theory is that firms with large market shares have the power to obtain inputs at lower costs, extract concessions from channel members, and be in a position to dictate prices in order to increase profits (Martin 1988; Schroeter 1988). A number of prior studies have found support for these theories (see Szymanski, Bharadwaj & Varadarajan 1993 for a meta-analytic review)

However, this study also points out that competitive position is an outcome of the efficacy of the marketing efforts of the firm and per se doesn't hold any intrinsic value Rather it is imperative to examine the resources which were deployed to achieve these product-market positions in the first place (Caves 1984, Rumelt 1984, Teece 1984, Wernerfelt 1984, Dierickx & Cool 1989) A section of researchers have argued that it is third factor, chief among them being firm-specific variables, that are important (Rumelt 1984, Jacobson & Aaker 1985, Jacobson 1988 and 1990, Boulding & Staelin 1990) Those models that do not eontrol for firm specific factors, have a market share coefficient biased upwards In fact, the findings of a meta-analysis (Szymanski, Bharadwaj & Varadarajan 1993) reveals that market share has a negative impact when firm-specific factors are modelled in the profit equation In another large scale meta-analysis of 320

published studies (Capon, Farley & Hoenig 1990) it was found only one organisational variable (capacity utilization) has been modelled with firm performance as the dependent variable A major fallout of this debate is the need to realise that excluding firm-specific variables may lead to a specification bias Theoretical support for this direction of research comes largely from the proponents of the resource-based theory of the firm This study thus chooses to propose that; Market share is an insignificant explainator of firm performance

6.6 Model

The study's proposed model of firm proactivity may be expressed thus

"Differential financial performance amongst firms is a function of a firm's choice of high growth market segments, it's (conservative) dividend payout policy resulting in (an improved) retention ratio, the degree to which the firm is vertically integrated, and the intensity of the firm's marketing effort mainly consisting of a market orientation, firm reputation and the equity of it's brands. Market share is per se a determined variable and hence, cannot explain variance in performance significantly".