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Strategic Groups, Industry Structure and Firms' Strategies: Theory and Evidence from the UK Grocery Retailing Industry

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Abstract

This research analyses the explanatory and descriptive limitations of strategic groups research, a theory that addresses a number of important issues for strategy research. That is, it considers rivalry among firms in a similar competitive environment, the relation between strategy and performance and similarities and differences among competing firms.

An historical study of the origins and development of strategic groups research shows that the concept of strategic groups was independently developed in strategic management and industrial organisation in the mid-1970s. Much research has been conducted since its inception. However, this research has been mainly empirical in nature. Empirical research has not brought unambiguous findings with regard to some of the fundamental hypotheses of the theory of strategic groups. This has led researchers to raise fundamental questions about the usefulness of the concept of strategic groups.

A number of approaches emerged in the 1980s that question some of the fundamental hypotheses of strategic groups theory. Our analysis shows that each approach has its limitations and that strategic groups theory is still the most comprehensive approach, addressing a number of issues of interest for strategy researchers.

Given the problems identified at both theoretical and methodological levels, an exploratory approach is used in this research. An historical analysis of the dynamics of firms' strategies and competitive structure in the UK grocery retailing industry between 1980 and 1995 is used to gather information. This forms the basis of the analysis of (a) the importance of similarities and difference in the strategies of comparable firms and (b) for understanding the mechanisms underlying industrial and business dynamics.

The empirical research shows the severe limitations that characterise strategic groups at analytical, descriptive and theoretical levels. The information gathered in the empirical research is an important basis to start thinking about developing a better approach to analyse and explain the dynamics of firms' strategies and competitive structures.

Chapter 1 Introduction

1.0 The Research

The key question of this research is: what are the limits of 'traditional' strategic groups research for 'analysing and explaining' the dynamics of firms' strategies and industry structure?

The concept of strategic groups[1] was developed at Harvard University, at the beginning of the 1970s, when a number of researchers studied differences among firms in an industry and the implications of these differences for market equilibria. At around the same time, researchers at Purdue University developed quantitative models to analyse the effectiveness of firms' strategies in an industry using clustering techniques. These were subsequently used widely in strategic groups research. However, while research carried out at Purdue tended to be empirical in its characteristics, research carried out at Harvard was mainly theoretical.

In following years, research on strategic groups was conducted in both Industrial Organisation (IO) and Strategic Management (SM). Clear differences exist between the two research fields. In IO, researchers study industries at the macro-level in order to assess the impact of the characteristics of an industry on consumer welfare. Consequently, the concept of strategic groups has been used in order to explain the

[1] Porter (1980: 129) defines a strategic group as "the group of firms in an industry following the same or similar strategy along strategic dimensions". Variuos definitions of strategic groups will be analysed in more detail in Chapter four.

existence of heterogeneity in the industry and in firms' performance. SM is its opposite as a focus of analysis. It concerns research on the single firm rather than on the aggregate of firms, and on the competitiveness of the specific firm in the market. However, strategy researchers are also interested in issues of organisational performance (Hofer and Schendel 1978), and since the mid - 1970s there has been an increasing use of quantitative techniques, previously typical of IO (Rumelt *et al.* 1991).

The development of the concept of strategic groups was seen as opening new avenues in the strategy field. Hatten and Hatten (1987: 329) argue that strategic groups is a "powerful tool in the armoury of the strategic analyst." In their view, the concept would allow researchers:

1. to preserve the information of individual firms, which is lost when performing industry studies; and
2. to investigate the effectiveness of strategic actions, since, by conducting a study over a wide range of firms performing in the same industry, it would be possible to assess the most successful strategies in the industry.

However, the fact that both the Harvard and the Purdue research focused on the analysis of the relationship between firms' strategies and performance and used quantitative techniques successively created some confusion, with researchers often unable to distinguish the differences between the two approaches. This confusion has been made worse by the publication by some of the first researchers of strategic groups in both SM and IO[2] and by the overall little attention that has been given to a number of related methodological issues.

[2] Hatten and Schendel (1977) reproduced their model and empirical research in an article published in the *Journal of Industrial Economics*. Porter (1980) published his book, bringing the theory he had developed

Since the early 1980s, considerable research has been conducted on strategic groups. However, while initial research was mainly conceptual, subsequent research mainly has been empirical in its characteristics. A variety of methodologies has been used by researchers to study the relation between strategies and performance. This variety has been a matter of concern among researchers. "There is no uniformity in the treatment of strategic groups in empirical research settings. A variety of methods have been used to derive groupings in empirical research setting, which make the much-needed exercise at the accumulation of research findings an almost impossible task" (Thomas and Venkatraman 1988: 538).

At the beginning of the 1990s, some researchers expressed doubts about the usefulness of the strategic groups research. The argument is that there are fundamental problems with the concept and that it should be abandoned (Barney and Hoskisson 1990). However, notwithstanding the problems with strategic groups, no valid alternative to it has been proposed. The theory of strategic groups is the only concept that comprehensively addresses fundamental issues for strategy researchers such as:

1. the relation between strategies and performance;
2. the importance of similarities between firms in a competitive market;
3. stability and change of strategy over time;
4. managerial perception of the competitive environment; and
5. the existence of asymmetries in firms' positions in the industry and their role for the dynamics of firms' strategies.

in IO into SM.

In this research, we use a critical approach to provide a comprehensive evaluation of the limitations of strategic groups research for analysing and explaining the dynamics of firms' strategies and industry structure.

The research focuses on the dynamics of firms' strategies and industry structure in the UK Grocery Retailing Industry (GRI) between 1980 and 1995. A longitudinal historical study of the strategies of a number of firms and of the industry is used as a basis for assessing two themes that are fundamental to the research question:

1. the mechanisms characterising industrial and business change; and
2. the importance of similarities and differences among firms that are competing in the same industry for the dynamics of these firms' strategies and industry structure.

The UK GRI has been chosen for a number of reasons.

1. There is high degree of rivalry among firms operating in the industry. Hence, it is possible to study in detail the dynamics of firms' strategies, as well as the effects of competition on firms' strategies.
2. Firms operating in the UK GRI tend to be specialised businesses, drawing most of their revenues from grocery retailing in the UK. Further, there is a minimal presence of foreign operators. The combination of these two elements reduces to a minimum the level of external influence on the dynamics of firms' strategies in the UK GRI.
3. Because firms mainly operate in the GRI, there are a few differences between the management at the corporate and the business level. Senior management is often also involved in business operations and is knowledgeable about issues such as pricing strategies, logistic strategies, merchandising, supplier relationships, competition and consumer markets. Hence, when talking about firms' strategies, senior management often refers to business operations.
4. Firms' activities and the industry have a high public profile. This is probably due to possible implications of firms' activtities in the GRI on consumer welfare. Because of the nature of the industry, media coverage of what happens in the industry is broad and much information is available about retailers' activities (price promotions, market positions and store location, as well as mergers, changes in management and diversification).

Because of the combination of these elements, the UK GRI offers an ideal case for testing the descriptive and explanatory power of strategic groups theory, which directs its attention to firms' strategies at the business level.

1.1 Structure of the Research

Chapters two and three analyse the theoretical foundations of the concept of strategic groups. (Harvard Approach and Purdue Approach). The purposes of their research are considered. The review also analyses the underlying view of firms' strategies, industry structure and their dynamics, as it emerges from the original approaches. The Harvard approach proposes a number of hypotheses about industry structure, while saying little about dynamics of firms' strategies. The Purdue approach says little about the dynamics of industry structure and firms' strategies, while exposing the complexity of firms' strategies and the difficulties in distinguishing between strategic and operational issues.

Since the concept of strategic groups was created, little theoretical work has been conducted. Research was initially directed at demonstrating the existence of groups structures within industries; successively, research has been directed at testing some hypotheses. Chapter four, thus, focuses on how researchers have used strategic groups to study firms' strategies, industry structures, and their dynamics. Specific attention is given to the definition of strategic groups used by researchers to operationalise firms' strategies for strategic groups analysis, and to the view of firms' strategies and industry structure emerging from the way research on strategic groups is normally conducted. We argue that differences between the two approaches have blurred over time, with a shift towards an IO approach to strategic groups analysis.

Chapter five analyses the concept of strategic groups in light of the development of alternative and complementary theoretical approaches. The emergence of other frameworks has not provided a "best alternative" to strategic groups. Some researchers have argued that the concept of strategic groups should be abandoned, others that we should try to develop a meta-theory of strategic groups. The position taken here is that more exploratory work first needs to be done to understand the dynamics of firms' strategies and industry structure. This position leads to a number of specific questions. The objectives of this research are thus twofold: to test some of the fundamental assumptions characterising the concept of strategic groups as it was developed at Harvard; and, to improve our understanding of the dynamics of firms' strategies and industry structure.

Chapter six specifies the methodological characteristics of the empirical research. In the analysis of the questions driving this empirical research, we draw from Chandler's

(1962) research on the evolution of firms' strategies and organisational structures in the US corporations, at the beginning of the century. In his book "*Strategy and Structure*", Chandler (1962: 1) notes that "historians have provided social scientists with little empirical data on which to base generalizations or hypotheses concerning the administration of great enterprises." His main purpose was to provide an empirical basis to be used by researchers to develop hypotheses and assumptions about the evolution of firms' organisational structure. He did this, through an historical analysis of the development of organisational structure. In this research, Chandler's process is reversed. Having analysed the theoretical and methodological foundations of strategic groups, we subsequently examine the assumptions and hypotheses characterising the theory of strategic groups through an historical analysis.
The analysis focuses on changes in the industry structure and the strategies of a number of firms operating in the UK GRI. This industry has already been object of strategic groups research (e.g. Lewis and Thomas 1990).

Chapter seven analyses the dynamics of the UK GRI since the 1950s until 1995. The analysis describes in detail how the microstructure of the industry has changed between 1980 and 1995.

Chapters eight, nine, ten and eleven analyse in detail the historical developments of the strategies of four firms (Argyll, ASDA, Sainsbury's, and Tesco) in the industry.

Chapter twelve discusses the research issues highlighted in Chapter Five. The historical reconstruction of changes in firms' strategies and industry structure is the basis for the assessment of the questions outlined at the end of Chapter Five. The analysis shows severe limits of strategic groups and of its descriptive and prescriptive power relative. The concept remains an interesting theoretical construct, but from a SM standpoint, it is clear that we need to move forward.

Chapter thirteen concludes the research. Having reviewed the earlier work done and summarised the research findings, this chapter looks at how the information gathered in the empirical research could be used for future research into the dynamics of firms' strategies and industry structure, and by top management in the strategy process.

Chapter 2 The Theoretical Foundations of Strategic Groups: the Harvard Approach

2.0 Introduction

The concept of strategic groups and mobility barriers originates in the early 1970s at Harvard university, where a number of doctoral researchers (Hunt, Newman, and Porter), guided by Richard Caves, studied the existence of structural (strategic) asymmetries within an industry and the implications of these asymmetries on market equilibria and on firms' behaviour. This research was carried out in an Industrial Organisation framework and produced a theory of strategic groups and mobility barriers.

Caves and Porter's work (1977) is unquestionably the most important paper published by researchers working on that research at Harvard. The article addresses the fundamental issue of why the study of strategic groups and mobility barriers is important. It also examines the effects that strategic groups and mobility barriers have on market equilibria and on firms' strategies.

A second important article by Porter (1979) attempts to develop the research by proposing a theory of the determinants of firms' profitability; but, in so doing, it develops a number of hypotheses that conflict with the 1977 paper. However, the 1979 paper has had little impact on subsequent research on strategic groups[1].

Research on strategic groups carried out in the last 20 years has been greatly influenced by that research carried out at Harvard. Researchers have tried either to confirm some of the hypotheses developed by the authors or to develop some of the issues presented in these two articles.

In this review, we analyse the content of the theory of strategic groups and mobility barriers. In so doing, we consider their origins and the influence of the standpoint taken as well as the assumptions made. We start by analysing the research context that led to the development of the concept of strategic groups and mobility barriers. Subsequently, the analysis focuses on the theoretical foundations of the concept of strategic groups and mobility barriers and on the view of firms' strategies and industry structure. In the final part, we analyse Porter's (1979) work on the determinants of firms' profitability and the consequences of this article for the theory of strategic groups.

2.1 The Research Context: Industrial Organisation and the Structure-Conduct-Performance (SCP) Paradigm

The concept of strategic groups developed in IO research where researchers have originally been interested in studying the relation between industry structure, firms'

[1] This is clearly indicated by the fact that Porter (1979) is rarely mentioned in bibliographies of research on strategic groups, and by the fact that its assumptions about the determinants of firms' profitability have

conduct, and performance. Mason (1939) and Bain (1956, 1968) developed the SCP paradigm to explain why industries have different average profitability. Their research has provided the theoretical justification for industrial policies (typically competition policies), designed to prevent market structures from promoting behaviour and performance that are against the public interest.

In the original formulation of the SCP paradigm, the reason for the existence of differences in average profitability among industries is the existence of barriers to entry. This implies that a potential entrant faces additional costs compared to incumbent firms when entering an industry. The existence and the height of barriers to entry and the dimension of the plants are the primary determinants of the industry structure, and the industry structure determines the profitability of firms operating in the same industry. The possibility of new firms entering the market and the existence of barriers to entry are the elements determining the market price. As incumbent firms try to limit competition, the market price is fixed at a level limiting new firms entry. However, potential entrants enter the market only if they expect to earn extra profits. Firms decide price of products, advertising, capacity and quality, but ultimately decisions are determined by the characteristics of the industry structure, and firms' management does not really have discretionary behaviour. In its original version the model was summarised in the following form:

Figure 2.1 The Original SCP Model

Industry Structure ⟶ Firms' Conduct ⟶ Performance

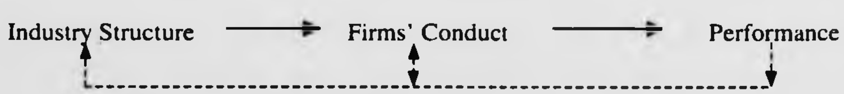
been widely ignored.

The SCP paradigm is based on neo-classical economics, and as such, is characterised by the following assumptions:

1. technology is given and accessible to all firms;
2. economies of scale exist in the industry;
3. incumbent firms will not modify their production level as a result of new entries in the industry;
4. price is set by firms with large plants and it is unique in the market;
5. there are no significant differences among firms in the same market except for the scale of operations;
6. there is no uncertainty in the market or asymmetry of information. Potential entrants and incumbent firms know the demand and the cost curves;
7. firms exhibit a perfect rational and maximising behaviour; and
8. firms operating in the industry are all in competition with each other.

Since the SCP paradigm was created, a large amount of research has been conducted, both at an empirical and theoretical level. A famous modification of the original form of the SCP paradigm recognises a feedback effect from a firm's own performance on its conduct and from the conduct of firms on the industry structure (Scherer 1970):

Figure 2.2 The SCP Model in the Revised Form



The argument is that firms' conduct (decisions to merge and to acquire other businesses; advertising expenditures) raises entry barriers and affects the number and size

distribution of firms in the market (elements of industry structure). At the same time, these strategic decisions are made possible by the high performance earned by extant firms.

However, the feedback effect creates some problems (Sutton, 1991). While the initial formulation of the model with its causation links, is easy to test with linear equation techniques, the new version creates significant econometric difficulties. It was initially thought that the use of simultaneous equations techniques could solve this issue. However, results have not been very productive[2].

Despite modifications, it has to be said that IO researchers still regard industry structure as the determining factor for firms' performance, whether or not it has resulted from the past conduct of firms or from external elements. This is exemplified by the emphasis placed on elements which are characteristic of industry structure for the analysis of firms' performance.

In the 1970s, the SCP paradigm came under increasing criticism. Researchers then, argued that it was unable to explain differences in profitability among firms operating in the same industry. This created a fertile ground for the development of the concept of strategic groups.

At around the same time that the concept of strategic groups was developed, late 1970s,

[2] The application of simultaneous equation techniques is itself somewhat problematic. Whilst single stage linear regression can overcome some of the problems of high unexplained variance by resort to large samples (Wensley 1997), more complex instrumental variable approaches that help to deal with the simultaneity issue also have considerable problems in estimating reasonable equations for the instrumental variables themselves (Rumelt and Wensley 1981).

a new approach to IO was also developed, and this was to receive a lot of attention in the 1980s. This approach posed as a fundamental assumption that "variations in conduct or behaviour were the major influences on outcomes, and in the longer term on structure, rather than conduct being itself strongly affected by structure." (Singh *et al.* 1995: 1). Conduct, and not structure, became the primary object of attention among researchers, who investigated "the powerful influences that changing behavioural assumptions could make. In particular, behaviour was often presumed to take very sophisticated account of rivals." (ibid.) This approach materialised in numerous studies modelling firms' behaviour. These were to come under the umbrella of *game theory*. This stream of research, which has been deemed as "revolutionary" has also been described as the "new IO" (Singh *et al.* 1995). However, as it happened to the SCP paradigm, it has been object of severe criticism, especially from "structuralists". In fact, although there has been a decline in the importance of the SCP paradigm in IO, the emergence of behaviourists has not had the effect of wiping out structuralist research. Structuralists point out the problems of behaviouralist research. Sutton (1991: 507) argues that, as multiple equilibria are endemic in modelling industry behaviour and that the structures of strategic moves is capable of subtle variations, "the richness of possible formulations leads to an often embarrassingly wide range of outcomes." Shepherd (1988) argues that although strategic behaviour has been modelled in a variety of ways, little empirical research has actually been conducted to show the importance of the types of strategic behaviour. This is a point also taken by Scherer (1988: 517), who argues that "a sorting-out, based upon solid empirical work, quantitative and qualitative, is needed." Hence, important doubts also exist about the supposed superiority of game theory on structuralist frameworks.

2.1.1 Firms' Strategies and the Industry Structure in the SCP Paradigm

The SCP paradigm has a neo-classical view of the firm and of the industry. The industry exists *a priori* and its size is determined by market demand. The market is homogeneous and the industry structure is stable over time. The model is deterministic in its characteristics, firms are seen as "black boxes" with strategic decisions determined by the industry structure conditions. There is no process in the strategy making, information is shared at the top management level, and top management agrees on the strategic decisions. Furthermore, once decisions are taken, no significant (in economic terms) problems are encountered in the implementation of decisions. This is because of the absence, in a neo-classical framework, of time as an important variable and because of the incorporation of decision - making activities in the theory of the firm (Zan and Zambon 1993). It is not surprising therefore that there is no question of how firms came to exist or how they developed their positions.

In the form of the SCP paradigm that assumes the existence of a feedback effect from firms' conduct on market structure (figure 2.2), some importance is placed on firms' decisions. However, ultimately strategic options are determined by market conditions.

The issues of the dynamics of firms' strategies and industry structure are not taken into consideration. The model is static in its characteristics. When changes occur, they are driven by external events (mainly technological change or governmental intervention), breaking the extant equilibria and creating opportunities that lead to changes in the industry structure. However, new equilibria immediately follow changes in the structure.

2.2 The Theory of Strategic Groups and Mobility Barriers

Having analysed the research context preceding the development of the concept of strategic groups, the following sections analyse how the theory of strategic groups was developed by Caves and Porter in 1977. The analysis begins with an assessment of why it was important to study strategic groups. In the following section, we analyse how Caves and Porter developed their theory of strategic groups, the assumptions proposed about the origins of strategic groups and firms' strategic behaviour and related hypotheses about mobility and industry dynamics.

"Strategic groups" is a term coined by Hunt (1972). In his PhD dissertation, he defines strategic groups as "a group of firms within an industry that are highly symmetric ... with respect to cost structure, degree of product diversification --- formal organisation, control systems, and management rewards and punishments ... (and) the personal views and preferences for various possible outcomes" (Hunt 1972: 8). The concept of strategic groups was originally developed as "an intermediate level of analysis to explain competitive rivalry observed in an in-depth analysis of the home appliance industry" (Thomas and Venkatraman 1988: 538). Research (Newman 1973; Porter 1973) initially focused on proving the existence of differences in firms' structural characteristics and the existence of stable group structures in an industry.

The concept of strategic groups introduces an important innovation in the SCP paradigm. The argument is that firms of the same industry are likely to differ in traits other than size. In 1977, Caves and Porter published an article that examines the implications of the existence of stable groups structures on firms' strategic behaviour

and on an industry structure:

> "Common observation suggests that the firms in an industry often differ from one another in their degree of vertical integration or diversification, the extent to which they advertise and "brand" their product, whether or not they use "captive" distribution channels, whether they are full-line or narrow-line sellers, whether they operate in the national market or only regionally, whether they are multinational in operation, etc. An industry thus may consist of groups of firms, each group composed of firms that are quite similar to one another along some structural dimensions." (Caves and Porter 1977: 251).

The starting point of a strategic groups theory is that it is possible to observe the existence of groups structures in an industry. From an economic point of view, the key issue is how relevant are structural differences among firms operating in an industry (i.e., what is the impact of these differences on firms' collusive behaviour and on firms' profitability in industries?). It could be argued that researchers already knew that these structural differences exist but, in the SCP paradigm, had not taken them into consideration because they were not perceived as having relevant implications for firms' profitability and collusive behaviour. To pose a credible challenge to the assumption that firms are homogeneous in all "economically" important aspects except for their size, it is necessary that structural differences among firms are associated with advantages or disadvantages that have consequences on collusive behaviour and/or market equilibria. Nonetheless, in the SCP paradigm, advantages and disadvantages are directly related to barriers to entry, which only exist at the industry level and are exogeneously determined. Therefore, to move towards a theory of strategic groups, it is necessary to:

a) modify another assumption of the SCP paradigm (i.e. the exogeneity of barriers to entry), and
b) argue that barriers to entry also exist in the industry.

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The existence of endogeneously created barriers to entry at the industry level is not enough *per se*. Barriers to entry could be endogeneously created but could protect all firms composing the industry in the same way. It is necessary that barriers to entry also exist in an industry and they are associated with structural differences among firms. In other words, it is necessary to break the hypothesis of homogeneity among firms of the same industry and argue that there are economic rents associated with these differences. In the following section, we analyse the first part of Caves and Porter's (1977) paper, which focuses on the issue of endogeneity of barriers to entry and their relevance.

2.2.1 Structural and Endogenous Barriers to Entry

Caves and Porter (1977: 245) argue that if incumbent firms decide to try to deter entry, "none of the structural sources of entry barriers, advanced by Bain as purely exogenous stockades around going firms, is immune to change through their actions". Forms of entry deterrence result from firms' investment decisions rather than from structural, exogenous factors. In conditions of uncertainty about the future state of the industry, firms take decisions that change the structure of the industry and the height of barriers to entry. Among the decisions incumbent firms take to alter conditions of entry, are:

1. excess capacity in several forms (production, funds, fixed assets), which strengthen firms retaliatory power;
2. product differentiation, which reduces the cross-elasticity of demand between going *brands* and the potential entrant's product, and forces entrants to make extra expenditures in order to offset the *goodwill* assets of incumbent firms;
3. cost structures, whereby investments by the incumbent can augment fixed costs or

shift the production curve by increasing the diseconomies of small scale; and
4. vertical integration, which increases the financial investment required.

The existence of endogenous barriers significantly changes the nature of strategic and competitive behaviour in an industry and it specifically raises problems with regard to the "*form and extent of collusion*"(Caves and Porter 1977: 247). An investment in entry deterrence is not only going to protect the investor but also his oligopolistic rivals. Further, expenditures exceeding levels that maximise short-run joint profits for going firms "*can build entry barriers surrounding firms as a group, yet at the same time they can disrupt consensus and reduce joint monopoly profit.*" (ibid. 1977: 247).

According to Caves and Porter, this dual role has several implications:

1. the entry barriers surrounding an industry can be viewed as a collective capital good, generating joint profits for the going firms;
2. firms' share of the rents from collective entry barriers will probably be in proportion to their shares of sales. However, if each firm styles investment in order to maximise its own profits, the result could be that investments at the industry level could either be higher or lower than the ones needed in order to deter entry; and
3. oligopolists, in the absence of collusion, have an interest in diverting their rival's behaviour to activities that contribute to entry barriers (i.e., over-capacity and not price limiting).

Investments in building mobility barriers augment the risk for the firm making the investment as well as for its going rivals. To the incumbent firm, "they reduce short-run profits, and they may increase the probability of a ruinous loss by increasing the fixity of costs or lowering the average salvage value of the firms' assets. The firm investing in higher barriers often purchases an intangible asset, seldom a tangible one that can be sold or rented out on short notice. This self-exposure to risk should discourage barrier-raising investments to some degree. If the rivals imitate the investment in order to avoid the diversion of market share and profits away from themselves, they assume the same increase in risk exposure as the incumbent who started the process. Therefore, entry-barrier investments are likely to increase the risk faced by all incumbents and their susceptibility to fatal accidents and exit from the industry, even if barrier-building outlays are no larger than those that maximise joint profit for the incumbents." (ibid. 1977: 248-249).

2.2.2 Barriers to Mobility and Strategic Groups

Having observed groups structures in an industry and having argued that barriers to entry are partially the results of firms' investment decisions, Caves and Porter (1977: 249) then argue that barriers also exist between firms trying to move inside an industry:

> "The key to conjoining barriers to entry to a more general theory of inter-scales mobility of firms is the hypothesis that sellers within an industry are likely to differ systematically in traits other than size, so that the industry contains subgroups of firms with differing structural characteristics; we refer to them simply as **groups**. ... group boundaries impede (but do not prevent) the development of oligopolistic consensus, and thus an industry with a more complex structure of groups shows more competitive performance **ceteris paribus**. Barriers to entry then become specific to a group rather than protecting all firms in the industry equally, and barriers to mobility **between groups** rest on the same structural features as barriers to entry into any group from outside the industry".

By linking groups structures of an industry to the existence of barriers within an industry, the authors propose a strong argument for the relevance of differences in

structural characteristics between firms composing an industry. The existence of differences in structural characteristics (i.e., those which matter in terms of strategic or competitive behaviour and performance) between firms in an industry is the common feature to all research on strategic groups and mobility barriers. It is the declared and undeclared commonality to all research on strategic groups. The argument that structural differences are partly the results of firms' *strategic* investments, which in IO are thought to be aiming at the creation of disadvantages to the potential entrant, represents the passage from group structures to strategic groups.

2.2.3 The Origins of Strategic Groups and Firms' Strategic Behaviour

Observation of similarities and differences among firms structural characteristics have led to definitions of groups structures in an industry. These groups have been defined as *strategic* because structural characteristics result from firms' strategic decisions, which are linked to mobility barriers. Caves and Porter's (1977) next step is to propose a number of assumptions about how strategic groups develop and how firms behave in presence of groups structures.

In their paper, Caves and Porter do not explore the issue of how strategic groups come to exist. They argue that if we *assume* the existence of an industry with firms that are initially identical in all aspects except for random differences in scale, the investment by a firm will also affect competitors, who will react either by matching the initiating strategy or by adopting different strategies more suitable to their initial sizes. If rivals systematically follow different strategies, we have the basis for groups structures.

Groups may also be a consequence of different risk aversion strategies, of random initial differences in their preferences or skills or of qualities of firms' assets.

In their theory, firms have a history of similarities in objectives, risk attitude, and strategic behaviour, which result in similarities in structural dimensions. Because of this history, firms recognise the existing interdependence and behave in a similar way.

> "Because of their structural similarities, group members are likely to respond in the same way to disturbances from inside or outside the group, recognising their interdependence closely and anticipating their reactions to one another's moves quite accurately. Profits rates may differ systematically among the groups making up an industry, the differences stemming from competitive advantages that a group may possess against others. The industry's profits and (perforce) the average level of its groups' profits depend on the general structural traits of the industry and also the internal heterogeneities that demarcate its groups."[3] (ibid. 1977: 251-252).

According to Caves and Porter, firms of a group are not the same but resemble one another along key strategic variables, and it is because of the importance of these similarities that firms recognise their mutual dependence and behave in a certain manner. Differences among firms in the same group are insignificant. Caves and Porter's model of firms' behaviour stems from the assumptions characterising the SCP paradigm, where firms, *ceteris paribus*, behave similarly and achieve the same performance.

2.2.4 Intergroup Mobility, New Entry and Mobility Dynamics

Having analysed the impact of the existence of strategic groups on firms' strategic

behaviour, Caves and Porter (1977) analyse the implications of the existence of strategic groups on entry and mobility of firms in an industry.

In Section 2.1, we have seen that according to Caves and Porter entry barriers are partly defined by characteristics existing at the group level, but also result of investment decisions by incumbent firms. These two elements may differ among strategic groups, which has important consequences on the industry dynamics and firms' profitability.

The existence of strategic groups, which are *protected* in different measure, means that mobility barriers protect firms from external entry as well as from other firms trying to change their position in the industry. Because of the hypothesis of differences in profitability among strategic groups due to intergroup mobility, if one strategy is more profitable than another, then it would be expected that remaining firms would try to copy that strategy. If this does not happen, it is either because of the existence of differences in management's preference function, or because firms trying to achieve a specific strategic position do not possess the asset structure to assume that strategic position.

The existence of different strategic groups with different structural characteristics and mobility barriers has a number of implications for entry and mobility patterns, with entry being easy in a group and blockaded into another.
Firstly, the existence of strategic groups with various degrees of protection raises the possibility of entry paths within an industry. A potential entrant has the possibility of

[3] "Firms within a strategic group resemble one another closely and, therefore, are likely to respond in the same way to disturbances, to recognise their mutual dependence quite closely, and to be able to anticipate each other's reactions quite accurately" (Porter 1979: 215).

choice on which group to target. It could target the group with the lowest barriers to entry, or other groups. However, it could also be that a firm may follow a pre-fixed *entry path*. "If the firm will ... alter position within its industry after entry, and if it is not completely ignorant of this possibility when it makes its entry choice, then the initial entry plan will rationally include some provision for expected future moves. An outsider entering a group-segmented industry may proceed by a sequence of moves, as may a going firm's intergroup shift" (ibid. 1977: 255). The probability of successful entry into the most profitable group may be higher if the firm proceeds indirectly. The presence of a successful strategic position in the industry means that "the newcomer (or firm in another group) could prefer entry into j by a sequence of moves even if the expected probability of reaching j successfully via the indirect route is no higher or even lower than via direct entry. This follows from the irreversibility of the decision to enter" (ibid.). Unsuccessful entry into the less protected group may result in a much smaller loss. Groups may differ in the degree of irreversibility of their investment, a condition that favours a strategy of circuitous entry. Investments in production are largely reversible while expenditures on product differentiation are more risky, because they are mostly irreversible. The advantage of entering a group with lower barriers may affect entry-deterring investments made by that group's sellers. "Easy entry in an industry's fringe group is therefore no guarantee against monopoly profits and resource misallocation in an industry if strategies chosen by the dominant group block all expansion possibilities for the fringe" (ibid. 1977: 257).

Secondly, entry is an issue of comparative analysis between the factors (determining the strategic position) an incumbent has and those a potential firm possesses. Different firms may possess these *factors* in various degrees. The assets and capabilities a firm

possesses are, at the same time, the basis for a measurement of the firms' competitive advantage and disadvantage. A competitive advantage is measured by the assets and capabilities a firm possesses compared to those of a firm trying to acquire the same strategic position. A competitive disadvantage is calculated by the difference between the structural characteristics needed to get to the strategic position desired and those already owned. Caves and Porter classify assets and capabilities into: absolute-cost barriers, skilled management, vertical integration, intangible goodwill assets, scale economies, and diversification of risks.

In Caves and Porter's view, entry is easier when the potential entrant is an established firm in another market. In this case, the *strategic path* followed may differ from that of a newly formed firm. However, "the established firm in the same industry enjoys advantages over the newcomer, if only from learning by doing and the inexpensive acquisition of information" (ibid. 1977: 256). "Some going firms enjoy advantages in overcoming each of the structural sources of barriers to mobility, although there is no basis for thinking that the assets of going firms eliminate the advantages of incumbent sellers over entrants" (ibid. 1977: 259).

2.3 The Characteristics of Strategic Groups Theory

Caves and Porter (1977) argue about the importance of structural (strategic) differences among firms within an industry. They propose a theory of firms' behaviour in an oligopolistic industry characterised by the existence of groups structures. Although they only argue for the potential existence of a relationship between strategic groups, mobility barriers and firms' performance[4], their theoretical framework is based on the existence of a relation between firms' strategies and performance. The persistent differences in profit rates among groups of an industry are explained through 'intergroup mobility' (i.e., without mobility barriers, firms of the same industry would have the same rate of profitability). If differences exist in performance among firms of the same group, then difficulties arise in terms of the understanding of firms' strategic behaviour and the consequences for collusive behaviour within an industry.

Strategic groups, whose mobility barriers differ in their respective "height", influence the distribution of profits among firms of the same industry. The higher that the mobility barriers are, the higher the profits of the incumbent firms and the stability of the group. As differences in performance exist between the different strategies and firms tend to maximise profits, firms will try to enter the most attractive group in the long term, but this will be made difficult by the existence of mobility barriers.

The development of strategic groups puts an end to the idea of one best strategy. It recognises that firms can successfully follow different strategies within a similar competitive environment. However, at a level of firms' strategies, the theory is a deterministic one. Performance is determined by the strategy a firm followed in the past, expressed in terms of asset endowments, rather than firms' behaviour. No specific factors at the firm level influence its profitability. If a strategy represents part of a firm's complexity, it can be said that other parts (i.e., operational issues) not considered are irrelevant. The meaning of strategy used in strategic groups is a very simple one, characterised by underlying assumptions such as the existence of a direct relation

[4] "Profits rates may differ systematically among the groups making up an industry, the differences stemming from competitive advantages that a group may possess against others" (Caves and Porter 1977: 251).

between strategic decisions, implementation, and results. No discretionary behaviour is acknowledged at the firm level. The strategy options are determined by the structure of the industry. This is a neo-classical view of strategy and the firm, where the firm is still treated as a "black box".

With regard to the issue of industry dynamics, "the most evident lacuna ... is the extent to which the longevity of any particular mobility barriers is seen as relatively unproblematic." (Wensley 1996: 45). The industry is fundamentally static. The perspective characterising the strategic groups theory "is one of comparative static rather than a dynamic one." (ibid. 1996: 45).

Overall, strong similarities exist with the SCP paradigm examined in Section 2.1, the main difference being that a homogeneous industry structure is replaced by a more complex strategic groups structure (Figure 2.3).

Figure 2.3 The Strategic Groups Model of Firms' Performance

Strategic Groups Structures ⟶ Firms' Conduct ⟶ Performance

Similar to the SCP paradigm, the hypothesis proposed is one of a causal relationship between structure, conduct, and performance. As with the initial version of the SCP paradigm, there is no feedback effect. In the eventuality a feedback effect was identified, similar problems for econometric testing would arise.

The conceptualisation of strategic groups by Caves and Porter is strongly influenced by the characteristics and assumptions of the SCP paradigm, to the extent that it is possible to imagine a homogeneous industry being replaced by a set of smaller industries. However, Caves and Porter (1977: 250-251) stress that this view should be excluded:

> Our concept of industry subgroups inevitably raises the question of industry boundaries. We stress that the following discussion does not reduce to a redefinition of the homogeneous set of sellers as a group instead of an industry, for two reasons. First, although we suppose that oligopolistic interdependence is recognised more fully within groups than between them, we also suppose that it is recognised by firms in the same industry than by firms in different industries. The industry becomes segmented but does not disappear. Second, groups may be distinguished from one another because their products are imperfect substitutes, but this is not necessary. As we shall see, groups can be differentiated by factors that affect the conditions of sale of a good but not the good itself (such as the width of the product line of which it is a part), or by factors (such as vertical integration) that differentiate the product not at all in the eyes of the customer".

Since the paper was published, little research has been conducted on the validity of the assumptions and the hypotheses proposed of how groups structures emerge and how firms behave [see McGee and Thomas (1986), Thomas and Venkatraman (1988) for reviews]. The main study that concerns some of the hypotheses and assumptions proposed in Caves and Porter's paper, is that by Porter (1979), which addresses the issue of the determinants of firms' profitability. The following Section analyses the characteristics of Porter's (1979) paper.

2.4 Further Theoretical Development: Porter's (1979) Theory of a Firm's Profitability

The main objective of Porter's (1979) is the analysis of the determinants of firms'

profitability.

> "The purpose of this paper is to present a theory of the determinants of the companies' profits which rests on the structure within industries as well as on industrywide traits of the market structure. Built upon the concepts of strategic groups and mobility barriers, this theory provides an explanation both for stable differences in competitive strategies among firms within an industry, and for persistent differences among firms" (Porter 1979: 214).

In his paper, Porter partially abandons the hypothesis of a 'pure' relation between strategic groups and performance to develop a contingency theory of firms' performance. In his new theory, the strategy followed by a firm is only one of the elements at play in potentially explaining profitability differences:

> "Industrywide traits (such as industry growth and the structure of buying industries) influence the profits of all firms in the industry, and hence firms profitability. In this context, however, the height of mobility barriers protecting a particular strategic group determines its potential profitability. The degree to which these potential profits are eroded by rivalry with other strategic groups is determined by the position of the strategic group in the group structure in the industry ..., and the potential profits of the group also depends on its bargaining power with adjacent industries and its exposure to substitute products. We need a number of additional elements to complete the model of firm profit determination. First the profitability of the strategic group will be influenced by the degree to which firms within the groups compete among each other. ... The second element is differences in firms scale within the strategic group. ... The third element is differences in the cost of mobility into the strategic group. ... The final element in the theory is the ability of the firm to execute or implement its strategy in an operational sense" (ibid. 1979: 218-219).

Structural characteristics defining strategic groups membership is only one of the factors potentially influencing firms' profitability. Other relevant factors are rivalry existing among and within groups, other groups' characteristics and firms' specific characteristics. Having already addressed the relationships between mobility barriers and strategic groups, we now analyse the other elements which Porter argues influences firms' profitability.

2.4.1 Oligopolistic Rivalry and Firms' Performance

Divergent strategies reduce the ability of oligopolists to co-ordinate their actions tacitly because firms with different strategies have different preferences about market prices, rates of new product introduction, and so forth. Porter questions whether all strategic groups are equally powerful in influencing industry rivalry or if changes in the make-up of strategic groups affect the outcome. He argues that "the impact of strategic groups on industry rivalry depends on three factors that also hold the key to the rivalry of particular groups with each other" (ibid. 1979: 218):

1. The number and size distribution of groups. Other things held constant, the more numerous and equal in size that strategic groups are, the higher the rivalry. On the other hand, if one strategic group constitutes a small portion of an industry while another forms a very large portion, then strategic asymmetry is likely to have little impact on rivalry since the power of the small group to influence the large group is probably low.
2. The strategic distance between groups. this refers to the degree to which strategies in different groups differ in terms of the key strategic decision variables. The greater this distance, the more difficult tacit co-ordination becomes and the more vigorous rivalry is in the industry.
3. The market interdependence among groups. Diversity of strategies increases rivalry among groups, the most where market interdependence is high. Nevertheless, those strategic groups that possess high mobility barriers are relatively more insulated from rivalry. However, when strategic groups are targeting very different segments, their effect on each other is much less severe.

These factors interact to determine the pattern of intergroup rivalry "in the industry as a whole" (ibid. 1979: 218). However, each factor is complex in its characteristics and can present a variety of values. It is possible to have few large strategic groups or many small ones. Consequently, the impact of intergroup rivalry on a particular strategic group depends on a complex combination of elements.

2.4.2 Strategic Groups' Factors Influencing Profitability

Further reasons why profits among strategic groups vary are related to:

1. The bargaining power some strategic groups have towards customers and/or suppliers. Differences in bargaining power are due to differences in scale, threat of vertical integration or product differentiation following from differing strategies.
2. The exposure of strategic groups to substitute products produced by other industries.
3. The degree to which firms *within* the group compete with each other. Porter argues that while mutual dependence should be fully recognised within a group that contains few firms, it may be difficult to sustain if there are numerous firms in the strategic group or if the risk profiles of the firms differ.

2.4.3 Firms' Specific Factors Influencing Their Profitability

The characteristics specific to firms that influence their profitability are:

1. Differences in firms scale within the strategic group. Although firms within the

same strategic group are likely to be similar in the scales of their operations, differences in scale may exist and work to the disadvantage of smaller firms in the group where there are aspects of the strategy subject to economies of scale.

2. Differences in the cost of mobility into a strategic group. If there are absolute cost advantages of being early in establishing brand names, locating raw materials, a late entrant in a specific strategic group face some disadvantages with respect to established firms. Timing is, in this case, a factor that impacts on profit differences. This is also the case if an established firm possesses assets from its operations in other industries that can be jointly utilised.

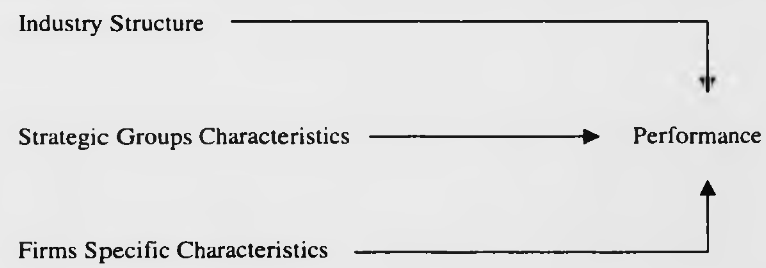
3. Ability of the firm to execute or implement its strategy in an operational sense. Some firms may be superior in their ability to implement strategies. "While these are not structural advantages of the sort created by mobility barriers ... they may be relatively stable advantages if the market for managers, scientists and creative personnel is imperfect." (ibid. 1979: 219). Therefore, firms in a group with superior abilities to execute strategies will be more profitable than others firms in the same group.

> "In view of the interacting nature of these considerations, the **profit potential** of a firm in any group is affected by the outcome in those strategic groups that interact closely with its groups but have higher mobility barriers. These groups have greater profit potential than the less protected group if competition within them is not too great. However, if competition within them is fierce for some reason and prices and profits are competed down, this will ruin the profits of the firms in the interdependent groups less protected by mobility barriers. Lower prices (or higher costs through advertising competition, etc.) spill over via market interdependence to require that less protected groups respond, driving down their own profits" (ibid. 1979: 219).

> "The firm will have higher profits if it is located in a group with the best combination of high mobility barriers, insulation from intergroup rivalry and substitute products, bargaining power with adjacent industries, the fewest other members, and suitability to the firm's execution ability. One or another of these elements may involve a tradeoff with the other. For example, the strategic group with the highest mobility barriers (and greater profit potential) may have to compete more vigorously with other groups than one with lower mobility barriers (lower potential profit), or a firm entering the group may be a relatively small scale (less profitable) member of the group" (ibid. 1979: 219).

Porter's (1979) paper represents a significant departure from the underlined assumptions about the relationship between strategic groups and profitability presented in the 1977 paper. In a simplistic way, the strategic groups model of firms' performance (Figure 2.3) becomes the following one:

Figure 2.4 Porter's (1979) Model of Firms' Performance



However, each variable is a complex factor that can assume a variety of values. The theory loses the determinism that characterised the earlier version, as it is recognised that firms play a role in determining their own profitability, while highlighting the importance of the relation between structural differences, competition in an industry, and profitability.

2.5 The Implications of Porter's (1979) Paper on the Theory of Strategic Groups

The objective of Caves and Porter's (1977) paper is to prove that structural differences among firms of an industry have relevant implications for firms' strategic and competitive behaviour. The authors also propose a number of hypotheses about firms' behaviour based on groups structures characterised by strong assumptions about the way the groups emerge, industry boundaries, top management ability to understand the composition of the environment and its ability to implement strategies. Their set of hypotheses complement their argument regarding the importance of structural differences among firms of an industry rather than represented a core part of the publication.

In the later paper, Porter develop a theory of firms' profitability, clearly stating that although there is a *potential* relationship between strategy (meaning asset endowments) and performance, other factors play an important role in determining profitability differences among firms. According to Porter's (1979) theory, profitability is the result of the interaction of factors at the industry level, strategic groups level, and firm level.
Porter's (1979) article significantly complicates the analysis of strategic groups and raises important questions about what was argued the Caves and Porter's (1977) paper. However, it also has a number of weaknesses. In our view there are two elements complicating Porter's (1979) analysis:

a) that the consumer market is heterogeneous and that rivalry among firms in the industry varies (so that some firms may be more subject to substitute products from other industries); and
b) that firms' specific characteristics matter in terms of performance and therefore in terms of collusive behaviour.

These two elements have consequences for the theory of strategic groups as proposed in the 1977 paper:

1. the concept of strategic groups is no longer a good enough indicator predicting firms' performance as other elements also matter; and
2. if we assume that other elements of the same group matter in terms of performance, then another concept other than mobility barriers is needed at the firm level to explain profit differences among firms of the same group. However, the existence of profit differences among firms of the same group may have consequences for firms' strategic behaviour, both in terms of collusive behaviour and investment strategy.

Therefore, the basis of the theory of strategic groups and mobility barriers, as developed in 1977, collapses. However, there are some flaws in the reasoning of Porter's (1979) paper. Porter maintains a neo-classical framework for his theory of firms' profitability. Therefore, to be consistent with the characteristics of the framework, he should have considered the following elements.
First, if a firm were not as capable of implementing the strategy as other companies of the same strategic group, then at some point the underperforming company would leave the group. A necessary condition for a firm staying in the same group over time is to have similar success in implementation processes (a constant under-performance by a firm implies that this company is not able to regenerate the funds necessary to maintain the investment strategies of other firms of the same group).

Second, if differences in terms of market segments served existed among firms of the same strategic group, then they should not have implications for profit potential; otherwise, they would, by definition, be of strategic importance and consequently lead to clustering of firms in different strategic groups. Furthermore, if firms of the same group did not focus on the same market segments, then it would be difficult to argue that they would recognise their interdependence and would behave similarly, as strong influences would also come from firms of other strategic groups. At the same time, if differences in market segments were of strategic importance and firms targeting the same market segments were grouped together, we would have an industry populated by smaller sub-industries, as there would be a coincidence between strategic groups within the industry and competitive groups within the market, where the latter identified groups of firms serving the same market segment.

In concluding our analysis of the Harvard approach to strategic groups, it is necessary to say that Caves and Porter's contribution is an important one. It highlights the importance of differences among firms of an industry. It returns some role to the firm and lays the basis for studying firms' strategic position, as well as their strategic and competitive behaviour. On the other hand, it leaves a number of issues unresolved. The theory of strategic groups as they have developed it, is based on a neo-classical economic framework, and as such, is characterised by strong assumptions and a strong normative content. Furthermore, at a practical level, methodological issues, such as how to identify strategic groups[5], are not addressed.

[5] This issue was not considered in the 1977 paper. In the 1979 paper, Porter tested the theory using the relative size of a firm in its industry as a proxy for its strategic group membership.

In light of this review, we can say that the theory of strategic groups as developed at Harvard should have been considered as the starting point of a research programme of the dynamics of firms' strategies and industry structure, rather than the end result. On the other hand, the objective of Caves and Porter's paper was to show to IO researchers the importance of studying difference among firms for public policy purposes. From this point of view, their objective was achieved.

Chapter 3 The Theoretical Foundations of Strategic Groups: the Purdue Approach

3.0 Introduction

In the early 1970s, at the time Caves and Porter were trying to demonstrate the importance of differences among firms within an industry, Hatten and Patton, at Purdue University, under the supervision of Schendel and Cooper, used the concept of strategic groups to develop a model for studying relationships between strategies and performance. This stream of studies forms the Purdue approach to strategic groups research, the focus of this chapter.

3.1 Strategic Groups in Strategic Management: the Purdue Approach

> "While mathematical model building has been commonplace over the last quarter century, what about models at a macro-level, models that capture the total enterprise, as the top management views the firm, models that can enter the boardroom and be used? Here, little work has been done, both conceptually and empirically. To be sure, the economist has been engaged with models that relate industry competitive (market) structure to conduct and in turn to performance. ... But these models have dealt primarily with variables managers cannot manage, e.g. numbers of competitors or concentration ratios. Moreover, the economist's concern has been with public policy issues. Corporate financial models have also been developed, but these models are concerned mainly with funds flows generated by decisions about variables external to the model. Similar limitations in scope and purpose exist for models built in other functional areas such as marketing." (Schendel and Patton 1978: 1611)

Confident of the benefits of the use of quantitative models in strategy, and building on ideas about the development of quantitative research in business studies, Hatten and Patton use the concept of strategic groups and quantitative techniques to study the effectiveness of firms' strategies within an industry. The objective is to build a bridge "between the qualitative nature of corporate strategy now finding so much current usage by top managers in strategic planning, and the mathematical model building characteristic of management science." (Schendel and Patton 1978: 1611)

In their research, strategy is defined as "a pattern or a positioning of resources of the firm relative to its environment, all to achieve desired performance outcomes." (Schendel and Patton 1978: 1611). Having distinguished between corporate, business, and functional level strategy, their research studied the effectiveness of strategy at the business level. However, they note that "at whatever organizational level considered, the concept of strategy is related to three fundamental aspects of any purposive organization: (1) the **goals** of the organization, (2) the **means** or resource allocations possible, and (3) the **environmental constraints** to which the firm must adapt." (Schendel and Patton 1978: 1612). Viewing performance as the measure of goal achievement, the three components of strategy are related in the following form:

(3.1) Performance $= f$ (means, environmental constraints) where *means* are variables under the control of top management and *environmental constraints* are elements beyond managerial control. Alternatively, equation 3.1 takes the following form:

(3.2) Performance = *f* (controllable variables, non controllable variables).

What can be defined as the strategic groups model proposed by the Purdue researchers is synthesised in equation 3.2. However, what has traditionally been seen as a unitary approach to strategic groups research has a number of significant differences.

The first important difference among the papers concerns the type of *controllable* variables considered and their impact on profitability. Controllable variables are distinguished into strategic variables and operating variables. Schendel and Patton (1978) choose both strategic and operational variables to analyse the relation between strategy and performance. The decision to include operational variables is taken on the basis of previous research showing "the severe effects of inefficient operations" (ibid. 1978: 1612) on performance. Nevertheless, Hatten *et al.* (1978: 598) assert that "over a long time period, strategy, whether good or bad, dominates operational efficiency", and therefore, they only consider strategic variables. Consequently, they further develop equation (3.2) as follows:

(3.3) Performance = *f* (Controlled or Strategic Variables; Non-controllable or Environmental Variables)

Hatten and Schendel (1977) take a similar position. In an article published in *The Journal of Industrial Economics*, the equation (3.3) takes the following form:

(3.4) Profitability = *f* (Market Conduct, Market Structure)

However, there are no significant changes in content, as the market conduct variables represent "the strategies of firms within the industry" (ibid. 1977: 106).

Commonly, researchers at Purdue use a single industry, the US brewing industry, as the basis for testing their model. The US brewing industry is particularly apt for researching brewers' strategies, as in the period considered most companies were single businesses and quoted on the stock market. This is important in order to assess the relation between firms' strategies and performance properly.

> "Recall that the focus of this research is on business strategy and not on product / market choice. The selection of the brewing industry controls the product / market variable - diversification - at a low and non significant level. Indeed, to maintain control of the product / market variable over the 1952-71 period, one company, Rheingold, was dropped from the study since it obtained a large percentage (about 50 percent) of its profits from soft drinks." (Hatten *et al.* 1978: 598).

Schendel and Patton (1978: 1615) also argue that the choice of a single industry, without diversified firms, is made in order to "avoid cross-industry, cross-product heterogeneity." The brewing industry is particularly appropriate to study the effectiveness of firms' strategies as,

> "between 1952 and 1971, the brewing industry underwent a major transition. In this period the number of breweries declined from 357 to 148 and the market share of the four largest brewers increased from 24.2% to 48.%. During this same period, ..., the fortunes of many companies, both large and small, shifted dramatically. Schiltz lost its position as market leader to Auheuser-Bush whose market share increased from 7.1% to 19.2%. Once prominent large firms like

Ballantine and Blatz disappeared while firms like Carling, Hamm, Falstaff and Associated Breweries enjoyed a short period of vigorous prosperity and then began to wane. Companies like Coors, and more recently Miller, began to grow." (Hatten and Schendel 1977: 2).

Having studied the institutional features of the brewing industry using interviews, industry and business press, and public documents, a number of variables representing the companies' strategies and environmental forces are identified. Variables are chosen according to their significance and availability. **Here, the second important difference emerges between the research. Different variables are used in the different papers to operationalise firms' strategies**. Hatten and Schendel (1977) specify an eight variable model relating profitability to six strategic variables (three manufacturing variables and three marketing variables) and to two structural variables.

Hatten *et al.* (1978) specify a sixteen variable model relating profitability (ROE)[1] to twelve strategy variables (five manufacturing variables, two financial variables, and five marketing variables) and four environmental variables. Strategy variables are related to a multiplicity of functional areas as:

> "The thrust of strategic management or business policy area is that managing the whole of an organisation is a different task than managing the sum of its parts. ... General managers face both challenges and are finding that doing the right thing, i.e., strategic management, requires concepts and ways of thinking about problems that differ from those of operations management, which is concerned with doing things right or efficiently. One cannot substitute the other" (Hatten *et al.* 1978: 595).

The focus of Schendel and Patton's (1978: 1611) paper is a different one:

[1] "The choice of a single dependent variable, ... was not made lightly. It can be argued that over the long time period relevant to strategy, the firm will survive only to the extent that it can show profits. Although management may give growth (or some other objective) priority over profit in the short term, it will do so only when profits are expected to flow from the growth achieved. Hence, it is assumed here that the need for profit, the ultimate key to survival, will dominate any quest for growth (or other objectives) in the long term. The choice of return on equity as a measure of profitability was made on the grounds that it takes into account alternative financial structures and risk levels while it measures the effectiveness and efficiency of the firms' resources allocations." (Hatten *et al.* 1978: 598)

> "Prior research has been limited to single equation models linking strategy and environment to only one performance goal, profitability. While there is some controversy about it, complex organizations set multiple, and sometimes conflicting goals, creating a need for models that can encompass more than a single performance goal. Moreover, the interactive effects of strategic variables governing the efficiency of daily operations, suggests that single equation models of strategy cannot capture the complexity of the modern firm."

They thus propose "a simultaneous equation model of corporate performance as a means of overcoming the multiple performance goal problem, while capturing the complex patterns of the strategic, operating, and environmental variables that influence goal achievement." (ibid. 1978: 1611). They specify a twenty-three variable model relating three performance[2] variables to sixteen strategic and operational variables and to seven non-controllable variables.

Once the researchers have identified the variables, **a third important difference emerges: the use of different techniques to clusters firms**. Hatten *et al.* (1978) and Hatten and Schendel (1977) consider the possibility of clustering firms on the basis of similarities in management goals or on the similarities in resources among firms. However, they cluster firms on the basis of the strategic variables identified and use a statistical technique in order to maintain objectivity[3]. However, Schendel and Patton (1978: 1615) assume the existence of "homogeneous subgroups ... on the basis of firm size and geographic scope of operations". Having identified the clusters, tests of statistical homogeneity are carried out in order to be sure that the clusters are internally

[2] The three variables were ROE, market share, and production efficiency. ROE is taken as a measure of profitability, because without profits, long term survival is not possible. Market share is taken as a measure of sales growth. This is based on a detailed analysis of the industry and indicated that although the industry had not grown over the decades, some firms had grown considerably in size. Finally, their analysis reveals that production efficiency was a clear goal in the industry "has been a key factor in the failure of many firms, while increased efficiency has been a key success factor for many firms." (Schendel and Patton 1978: 1614-1615).

homogeneous. Results show that the clusters identified are internally homogeneous and externally heterogeneous.

Early research on strategic groups by Hunt (1972) and Newman (1973) is criticised because although it was argued that heterogeneity existed within an industry, this hypothesis was not correctly tested.

> "Prior studies of the profit impact of strategic and environmental variables have often indiscriminately pooled firms into single composites, and industries have been pooled into even more heterogeneous aggregations of data. Not only does the tradition of business policy argue for care in considering firms in combination, but so too does the strategy construct itself. Bass (1974) demonstrated that indiscriminant pooling of firms and industries could be misleading in understanding the impact of advertising on profitability. Thus, for both theoretical and statistical reasons, because they were drawn from pooled samples, the conclusions of many prior studies of the causes of profitability must be suspect. Indiscriminant data pooling can mask the very essence of both corporate and business strategies and the key contribution they make to differential corporate performance." (Hatten *et al.* 1978: 597)

The use of different variables and methods leads to the identification of a different number of clusters in the three studies. In some cases, there are also significant changes in the way firms are clustered. While significant similarities exist between the papers by Hatten and Schendel (1977) and Hatten *et al.* (1978), both in terms of numbers of clusters and companies clustered together, important differences exist between these two studies and the third by Schendel and Patton (1978). As we can note from Table 3.1, Hatten *et al.* (1978) identify five groups: (1/B) large national operators, (2/B) semi-national and financially weak firm, (5/B) relatively strong regional brewers; (3/B) weak regional brewers; (4/B) small regional brewers. Hatten and Schendel (1977) identify six clusters: 1/A, 2/A, 3/A and 4/A correspond to groups 1/B, 2/B, 3/B and 4/B. The only

[3] Hatten and Schendel (1978: 105) develop a quantitative method for grouping firms based on cluster analysis. However, they point out that the groups needed to be made up of "firms which have a priori some theoretical or logical similarity."

difference is that firms clustered together in 5/B (relatively small regional brewers) are put into separate groups, 5/A and 6/A. Finally, Schendel and Patton (1978) identify three groups: (1/C) the large national firms, (2/C) large regional firms, and (3/C) small regional or local firms.

Table 3.1 Characteristics of the Strategic Groups Research at Purdue

	Hatten and Schendel (1977)	**Hatten, Schendel and Cooper (1978)**	**Schendel and Patton (1978)**
Number of Firms	13	13	12
Independent Variables	8	16	23
Dependent Variables	1 (ROE)	1 (ROE)	3 (ROE, Market Share, Production Efficiency)
Number of Clusters	6	5	3
Strategic Groups	Anheuser Bush, Schlitz (1/A)	Anheuser Bush, Schlitz (1/B)	Anheuser Busch, Schlitz, Pabst (1/C)
	Associated Breweries, Falstaff (2/A)	Associated Breweries, Falstaff (2/B)	Olympia, Heileman, Falstaff, Associated Breweries, (2/C)
	Iroquois Industries, Lucky Breweries (3/A)	Iroquois Industries, Lucky Breweries (3/B)	Grain Belt Breweries, Lucky Breweries, Rainers, Pittsburgh, Lone Star (3/C)
	Pittsburgh, Rainers (4/A)	Pittsburgh, Rainers (4/B)	
	Heileman, Lone Star, Olympia (5/A)	Heileman, Lone Star, Olympia, Grain Belt Breweries, Pabst (5/B)	
	Grain Belt Breweries, Pabst (6/A)		

3.1.1 Research Findings

> "Generally, a comparison of industry versus group-level equations reveals a number of instances where the consequences of business strategies followed by specific groups of brewers differ, and certainly differ from the "averaging" and perhaps misleading industry estimates. So, the hypothesis derived from the strategy concept, that different firms can ... use different resource deployments to compete successfully, is supported by the estimated coefficients." (Hatten *et al.* 1978: 604).

This research finding is shared by the three publications. As can be seen by examining the results in Table 3.2, there are many cases where results at the industry level contradict results for some of the groups. When a more detailed analysis is carried out, notwithstanding the use of different variables, clustering methods and results in terms of clusters, findings on the effectiveness of firms' strategies within the sector in the three papers tend to converge. It also seems that the information gathered at the beginning of the studies significantly support the convergence of research findings.

The general picture is of efficiency at a national level, the maintenance of some defensible hold for regional companies, while the critical issue for smaller brewers was not to expand.

Table 3.2 Results of the Econometric Regressions

	Hatten and Schendel (1977)	**Hatten, Schendel and Cooper (1978)**	**Schendel and Patton (1978)**
Number of Plants	Negative at the industry level. Positive and significant for group 2/A. Negative and significant for 3/A	Negative and significant at the industry level, and for 5/B. Positive and significant for group 1/B.	**Market share**: positive and significant at all levels.
Newness of Plants	Positive and significant at the industry level, for 1/A, 2/A, 3/A, and 5/A. Negative and significant for 4/A.	Positive and significant at the industry level and for 2/B, 3/B and 5/B.	**ROE**: Negative and significant at the industry level. Positive and significant for 1/C. **Efficiency**: Positive and significant at the industry level. Negative and significant for 1/C.
Average Capacity of Plants	N/A	Negative and significant at the industry level and for 5/B.	**Efficiency**: positive and significant at the industry level and for 1/C. Negative and significant for 3/C.
Length of the Production Cycle	N/A	Negative and significant at the industry level and for 1/B.	**ROE**: negative and significant at the industry level and for 1/C. **Efficiency**: negative and significant at the industry level and for 3/C.
Capital Intensity	Negative and generally significant.	Negative and significant at the industry level, for 1/B, 2/B and 5/B	**ROE**: negative and significant at all levels.
Leverage	N/A	Positive and significant for 4/B and 5/B. Negative and significant for 2/B	**ROE**: positive and significant at the industry level, 1/C and 3/C. Negative and significant for 2/C.
Market Share	N/A	Positive and significant at the industry level. Negative and significant for 1/B	**ROE**: positive and significant at the industry level. Negative but not significant for each subgroup.
Distribution Costs	Negative and significant at the industry level, and for 1/A and 2/A.	Negative and significant at the industry level and for 1/B, 2/B and 3/B.	**ROE**: negative and significant at the industry level, and for 3/C.
Marketing Expenditure	N/A	Positive and significant at the industry level.	
Advertising	N/A	N/A	**Market share**: positive and significant at the industry level and for 1/C.
Number of Brands	Negative and significant at the industry level, and for 2/A, 6/A. Positive and significant for 5/A. (Note that in its group, Heileman is the only firm with a successful multiple brands strategy).	Negative and significant at the industry level, for 1/B and 4/B. Positive and significant for 5/B.	**ROE**: negative and significant at the industry level and for 3/C. Positive and significant for 2/C. **Market share**: negative and significant for 2/C. **Efficiency**: negative and significant for 1/C.
Price	Negative and significant for 1/A, 4/A and 6/A.	Negative and significant for 1/B and 2/B. Positive and significant for 3/B	**Market share**: positive and significant at the industry level. Negative and significant for 1/C.
Size	Not significant effects	Positive and significant at the industry level and 1/B.	**ROE**: positive and significant at all levels. **Efficiency**: negative and significant at the industry level for 1/C and 2/C. Positive and significant for 3/C.
Concentration	Positive and significant at the industry level. Negative and significant for 3/A, and 4/A	Negative and significant for 1/B and 3/B.	**Market share**: positive and significant at all levels. **ROE**: negative and significant at the industry level and for 2/C.

The strategy by the large brewers (Anheuser Busch - Schlitz) was clearly one of growth. A number of the large national firms expanded the scope of their operations over the period considered. They expanded by building new production facilities rather than by acquiring older plants. Modern plants were highly automated with large capacity, which, when fully utilised, offered economies of scale. Having more plants spread out in the country also offered a flexible solution to expansion strategies. Interestingly, Hatten and Schendel (1977), when analysing heterogeneity across time, find that the newness of plants changes from 'not significant' in the first period to 'significant' in the second period[4]. This issue is not explored in detail, but it indicates that the relevance of some variables may be time dependent. Successful expansion was made possible by the support given by distribution and advertising expenditures, which had a negative impact on profitability but a positive one on market share. Because marketing expenditure and receivable/sales were negative, and because a negative and significant relation between market share and profitability is found, it is argued that the larger "*national firms have been deliberately sacrificing current profits for sales growth (which they have achieved) and they have been doing so since the mid-1950s.*" (Hatten *et al.* 1978, p. 606).

Stronger differences exist among regional companies than national companies. Heileman and Olympia (5/A) were successful in increasing market share with the support of a strong balance sheet. The larger but financially weak Associated Breweries and Falstaff (2/A and 2/B) suffered a declining market share. Large regional firms had been in direct competition with the expansion strategies of the national firms but they were less effective in their strategies. A major conclusion is therefore that within the

[4] "The meaning of the finding is unclear; it could signal a change in management's policies or in the effectiveness of its decisions, or it could signal a major change in the structural environment of the

same industry, similar strategic actions may be associated with different performance consequences for firms belonging to different groups. Heileman and Associated Breweries were the only companies with a multiple brand strategy but only Heileman was successful with that strategy. Findings seem to indicate that it was not possible to give market support to the various brands. For Associated Breweries and Falstaff, two negative relationships are found between profitability and distribution costs, and between profitability and market share (although the latter is not significant). These firms suffered a decline in their market share. Consequently, it is suggested that these firms traded profitability for market share without achieving the desired result. It also has to be noted that these firms tried to match their rivals but took a cheaper 'plant by acquisition' route, preferring to match their rivals on advertising dollars/barrels. This expansion strategy did not work, probably because the plants were technologically obsolete. However, it affected negatively on leverage and therefore on profitability.

At regional level, different studies cluster firms in various groups. Thus, a comprehensive analysis is more difficult. Hatten *et al.* (1978: 606) suggest that some smaller regional companies (Iroquois and Lucky) might improve profits by increasing price with caution: "it can be speculated that these small, regional brewers, with loyal, and in some cases, intensely serviced local markets, have a clientele less sensitive to price changes." Schendel and Patton (1978: 1619) argue that "*the smaller firms do not have the resource necessary to follow a successful multiple brand strategy.*" This is based on research findings that indicate that the number of brands had a negative and significant impact on profitability. Average capacity of plants was also negative and

industry. Alternatively the change could be due to an unidentified or exogenous change in the wider social environment." (Hatten and Schendel 1977: 110) significant, (probably because large plants were under-utilised). These results are confirmed by the other two pieces of research.

Having analysed the research carried out at Purdue, in the next part of the paper, we focus on an assessment of similarities and differences between the Harvard and the Purdue approach to strategic groups.

3.2 The Purdue Approach and the Harvard Approach to Strategic Groups Research

Similar to Caves and Porter's theory of strategic groups, the Purdue approach to strategic groups also draws on the SCP paradigm. The SCP paradigm views performance as a result of the industry structure, with firms' decisions resulting from the industry structure:

Figure 3.1 The Original SCP Model

Industry Structure → Firms' Conduct → Performance

Caves and Porter (1977), in their theory of strategic groups, transform the SCP paradigm without, however, significantly changing the content of the SCP paradigm. In their theory, a homogeneous industry structure is replaced by a more complex structure of

strategic groups, which is internally homogeneous and externally heterogeneous. Firms within the same group recognise that they are part of the same group, and their conduct and performance follow the strategic groups structure:

Figure 3.2 The Strategic Groups Model of Firms' Performance

Strategic Groups Structures → Firms' Conduct → Performance

The Purdue approach differs in a number of ways. Although the variables that are considered are the same, the relations among them are different. Firms' strategic and operational decisions have a much higher degree of independence from the industry structure:

Figure 3.3 The Purdue Model of Firms' Performance

Firms' Conduct (Firms' Strategic and Operational Decisions) → Performance

Industry Variables → Performance

The use of the same variables is virtually about the only similarity between the two approaches. While Caves and Porter's theory of strategic groups has an underlying theory of the firm and firms' behaviour, the model developed at Purdue does not contain any theoretical framework about the nature of the firms and firms' strategic behaviour within an industry. In the Harvard approach, similarities among firms are substantial and they have consequences for firms' behaviour. In the Purdue approach, strategic groups are the result of a statistical technique rather than entities existing within industries. Strategic groups are viewed as an aggregation of companies with similarities along a number of strategic characteristics, but firms within the same groups "are comparable but different" (Hatten and Hatten 1987: 333). Further differences lie in the complexity of the variables. In Caves and Porter's theory, strategy and performance are seen in simplistic terms and a straightforward relation is assumed to exist between decision, implementation and performance. At Purdue, the issue of strategy and performance receives much more attention. Schendel and Patton (1978: 1612) argue "a conceptual distinction can be made between effective strategy and efficient operation, but their respective effects on performance are difficult to isolate." They initially assume that variables related to strategic and operational decisions are independent, although "in reality the components form a dynamic system and are interactive over time." (ibid. 1978: 1613). Findings support this view by indicating that:

1. strategic and operational decisions are complex, with a multiplicity of interactive effect among themselves and on performance;
2. firms have a structure of multiple goals that are not always positively correlated. For example, the authors have found that for a long period of time there was a significant negative relation between market share and profitability;
3. some explanatory variables have multiple effects on different performance measures, with the same controllable or non-controllable variable displaying different directions and magnitudes of effect on the various dimensions of performance. For example, *concentration* had a strong positive effect on market share of firms in group 2/C, while it had a strong negative effect on profitability for the same firms; and,
4. the relationships between performance measures, controllable and non-controllable variables vary among the different subgroups of firms. A research finding shared by the various research, with Hatten *et al.* (1978: 604) concluding that "*different firms can (and must) use different resource deployments to compete successfully.*"

The complexities of firms' strategies, linked with the fact that strategic groups are seen as statistical artefacts rather than real entities, means that when examining the effectiveness of strategic decisions, the analysis centres on the relations between the variables of a group and performance rather than between the group and performance. Because strategy is complex and because there is not a 'single strategy' but a series of decisions that have a varied impact on performance, researchers try to isolate the effects of single variables. The complexities of firms' strategies also means that in explaining research findings, the authors have to make a strong use of qualitative information.

> "The present research is empirical and quantitative in nature. Yet, it becomes feasible only when the empirical nature is combined with conceptual and qualitative study ... Qualitative investigation of the sample under consideration is necessary to identify the relevant sets of performance measures, managerially controllable, and noncontrollable factors used to specify the model. With a proper background study and model specification, the benefits of explicit mathematical modelling can be more fully realised." (Schendel and Patton 1978: 1620).

The use and integration of qualitative information is a specificity that has not since occurred in strategic groups research.

The differences between IO and SM with regard to the specification of the model and the complexities of the variables have to be examined by considering the differences in the research focus. At the time the concept of strategic groups was developed, IO researchers were mainly interested in the way markets operated for the purpose of understanding their implications for welfare efficiency issues from a public policy viewpoint. Because of the large numbers of firms, researchers generated assumptions that tended to highlight similarities, and to simplify what happened within firms. However, SM was oriented to management decision-making in an individual firm context, with more attention given to single specificities as potentially the source of competitive advantage. It is not surprising, therefore, that apart from differences in the characteristics of the models and in the complexities of the single variables, significant differences also exist in the way strategic groups originate. In IO, the concept of strategic groups emerges for the purpose of demonstrating that differences exist among firms in an industry. Caves and Porter (1977) argue that the existence of differences among firms have relevant implications for market structure and competitive behaviour. Firms were previously assumed similar in all relevant aspects except size. The assumption of homogeneity within an industry is eliminated but it is still possible to identify a cluster of relatively homogeneous firms within an industry.

The main objective of research carried out at Purdue (SM) on the brewing industry is "to show that the strategy construct can be mathematically modelled and that quantitative approaches can provide top management with help in the major resource allocation decisions that it must make to achieve its goals in a complex, changing environment" (Schendel and Patton 1978: 1611). On the other hand, in a context that has traditionally stressed the specificities of companies (Rumelt *et al.* 1991), researchers at Purdue indicate the existence of important similarities among firms operating within the same competitive environment.

Having analysed in detail the different papers published by researchers at Purdue and the similarities and differences between the Harvard and the Purdue approaches, in the next section we assess the methodological and theoretical weaknesses of the Purdue approach.

3.3 The Purdue Approach to Strategic Groups Research: Methodological and Theoretical Issues

Researchers at Purdue argue that the proposed strategy model has clear advantages in terms of greater objectivity and rigour compared to other techniques used at the time. At a practitioner level, the advantages are:

1. the provision of a better understanding of the relation between the variables and performance;
2. the provision of the means for an *ex-ante* evaluation of proposed strategies. Given the accumulation of competitive information, the model could be used as a what if technique; and,
3. the acquisition of information on alternatives that could be used as strategy choices.

Having conducted the empirical analysis, Hatten *et al* (1978: 608) argue that the usefulness of the model have been proven:

> "The research has shown that it is possible to build quantitative models of business strategy that go beyond qualitative statements of the basic nature of a business and reveal significant relationships between purpose, strategy and the environment in which a firm operates. ... While not substitutes for management

judgement and decision making, strategic models can provide important help in assessing past strategies, defining new strategies, and evaluating proposed strategies before their adoption and implementation."

However, having analysed the different papers published from the research carried out at Purdue, it is possible to identify weaknesses in both the theory and methodology, hence raising questions about the usefulness of the technique.

At a methodological level, although quantitative techniques can deliver more *objective* results, the number and the type of variables to be considered is an important issue. This is particularly when we consider that a common criterion to cluster firms together has not been specified. Schendel and Patton (1978) use a geographical criterion and Hatten and Schendel (1977) and Hatten *et al.* (1978) cluster firms on similarities and differences in the variables, they identify. Although results tend to converge, it was expected that these researchers, using the same industry in the same time frame, would adopt similar methodologies. However, this has not happened, thus raising new questions about the ability of researchers to *objectively* identify the strategic variables responsible for firms' performance. A final element, not considered by researchers, is that, in analysing the effectiveness of firms' decisions, it would have been sensible to analyse firms that have disappeared during the 20 year period they studied, and analyse the reasons behind their exit from the industry.

At a theoretical level, the first main issue concerns the fundamental ambiguity about what types of variables have an impact on performance: *strategic*, or *strategic and operational*? Hatten *et al.* (1978: 598) make a distinction between strategic and operational issues but only consider strategy variables as they assert that "over a long time period, strategy, whether good or bad, dominates operational efficiency." This

position is not shared by Schendel and Patton (1978), who show that operational inefficiencies have an important role on performance and can lead to exit from the industry.

A second weakness relates to the specification of the model. While Caves and Porter (1977) fall into structural determinism in their strategic groups theory, at Purdue, researchers assume independence between firms' strategies and the industry structure. Nonetheless, in their analysis it is clear that firms' strategies have consequences for the dynamics of strategic options available to firms over time. This leads directly to the third issue: the use of the model to assess the effectiveness of strategic options. The cornerstone of the Purdue approach is that the model may be used by senior executives to assess the effectiveness of their strategic options. The model uses variables related to past firms' strategies to assess *ex-ante* strategic options available to firms. This position completely ignores the fact that the past strategies were also successful because external conditions were favourable to those strategies, as well as that the structure and nature of competition within the industry may have changed[5].

The argument that the choice of the strategy to follow is the main factor responsible for performance and the relative insignificance of operational issues reproduces the neo-classic economic view of a company as a "black box", where the role of market mechanisms is replaced by the role of strategy decisions. Firms are now seen as playing a determining role of their performance, but this role is restricted to strategy choice and is only loosely linked to the inner context of the firm. Furthermore, it is possible to abstract firms' strategies from their context without significant consequences.

[5] Hatten and Schendel (1978) indicate that the effect of some variables may vary over time, which again raises questions about the possibility of utilising the model to predict firms' future success and specifically about the effectiveness of the same strategy over time.

In management research, this view was, in the 1970s, not exclusively limited to strategic groups research. At Harvard Business School, Scott and his doctoral students built upon Chandler's (1962) work and developed research which analysed the relationships between strategy, organisational structure and performance. This research also shared a similar view of "decision" being the single most important variable in determining performance differences. It has to be remembered that, at the beginning of the 1970s, SM was in its early stages as an independent research field. "Until the seventies, academic strategy research consisted chiefly of clinical case studies of actual situations, with generalisation sought through induction." (Rumelt *et al.* 1991: 8). New concepts, models and methodologies, typical of Economics, were being introduced. Consequently, some of the economic views were also being *transposed* into business studies. This *economic* view of strategy research has had an enormous influence in the strategy field, with the nature of research, for a long time, being on strategic decision rather than on the strategy process. There has been, among some researchers, an implicit and naive trust in the company's abilities to implement strategies. This view was successfully challenged during the 1980s building on conflicting results achieved by researchers trying to verify the existence of a relation between strategy and performance and on a large amount of research stressing the importance of processual characteristics (Mintzberg, Raisinghani and Théorêt 1976; Mintzberg and Waters 1985; Pettigrew 1985).

By comparing the strategy model proposed by Hatten, Schendel and Cooper, and generally the tendencies emerging in the strategy field to what was happening in economics, a striking paradox emerges. In IO, there was a trend towards less deterministic approaches, highlighted by the modification proposed by Scherer to the SCP paradigm in 1970 and by the theory of firms' performance proposed by Porter in

1979. This was driven by a growing dissatisfaction with the deterministic models that had characterised the field over the previous decades. In SM, the trend was in the opposite direction and researchers were moving towards more quantitative and deterministic cause-effect type of studies. This has led to deterministic and reductionist approaches (Bourgeois 1984).

3.4 Summary

The analysis of the Purdue approach to strategic groups concludes with the publications of Schendel and Patton (1978). However, research at Purdue continued throughout the 1980s. In 1987, Hatten co-authored an article (Hatten and Hatten 1987), stressing the differences between the Harvard and the Purdue approach and analysing the role of asymmetrical mobility barriers and contestability in the process of industry consolidation and concentration. Concepts and ideas generated at Harvard were used but the theoretical foundations of concepts were not considered, contributing to the ambiguity and confusion in strategic groups research which we shall analyse in the next chapter. In the first part of the 1980s, Cool completed his PhD at Purdue under the supervision of Schendel. However, little theoretical progress was achieved in his work (Cool 1985; Cool and Schendel 1987).

The initial objective of the research carried out at Purdue was to develop a model that can be used by top management to make decisions about their strategic and operational decisions. The problems both at a theoretical and methodological level raise serious doubts about whether this objective was achieved.

Chapter 4 The Development of Strategic Groups Research: a Critical Review

4.0 Introduction

Following the development of the concept of strategic groups, research was initially directed at demonstrating the existence of groups structures within industries (Porter 1973; Newman 1978; Oster 1982). Successively, strategic groups research developed into two streams. The main objective of the first stream of research was to test the hypothesis of the existence of a relationship between strategic groups and performance. A second, minor stream of research focused on the dynamics of groups structures and firms' strategies within an industry over time.

Research trying to prove the existence of a relationship between strategy and performance constitutes the bulk of strategic groups literature. Towards the end of the 1970s, SM was on its way to becoming a relatively independent research field. Its development was supported by the publication of books by Hofer and Schendel (1978) and by Porter (1980), as well as by the establishment of the *Strategic Management Journal* in 1980. Strategy research was mainly interested in issues of organisational performance (Hofer and Schendel 1978) and was characterised by an increasing use of quantitative techniques. In this context, strategic groups research well reflected the trend of that time. It linked firms' strategies to performance and it had been among the innovators with respect to using quantitative techniques. It is, therefore, not surprising

that following research at Purdue and Harvard, strategic groups became a popular technique in the analysis of the relationship between firms' strategies and performance in an industry.

A variety of methodologies was initially used by researchers to study the relation between strategy and performance, this being reason of concern in the strategy field: "there is no uniformity in the treatment of strategic groups in empirical research settings. A variety of methods have been used to derive groupings in empirical research setting, which make the much-needed exercise at the accumulation of research findings an almost impossible task" (Thomas and Venkatraman 1988: 538). The initial fragmentation characterising research on strategic groups is not surprising, given that research was conducted in two different research fields (IO and SM) and given the absence of a conceptual framework which was common to the two research fields. The confusion was worsened by the publications by some of the earliest researchers on strategic groups in both SM and IO[1] and by the use of the concept of *mobility barriers* in strategy research, initially developed by Caves and Porter (1977) in IO.

In the first part of this chapter, we examine some empirical characteristics of strategic groups research. By looking at the method employed, we show that whilst the complexity of the strategy field was increasing (as the development of a number of research interests with different foci indicate), research on strategic groups has been characterised by an increasing simplification of the concepts of firms' strategies, industry structure and performance, more typical of the Harvard approach. The

[1] Hatten and Schendel (1977) reproduced their model and empirical research in an article published in the *Journal of Industrial Economics*. Porter (1980) published his book, bringing the theory he had developed in IO into SM.

consequence is that the initial theoretical differences between the two approaches have blurred.

Notwithstanding numerous empirical studies on the strategic groups - performance link, there is no general agreement among researchers about whether there is a relationship between firms' strategies in the industry and their performance. McGee *et al.* (1995) and Thomas & Venkatraman (1988) have extensively reviewed past research and found conflicting evidence. However, researchers that have analysed the dynamics of firms' strategies in an industry have found that firms tend to maintain similar strategies over time. When changes occur, they are usually incremental with firms moving into the next similar group. These patterns of change have been explained with the existence of mobility barriers, inhibiting firms from significantly changing their strategies.

4.1 A Shift Towards the Harvard Approach

The publication of the article by McGee and Thomas in 1986 opens up a period of reflection on the characteristics of empirical research on strategic groups. McGee *et al.* (1995), Thomas and Venkatraman (1988) and McGee and Thomas (1986) extensively review past research[2]. In this chapter, we are interested in a critical analysis of how researchers have conducted their research. This is the basis for assessing the implications this type of research has on the view of firms' strategies and industry structure.

4.1.1 Firms' Strategies and the Concept of Strategic Groups

A first issue that merits attention is what defines strategic groups. Hunt (1972: 8), who coined the term in his PhD dissertation, defines strategic group as "a group within an industry that are highly symmetric ... with respect to cost structure, degree of product diversification ... formal organisation, control systems, and management rewards and punishments ... (and) the personal views and preferences for various possible outcomes." Hunt's dissertation was never published and its definition has rarely been used in research. In the following years, neither researchers at Harvard or Purdue gave a definition to the concept of strategic groups. What researchers meant by strategic groups has to be deduced from the content of their articles. However, in the 1980s, a number of definitions with varying foci were advanced.

The first published definition of strategic groups is given by Porter (1980: 129) who affirms that a strategic group is "the group of firms in an industry following the same or similar strategy along strategic dimensions"[3].

Porter's definition is the most popular in strategic groups research. At first, it may give the impression of referring to firms' *strategic investments* rather than to firms' *strategies*. The difference between the two terms is a subtle but important one. It is possible to think of a firm's *strategy* as referring to a firm's position at one point in time in an industry; position illustrated by its asset endowments, resulting from past investments. Firms' *strategic investments* can be seen as the dynamic part of firms'

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[2] We invite researchers interested in some methodological and technical issues to refer to these articles.

[3] The dimensions to use in order to identify strategic groups are: specialisation; brand identification; push versus pull; channel selection; product quality; technological leadership; vertical integration; cost position; service; price quality; leverage; relationship with parent company; and relationship to home and host government.

strategies. It can be regarded as indicating the current firms' investments or firms' approaches to their asset structures. Cool *et al.* make a similar distinction, by distinguishing between *stocks* (identifying the strategy) and *flows* (identifying investment): " "stocks" ... are accumulated over time through a history of investments or "flows". ... Asset stocks are "state" variables, which describe a firm's competitive position. Flows are the policy instruments which the firm directly controls and as such represents "current strategy" " (Cool *et al.* 1994: 222-223). However, Porter refers to firms' *strategies* rather than firms' *strategic investments*. This is clear when we examine the context in which the definition is located. Porter talks about strategic groups being helpful in structural analysis of an industry: "The first step in structural analysis within industries is to characterise the strategies of all significant competitors." (1980, p. 129). The dimensions indicated as useful to identify groups mostly concern past, long-term, firms' commitment, which confirms that Porter refers to firms' strategies. It also has to be remembered that Porter's (1980) book stems from the theory of strategic groups developed with Caves in the 1977 paper (analysed in chapter 2), where the concept of strategic groups clearly refers to the analysis of groups structures.

Cool and Schendel (1987: 1106) defines strategic group as "a set of firms competing within an industry on the basis of similar combinations of scope and resource commitments." Where the scope commitment relates to:

- the range of market segments targeted by the firm;
- the type of products and/or services offered in the market selected; and
- the geographic reach of strategy.

In addition, the resource commitment relates to:

- the business-level deployments of resources (both material and immaterial).

Cool and Schendel (1987) emphasise that past research has not always been attentive to the concept and the definition of strategy. They stress that their definition of strategic groups is still general, but specifies the components that must receive minimum attention. They argue that scope and resource commitments are industry specific and that the determination of the variables used to identify strategic groups is contingent to the industry studied.

Cool and Schendel clearly refer to firms' *stocks* rather than firms' *flows*. Nevertheless, their definition may lead to confusion between strategic groups and competitive groups. An *industry* is supposed to be formed by firms in competition for the same customers. However, it is often the case that an industry comprehends firms focusing on different market segments. Consequently, competition within an industry is not for a homogeneous market, but for a market linked by the elasticity of demand to price variations for the goods offered. From this paper, it is clear that the criterion used to cluster firms together is not one leading to groups characterised by maximal internal and minimal external competition. It seems, rather, that 'competing within an industry' has a broader meaning, incorporating direct and indirect competitive relationships. Therefore, in a heterogeneous, geographically-dispersed market, where not all firms are in direct geographic competition, firms in direct competition may be clustered in different strategic groups and firms which are similar but do not compete in the same geographical area will be clustered in the same groups.

Mascarenhas and Aaker (1989: 475) take a different view of what strategic groups identify, affirming that a strategic group is "a grouping of businesses within an industry that is separated from other groupings of businesses by mobility barriers, barriers to entry and exit." In their view, mobility barriers represent the theoretical core of strategic groups and consequently they should be used to study strategic groups. In Chapter 2, we saw that Caves and Porter created the concept of mobility barriers to address the common financial advantages or disadvantage of firms of the same strategic groups. Mascarenhas and Aaker argue that, because mobility barriers deter movement between groups, a definition based on mobility barriers is better for judging the attractiveness of each group and about the assets and skills needed to compete successfully within each group. In their view, a strategy can be supported by a set of assets and skills but such a linkage does not always exist. If the strategy is not supported by a *unique* set of assets and skills, then it can be easily duplicated because mobility barriers do not exist.

Mascarenhas and Aaker's view had already been advanced by McGee and Thomas (1986)[4], who similarly argue for the importance of the analysis of mobility barriers. "A firm within a group makes strategic decisions which cannot be imitated by firms outside the group without substantial costs, significant elapsed time, or uncertainty about the outcome of those decisions. These barriers to causal imitation by firms outside the group, and the definition of group, require the existence of such barriers." (ibid. 1986: 150). However, McGee and Thomas do not see the necessity of defining strategic groups using a definition of mobility barriers. For them, it is obvious that the strategic variables that are used to identify groups are linked to mobility barriers: "recognising

[4] "Classification of groups by their mobility barriers (or through similar notions of idiosyncratic capital and isolating mechanisms) is an appealing idea which stresses the cost advantages enjoyed by group members and emphasizes the elapsed time as well as the investment expenditures required of would-be

that these mobility barriers (or group-specific entry barriers) afford protection to group members, it is natural to envisage the key strategic variables as those which affect the height of mobility barriers." (ibid. 1986: 150).

Having analysed these three definitions of strategic groups, what can we conclude? Using Dierickx and Cool's (1989) terminology, we can say that the concept of strategic groups and some of the definitions analysed here may give the impression of a shift of focus from the analysis of firms' *stocks* to firms' *flows*. However, the shift is illusionary. Some researchers have identified strategic groups based on similarities in firms' strategic investments [Oster (1982) used 'advertising to sales' ratio to cluster firms], but most researchers have favoured an analysis based on similarities in firms' asset endowments, said to represent firms' strategies.

However, the fundamental question is "what is the concept of strategic groups supposed to identify?" Cool *et al.* (1994: 223) state that "if strategic groups are conceived as elements of industry "structure", then they should be identified on the basis of structural or stable firm attributes, i.e. stocks. In contrast, if strategic groups are conceptualised as a mapping of industry "conduct", then it is appropriate to use control or flow variables to define strategic groups."

We believe that the issue of definition of strategic groups is complex and needs to be linked to the theoretical foundations of the concept of strategic groups.

Thomas and Carroll (1994) have distinguished between a strong definition of strategic groups and a weak one. A strong definition arises from the way the concept of strategic

'entrant' to overcome the barriers" (McGee and Thomas 1986: 150).

groups was developed at Harvard. Firms are similar in all relevant aspects, and because of these similarities, they recognise interdependence and copy each other's moves. Firms of the same strategic groups are also expected to achieve a similar performance. From a typical neo-classical perspective, there is an identification of theory of decision-making with the theory of the firm, so the difference between strategy flows and strategy stocks is not at issue. However, the attention is on structural elements. Therefore, strategic groups should identify strategy "stocks".

A weak definition derives from the view of strategic groups as developed at Purdue. Strategic groups therefore identify firms taking similar independently strategic decisions. The emphasis is on strategy formulation or choice and little attention is given to the relation between strategy formulation and realised strategy or to that between strategy formulation and asset configurations. Therefore, it is not clear whether stocks or flows should be used to identify strategic groups.

Hence, what emerges is that early researchers of strategic groups did not think of differentiating between strategy stocks and strategy flows. The most appropriate explanation seems to be the simplistic view research has taken about the relationship between asset structures and firms' decisions about strategic investments (as well as between strategy and competition). However, because of the popularity of Porter's (1980) book and his definition, as well as Caves and Porter's (1977) paper, we believe that strategic groups should identify firms' strategic positions in their industry (i.e., their asset endowments). Nevertheless, researchers studying strategic groups should clearly state the type of strategic groups they are investigating.

4.1.2 Strategic Groups and the View of Firms' Strategies and Industry Structure Emerging from Empirical Research

Fiegenbaum *et al.* (1987) and Fiegenbaum & Thomas (1990) developed a method for empirical strategic groups research. This method comprises five stages:

(a) choice of the strategy space (industry);

(b) choice of organisational level to analyse (corporate, business or functional);

(c) identification of the variables which best capture firms' strategies;

(d) identification of stable time periods; and

(e) clustering of firms into strategic groups.

This method captures the important phases of the operationalisation process characterising strategic groups research. In this section, we are interested in examining the view of firms' strategies and industry structure emerging from the analysis of the method used for the identification of strategic groups.

The main issue concerning the choice of the industry (phase a) relates the identification of the boundaries of an industry. Thomas and Venkatraman (1988) criticise the implicit acceptance of the pre-specified boundaries of industry based on Standard Industrial Classification (SIC) codes. Their argument is that it is inappropriate to be bound to a SIC scheme that mostly mirrors product variation. Further, when using the SIC codes, the focus tends to be on national companies, and the exclusion of foreign-owned companies and products poses questions about the validity of research findings. They suggest a pragmatic approach, where national and international industries are seen as complementing each other.

When choosing the organisational level at which to analyse firms' strategies (phase b), possibilities exist for identifying firms' strategies at the corporate or business level. Researchers usually consider the latter, the main reason being that the concept of strategic groups has traditionally been directed at the analysis of firms' strategies within the industry. Hence, there is a simplification of the complexity of firms' strategies, as the relation between corporate and business strategy is not examined. However, this process of reduction and simplification appears in even clearer form when we analyse the subsequent phases: the identifications of the variables representing firms' strategies (phase c),; the identification of stable time periods (phase d), and the clustering of firms into strategic groups (phase e)[5].

4.1.2.1 The Identification of Variables Representing Firms' Strategies

On identification of the variables representing firms' strategies (phase c), Porter (1980: 129) argue "usually ... there are a small number of strategic groups which capture the essential strategic differences among firms in the industry". Thus, he suggests that the chosen variables should capture the relevant strategic differences and that a pragmatic approach to the operationalisation of firms' strategies should be used.

Thomas and Venkatraman (1988), in their review of empirical research, find that some researchers use a narrow definition of strategy, focusing on one functional area or a single dimension, whereas other researchers view strategy in broader terms and analyse multiple functional areas or dimensions. IO researchers predominantly use a single

[5] In the discussion, the analysis of clustering of firms into strategic groups (phase e) will be undertaken before the analysis of the identification of stable time periods (phase d). This swap is solely to facilitate the discussion.

variable as a proxy to firms' strategies[6]. This common practice reflects the neo-classical tradition of IO research being concerned with strategic groups analysis, seeing firms in simplistic terms.

The operationalisation of firms' strategies in a simplistic manner has been a matter of concern within SM. Hatten *et al.* (1978) argue that the process of identification of the variables representing firms' strategies within an industry should be based on in-depth case study research. They also assert that strategy should refer to the whole of an organisation. Thomas and Venkatraman (1988: 539) also argue that "the development of strategic groups using a narrow conceptualisation of strategy is unlikely to capture the complexity of the strategy construct, thus limiting the usefulness of strategic groups for both descriptive and prescriptive purposes". Lewis and Thomas (1990, 1994) find that using a narrow or broad definition of strategy has important consequences for the way firms are clustered. In their analysis a number of businesses are clustered in the same groups irrespective of the definition of strategy used, but other businesses are grouped differently.

There is, therefore, an open question about the operationalisation of firms' strategies and the number of variables to use to cluster firms. It is easy to agree with Thomas and Venkatraman that a classification of strategic groups, which uses multiple criteria to group firms, would provide a better view of firms' strategies. However, a more fundamental question is: to what extent is the use of multiple criteria referring to the whole of an organisation likely to capture the complexity of firms' strategies?

[6] Newman (1978), Porter (1979), Oster (1982), and more recently Kumar (1990), all use a single variable to identify strategic groups. Newman (1978) use the degree of vertical integration. Porter (1979) use size as a proxy for strategy. Oster (1982) use 'advertising to sales ratio' as a proxy for product strategy. Finally, Kumar (1990) use country of origin as a variable for grouping firms. The only exception is Amel and Rhoades (1988) who use 15 variables to group firms.

What emerges from the analysis is that:

1. In the analysis of definition of strategic groups, the concept of strategic groups can be used to identify either firms' strategic *flows* or strategic *stocks*.
2. Strategic groups are defined either at the corporate level or at the business level. If the relationship between corporate and business strategies is not considered, as often happens, then we may have a simplistic view of firms' strategies.
3. The exclusive use of data on what businesses have done, implies that only the result of the strategy process is observed[7]. Mintzberg has extensively analysed the differences between an intended strategy and a realised one (Mintzberg *et al.* 1976; Mintzberg and Waters 1985).

It is therefore possible to say that the quantification of firms' strategies into variables inevitably reduces the complexity of firms' strategies. The use of more variables referring to the realised strategy of a business, which may be part of a diversified company, gives a simplified view of the business strategy. This can be seen as a necessary process for comparing and contrasting firms within the same industry. However, problems may arise when the analysis of firms' strategies is exclusively based on the variables identified and it is said that it represents firms' strategies.

4.1.2.2 Clustering of Firms into Strategic Groups

A number of different methods exist for clustering firms into groups (phase e). Harrigan's (1985) article examines some analytical tools that may be used to group

[7] Dess and Davis (1984) use 'intended strategy' based on Porter's typology of the three generic strategies (cost leadership, differentiation and focus) to group firms within the industry. However, by not considering the realised strategy, Dess and Davis also offer a partial view of firms' strategies.

firms based on some criteria. Taxonomies are seen as offering better solutions to researchers for understanding the similarities and differences among firms within the same competitive environment. Among the various taxonomies, cluster analysis is preferred to factor analysis. When using factor analysis, meaningful interpretations of the factor scales used as dimensions in grouping competitors may be somewhat complex unless a reasonable theoretical construct is represented by each factor. Further, object-based factor analysis techniques create overlaps in the identities of firms assigned to different groups. According to Harrigan, cluster analysis does not present the problems of factor analysis, and it has a number of advantages:

1. Cluster analysis does not pre-specify the boundaries of the group. Consequently, if researchers cannot isolate dimensions that describe essential differences among competitor, they can use additional interpretation to identify to which groups assign some of the firms.
2. Cluster analysis indicates the distance existing between strategic groups as well as between companies of the same strategic group. The distance between clusters can be considered as approximating the height of mobility barriers, while the distance between firms can be used as a basis to analyse the differences existing among firms of the same group.

The analysis of empirical research indicates that most researchers use cluster analysis. However, when conducting research on strategic groups, researchers have often made use of cluster analysis in a less than ideal fashion [see Ketchen and Shook's (1996) review on the way cluster analysis has been used in strategy research].

At Purdue, the concept of strategic groups was initially nothing more than an *analytical convenience* (Hatten and Hatten 1987: 329). Clustering techniques were used to verify the statistical significance of "specific" strategic variables on performance. Hence, qualitative research had to be used to assess the link between the various variables. This approach has the advantage of clearly showing the complexity of the firms' strategies and of stressing the existence of differences among firms of the same groups.

Subsequent research has used a different method. Once strategic variables have been identified, researchers generally use clustering techniques to form groups so that homogeneity is at its maximum internally and at its minimum externally[8]. The way cluster analysis has been used in strategic groups research has strongly affected the view of firms' strategies and industry structure. Cluster analysis has the advantage of indicating the distance among companies of the same cluster. However, an analysis of the differences among firms of the same cluster has rarely been made. Groups are generally presented as highly homogeneous internally and highly dissimilar among themselves, which results in a further simplified view of firms' strategies, with differences among firms of the same groups being excluded. However, the view of the industry structure has also been influenced. The industry is no longer seen as a collection of heterogeneous firms, but as a collection of groups of similar firms, a view very similar to Caves and Porter's (1977) perception of the industry.

[8] Thomas and Venkatraman (1988) argue that most researchers do not actually test for the internal homogeneity hypothesis. They only assume it. This leads, in their view, to dubious research findings.

4.1.2.3 Identification of Stable Time Periods

Lastly, we analyse the impact the identification of stable time periods (phase d) has on the view of firms' strategies and industry structure as it emerges from the empirical analysis.

The issue of the identification of stable time periods is important when conducting longitudinal research on strategic groups. The analysis of empirical research indicates that most longitudinal research is conducted in SM. In IO, researchers are mainly interested in either confirming the assumption of the existence of heterogeneity within an industry or in proving the existence of a relationship between strategy and performance. This has mainly been done by examining several industries and geographical markets over a short time period, with the assumption that these markets are in equilibria[9].

SM empirical research is more varied. Although many researchers still study firms' strategies over a short period, there has also been research on single industry over a long period. (Hatten *et al.* 1978; Cool and Schendel 1987; Fiegenbaum and Thomas 1990, 1993).

When studying strategic groups longitudinally, there is a problem about how to measure change. Hatten (1974) first paid attention to the influence of time on competitive strategy. "He initially assumed that the brewing industry would exhibit homogeneity in strategic behaviour across time, and then subsequently relaxed this assumption by using

[9] Newman (1978) consider 34 four-digit producer goods industries all related to chemical processes. Porter (1979) analyse 38 three-digit consumer goods industries. Oster (1982) examine approximately 2700 firms in over 40 consumer goods industries for a over 7 year period, and Kumar (1990) analyse 43,

content analysis of annual reports to determine break-points at which strategic heterogeneity manifested itself" (Fiegenbaum *et al.* 1987: 139). Cool and Schendel (1987) develop a *more objective* technique to identify changes in firms' strategies and groups structures. A statistical technique, based on the test of the variance-covariance matrix of strategic variables for a given firm over time, enables the identification of 'transition points' separating sub-periods with distinct strategic groups structures. Cool and Schendel (1987: 1114) stress that the "statistical procedure alone, however objective, cannot establish whether the transitions observed are owned to exogenous shocks in the environment, are triggered by autonomous firm actions, or are due to some combinations of both". Their study of the industry indicate that major changes had taken place in the industry. This provided a potential explanation for the changes in firms' strategies. However, "a more extensive analysis would be needed to establish causal relationships between these changes and the observed patterns of strategic group formation" (ibid. 1987: 1114). Once stable periods and groups have been identified, Cool and Schendel study the relationship between strategy and performance for each period.

The use of statistical technique to identify 'relatively' stable sub-periods enables researchers to form strategic groups in a relatively easy way. The technique also enables researchers to identify the dynamics of firms' strategies and groups structures. However, the way longitudinal strategic groups research is conducted reveals two interesting issues:

1. Firms' strategies and industry structure are seen in equilibria during each strategic time period. When the equilibria end, some firms change their strategies; at the same

three digit, Indian manufacturing industries.

time, new strategic groups are formed while others disappear. This process is instantaneous and new equilibria follow as companies move into the next stable time period. Only the result of the process of change is observed. Nothing is known about the internal and external context as well as how the process of change has developed. Transition points are identified on the basis of statistical techniques, thus averaging out differences between firms that may have started this process in different years.

2. The stability of firms' strategies and groups structures is justified through the existence of mobility barriers inhibiting firms from changing their strategies. However, the end of each stable period should, theoretically, be characterised by changes in the relevance of mobility barriers. However, the dynamics of mobility barriers are not considered. This is consistent with the little attention given by researchers to changes in the importance of strategic variables. The same strategic variables have been used across the entire period of study to identify firms' strategies. There is therefore an underlying assumption that these strategic variables have remained significant for the whole period, even when changes in the strategic groups structures have occurred.

3. As mobility barriers, by definition, only refer to group-common characteristics, no attention is given to firms' specific characteristics, thus strengthening the view of firms of the same strategic groups as being very similar.

4.1.3 Summary

In this review, we have seen that:

1. Different definitions of strategic groups have been proposed with emphases on different elements. However, there is general agreement that strategic groups should identify groups structures within the industry, reflecting asset endowments. In the original development of strategic groups, no distinction was made between firms' asset endowments and firms' strategic investments. This is a consequence of the simplistic view initially taken about the relationships between strategy stocks and strategy flows.
2. Strategic groups are generally identified at the business level. However, as it happens, if the relationship between business unit and corporate centre is not examined, an important variable for the analysis of firms' strategies within an industry will not have been considered (Porter 1980).
3. Strategies are operationalised through a number of variables representing the relevant aspects of firms' strategies. This is a necessary step for the classification of firms' strategies but inevitably simplifies the complexity of firms' strategies.
4. Clustering techniques tend to highlight similarities among firms and therefore, the use of these techniques further smooth out differences among firms.
5. In strategic groups research, it is generally assumed that the industry is in equilibria. When longitudinal analysis is carried out, the period taken into consideration is divided into stable sub-periods of time. In the analysis of the dynamics of firms' strategies and industry structure, changes in the structure of the industry and in firms' strategies occur instantaneously. However, the significance of the strategic variables remains the same and nothing is said about the dynamics of the variables responsible for firms' performance or inhibiting firms from changing their strategy.

It is therefore clear, that at each stage of the empirical process leading to the formulation of strategic groups, the method used for strategic groups analysis tends to simplify the complexity of firms' strategies, smooth out the differences and homogenise firms into groups. The resulting view is one of an industry composed of internally homogeneous groups structures. This poses some questions in relation to the epistemological meanings of the way strategic groups research has been conducted, the focus of next Section.

4.2 The Epistemological Characteristics of Strategic Groups Research

The review indicates that research on strategic groups as performed in SM and IO carries a neo-classical economic perspective of firms and industry structure. The industry is static, in equilibria, which are broken at a specific point in time either by internal or external events. At this point on time, a firm may change its strategy; new groups may be created while others may disappear. Changes happen instantaneously and new equilibria are again reached within the industry. When analysed longitudinally, the method gives little indication as to the process of change and how it was carried out. The view of firms' strategies is a static one and the analysis of change is a multi-static one.

The simplistic view of firms' strategies as exposed in strategic groups analysis can only be partially attributed to the origins of strategic groups. As we have seen in the previous chapters, the concept of strategic groups as developed at Harvard (IO) is posited on the neo-classical theory of the firm. In neo-classical economics, there is a correspondence between the theory of the firm and the theory of decision-making (Zan and Zambon, 1993). Consequently, the identification of the final results of firms' strategies could effectively be thought as identifying firms' strategies. Further, the deterministic tradition of IO pays little attention to contextual complexities. However, the story is a different one in SM. When the concept of strategic groups was initially developed at Purdue, the concept was nothing more than an *analytical convenience*. Firms' strategies were seen as complex and firms of the same groups were *comparable but different*. The use of clustering techniques was undertaken to maintain the complexity of firms' strategies and to stress differences among firms. Research since then has used different methods. Once strategic variables have been identified, clustering techniques are used to identify groups where homogeneity is supposed to be at its maximum internally and at its minimum externally. Differences among firms have a residual role. They are analysed when the main variables do not suffice to explain initial hypotheses about firms' strategic behaviour or the relationship between firms' strategies and performance. At the same time, the concept of mobility barriers has been used to stress the existence of elements inhibiting firms from changing their strategy within the industry. This was originally developed in the IO stream of strategic groups research, and the context in which it was developed was meant to identify those barriers protecting incumbent firms (enabling them to earn higher profits).

Based on this analysis, it is clear that, in the SM research stream of strategic groups research, there has been an increasing use of concepts and methods typical of IO. However, there has been little integration with other theoretical developments in SM.

When the concept of strategic groups was developed, *strategy formulation* was the dominant approach in the strategy field (Rumelt *et al.* 1994). Researchers were mainly interested in issues relating to the alignment between firms' resources and a theoretical 'optimal' existing in the environment. This view paid little attention to the continuous dynamics of the environment; it also paid little attention to the firms internal complexities. It was not until the late 1970s that the complexities of the environment and internal characteristics were fully appreciated (Mintzberg *et al.* 1976; Weick 1979). However, little of this complexity has been incorporated in strategic groups research.

Having analysed the historical evolution of strategic groups research over the 1980s and early 1990s, it is possible to say that strategic groups research has been characterised by an increasing simplification of the strategy construct. In the next section, we will analyse the implications of this type of approach to strategy research.

4.2.1 Simplistic and Deterministic Approaches to Strategy Research

Simplification is typical of deterministic approaches to management and strategy research. Researchers, in pursuit of deterministic explanations, reduce the complexity of the object they research, leading to a simplification of the events. Bourgeois (1984: 590) point out the problems of using such an approach for the study of firms' strategies:

> "The primary limitations of deterministic theories ... are that they: (1) are reductionist, resulting in losing the richness of both independent variables (such as environment) and dependent variables (structure, strategy); (2) ignore reciprocal cause - effect; (3) if pursued to their extreme, result in hyper - contingency theories or studies of situational cases; most important; (4) reduce managers to mechanistic computers who must apply scientific laws to achieve results; and (5) relegate managers to a passive role, constrained by a variety of forces."

Thus, "the inherent reductionism eliminates much of the richness that characterizes the strategic management process, and that they may constrain the advancement of strategic management as an academic discipline." (ibid. 1984: 586). He finds 'curious' the development of a deterministic approach in management research. It is difficult, he argued, to explain the spread of deterministic approaches in a research field traditionally characterised by qualitative, processual types of research.

For strategic groups research, the use of a deterministic approach has implied that although a distinction between strategic and operational issues has been proposed (Hatten *et al.* 1978), only strategy variables have been considered as "over a long time period, strategy, whether good or bad, dominates operational efficiency" (Hatten *et al.* 1978: 598). The argument that the strategy a company follows determines its performance and the relative insignificance of operational issues, reproduces on a smaller scale the neo-classic economic view of a company as a "black box", where the role of market mechanisms is replaced by the role of strategy decisions. Firms are now seen as playing a determining role in their performance, but this role is restricted to the choice and is only loosely linked to the inner context of the firm. Top management has little discretion; it can chose the right strategy or fail.

A second problem is that firms' profitability depends upon the profitability of the other firms of the same group. We have therefore a second important problem of recognising the role of the specific firm in a group structure.

Barney and Hoskisson (1990) fundamentally doubt the advantages of using a model based on IO economics deriving from a neo-classical theory of the firm in strategy research. They question whether it is worth continuing research on strategic groups or whether the concept should altogether be abandoned "in favour of a model based on the idiosyncratic attributes of individual firms." (ibid. 1990: 195)[10].

> "Despite the apparently close link between IO economics and the theory of strategy, the integration of these two theoretical traditions has not been without difficulties ... Primary among these has been the different units of analysis they employ. IO economics has been developed at the industry level of analysis and IO economists have generally assumed that firms in an industry are homogeneous except for differences in size ... while strategic theory has been developed at the level of the individual firm, or at the level of the strategic business unit within a firm, and strategy theorists have assumed that firms within an industry are idiosyncratic in strategically important ways ...
> These differences between IO economics and strategic theory manifest themselves most clearly when applying IO logic to help firms choose strategies ... IO logic can only assist firms in analyzing their external opportunities and threats ... It cannot be used by firms to analyze their individual strengths and weaknesses, strategy theorists require a conceptual model that includes some degree of intra-industry firm heterogeneity as a key component. Traditional IO economics ... does not meet this requirement" (ibid. 1990: 188).

Our position is that if there are no doubts about what determines what and this is empirically proven, there are not inherent problems with deterministic approaches to strategy research. The problem is that the existence of an unequivocal link between strategic groups and performance is arguable.

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[10] Barney and Hoskisson's argument is mainly directed at the theory of strategic groups emerging from the paper of Caves and Porter (1977) and was analysed in the second chapter. Their analysis is not complete as strategic groups as developed at Harvard stands in opposition to the view of strategic groups emerging from the research conducted at Purdue, where "... groups do not exist and a strategic group is not an antropomorphized unified competitive force of many firms. It is merely an analytical convenience."

4.3 Summary

The initial objective of this chapter was to analyse the view of firms' strategies and industry structure as it emerges from strategic groups research. A number of interesting observations surface from this analysis:

1. The simplification of firms' strategies and industry structure characterising strategic groups research is only partially due to the theoretical framework which was initially proposed. At Purdue, the focus of the analysis was on similarities and differences among firms of the same group.
2. Over time, the strategy concept in the strategy field has become more complex. This complexity, it could be argued, would require a more refined type of analysis and multiplicity of methods. However, there has been a trend in strategic groups research conducted in SM to adopt a more simplistic view of firms' strategies, though this was initially only typical in IO. The stress on similarities rather than on differences, the relatively simplistic view of firms' strategies and the use of the concept of mobility barriers as a means of explaining stability in firms' strategies over time, all contributed to a significant shift within strategic groups research from a view of groups as being a cluster of firms with significant similarities but fundamental differences, to a view of groups as being a homogeneous entity. In other words, there has been a shift in SM to a way of undertaking research that reflects Caves and Porter's IO view of strategic groups. This has been supported by the method used in analysing the dynamics of firms' strategies with strategic groups analysis.
3. Finally, while the practice has been to identify firms' strategies through variables, the review questions the extent to which this approach illuminates firms' strategies

(Hatten and Hatten 1987: 329).

and industry structure. Research has focused on either confirming the hypotheses of the existence of a relation between firms' strategies and their performance or on analysing the dynamics of firms' strategies and groups structure in an industry. The approach used says nothing about the reasons behind the dynamics of firms' strategies and industry structure. However, the way quantitative techniques are used leads to a neo-classical view of the firm and the industry. The main consequences include a reification of the nature of the firm and an increasing importance of hypotheses about other external conditions.

Chapter 5 Strategic Groups Research and the Development of other Theoretical Approaches

5.0 Introduction

In the preceding chapters, we analysed the theoretical foundations of the concept of strategic groups (Chapters two and three) and we examined the characteristics of the development of strategic groups research (Chapter four). On the one hand, the analysis indicates a number of problems with strategic groups theory and, on the other hand, an increasing reliance on quantitative techniques in studying strategic groups, with a shift towards a neo-classical view of firms and industry structure. The latter is characterised by a simplistic view of firms' strategies and by a mechanistic view of industrial and strategic change.

Since the late 1980s, studies have developed which, directly and indirectly, question strategic groups research. At one level, is the development of a number of studies looking at groups structures within an industry from different perspectives. At a second level, there are some attempts to stress the specificities of firms, in a context that still highlights the importance of similarities among firms of the same groups. At a third level, is the emergence of an evolutionary theory of the firm, which challenges the assumption and hypotheses characterising research based on neo-classic economic theory. In this chapter, we analyse these three streams of research.

Attempts have been made to reconcile some approaches for the analysis of groups

structures within the industry. However, fundamental questions and challenges for strategic groups, have remained unanswered. The problem is that there is still little understanding of the industry structure and the dynamics of firms' strategies within an industry. We believe that there will be little progress on these issues until a better understanding of the dynamics of the industry structure and firms' strategies, and of the complexity of this process, is achieved. Having reviewed these approaches and assessed their impact on strategic groups, two research themes are set up, which will drive the empirical research. Around these themes, a number of more detailed questions for the empirical research are outlined.

5.1 Alternative Frameworks for the Analysis of Groups Structures within an Industry

In this section, we analyse the main characteristics of two approaches that look at groups structures in similar competitive environments from two different theoretical perspectives: population ecology of organisation and cognitive communities.

5.1.1 Strategic Groups and Population Ecology of Organisations

Ecology approaches to the study of population of organisations have developed out of the seminal paper by Hannan and Freeman (1977): *The Population Ecology of Organizations*. Hannan and Freeman argue the advantages of using population ecology models originating from biology to study and explain the emergence, growth and decline of populations of organisations.

In population ecology, the existence of different organisational forms is explained by the existence of different environments (i.e. niches). Growth of an organisational species and its stability over time is a function of (a) the quantity of resources that a specific environment can offer and (b) of competition with other species living in the same environment.

The same territory can provide many niches for a plurality of species that use different resources. However, if a second population *migrates* to the same niche and makes use of the same resources, there will be competition among species. The more similar that populations are, the more difficult it is for the same environment to sustain two populations in equilibria. The tougher that competition for scarce resources is, the more likely it is that the less apt organisation will be eliminated.

The existence in the environment of (a) limited resources, (b) competition, and (c) stability explains the phenomena of stability, homogeneity within species and isomorphism (i.e., the existence of an ideal match between the niche and an organisational form). Isomorphism can result either because non-optimal forms are "selected out" of a community of organisations or because organisational decision-makers learn optimal decisions and adjust organisational behaviour accordingly. Although it is recognised that a selective view must be complemented with an adaptive one, population ecology focuses exclusively on selection processes. This is justified by the existence of *structural inertia*, which constrains the range of alternatives available to

firms. One implication is that if radical changes occur in the environment, organisations will tend to be relatively inert to environmental changes, and therefore will be selected out. Inertial pressure is due to both internal structural arrangements and environmental constraints.

As the focus of population ecologists is on the dynamics of populations of organisations, performance is also an important issue. However, whilst performance has traditionally been measured in management research with financial ratios, population ecologists have introduced different measures of performance (i.e., rates of deaths and survival of organisations over time).

With the attention on populations of firms with similar characteristics in relation to a number of criteria and on the performance of populations over time within a certain environment, it is not surprising that there have been studies proposing population ecology of organisations as a theoretical framework for strategic groups research. Two studies have analysed strategic groups from a population ecology perspective: Boeker (1991) and Carroll and Swaminathan (1992). The key premise is to examine strategic groups as *species* and to analyse their dynamics within the same competitive environment.

According to Carroll and Swaminathan (1992), the existence of conflicting evidence on the relationship between strategy and performance is due to two methodological aspects: (a) how strategic groups are identified and (b) how performance is measured. In their view, groups should be identified on the basis of some organisational form criteria rather than on the basis of criteria trying to identify the strategies of firms, as the latter are vague and ambiguous, and therefore open to different interpretation. By organisational form, Carroll and Swaminathan (1992: 68) mean "much more than the formal structure of the organisation - it includes all factors that define a population's niche, including especially environmental factors". Interestingly, Boeker (1991) and Carroll and Swaminathan (1992) use the same industry (the US brewing industry) for their analysis but they employ different criteria to identify strategic groups and cluster groups differently[1]. There are therefore doubts concerning the unequivocal advantage of using a population ecology approach to study strategic groups.

At a theoretical level, there are interesting similarities and differences between the theory of strategic groups and organisational ecology. Researchers of both approaches argue that there are mechanisms that inhibit firms from changing their strategy (mobility barriers and structural inertia) and in both approaches, the focus is on groups analysis. Similarly to strategic groups theory, population ecology of organisation is deterministic in character. However, the determinants are contrary in the two theories. In strategic groups, performance is determined by strategy. In population ecology, the environment determines the fortune of businesses. Hannan and Freeman recognise that adaptive and selective views ought to be seen as complementary rather than as alternatives. However, the entire theory of population ecology and related models are based on the fundamental assumption that it is the environment that determines firms' fortunes. This issue creates notable difficulties for using population ecology frameworks in strategic groups research. Further, the deterministic nature of population ecology, with its focus on the environment, means that little attention is paid to the nature of industrial and business change over time.

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[1] Boeker (1991) identifies three groups of Brewers: national firms, regional firms and local firms. Carroll and Swaminathan (1992) identify three different groups: mass producers, microbreweries and brewpubs.

At another level, it is particularly interesting in organisational ecology is the idea of distinguishing between firms and environment with attention to the relationships between these two elements (in strategic groups, the environment is incorporated in the industry/groups). By analysing these two elements independently, there is a possibility of increasing our understanding of the complexity of the relationship between the two.

5.1.2 Strategic Groups and Cognitive Communities

A second research stream that analyses groups structures within an industry comes from cognitive analysis and goes under the name of **cognitive communities**. The theoretical background of this research lies in cognitive science. Stubbart and Ramaprasad (1990: 251-252) describe the nature and scope of cognitive analysis:

> "Cognitive science characterizes minds ... as intentional, representational, and computational. In addition, it stresses the significance of tracking the overt manifestations of intelligent behaviour: intelligent strategic behaviour in strategic management - that is, observing what strategists do. These four themes span philosophy, cognitive psychology, artificial intelligence, and anthropology, respectively. A cognitive science approach ... uses these four themes to comprehend managerial minds: fathoming managers' strategic intentions, deciphering their representational knowledge about strategy, studying their reasoning processes and recording a description of managerial behaviour in strategic management settings. In short, cognitive science applied to strategic management means that scholars must research, model, understand and extend the mind(s) of strategic managers".

Research on cognitive communities has developed from research concerned in how management of different firms perceives the competitive environment and acts on the basis of it. The argument is that there is a difference between what has traditionally been defined as an objective environment and what top management perceives. Top management takes decisions on the basis of how it perceives the environment; the way management sees its firm's activities and its competitors is expected to have tangible effects on strategy reformulation and subsequent industry structure. "Material decisions ultimately reflect the intuition and cognitive constructions of decision makers. At a **cognitive** level, business competition must be analysed in terms of the mental models of decision-makers and how such mental models lead to a particular interpretation of the competitive milieu" (Porac *et al.* 1989: 398).

Thomas and Carroll (1994) argue that two definitions of cognitive communities can be identified. The **weak definition** limits the analysis to similarities of cognitive communities. It is argued that individuals sharing similar beliefs about a given transaction will be more likely to interact among themselves. Furthermore, they may influence each other through the diffusion of information. The **strong definition** requires further active interactions, mutual influence and collective efforts. These have also been defined as ***cognitive oligopolies*** (Porac *et al.* 1989) to indicate the importance of interaction between firms. A cognitive community could therefore extend the boundaries of rationality by pooling existing information and cognitive resources.

Porac *et al.* (1989) examine the relevance of managerial cognition for strategic groups analysis. They indicate that industry participants share perceptions about strategic commonalties among firms and that participants cluster competitors in subtle ways not reflected in extant research on strategic groups. They also argue that decision-makers' perceptions and cognitions are phenomena that can be expected to influence industry evolution. They therefore call for complementing traditional strategic groups analysis with a cognitive-based type of research. "When attempting to understand the strategic interactions occurring within and among groups of similar firms, the social

psychological reality of 'the group' must be taken into account" (ibid. 1989: 413). The argument is that strategic groups is a useful technique when the aim is to assess similarities and differences among firms regardless of their strategic relevance. However, for a comprehensive analysis, it is necessary to examine managerial perceptions and how they influence strategy formulation. [See also Bogner and Thomas (1993) and Reger and Huff (1993)].

By using a cognitive perspective, it is also possible to provide a solution to the problem of the underlying static characterising strategic groups research. In both strategic groups and cognitive communities, top management has some external reference points influencing its decision activities. However, in cognitive research, reference points change because cognition is a continuous process, with a continuous internal dynamics. In strategic groups, sensemaking is not a continuous process. Management has a clear cognitive structure of industry and competition, and this state remains until new changes occur in the industry.

However, there are a number of problems with cognitive research. Reger and Huff (1993: 119) point out that "Research shows, ... that established mental maps lead individuals to ignore contradictory data (e.g., Prahalad and Bettis 1986). Thus, a problem with cognitive associations is they may not reflect evidence from a changing world. Cognitive structures also are inevitably based on incomplete knowledge, and even the simplest inferences are frequently biased (Schwenk, 1984)".
Weick (1995) also notes that there is little understanding of how cognitive structures develop. The focus of cognitive studies is on attending to cues in the environment, interpreting the meaning of such cues and then externalising these interpretations via

concrete activities. Meaning is created when cues are linked with already learned or developing cognitive structures (Porac *et al.* 1989). However, what is left unspecified is "how the cues got there in the first place and how these particular cues were singled out from an ongoing flow of experience. Also unspecified is how the interpretations and meanings of these cues were then altered and made more explicit and sensible, as a result of 'concrete activities' " (Weick 1995: 8). Cognitive communities "seems more evolutionary than planned, having developed over several decades in response to problems encountered in the market place" (Porac *et al.* 1989: 404).

There is no doubt that cognitive research provides an interesting area of research for strategy researchers interested in the dynamics of firms' strategies, especially in the area related to the process of changes in firms' strategies. The main problem lies in the little attention given to firms' performance and dynamics, which are at the heart of strategic groups research and strategy research (Rumelt *et al.* 1991). Further, where the focus of analysis is on industrial and business change, it is necessary to complement cognitive analysis with other approaches, to help us understand the mechanisms underpinning the dynamics of the competitive environment (i.e., innovation and competitive positions).

5.2 Integration of Firms' Specific Aspects with Strategic Groups

Having analysed research on groups structures in similar competitive environments from different perspectives, in the following two Sections we examine research on firms' specificities within a context that still highlights the importance of commonalities

among firms. The first approach examined argues for an integration of Porter's (1979) theory of firms' profitability. The second supports the integration of the Resource Based View of the firm.

5.2.1 A Stronger Integration of Porter's (1979) Theory of Firms' Profitability

In Chapter two, we examined how Porter's (1979) paper departs from his 1977 paper with Caves. Porter (1979) argues that when studying the relationship between strategic groups and performance, other elements at group and firm levels should be taken into account. These may be responsible for differences in performance among firms of the same strategic groups. Cool and Schendel (1988) find that little of Porter's (1979) theory on firms' performance has been included in empirical research. "That this empirical research produced mixed results should not be surprising given the many (potentially) intervening variables that have been identified since the formulation of the original IO model. If the conflicts noted are to be resolved, then it is likely that a richer, unfortunately more complex, model which includes the moderating factors ... needs to be developed" (Cool and Schendel 1988: 208). In particular, they call for a stronger integration of Porter's (1979) paper as a way forward for understanding performance differences among firms of the same strategic groups. However, researchers on strategic groups have rarely tried to incorporate elements other than firms' strategies in their analyses in groups structures. The only attempts to integrate Porter's (1979) theory on research studying the relation between strategic groups and performance has been made by Cool, who has often addressed this issue (Cool and Schendel 1988; Cool and Dierickx 1993). In the first paper, Cool and Schendel analyse the relevance of risk on performance differences. In the second, Cool and Dierickx study the role of rivalry on performance differences among firms. However, the theoretical inconsistencies of Porter's (1979) paper identified in Chapter two are not taken into consideration. Therefore, the problems in the theoretical framework proposed by Porter in his 1979 paper, which were discussed at the end of Chapter two, remain.

5.2.2 The Resource Based View (RBV) of the Firm and Strategic Groups

Researchers of the Resource Based View (RBV) of the firm have also stressed the role of firms' specificities as a determinant of profitability. The RBV can be seen as a development of the Chamberlainian view of the firm and Penrose's (1959/1963) theory of the growth of the firm. As such, the RBV has affinities with the Chicago School of IO. In IO, the Harvard School of thought stands in opposition to that of the Chicago School (Rumelt *et al.* 1991). Researchers from Harvard argue that higher profits are due to the market power of large companies, which exploit market inefficiencies. On the other hand, researchers from the Chicago School claim that higher profits within an industry result from greater efficiency by the leading firms. Greater efficiency is expected to lead to greater market share and profitability. This view stems from the character of US legislation that, for a long time, had strong anti-merger and anti-acquisition policies for firms operating in the same sector. According to the Chicago School, efficient firms are able to earn higher profits and consequently are able to fund faster growth. Hence, they will outpace competitors and increase the level of concentration in the industry. Consequently, the industry structure reflects efficient outcomes rather than market power (Rumelt *et al.* 1991).

In her seminal work on the theory of the growth of the firm, Penrose (1963: 24) argues:

> "The cohesive character than an administrative organization imparts to the activities of the people operating within it provides the justification for separating for analytical purposes such a group from all other groups. The activities of the group which we call an industrial firm are further distinguished by their relation to the use of productive resources for the purpose of producing and selling goods and services. Thus, a firm is more than an administrative unit; it is also a collection of productive resources the disposal of which between different uses and over time is determined by administrative decision".

Penrose's work is characterised by her focus on the firm, and specifically, on its internal characteristics. She distinguishes between physical and human resources and makes an important distinction between resources and services:

> "it is never **resources** themselves that are the 'inputs' in the production process, but only the **services** that the resources can render. The services yielded by resources are a function of the way in which they are used - exactly the same resource when used for different purposes or in different ways or in combination with different types or amounts of other resources provides a different service or set of services. The important distinction between resources and services is not their relative durability; rather it lies in the fact that resources consist of a bundle of potential services and can, for the most part, be defined independently of their use, while services cannot be so defined, the very word 'service' implying a function, an activity" (ibid. 1963: 25).

Since the late 1980s, the RBV has received considerable attention in strategy research. A number of researchers have explored in more detail the idea of examining a firm as a system of resources and have tried to link firm's resources and performance. Grant (1991) and Amit and Schoemaker (1993) have proposed a somewhat different way of looking at the firm than offered by Penrose. They distinguish between resources and capabilities. *Resources* are defined as stocks of available factors that are owned or controlled by the firm. They are converted into final products or services by using a wide range of other assets of the firm and bonding mechanisms such as technology, management information systems, incentive systems, and trust between management and labour. Resources consist also of knowledge that can be traded (e.g., patents and licences), financial or physical assets (e.g., property, plant and equipment) and human capital. *Capabilities*, on the other hand, refer to a firm's capacity to deploy resources using organisational processes to effect a desired end. The focus is therefore on resources rather than the services these can provide.

In the RBV, each firm has specific resources and capabilities. Two firms may resemble each other along some important structural dimensions. However, they are still regarded as unique and distinct entities.

At the level of the practitioner, it is argued that in the formulation of strategy, each firm has to examine the potential of its resources for the generation and the appropriability of the returns and to assess how sustainable its competitive advantage is. Hence, based on this analysis, it has to select a strategy that best exploits the firms' resources and capabilities. "The general point is that by analyzing his resource position, a manager would have a clearer understanding of whether his situation meets necessary conditions for a sustainable advantage. Fewer strategic mistakes would be made" (Peteraf 1993: 187).

Lawless *et al.* (1989) have proposed a model of firm's performance using the RBV. They test for a relation between strategic groups and performance, finding little empirical support for their hypothesis. This leads them to further develop their model, whereby performance becomes a function of industry structure, group membership and firms' capabilities:

Performance = *f* (industry structure, group membership, and firm capabilities)

However, by looking at the terminology used by Lawless *et al.* in their model (i.e., group membership), we can say that there is not much difference in it from Porter's (1979) theory of firms' performance, which implies that groups structures exist as entities within the industry and are clearly identified by their members. Nevertheless, it is very different from what Hatten *et al.* (1978) theorise. Researchers from the RBV of the firm have not addressed the issue of how firms behave within a competitive environment. Therefore, a more appropriate way of putting the determinants of performance would be as follows:

Performance = *f* (Environmental factors; firm specific factors; common factors at the group level)

However, this represents a backward step compared to Porter's (1979) theory of firm's profitability as the RBV pays little attention to the characteristics of the external environment and to firms' behaviour given the existence of strategic similarities. The RBV is a more introspective theory - the focus is on the firm rather than on the external environment.

A number of other problems rest with the RBV of the firm. Porter (1994) notes that the RBV has been proposed as a theory of strategy. Surely, he says, to maintain their competitive advantage, firms should take care of their resources, still in the RBV:

a) there is little understanding about how resources are developed and about changes in the value of resources;
b) little attention is given to the issue of sustainability of firms' performance; and
c) resources and capabilities are seen as the determinants of firms' success. However,

resources are not valuable in themselves. Their value is a function of their availability on the external market. This issue is not addressed in the RBV of the firm.

Porter (1994: 446) notes that researchers of the RBV are just beginning to discuss these issues and that the RBV of the firm cannot be seen as an alternative theory of strategy until these fundamental issues are solved.

> "The resource-based view cannot be an alternative theory of strategy. It cannot be separated from the cross-sectional determinants of competitive advantage or, for that matter, from the conception of a firm as a collection of activities. Stress on resources must complement, not replace, stress on market positions".

Porter argues that the resource-based view does not shed any light on "why can valuable resources be created and sustained?" (ibid. 1994: 448). It has to be said that Peteraf (1993) has written a paper that spells out the underlying the economics, the conditions underlying competitive advantage, which are at the heart of the RBV of the firm. In her view, the four conditions are:

(a) heterogeneous resource-based bundles and capabilities underlying firms' production. Heterogeneity in an industry may "reflect the presence of superior productive factors which are in limited supply" (ibid. 1993: 180);

(b) the preservation of the condition of heterogeneity. "*B*y this I mean that subsequent to a firm's gaining a superior position and earning rents, there must be sources which limit competition for those rents" (ibid. 1993: 182). Two critical factors limiting *ex-post* competition are imperfect imitability and imperfect substitutability;

(c) imperfect mobility of resources. If resources are immobile or imperfectly mobile, resources are non-tradable or less valuable to other users; and finally,

(d) *ex-ante* limits to competition. "By this I mean that, prior to any firm's establishing a superior resource position, there must be limited competition for that position" (ibid. 1993: 185).

However, Porter (1994: 445) is highly sceptical of Peteraf's theory of strategy "what is really unique about a firm, so the argument goes, is its bundle of resources. It is factor market impediments, then, rather than product-market circumstances that define success. The role of internal resources is an important insight for economic modeller, though not as novel a notion for strategy researchers".

The position taken here is that Peteraf spells out the conditions necessary for a firm's competitive advantage. However, she is limited in her analysis of the characteristics of the process leading to a superior performance and its dynamics. Furthermore, she uses some concepts that are characteristic of the evolutionary theory of firms' strategies without examining their potential implications. As already noted, notwithstanding the considerable step made toward incorporating elements of the external environment, her focus is still very much on the firm and little attention is given to the characteristics of the external environment.

5.3 The Evolutionary Theory of Firms' Strategies and Strategic Groups Research

Alongside the approaches just examined, a research stream has emerged within SM that criticises the neo-classical theoretical framework characterising the strategy literature.

This approach also proposes an alternative theoretical framework for the analysis of the dynamics of firms' strategies and industry structure as well as for the determinants and dynamics of firms' profitability. This is the evolutionary theory of firms' strategies.

5.3.1 The Evolutionary Theory of Firms' Strategies

In the context of this research, we are particularly interested in the evolutionary approach originating from economics and the theory of firms and organisation[2]. The former has its main reference point in the work of Schumpeter (1911/1934, 1942). The latter has developed from the work of Simon (1957), Cyert and March (1963), Penrose (1959/1963) and Nelson and Winter (1982).

Schumpeter reasoned that the focus of research in economics should be on how capitalist economies develop. In the *Theory of Economic Development* (1911), Schumpeter argued that *entrepreneurs* are the key to economic development and that the economy is in continuous evolution because of the innovations entrepreneurs introduce into the market, enabling them to earn profits. The introduction of new and better products has the effect of changing the initial conditions of the market, with established firms forced to adapt to changes or to exit the market. "There are winners, and losers in Schumpeter's 'process of creative destruction', and these are not determined mainly in ex-ante calculation, but largely in ex-post actual contest" (Nelson

[2] It is not easy to accurately define what constitutes an evolutionary approach. Saviotti and Metcalfe (1991: 2) argue that "in order to establish the conceptual foundations of an evolutionary approach it must be realised that a number of research traditions are related and contributing to it." They identify five research traditions that discuss evolutionary approaches (Economics; Biology; Chemistry and Physics; Theory of Complex Systems; and Theory of Firms and Organisations). Although, there are important differences among these approaches, they assume a secondary role when compared with the more fundamental differences with the neo-classical theory of the firm.

1991: 66). By 1942, when he published *Capitalism, Socialism, and Democracy*, Schumpeter's view of the how capitalist economies develop had evolved. The development of large corporations, with their Research & Development laboratories influenced his thought. He argued that the "modern firm, equipped with research and development laboratories, became the central innovative actors in Schumpeter's theory" (Nelson 1991: 67).

For a long time evolutionary researchers have been primarily concerned with criticising the most 'famous' and widespread neo-classical competitive models and their descriptive or normative validity. However, while the economic analysis of innovation and entrepreneurship has been only weakly concerned with the description of real events. However, since the late 1970s, notable progress has been made in the development of an evolutionary theory of firms' strategies. A number of researchers have analysed the role of uncertainty (Boxer 1979; Wensley 1979) and ambiguity (Mintzberg *et al.* 1976; Rumelt and Wensley 1980; Wensley 1982; Rumelt 1984) in management research. This has led to a number of papers (Wensley 1982; Rumelt 1984; Rumelt 1987) that emphasise the problems of using a neo-classical model for the analysis of the firms' strategies within an industry and for analysis of the competitive environment. The most important paper is by Rumelt (1984), who poses the basis for a strategic theory of the firm. In 1987, Rumelt published a second paper, completing the arguments presented in the first paper. The papers use an evolutionary framework, where the fortunes of firms are the result of both entrepreneurial activities by firms as well as of the behaviour and characteristics of the competitive market. The focus is mainly on the interface between firms and competition rather than on the internal characteristics of the firm.

At around the same time, the work of Nelson and Winter (1982) gave an important impetus to research analysing the internal characteristics of the firm from an evolutionary perspective. In the following two Sections, we analyse (a) the view of the firm and the market as it emerges from the evolutionary theory and (b) the organisational context of the firm.

5.3.2 Firms, Competitive Market and Profitability in an Evolutionary Perspective

The simplistic view of entrepreneurship, resource heterogeneity, uncertainty and ambiguity that characterises models based on a neo-classical perspective, is a matter of concern for evolutionary researchers. In traditional neo-classical models, innovation is external the market and firms are generally seen as having a perfect knowledge of the factors determining performance and how to combine them. Consequently, it is expected that firms, with similar deployment of assets and resources, achieve, *ceteris paribus*, similar performance. When uncertainty is taken into account, the possible outcomes are known *ex-ante* and uncertainty is seen in terms of probabilities associated with the possible outcomes (Wensley 1982). The industry and the market are stable and this state continues until changes are generated by the introduction of innovations into the market. In an evolutionary perspective, the market evolves because of the innovative and imitative activities of firms. Changes in the industry structure are not the result of the adoption of an externally-generated technology, but of the diffusion of innovation generated by firms inside the industry. Rumelt (1987) distinguishes between two basic kinds of entrepreneurial discovery: *resource value* and *demand patterns*. Discoveries of *resource value* include mineral exploration, real estate development, technological

invention and the creation of new means of producing and delivering products and services. Discoveries of *demand patterns* include satisfying new consumer needs and wants and identifying new market segments worthy of attention. Interestingly, innovation does not only refer to the invention of new technologies, but also encompasses organisational and social innovations.

Firms innovate because they may earn returns above the average returns through entrepreneurial activity. In a neo-classical framework, it is usual to look at profits more than fully competitive returns as monopoly profits. In evolutionary theory this is defined as entrepreneurial rent and is measured by the "difference between a venture's *ex post* value (or payment stream) and the *ex ante* cost (or value) of the resources combined to form the venture"[3] (Rumelt 1987: 143). Rumelt (1984) defines the situation of a firm that does not know ***ex-ante*** whether the action taken will be successful as one of ***potential rent***. Given expectational equilibria, it is uncertainty that produces the possibility of entrepreneurial rents (Rumelt 1987). Uncertainty is seen as a different type of phenomenon in evolutionary theory.

> "In considering the problem of risk most economists are much happier with the idea of probability distributions ... and often unwilling to recognise uncertainty as a different type of phenomenon ... In strategic analysis, others have however been less cautious and suggested that doubts about the causal structure should be seen as essentially different from risk under such terms as structural uncertainty ... or ambiguity" (Wensley 1982: 152).

Changes in technology, relative price, consumer tastes, law, tax and regulation or new discoveries and inventions are sources of potential rent for firms, which, at the same time, trigger the established success of other firms within an industry, "if the basis for success in a market shifts to a new function, firms that have been successful in the past may now be at a disadvantage relative to outside firms possessing demonstrated skills related to the new required competence" (Rumelt 1984: 566). For the existing firm, the possibility of sustaining or improving its competitive position depends upon its ability to quickly recognise changes in some underlying factors and its reaction to it. "Opportunities for profit can arise through two rather different mechanisms: either the firm is best placed in competitive terms to exploit the opportunity or it has access to private information which gives prior indication of such an opportunity" (Wensley 1982: 153). *Potential rent* does not necessarily become *entrepreneurial rent.* This requires the existence of a number of conditions (Rumelt 1987):

1. the innovation must be a sufficient and efficient replacement for substitutes;
2. the firm must resist the appropriation of rents by other players such as powerful buyers or suppliers (including employees), the owners of co-specialised assets, and governments; and
3. the firm must have some protection against imitative competition. The existence of barriers to imitability is due to the existence of **isolating mechanisms**, which are defined as "phenomena that limit the *ex post* equilibration of rents among individual firms" (Rumelt 1984: 567). The emphasis on the ***ex post*** is posed to stress the difference from an ***ex ante*** situation, when what exists is only **potential rent**.

The most important isolating mechanisms are property rights (Rumelt 1987). The law provides firms with property rights over discoveries of minerals, patentable inventions, written material and trademarks, but no such protection exists for most business innovations. "New packaging concepts, method of distribution, manufacturing methods and planning techniques, consumer research methods and information, and the most new product ideas entail no assignment to property rights" (Rumelt 1987: 145). Where no legal property rights exist, **causal ambiguity** may entitle firms to earn higher than

[3] Rumelt (1987: 142-143) distinguishes between Ricardian Rent, Pareto Rent and Entrepreneurial Rent.

average profits. In fact, the existence of (a) an irreducible uncertainty connected with the creation (or production) of a new production function and (b) non-recoverable cost associated with such entrepreneurial activities implies that there will be "ambiguity as to what the factors of production actually are and as to how they interact." (Rumelt 1984: 562). The existence of uncertainty and ambiguity produces an *ex-post* barrier to imitability. Therefore, in the absence of property rights, there are "numerous lags, information asymmetries, and friction that function as **quasi-rights**, thereby sustaining entrepreneurial rents" (Rumelt 1987: 145). The isolating mechanisms that protect entrepreneurial rents from imitative competition normally appear as "first mover" advantages. Wensley (1982: 154) argues that for an established firm, the chance to substantially improve the competitive position depends on the prompt recognition of change in some underlying factor and the firm's reaction to it. "In the product-markets most private information is context specific and ambiguous. The more we wish to validate information by standards of generalizability and clarity, the more the information is likely to be public rather than private".

In the original conceptualisation of strategic groups by Caves and Porter (1977), firms within the same strategic groups have similar structural characteristics resulting from similar strategic decisions. Uncertainty, ambiguity and bounded rationality do not exist, and mobility barriers collectively protect all firms within a group. Because of the similarities in external and internal conditions, firms are assumed to have similar performance. In an evolutionary perspective, "there is no theoretical reason to limit mobility barriers to groups of firms" (Rumelt 1984: 567). Each firm is a unique and distinct entity and although firms may be grouped according to similarities in their assets, this might not lead to similar performance. In evolutionary theory, innovations are firm specific and because of the characteristics of the entrepreneurial process (uncertainty and ambiguity), isolating mechanisms exist at the firm level.

5.3.3 The Organisational Context in Evolutionary Theory

Having examined the characteristics of the relationships between firms and the market context, we now analyse firms' internal contexts from an evolutionary perspective. The work of Teece *et al.* (1994), which builds on the *Evolutionary Theory of Economic Change* of Nelson and Winter (1982), provides the framework for examining the characteristics of the firm in an evolutionary perspective.

For a long time in Economics, there was not an alternative view to firms other than the "black box" of neo-classical economics. Transaction cost economics has developed a view of firms as internal markets displacing external market organisation. This theory originates from the famous article by Coase (1937) but was developed by Williamson (1975, 1985).

In evolutionary theory, a portfolio of business units, which amalgamate through formal contracts, cannot replicate the properties of internal organisation. This is because firms are learning entities, and the very nature of the learning process inhibits a proper valuation and formalisation of the contract.

> "A fundamental characteristic of economic activity is that it provides the opportunity for learning. Learning is a process involving repetition and experimentation which enables tasks to be performed better and quicker, and new production opportunities to be identified. As Simon (1991) notes, 'All learning takes place inside individual human heads; organization learns in only two ways: (a) by the learning of its members, or (b) by ingesting new members who have knowledge the organization didn't previously have" (Teece *et al.* 1994: 11).

Routines (Nelson and Winter 1982) and standard operating procedures[4] are created inside the firm for maximising the benefits of the learning process. Their role is to incorporate the knowledge generated by the learning process into common codes of communication and co-ordinated search procedures that can be easily comprehended and used by individuals inside the firm. However, because of the complexity of the learning process, knowledge cannot be fully captured in a codified form. There is often a tacit dimension to the learning process that cannot be fully articulated. This constitutes a barrier to imitation by other firms and may contribute to the development of a firm's distinctive competencies and capabilities. "Such capabilities, by virtue of their evolution in particular environment and organizational contexts, are likely to differentiate firms from each other and provide the basis for differential performance vis-à-vis competitors." (Teece *et al.* 1994: 15). The extent to which such competencies and capabilities can contribute to a firm's profitability depends on the value they generate and on whether the firm can appropriate the rents generated by the effects of the learning process.

Two important aspects of the learning process concern the technologies being employed and the product markets in which the firm already operates. Because of the local nature of the learning process, a firm's future activities, and the development of new products "are highly dependent on what they have done in the past" (Teece *et al.* 1994: 16). This leads to the notion of *path dependency*. A firm's 'history' with its collection of past investments and its repertoire of routines with their *tacit dimensions*, constrains its future activities and success. History may therefore create an embedded inertia to change.

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[4] There are different types of routines. Static routines are oriented at replicating certain tasks. Dynamic routines are directed at learning and at the development of new products and processes (Teece *et al.*

The existence of an evolutionary path also affects top management. In neo-classical economics, top management has a perfect knowledge of the structure of the industry, the factors determining performance and how to combine them. In the evolutionary framework, the existence of bounded rationality, uncertainty, ambiguity and asymmetry of information

> "restrict the range of businesses and products that most managers can understand. The limited capability of information systems to render useful information and the limited ability to understand multiple competitive environments appears to be a binding constraint, particularly in dynamically competitive markets. This is not only because of dynamics of technological change and market evolution are always complex, but also because dynamics are likely to vary markedly across industries and product lines and because long lags may be necessary to capture the performance feedback necessary for learning" (Teece *et al.* 1994: 17).

5.3.4 An Evolutionary Perspective of Firms' Strategies and Related Implications for Strategic Groups Research

Having analysed the characteristics of firms and the competitive market from an evolutionary perspective, this Section examines the view of firms' strategies that emerges from evolutionary theory and the associated implications.

Rumelt (1984: 568) argues that "a firm's strategy may be explained in terms of the unexpected events that created (or will create) potential rents together with the isolating mechanisms that will act to preserve them. If either element of the explanation is missing, the analysis is inadequate". From an evolutionary perspective, there is a significant shift from a view of the firm as the ultimate determinant of its own success to a view that stresses the roles of both firms and their external environment. This is evident in the analysis of firms' profitability but also in the strategy process, where the

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1994).

focus is on the firm and its management and on the dynamics of the competitive market. Management discovers new source of rents and/or try to protect existing ones. However, its activities are influenced by its experience and by the *path* followed by the company with its set of routines. Furthermore, the position that the firm has in the competitive market, its image among customers and ease of access to tangible and intangible resources also play an important role for both management decision and the dynamics of firms' strategies. This is why the analysis has to focus on both: events creating potential rents and isolating mechanisms.

However, what are the implications of an evolutionary theory of firms' strategies for the theory of strategic groups? When the concept of strategic groups was developed in the strategy field, at Purdue University, the objective of researchers was to develop a technique that would assist top management in taking decisions about how to compete within an industry. Their argument is that by analysing firms' past strategies by using econometric techniques and clustering techniques, top management would be able to identify the most effective strategies and this would be the basis for making strategic decisions about the most effective way of competing within the industry. Jacobson (1992: 793-794) questions this and argues that "the econometrician is an economic historian ... The criticism of econometric models is especially pertinent with regard to models of business profitability. If these regressions have detected regularities in business performance, why don't all businesses follow those strategies that are known to lead to supranormal profits?" In the evolutionary perspective, it does not make much sense to use strategic groups as a technique to study the strategic options available to firms. Undertaking strategies whose values and implementation are known involves little entrepreneurial discovery and will not generate abnormal returns. As we have seen in Section 5.3.2, Wensley (1982) argues that if the success formula could be identified, then it would become public information and the advantages associated to it would thus disappear.

The shared view among evolutionary researchers is that strategy involves a complex interaction among a number of variables, but historical events are unique and the variables and the relationships between them are likely to change over time. Consequently, no strategy can be fully reproduced. The changing nature of competition suggests that no replicable strategy allows businesses to earn long-term supra-normal profits. Further, as unobserved factors may be correlated with some of the observed strategic factors, this might result in biased estimates of the effect of strategic factors and an overstatement of their explanatory power (Jacobson 1992).

That an evolutionary framework does not allow for control and for prediction in the way that strategy research based on neo-classical framework does, is a controversial matter. Many researchers argue that it is a significant problem, limiting the diffusion of an evolutionary framework in strategy research. However, it is not problematic for evolutionary researchers who assert that many more benefits can be gained by addressing the issues that management should pay attention to (Rumelt 1984; Wensley and Day 1992)[5]. Rumelt (1984: 568) in particular argues that there are normative implications of this view of strategy and "they can be based on much sounder theory than much of the currently popular prescription. First, it should be clear that a firm's stability and profitability fundamentally depend upon entrepreneurial activity. There

[5] This is the most important difference between an evolutionary approach to strategy and the RBV of the firm. Researchers of the RBV have often mentioned the same references as we have done here (see, for example, Mahoney and Pandian 1992). However, RBV tends, in our view, to be more prescriptive in its characteristics for the content of the strategy to follow for achieving superior performance, as opposed by

cannot be a single algorithm for creating wealth". He summarises some normative elements that could be used to advice top management for its strategy-making activities in seven points. The picture that is presented is one where significant changes in the competitive environment occur infrequently and the success of a firm depends upon the early recognition of events changing the importance of factors underlying firms' strategies in an industry. If external shocks threaten the established structure of the industry, firms that recognise these changes sooner than others and act on this knowledge can be very successful. In this context, speed is a critical factor and management will have to pursue the idea notwithstanding the existence of ambiguity, "if firms wait until the proper method entering a market or producing a product is fully understood it will normally be too late" (ibid. 1984: 569). Further, because of the uncertainty characterising these events, strategy analysis must be a continuous and situational process and judgement therefore play an important role. If firms misjudge the strength of isolating mechanisms, investments might be wasted. Rumelt also argues that where industries are characterised by a high level of stability, firms that are in strong positions may ignore strategy for a long time and still appear profitable. "As a corollary, high levels of profitability are not necessarily an indicator of good management. If a strategic position is strong enough, even fools can churn out good results (for a while)" (ibid. 1984: 569).

From a research perspective interested in the competitive dynamics of firms within a competitive environment, the realism characterising the assumptions of an evolutionary view of strategy is much more appealing than neo-classical based frameworks. However, the problem is that, notwithstanding the progress that has been made, the focus is still on the firm and a somewhat undifferentiated competition. Only Wensley

to evolutionary approach to strategy.

(1982) argues for the importance of noting differences in competitive positions for extant firms when changes are taking place. Rumelt discusses isolating mechanisms. However, he does not say whether isolating mechanisms exist in absolute terms or are relative to the competitor, depending on the positions other firms have in a competitive market. In this sense, strategic groups theory, with its focus on comparative analysis, entry paths, and asymmetry of mobility barriers, is still one step ahead of evolutionary frameworks.

5.4 Themes and Questions for the Empirical Research

In the previous three chapters, we analysed the origins of strategic groups research and the way it has developed. We also highlighted some problems with the theory and the methodology. This analysis has led to the examination of the epistemological view underlying the theory and method of strategic groups research, and the related problems. In the previous sections of this chapter, we have reviewed a number of research approaches that have:

1. highlighted factors that traditional strategic groups research has put in a secondary position (the differences in cognitive structures of top management, the role of the environment as a force determining the success of firms and the relevance of firms' specificities); and
2. posed further questions about the underlying theoretical framework characterising strategic groups.

The analysis indicates that, beyond the criticisms concerning the concept of strategic groups, no valid alternative has been proposed for the analysis of the same issues addressed in strategic groups research. Among the frameworks analysed here, the most promising is the evolutionary approach to firms' strategies. However, research has still focused on single firms rather than aggregates.

Some attempts have been made to reconcile the various positions[6], stressing the potential complementarities among different approaches. However, the advantages of this are not clear. Jacobson (1992) argues that inconsistencies can arise when attempting to integrate other frameworks with different ontological positions. Willmott (1996) notes the difficulties of developing a meta-theoretical perspective in an 'a-critical' fashion. Astley and Van de Ven (1983) argue that any attempt to develop a meta-theoretical approach must try to preserve the authenticity of distinct viewpoints.

We believe that, until a better understanding of the limits of each theoretical framework is achieved, the development of a meta-theory of strategic groups does not offer a solution to the problems highlighted in this review. Hence, the following part of the research will have two objectives: (a) to complete the review of strategic groups and (b) to try to develop a better understanding of the dynamics of firms' strategies and industry structure. However, whilst this concluding part of the research has been theoretical in nature, the following will be empirically based. In order to achieve these objectives, we take two themes that are fundamental to strategic groups and to this research. Based on these themes, we develop a number of questions for empirical research.

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[6] Thomas and Carroll (1994) proposed Porter's (1980) *competitive strategy* as a basis for the development of a unitary framework for researching grouping structures in an industry. However, Porter's *competitive strategy* develops his work on strategic groups (1973, 1977, 1979). Therefore, their approach is based in IO. They are using a framework and trying to incorporate other approaches in that framework.

The key question of this research is: "what are the limits of traditional strategic groups research for analysing and explaining the dynamics of firms' strategies and industry structure?" In this research question, there are two fundamental themes:

1. the analysis of the mechanisms characterising industrial and business change; and
2. the importance of similarities and differences between firms that are competing within the same industry for the dynamics of firms' strategies and industry structure.

The development of an understanding of these two themes will characterise the empirical research.

The first theme aims to understand the characteristics of industrial and business change. There is an underlying static in strategic groups research. When equilibria are broken, firms change their strategies immediately and new equilibria follow. However, the evolutionary theory of firms' strategies argues that firms' strategies and industry structure are in a state of continuous change. We want to assess this issue of stability and change more in detail. In particular, our focus is on the mechanisms driving industrial and business change. This leads to the first question:

Question 1 ***How do changes in firms' strategies relate to changes in the industry structure? Are firms responsible for the process of change or do they react to changes in the external environment?***

Strategic groups theory is silent on the origins of changes in the competitive structure. The objective of this question is to give an insight into the process of strategic change within the industry, and specifically, to understand the relationships between firms and

the external environment. We also want to understand to what extent the external environment influences firms' strategies and how firms influence the external environment. However, it is also important to understand the synchronism existing between industry changes and firms' strategic changes. These are issues of general interest in management research, which for a long time has been characterised by a debate between supporters of the role of strategy choice and supporters of the role of environmental determinism (Child 1972 and Aldrich, 1979).

The second theme focuses on similarities and differences between firms that are in competition within the same industry. The concept of strategic groups assumes, for both explanatory and prescriptive purposes, the relevance of similarities existing among firms of the same groups and the significance of differences between firms of different groups. The theoretical framework developed by Caves and Porter is built on the assumption that similarities between firms of the same groups are significant enough and their differences are negligible enough to justify the analysis of firms in groups structures. We question this assumption by addressing the following issues that are at the heart of the strategic groups theory as developed at Harvard by Caves and Porter, and also of general interest in strategy research.

Question 2 ***What are the similarities and differences in the strategies of comparable firms within the same industry?***

The concept of strategic groups asserts that firms within the same strategic groups are similar in all significant aspects. Because of these similarities, firms have similar performance and, in the future, will follow a similar strategy. The purpose of this question is to see whether it is possible to form groups of firms where the similarities in their strategies are more important than the differences. This is an issue of interest to all research using clustering techniques for the analysis of similarities and differences among firms.

Question 3 ***How did firms develop their respective strategies? Are there important similarities in their origins and strategic investments over time?***

Having analysed the similarities and differences existing in the strategies of these companies, we want to see how these companies came to develop their respective positions in the industry. Caves and Porter (1977) argue that similarities among firms come from firms having a similar history of past investment. Because of this, firms recognise their interdependence and continue to follow similar strategies. The story is a simple one, of strategic similarities emerging from similar strategic investments, and of reciprocal influence among firms of the same groups.

With this question, we want to explore this issue more in detail. There is no doubt that these companies must have had similar investment strategies in the past. However, beyond these similarities, we want to see (a) if these companies did recognise similar opportunities in the environment at around the same time and (b) if these firms have similar origins. This question will inform us of the following issues: (a) if there has been a best way for firms' strategies of growth; and (b) if it is possible to develop a successful strategy in different period of times, at different stages of the industry's history.

Question 4 ***Are there reference points in the industry influencing management in its strategic decisions about investment strategies?***

In strategic groups theory, it is argued that some groups are more profitable than others and because of their higher profitability, other firms try to copy their strategies. Hence, some companies within the industry, with their successful strategies, play the role of "reference points" for other firms. In order to enrich our understanding of the dynamics of firms' strategies and industry structure, we need to understand more about the potential existence of points-of-reference for firms' management in the industry.

Question 5 ***Are there similarities in the cognitive structures of firms operating in the industry?***

Caves and Porter (1977) argue that firms of the same group have important similarities in their strategies and their cognitive structure. Because of these similarities, they follow similar strategies. This question aims to analyse the issue in more detail by trying to understand if there are similarities in the cognitive structures of similar firms.

The influence of cognitive structures on strategy-making is a theme that strategic groups share with cognitive research where the cognitive structures of firms operating within an industry with regard to the competitive environment are well defined and firms with similar cognitive structures follow similar strategies.

Question 6 ***Is it possible to identify unequivocal determinants of firms' performance in a way that they can be quantified and clear relationships between these determinants and firms' performance can be drawn? If this is the case, is it possible to use successful past strategies as a recipe for future strategy formulation?***

At the basis of strategic groups research and the preferred methodology used, there some fundamental assumptions, i.e., that (a) it is possible to classify firms' strategies into variables without missing out significant information; (b) it is possible to clearly define cause and effect relationships existing between these variables; and (c) a link can be established between these variables and performance. This analysis may later be used in strategy formulation to chose among the various strategic options.

This question aims to inquiry these assumptions and see (a) whether it may be possible to significantly represent firms' strategies in a set of variables, (b) if unequivocal relationships may be established between these variables and performance and (c) if this analysis may be used by management to identify the most successful strategies to follow.

The analysis of these issues will inform us on the debate between research on the evolutionary theory of firms' strategies and that on neo-classical approaches, which was exposed in Section 5.3.4.

In the next chapter, we will discuss the methodology used for the empirical analysis.

Chapter 6 Methodology

6.0 Introduction

Over the past few years, there has been an increasing discussion about which methodologies to use in management research. The consolidation of a variety of research traditions, and a multiplicity of foci and theoretical positions, justify and explain the existence of a multiplicity of research methods (Burrell and Morgan 1979; Gioia and Pitre 1990; Alvesson and Willmott 1996). However, the decline of the idea that a "best theory" and a "best methodology" exist has led, over the past decade, to increasing attention to methodological issues. Hence, if the use of different methodologies is more easily accepted, the justification of the use of a particular methodology has assumed increasing importance.

In the earlier chapters, we reviewed the theoretical foundations of strategic groups (Chapters 2 and 3), we also conducted a critical review of the development of strategic groups research (Chapter 4) and of how the development of other theoretical approaches has impacted on the concept of strategic groups (Chapter 5). The combination of problems in theory, methodology and the emergence of alternative theoretical frameworks has posed a number of fundamental questions about strategic groups as a theoretical concept and as a practical technique for the analysis of firms' strategies and industry structure. However, notwithstanding these problems, strategic groups still represents a very interesting theoretical and practical concept.

Having critically analysed the limits of strategic groups from a theoretical point of view, we need to empirically assess its limits. This led to the definition of two themes fundamental to the research question and to strategic groups research. Around these themes, a number of questions for the empirical research were outlined in the previous chapter.

The empirical research examines the historical developments of the UK Grocery Retailing Industry (GRI) between 1980 and 1995, and the historical development of the strategies of the four largest firms operating in the industry in 1995, by looking at their strategies over the period from 1980 to 1995. The longitudinal characteristic of the empirical research, linked with the comparative analysis of the four firms' strategies, will form the basis for the discussion. The empirical analysis comprises the next five chapters. The first describes the changes that have characterised the structure of the GRI since the end of the Second World War, with particular attention to the period between 1980 and 1995. The remaining four chapters present individual case studies of the dynamics of the four firms' strategies in the industry. The case studies are intended to be descriptive rather than analytical. The information provided in the empirical research constitutes the basis for subsequent chapters where we discuss the findings and the implications for strategic groups research. In this chapter, we now discuss the methodology used in the empirical research.

6.1 Methodology

The term *methodology* has a Greek etymology and results from the combination of two words: *methodos* and *logos*. The former refers to *way of proceeding*; the latter refers to *the study of* (something/ someone). Hence, methodology can be expressed as the *study of the way of proceeding*. This section provides a critical reflection of the way of proceeding in this research.

It can be said that the research method used in empirical research is directly linked to the epistemological stance that is taken. The epistemological origins of this research lie in Critical Theory and in Hegels' philosophy on dialectics (see Appendix 1). However, the existing literature on critical methodologies in management research is very small. The recent monograph by Alvesson and Willmott (1996), concerned exclusively with Critical Management Theory, is vague with respect to its discussion of possible empirical methods to follow in critical analysis. The paucity of literature on critical empirical methods is not a surprise as researchers making use of critical analysis seem to prefer theoretical to empirical discussions. Hypothesis testing is rare in critical analysis and the representation of countervailing views are presented in theoretical terms, with resolution of competing interests occurring via dialectic methods. However, Grawitz (1990) argues that a critical approach may make use of different research methods, which draw from philosophy, economics, sociology, and history.

It is therefore not surprising that we faced some problems when deciding which method to adopt for this empirical study. The chosen method is the result of a long reiterative process, rather than a logical planned one. It can be described as a dialectical method based upon historical analysis. However, for understanding the choice of the method, it is necessary to go back to the key research question: 'what are the limits of traditional strategic groups research for analysing and explaining the dynamics of firms' strategies and industry structure?' The first part of the study was dedicated to a critical review of the origins and the development of strategic groups. We also examined the challenges that have been posed, both directly and indirectly, to strategic groups by the emergence of other theoretical approaches. Each approach has its own limits, and strategic groups seems to be the approach that addresses important issues for strategy research, more than others. However, this does not represent a satisfactory solution, given the problems we identified in the theory of strategic groups in Chapters 2, 3, 4 and 5. Thus, this contributed to the decision that the empirical research would have two objectives: (a) to complete the review of strategic groups and (b) to try to develop a better understanding of the dynamics of firms' strategies and industry structure.

In order to achieve these objectives, we could not set a number of hypotheses and test them using the traditional strategic groups techniques. As we have posed fundamental doubts about the basic assumptions of strategic groups theory and about the methodology traditionally used in related research, it would be illogical to assess the validity of the technique - method – theory, by using the same technique and methods. Thus, it has been decided that the empirical research would be exploratory in character and would focus in particular on two themes which are fundamental to strategic groups research: (a) an assessment of the mechanisms which characterise the dynamics of industrial and business change and (b) the analysis of similarities and differences among firms competing within the same industry.

To assess these themes and specific issues, the empirical study will be based on an historical analysis of the development of the industry and a number of firms operating within it.

Historical research is concerned with the clarification of structures and the associated generative mechanisms from which generalisations are derived. The theory of strategic groups proposed by Caves and Porter (1977) informs through a set of underlying assumptions and explicit hypotheses, about the structure of the industry and the dynamics of firms' strategies. They propose their theory of strategic groups on the basis of the argument that it is possible to identify stable groups structures in an industry. In developing their theory, they draw heavily from the SCP paradigm and from neo-classic theory of the firm. Strategic groups research, as it was developed at Purdue, has its origins in the experimental use of quantitative techniques. However, both approaches are little informed by history.

In management research, historical research has become well-known with the work of Chandler on the evolution of firms' strategies and organisational structures in US corporations in the early XX century. In his book "*Strategy and Structure*", Chandler (1962: 1) notes that "historians have provided social scientists with little empirical data on which to base generalizations or hypotheses concerning the administration of great enterprises". His main purpose is to provide an empirical basis for use by researchers in developing hypotheses and assumptions about the evolution of firms' organisational structure. Chandler achieves this through an historical analysis of the development of organisational structures. In his research, "complex decisions, actions, and events are not taken out of context and presented as mere illustrations as they would have to be in a general history of American business or of the American economy. **They are not used to illustrate generalizations; they are the data from which the generalizations are derived**." (ibid. 1962: 7; emphasis added). In this research, Chandler's process is reversed. Having analysed the theoretical and methodological characteristics of strategic groups, the research examines the dynamics of the industry structure and the strategies of a number of firms through a comparative historical analysis. This will form the basis for the conclusions, where information is used to examine the issues addressed in the previous chapter. By comparing the facts emerging from the historical analysis with the assumptions and hypotheses characterising strategic groups (that have led to the specification of the questions for the empirical research), we will be able to complete the review on the limits of the concept of strategic groups. Moreover, we will also develop a better understanding of the highlighted issues. Further, as a number of studies have already been conducted in the industry, it will also be possible to make a direct comparison between the information gathered here with others that have used a traditional strategic groups approach.

6.1.1 Historiography

In this research, the entire discussion is based upon the analysis of the historical development of the strategies of the four firms and the history of the industry. In this section, we examine the importance of historical methods in management research.

Historical methods have often been subject to criticism in management research, in light of whether it is possible to use findings originating from historical analysis for

generalisation. According to some researchers, information derived as a result of such measures constitutes description rather than explanation. Nietzsche (1882: 820) argued that "only things without history are definable". Any entity produced by a unique course of events through time cannot be adequately described by general concepts. Consequently, history is informative to the degree that things are the products of a causally connected series of events that produces unique configurations in each thing. "The philosophical position of Nietzsche's aphorism is an illusion, but an illusion that reflects the difficulties of forming general concepts in history. This argument holds that general concepts in history are intellectual achievements which are more likely to be brought about by thinkers who take the problem posed by Nietzsche seriously." (Stinchcombe 1978: ix). Stinchcombe distinguishes between different approaches to history. In analysing the relationships between theories of social change and historical analysis, he argues that the test of any theory of social change is its ability to analyse the narrative of a sequence of events. Indeed, he argues against the excessive simplification of history: "great theorists descend to the level of such detailed analogies in the course of their work. Further, they become greater theorists down there among the details, for it is the details that theories in history have to grasp if they are to be any good" (ibid. 1978: 124).

Zald (1996) argues that organisations have histories and are located in history. It is therefore necessary to reconstruct the historical development of a firm within its context and to analyse the historical development of the context itself. This is necessary in order to avoid possible misinterpretations of the importance of elements inside or outside the firm[1].

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[1] "All behaviour is historical. It takes place over time and in particular contexts. Moreover, contexts themselves, the social relations and institutional forms, rules, and processes in which we exist, are subject

In this research, the focus is on firms' strategies and industry structure. At the firm level, the attention is on the relationships between the internal and external contexts, on the succession of internal and external events and how they shape firms' strategies. We also analyse the background to these events. By analysing statements made on various occasions by senior executives and by analysing other secondary sources, we also see what the objectives of the management initially were and how events are positioned in relation to management objectives.

As for the analysis of the changes in the industry, we reconstruct the changes that have occurred in the industry in logical progression and drawing from various sources. The focus is on the dynamics of the events that characterised the changes in the industry structure, events that have had important consequences for the structure of the industry and the strategies of firms operating within it.

This study is the basis for a critical examination in the discussion and the conclusion chapters, of issues highlighted in Chapter Five.

6.1.2 Historical Analysis and Strategy Process Research

Within SM, historical analysis has mainly been used in strategy process research. Strategy process researchers are very critical of the quantitative and logical approaches

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to historical change. Although these statements would seem to be unexceptionable, most of our mainstream journal articles are written as if they apply to some disembodied abstracted realm. Articles are written about abstract topics ... or abstracted entities ..., as if the paper dealt with some timeless entity. In the text, if the article is empirical, the time and place frame of the data may be mentioned; however the implications of that time and place frame for the topic under consideration may barely be mentioned." (Zald 1996: 256).

characterise mainstream strategy research. Mintzberg *et al.* (1976), Mintzberg (1978), Quinn (1980) and Pettigrew (1985) have challenged the rational view of strategy formulation and change. They argue that firms' strategies are more readily understood as being *crafted* rather than *planned*. "Strategic change should be regarded as a continuous process which occurs in a given context ... The hallmark of the processual dimension is that strategy does not move forward in a direct, linear way nor through easily identifiable sequential phases. Quite the reverse, the pattern is seen as continuous, iterative, uncertain" (Pettigrew 1992: 6).

The focus of process research is on the succession of actions, decisions, processes, stances and events characterising the life of a company. Mintzberg and Waters (1982), in describing the method used in examining how strategies and processes are formed in organisation, argue that the first step of the process is collection of basic data, the second step is to infer patterns and periods, the third step is to further investigate each period and the transitions between period, and finally comes building of theory.

> "The research team sat down with a detailed report on the organisation's history - the descriptions and explanations of its patterns and periods - for a series of brainstorming sessions. These focused on a set of major conceptual issues, with the intention of extracting and inducing whatever theoretical conclusions could be drawn from these particular results" (ibid. 1982: 467).

The use of a method that is typical of strategy process research and the critical spirit towards neo-classic research means that important similarities exist between the methodology followed in this research and the mainstream strategy process research. However, there are also important differences.

First, the consolidation of process research within the strategy field has led to the development of a research methodology where historical analysis is put into a wider context of a *theory of method* driving research on change (Pettigrew 1990, 1992). In this research, we do not apply theory to history; rather, we use history to test the theory of strategic groups. Stinchcombe (1978) in the introduction of his book, "Theoretical Methods in Social History", writes: "I would have written neither this book nor any other book on the subjects of historical methods, unless I thought that the question of how to apply social theory to historical materials, as it is usually posed, is ridiculous. One does not apply theory to history; rather one uses history to develop theory" (ibid. 1978: 1). The objective of his book is to "get down to historical methods, methods of thinking about historical facts" (ibid. 1978: 2) and to show that good historical interpretations exist independently of the theory of social change in which they are used. In this research, we use a similar approach. We believe that the analysis of historical materials has a purpose of its own and does not need to follow any theory. Nor is the validity of the historical interpretation seen as depending on the theory in which the interpretation would be made.

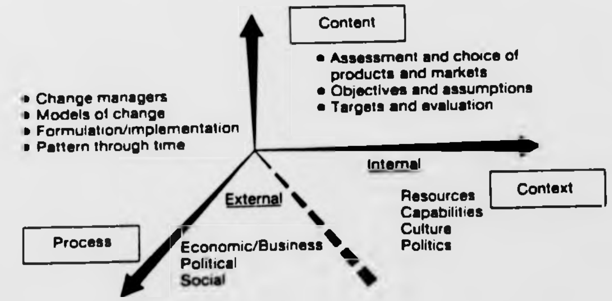
Second, strategy process research is strongly influenced by organisational behaviour, as such the focus is traditionally inside the firm. Child and Smith (1987) argue for the development of a firm-in-sector perspective in research on the organisational transformation of firms within a sector. However, in their research, the analysis of changes in the external environment has been limited to explain how and why internal processes of change were initiated. The attention has mainly been on the firm. Furthermore, when talking of success stories in terms of innovation introduced by firms within the sector, the analysis of the external environment is again limited to a basic argument that firms were in no condition to cope with the introduction.

Pettigrew and Whipp (1991) argue that the focus of strategy process research is to capture strategic change and competition as *holistically* as possible. They see strategic change and competition as *intimately linked*.

> "We find it impossible to comprehend such (strategic) changes as separate episodes divorced from their historical, organizational and economic circumstances from which they emerge. The point to appreciate is the richness of these contexts and their simultaneous shaping of strategic change." (ibid. 1991: 27).

Figure 6.1 shows the three fundamental dimensions necessary for the analysis of strategic change according to Pettigrew and Whipp.

Figure 6.1 **The Three Essential Dimensions Shaping Strategic Change**
Adapted from Pettigrew and Whipp (1991: 26)

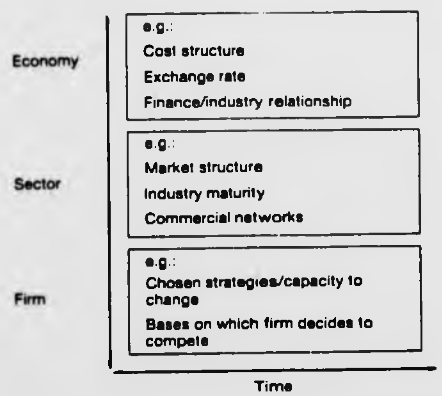


In the external context, Pettigrew and Whipp pay particular attention to competition. They argue that its complexity is best understood by distinguishing its two main dimensions (Figure 6.2): (a) the levels at which competition operates and (b) time. The three elements characterising the competitive levels are the firm level, the sector level, and the economy level. They conclude that: "the competitive performance of a firm hinges therefore on the recognition that business compete not merely against one another but *at the same* time within the sectoral and national/international structures and relationships" (ibid. 1991: 27).

Because of the interconnection between strategic change and competition, many similarities exist between the approach taken in this research and that of Pettigrew and Whipp. Nevertheless, as soon as Pettigrew and Whipp define the focus of the analysis, important differences emerge between the two approaches:

> "The sectoral and national conditions in which a firm operates and hence the bases on which it competes are quintessentially unstable. ... It is to these changes that management has to respond continuously and which provide part of the major external impultions for strategic change. **The ability to perceive those changes and to take necessary action diverges considerably between and within firms. It is those divergences of choice and execution which interest us**" (ibid. 1991: 28, emphasis added).

Figure 6.2 **The Three Levels of Competition**
Adapted from Pettigrew and Whipp (1991: 27)



Therefore, although in the search for a holistic explanation, their focus is on firms, and specifically, on the internal context and process. The analysis of the interface between

the internal and external environment is limited to how firms adapt to major changes in their environment. With the stress being on how change unfolds in the companies, it is understandable that researchers emphasise the importance of being inside the company and of the analysing actors involved in the strategy process (Van de Ven 1993). The centre of Whipp and Pettigrew's research is therefore the inner, rather than on the outer, context. Focusing inside the company, there is inevitably stress on the agents involved in the process of change and on the role of management involved in the process of change. The focus of this research is significantly different. With attention in strategic groups research on firms' strategies within the industry, the attention here is on the relationships between the firms' strategies and the industry structure. The objective is to analyse the process of change in firms' strategies within an industry and to see how industry structure changes.

The combination of the issues highlighted above means that the research strategy used in here differs from traditional strategy process research. In the next section, we describe in detail the technical characteristics of the methodology.

6.2 Research Method: Technical Details

In order to answer the questions posed in the previous chapter, the empirical research needs to look at both the industry and firms operating within it. The units of analysis remain single firms, rather than groups structures. By looking at specific firms, we avoid the problem of having to argue that these similarities are important *a priori*. By comparing and contrasting the strategic characteristics of firms, we will be able to assess the significance of similarities as well as differences existing between them, and indirectly we will assess the relevance of the concept of strategic groups in strategy research. Therefore, firms chosen for the empirical research need to *a priori* have some important strategic similarities. Another important element to consider is that strategic groups theory argues that because of these similarities, companies recognise the existence of strategic interaction with other firms which will influence top management in decision-making about investment to make. It is therefore necessary that some strategic interaction exists between the chosen companies. These three features, that is, analysis of firms' strategies and industry structure, the existence *a priori* of some important strategic similarities between the firms chosen and the existence of some strategic interaction between the chosen firms, are the key criteria around which the empirical research will be built.

6.2.1 Choice of Industry

The choice of the UK GRI for empirical research has been taken for a variety of reasons:

1. Considerable information on this industry and on the largest companies operating in the industry is available.
2. Operative issues (both in terms of product market issues as well as in terms of internal logistics) have a high strategic content. Therefore, senior management regularly makes statements about operative issues and the dynamics of the competitive market.
3. Companies mainly operate in the grocery retailing industry and there is a minimal presence of foreign operators. This allows to minimise the influence of other businesses and countries on the dynamics of firms' strategies in the UK GRI. Furthermore, because the dominant activity of firms is in the GRI, there often are no differences between management at the corporate and the business level. This again enables us to have senior management talking about the dynamics of firms' strategies at a business level, competition, and consumer markets.

6.2.2 Choice of Organisations

The choice and number of the organisations to study has strongly been influenced by the choice of the research method. The case studies have been written on the basis of information gathered from on-line newspaper sources. The collection of newspaper articles is a lengthy exercise. For example, out of the articles available for Sainsbury's on The Financial Times on line, 200 pages of articles have been selected as 'potentially interesting for the research', forming a text of circa 127,500 words. For Argyll, where Textline has been drawn on for the period 1980 - 1993 and The Financial Times on-line for the period 1994 - 1995, there are 457 pages of newspaper articles, totalling 233,700 words.

Given time and resources constraints, there is a trade-off between the breadth and depth of the analysis. If we examine two companies, we would have some problems in arguing the significance of the results. On the other hand, if we examine more than four companies, we will not be able to analyse in-depth their histories. Because we want to understand in detail the dynamics of firms' strategies, we have decided to limit the analysis to four companies. However, material on other companies has also been collected, and this has provided important information for the analysis of the dynamics of the competitive environment.

Table 6.1 **Market Share of the Four Companies Analysed at the End of 1994**

	1994 (%)
Sainsbury's	20.6
Tesco	19.1
ASDA	10.7
Argyll	10.8
Total Market Share	71.2

Source: AGB (1996)

We have selected the four largest companies at the end of 1995 and analysed their strategies in the period between 1980 and 1995. At the end of 1994, these four firms had a market share in the UK GRI of 71.2 per cent.

In IO, which has, for a long time, been the exclusive forum for industry studies, it has traditionally been argued that large companies can, with their policies, have an important influence on the dynamics of firms' strategies within the industry. The underlying idea is that, because of their size, the implications of their decisions with reference to investment decisions and competitive policies, are more far-reaching than those for smaller firms. It is not surprising, therefore, to learn know that size has been used as a proxy for firms' strategies in strategic groups research (see Porter 1979). Although we criticised the IO approach in Chapter 2, we must recognise that, generally, larger companies tend to operate on a larger geographic area than smaller companies. Therefore, decisions taken by a national firm may influence decisions of another national firm.

In choosing the four largest companies, we therefore respect two of the three above-mentioned criteria of the empirical analysis, that is the existence, *a-priori*, of some important strategic similarities between the firms chosen and the existence of some strategic interaction between the chosen firms. The choice seems appropriate also

because in a study made by Lewis and Thomas (1990) on the UK GRI, two of the four companies chosen here have been clustered together to form the same strategic group.

6.2.3 The Choice of Time Frame

With the objectives of the research centring on understanding the dynamics of firms' strategies and industry structure, longitudinal analysis is required. Initially, it was decided to analyse changes in the industry structure and firms' strategies in the period of 1980 - 1992. It was decided that 1980 would have been the first year for the analysis of firms' strategies in detail, because secondary data were available since 1980. Earlier information to 1980 was also collected to give a background to the analysis of firms' strategies and the dynamics of the industry. The analysis was initially supposed to terminate in 1992, but this has been extended to 1995 because the research has been suspended twice and interesting events have taken place in the industry over this period.

6.2.4 Data Sources

This study uses secondary sources as its main source for the industry study and four case studies. As already noted, the case studies are written on the basis of information gathered from on-line newspaper sources (Textline and The Financial Times). This information is complemented by an examination of annual reports, other articles on specialised management and industry reviews on companies. Journal articles from on-line sources have also been collected for other companies (Iceland, Morrison, Hillards, Fine Fare, Budgens, WM Low, Waitrose, Oriel, Amos Hinton, Lennons, Safeway US, WM Jackson, Fitch Lovell, and Isosceles), and have provided important information on the dynamics of the competitive environment.

Financial data have been collected from Datastream and annual reports. Datastream is a better source because it standardises data and makes comparisons easy. Unfortunately, it does not provide information on single business units. This information has been collected from the companies' annual reports.
The main source for the industry analysis is the Retail Trade Review of The Economist Intelligence Unit (which provides the data as well as background information on the dynamics of the industry), Key Note, and specialised sectoral reviews (e.g. The Grocer). Other sources of information are the library of the Institute of Grocery Distribution and Audits of Great Britain (AGB). For the analysis of the changes in the industry in the period preceding 1980, we use a variety of sources, mainly books reviewing the early changes in the industry structure, and the review *Retail Business* from the early 1960s onwards. The analysis of newspaper articles on the companies listed earlier also provides important information on the dynamics of the competitive environment.

6.2.5 The Role of Documentary and Archive Data

Qualitative methods have been criticised with regard to their internal and external validity. The former refers to the accuracy of the information acquired by such methods as interviewing, the latter to the issue of objectivity. In this research, we have avoided the use of interviews as a primary source for the development of the case studies. This

decision was been taken because of the following factors:

1. With the analysis being on the dynamics of firms' strategies over a considerable period, it was not certain, initially, that we would have been able to consistently interview management who had been responsible for firms' strategies since the late 1970s. Few changes had taken place in senior management and the information might no longer have been available, thus there would have been problems in getting the information needed for writing the case studies.
2. There is always a danger of *ex-post* rationalisation of the strategy process in interviews. Newspaper articles offer the best way to avoid this danger. Because we are able to get the information related to the time events happen, newspaper articles give the best perspective of the internal and external context at the time events take place. The main problem in technique relates to the potential bias introduced by the journalists writing the articles. However, because the primary focus of the analysis is on the events reported rather than on the journalists' comments, we believe this does not represent a main issue. Furthermore, by comparing external sources with information given by companies' annual reports, it is possible to have an intuitive feeling of the validity of the interpretation made.
3. Whilst the focus on the inner context justifies the importance of interviews as research method in strategy process research, here the focus is on firms but from an external viewpoint. Further, the inner context is more tangible than the analysis of the relationship between firms and the market.

The second source of concern for using secondary data is their external validity, that is, whether our interpretation of the dynamics of firms' strategies and industry structure reflects the interpretations other researchers would give to the same elements. We believe that the use of newspaper articles over a long period helps to overcome this problem. As the emphasis is on the stream-of-events and actions taken over time, rather than on a specific event, there is less margin for mis-interpretation of the role of events. Further, the companies analysed here are all quoted on the stock market. Therefore, if misleading information is published, it could be argued that, for their own interest's sake, companies would make sure that the public is correctly informed. In this context, the use of relevant financial newspapers is of much help. A second reassurance comes from the fact that, information gathered through newspaper articles is confronted with that from other sources. In a critical spirit, there is no need to only show the existence of a single interpretation. Therefore, when conflicting information has emerged in the analysis of the dynamics of firms' strategies and industry structure, either further information has been collected or if it is a matter of interpretation of the dynamics of the industry structure, these conflicting interpretations have been highlighted and discussed.

6.2.6 The Role of Interviews

When the research started, it was decided that the main source for the empirical research would have been the analysis of newspapers articles. However, it was also decided that for companies where little information is available, it would have been necessary to conduct some interviews. Furthermore, we had no guarantee that this technique would have worked. Therefore, interviews always represented an option, their role dependant on the results from newspaper analysis.

Two interviews were carried out in one company, on which, of the four companies, we

held least information from secondary sources for the early 1980s. Although, it was large by 1995, the company was still very small in the early 1980s. Therefore, there was a danger that the data collected were insufficient to properly reproduce the history of this company in its early stages.

One interview was with the company's chairman and deputy chairman; the other was with the chief executive. The three had worked in the company at senior executive level since the end of the 1970s. Before the interview, a revised form of the case study made on the basis of information gathered from newspaper articles and other secondary sources was sent to the management. The revised text did not contain management's statements collected from newspapers where the company's strategy was justified and explained. The text was a description of changes in the firm's strategy. There were three reasons behind this decision:

1. to see whether or not our interpretation of the dynamics of the firm's strategy was correct;
2. to assess whether our interpretation of the reasons behind some decisions or action taken was valid; and,
3. to not influence top management's view of the history of their companies by recalling their own statements.

The role of the interviews was to examine the accuracy of our interpretation of the dynamics of their firm's strategy within the industry over a particular period, by discussing it with senior management. However, it was also to provide a stronger understanding of the internal view about how the strategy of the firm was evolving, as well as of the industry dynamics. The objective was therefore to give external validity to our interpretation of the history of the company and to the technique we had decided to use, whilst endeavouring to comprehend the importance of the standpoint taken in addressing specific issues.

The interviews gave excellent results, beyond expectation. Much time was spent discussing the history of the company. What emerged from the analysis of newspaper articles on the company was largely confirmed in the interview. The results reassured us of the validity of the technique we had decided to use for the development of the case studies, especially because little information was available on this company. The information available made us certain that, given the larger amount of information available on other companies, continued investigation would have added little to the stories of these companies. However, we asked the chairman for advice about how to contact the management of other companies, hoping for a "snowball effect". The chairman advised us to write directly to the management of other companies. However, the other companies declined our invitation and it was decided that interviews in these companies would have not been undertaken.

6.2.7 Timing

The collection of newspaper articles from Textline was carried out in Spring 1993. However, by 1994, because of budget constraints, Textline was no longer available in the library. The collection resumed in Autumn 1994 and Winter 1996 with The Financial Times on line. Whilst, Textline is a better source as it contains articles from all the UK newspapers, The Financial Times on-line represented a very good alternative.

Chapter 7 The UK Grocery Retailing Industry

7.0 Introduction

The grocery retailing industry (GRI) is part of the broader food retailing industry. The British Standard Industry Classification identifies the former as "5411" and the latter as "5400". Companies operating within the GRI have traditionally been distinguished as multiples, independents and co-operative companies. Multiples are defined as companies operating 10 or more retail outlets. In this chapter, we review the evolution of the UK GRI from the end of the Second World War until the mid - 1990s. The objective is to describe the changes in the structure of the industry and the nature of competition.

Table 7.1 Share of the UK Grocery Retailing Industry According to Type of Shop

Years	'Multiples	Co-operatives	Independents
*1950	24	22	54
*1961	27	21	52
*1971	43	15	42
*1975	48	16	36
**1980	60.9	14.2	24.9
**1985	70.4	11.6	18.3
**1990	75.8	10.3	13.9
**1994	81.7	8.6	9.7

Sources: * Baden Fuller (1986) based on Nielsen
** IGD Research Services based on Nielsen; and AC Nielsen Trade Statistics (1995)

Over the past 50 years, the structure and nature of the industry and the market have changed significantly. In the 1950s and 1960s, the food market grew in real terms, mainly because of an increasing population. However, since the 1970s, the population has been growing more slowly. This, together with changing eating habits, has meant that there has not been real market growth (Mussannif 1988). Companies in the GRI have pursued market penetration and product development strategies. Multiples have increased their share in the market at the expense of co-operative companies and independent retailers (Table 7.1). On the other hand, by replacing larger retail outlets, they have been able to increase the range of products and services on offer to customers. A large superstore nowadays stocks any dry and fresh produce (which, after the war were retailed through food specialists such as fishmongers, butchers, dairymen, greengrocers, and bakeries), and also medicines, alcoholic drinks, newspapers, magazines and books. Nowadays, superstores often have photoprocessing services, dry-cleaning and post office facilities. Petrol stations are often attached to superstores. It is therefore possible to say that by opening larger retail outlets, multiple retailers have transformed themselves from traditional retailers of packed-dry food to retailers of a variety of fresh produce, other household products and to services providers. The expansion of multiples, with their market penetration and product development strategies linked with the increasing presence of large supermarkets and superstores, has meant that the boundaries of the industry have changed. It has also impacted on the number of companies operating in the GRI. The replacement of smaller units with larger ones has also meant that the number of outlets has slowly but steadily decreased (Table 7.5; page 151).

7.1 The UK Grocery Retailing Industry in the 1950s and 1960s

At the start of the 1950s, the structure of the GRI was highly fragmented with multiples only having 24% of the grocery market. During the 1950s and early 1960s, the structure of the UK GRI remained highly fragmented, with multiples only increasing their share of the grocery market to 27% by 1961 (Table 7.1). Various reasons are behind this slow increase in concentration. The period following the end of the Second World War was a difficult one for the United Kingdom. Food rationing became stricter because of the end of the Lend-Lease arrangement with the US, which had made possible for Britain to buy food on credit during the war. Food demand grew significantly only in the second part of the 1950s after controls were lifted in 1954. However, the increase was also due to a growing population and income.

In the post-war period, new retailing concepts, such as self-service and supermarkets were imported from North America. However, strict planning permissions made it difficult for companies to build new shops, meaning that supermarkets and self-services were slow to diffuse. According to Retail Business (1961), in 1960, out of 275,000 food shops, 150,000 were grocery shops, and these comprised 6,733 self-services and 367 supermarkets. The remainders were counter service outlets. After the war, companies were only able to restructure the outlets that had been damaged by the bombing during the war or to open new stores on sites previously used as warehouses or cinemas. At a competitive level, price was not an important variable for companies. The existence of resale price maintenance (RPM) meant that there were little price differences among different types of retailers. RPM had first been introduced in the 1890s to protect small independent retailers against multiples' price-cutting strategies. However, it also enabled individual suppliers to control retailing price. Suppliers had the support of the industry in collectively enforcing the prices. In 1954, the Restrictive Trade Practices Act abolished collective enforcement but individual suppliers were still able to fix the prices at which their goods were sold (Cox 1988).

In the 1960s, important changes took place in the GRI. Between 1961 and 1971, multiples increased their share of the grocery retailing industry from 27% to 43% (Table 7.1). In a growing market, resulting from the growing population and income, multiples followed a market penetration strategy. Companies expanded the scope of their operations by increasing the number of outlets and the geographic scope of their operations. Counter service outlets were progressively replaced by supermarkets and self-services, while superstores appeared for the first time around the country. Larger stores had some cost advantages over smaller stores. McClelland (1966) argued that economies of scale exist in establishments related to labour costs, equipment, occupancy costs, and stock costs[1]. Further, larger stores also enabled companies to enlarge the range of products on offer to produce *economies of scope*, defined by Dawson and Shaw (1989: 53) as "the economies associated with the assembly of groups of different products for common sale". During this period, price became an important competitive variable. After the Restrictive Trade Practices Act (1954), retailers pushed for the abolition of the RPM in food retailing. In 1964, the Resale Prices Act put an end to RPM in the food industry. Manufacturers could still enforce resale prices, but it was necessary to demonstrate to a Restrictive Practices Court that RPM would be in the

[1] Dawson and Shaw (1989: 52) argue that "the detailed operation of economies of scale at establishment level is unclear, and data are particularly difficult to obtain. On the basis of the evidence currently available, however, some size effects appear likely to exist".

public interest. Only one case was put forward, by confectionery manufacturers, but this was voted against in 1967 (Fulop 1983).

7.2 The UK Grocery Retailing Industry in the 1970s

Changes in the GRI continued in the 1970s, with multiples achieving 61% of the grocery market in 1980 (43% in 1971). Over this period, multiples took market share, not only from other food retailers, but also from other specialist retailers (Table 7.2). This trend, which started in the 1950s, continued until 1994.

Table 7.2 Share of the Grocery Industry on the UK Food Retailing Industry

Years	Grocery Total Sales (£ Mn)	Food Total Sales (£ Mn)	Percentage of Grocery over Food Sales
1961	2335	4090	57.1
1970	3633	6052	60.0
1980	17342	22858	75,9
1990	40382	48239	83,7
1994	54920	62081	88,5

Source: Our Estimation. Based on data from Retail Businesses (1962, 48; 1971, 165) and Retail Trade Reviews (1988, 8; 1995, 36).

Since the 1950s, great progress has continued to be made in "convenience food". Initially, this group included cooked-canned frozen meat and fish, frozen and canned vegetables, pastries, biscuits, puddings and other pre-cooked or prepared foods, with highly competitive prices. If consumers had previously had to buy recipes singly and prepare specific dishes by combining the recipes themselves, with the development of convenience meals, this task began to be performed by the manufacturer. However, the rapid growth in the demand of convenience food was also due to the growth in families owning a fridge, and by the increasing number of women at work. This meant higher demand for convenience goods and a decreasing number of trips for food shopping. Furthermore, grocery retailers, by replacing smaller stores with larger ones, were able to broaden the range of products on offer and take advantage of these trends. What emerges, therefore, is that parallel changes were taking place in the consumer market, food retailing and food manufacturing.

Baden-Fuller (1986) identifies retailers' market power as the reason behind the increase in concentration in the UK GRI in the 1970s. The argument is that a larger market share would have enabled multiples to improve their buying conditions from manufacturers. According to Baden-Fuller, this is confirmed by the fact that food manufacturers saw their profits going down in the 1970s. However, we might doubt this hypothesis, because multiples would have cashed in the better price bargained against manufacturers and increased their profits. This was not confirmed by the Monopolies and Merger Commission whose report (1981) indicates that lower prices were transferred to customers. In our view, the reason behind the increase in the share of the multiples in the 1970s is the internal expansion by multiples retailers, accompanied by strong price competition. This hypothesis is supported by Howe (1990).

In the 1970s, price was undoubtedly the most important competitive variable being used by grocery retailers (others included market segment positioning, localisation of the outlets, services, and range of products). The 1970s were turbulent years for the UK economy, and were characterised by two economic recessions. In March 1974, the Price Commission introduced stringent gross margin controls upon grocery retailers. Further, after two decades of rising demand, a low growth rate in the UK population means that

demand for grocery products stagnated in the 1970s. The stagnating demand and recessions, linked with rising prices (due to inflationary pressure), created many uncertainties among consumers. This means that *price* was an important competitive variable for grocery retailers. The way to increase profitability for companies was to expand the geographic scope of operations and the range of products on offer to customers in search of potential economies of scale and scope. Companies expanded the geographic scope of operations while also replacing smaller stores with larger supermarkets and superstores. The number of grocery outlets continued to decrease, but the number of supermarkets and superstores increased. In 1979, there were 7,130 supermarkets and 276 superstores, compared with 4,400 supermarkets and 24 superstores in 1970 (Fiori and Stellatelli 1983).

Table 7.3 Market Share of Main Companies in the Grocery Retailing Industry

	1970/71	1980
Tesco	7.2	13.8
Sainsbury	6.1	12.2
Allied Suppliers	7.9	4.8
Fine Fare	4.8	5.2
International Stores	3.2	4.8
ASDA	1.5	7.7
Kwik Save	0.3	5.2
Total	31	53.7

Source: AGB (1996)

At a competitive level, the 1970s witnessed the emergence of significant differences among multiples. After the 1964 Act, which had put an end to RPM in the food industry, a number of discounters appeared on the market. It is possible to distinguish between two price policies in food retailing: average low prices on all the goods and low prices on a limited range of products for a limited period. Kwik Save and ASDA followed a strategy of low prices for all the goods. At the beginning of the 1970s, ASDA and Kwik Save had a marginal presence within the market. Within a few years, they had expanded their operations by offering a limited range of products at low prices. ASDA used large supermarkets and superstores, often on the edge of towns, whilst Kwik Save focused on city centre sites. Their success encouraged these companies to expand their operations. Large retailers initially downplayed the emergence of discounters (Fiori and Stellatelli 1983). However, they were later forced to quickly respond. Other grocery retailers, with a much wider range of products (between 2,000 and 3,000, against the 300 averaging discounters), lowered their prices. Later, some companies started to convert smaller units into discount formats (Allied Supplier launched Presto at the discount end of the market, Fine Fare launched Shoppers' Paradise).

Between 1977 and 1979, a strong price campaign was launched by Tesco and Sainsbury. Because of the price campaigns, these companies significantly increased their market share in the GRI.

Table 7.4 The Co-operative Movement: Turnover and Number of Companies

Year	Total Turnover of Co-operatives (£ Mn)	Number of Coops Societies**
1941	N/A	1059
1953	N/A	988
1961	N/A	835
1970	N/A	357
1980	*3641	206
1982	*3860	145
1984	*4151	112
1986	*4442	100
1988	*4986	85
1990	**5826	77
1992	**6217	62
1994	**6013	52

Source: * Retail Trade Reviews (1988, 8; based on DTI indices)
** Retail Trade Reviews (1995, 36; based on data from the Co-operative Union)

7.3 The UK Grocery Retailing Industry between 1980 and 1995

Changes in the GRI have continued to the current time. Multiples continued to increase their share within the GRI until 1994 (the last year when data were available) with their share reaching 81.7% in 1994 (it was 61% in 1980). The decline of independent retailers and co-operatives companies has continued. This has occurred despite the consolidation that has taken place in the co-operative movements, where the number of co-operative societies has decreased (Table 7.4) mainly as a result of a number of mergers aiming at strengthening the position of a limited amount of larger co-operatives. The decline of the co-operative movement goes back for some time. Already in 1962, Retail Business (1962: 19, n. 52) wrote, "even though the co-operatives were the pioneers of self-service in this country, they have been steadily losing ground to multiples".

Table 7.5 Structure of the Grocery Retailing Sector: 1961 - 1992

	Large Grocery Retailers	Other Grocery Retailers	All Grocery Retailers
Number of Businesses			
1961	N/A	N/A	109034
1971	N/A	N/A	82666
1980	116	38814	38930
1984	98	34053	34151
1988	69	24821	24890
1992	71	18557	18628
Number of Outlets			
1961	N/A	N/A	131982
1971	N/A	N/A	97747
1980	12218	44342	56560
1984	9742	37636	47378
1988	8328	26992	35320
1992	8003	20584	28587

Source: Retail Trade Review (1994, 1992) Retail Business (1982). Tucker (1978), for 1961 and 1971 data.

Note: The distinction made between large grocery retailers (with a turnover higher than £ 12m) and other grocery retailers has been dropped due to reclassification and data are not available since 1993.

According to Bamfield (1987: 158) "co-operatives declined because they were unable to respond to the rapid changes in retailing." While co-operatives had been innovators in the 1950s, they have since been unable to configure their operations in ways that match the effectiveness of multiples.

At a macro level, the 1980s were characterised by a decreasing number of multiples (Table 7.5), which have significantly increased the geographic scope of their operations. Using a terminology developed by Duke (1991), we might say that retailers have followed a geographic "flanking attack" strategy. That is, they have developed new sites in catchment areas with little or no direct competition from similar offers, thus flanking the competitors, attacking them where they are weak or where they do not have outlets. By replacing smaller units with larger ones (there were 919 superstores in 1994, compared to 276 in 1979), the portfolio of stores among multiples has significantly changed (Table 7.6).

Table 7.6 Size Profile of Multiple Stores

Sales Area (sq. ft.)	1984	1988	1992
< 4000	44.6	28.9	26.6
4000 – 9999	29.1	28.1	22.5
10000 – 14999	9.5	13.0	12.2
15000 – 19999	6.7	10.1	9.7
20000 – 24999	3.2	6.0	7.0
>/ 25000	6.9	13.9	22.0
Total	100	100	100

Source: IGD Research Services

The importance of superstores and supermarkets has increased. This has happened in a context that has witnessed a continued decrease in the number of outlets. The expansion in the number of superstores has been made possible by easier planning permissions for

building superstores since 1985. This trend has continued throughout the 1980s and 1990s. Companies, when possible, have preferred to develop large supermarkets or superstores, because of the higher margins reported by these stores.

> "The quality of our new stores is reflected in their financial performance and we are seeing excellent sales growth from the stores in the previous years. New stores generally now come into profit in their first year of trading, and on maturity are currently exceeding our operational and financial criteria in terms of both sales and return on capital. The ability of our new stores to deliver substantially higher net margins than the corporate average ... gives us confidence in the future ...
>
> With regard to future development programmes, contrary to general market fears of saturation, all our detailed research has led the Board to conclude that there is substantial profitable opportunities for new superstores and so our development programme is being increased" (MacLaurin, Chairman of Tesco, Annual Report, 1989: 6-7).

The share of specialised businesses (fishmongers, butchers, dairymen, greengrocers and bakeries) has continued to decrease - slowly but continuously. A trend started in the 1950s. The novelty is that supermarkets and the superstores have given multiples the opportunity to expand the ranges of products on offer to customers. This has effectively enlarged the competitive basis and has changed the boundaries of the industry. "Filling stations are now big business for the major grocery multiples and one leading analyst estimates that the top grocers take over £2.5 bn a year from fuel sales. Tesco, Sainsbury, ASDA, Argyll and Wm Morrison are estimated to account for 17.7% of the UK petrol market, which compares with 8.4% in 1989." (Key Note 1995: 10).

7.3.1 Firms' Strategies and Industry Changes from 1980 to 1995: A Micro Analysis

Having examined the dynamics of the industry at a macro-level, we now look at it more in detail for the period between 1980 and 1995.

Following the recession at the end of the 1970s and price competition between the largest multiples, we find a situation where the market share of the various companies had significantly changed within a few years. Between 1976 and 1980, Tesco, Sainsbury, ASDA and Kwik Save made significant gains in terms of market share. The main losers were smaller multiples, Co-ops and Independent stores.

The price competition in the second part of the 1970s (from 1976 to 1979) was followed by a second price skirmish in 1982 launched by Tesco, which was losing sales to competitors.

Table 7.7 Market Share of Main Companies in the Grocery Retailing Industry between 1976 and 1984

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Sainsbury	8.9	9.0	11.1	11.1	12.5	13.7	15.3	16.1	16.7
Tesco	7.9	10.3	12.4	13.2	13.4	13.3	13.6	14.1	14.0
ASDA	5.7	6.3	6.6	6.9	8.4	8.6	9.3	9.3	9.8
Argyll	N/C	N/C	N/C	N/C	N/C	N/A	N/A	4.6	4.5
Kwik Save	2.2	2.7	3.1	3.7	4.1	4.2	4.3	4.5	4.6
Fine Fare	3.4	3.4	3.6	4.0	4.4	4.5	4.3	3.9	3.7
International Stores	2.9	2.5	3.2	3.5	4.0	3.5	3.5	2.9	N/C
Safeway	1.3	1.2	1.3	1.2	1.3	1.5	2.0	2.1	2.7
Waitrose	1.3	1.7	1.4	1.5	1.2	1.4	1.1	1.3	1.3
Allied Suppliers	5.1	6.9	6.5	6.6	6.8	6.7	6.6	N/C	N/C
Gateway	N/C	N/C	N/C	N/C	N/C	N/A	N/A	N/A	6.3
Total	38.7	44.0	49.2	51.7	56.1	57.4	60.0	58.8	63.6

Source: AGB (1996)

<u>The Effects of Price Competition</u>

Price campaigns have had important consequences for the structure of the industry. International Stores, Allied Suppliers and Fine Fare, which had been among the largest companies at the beginning of the 1970s, had seen their relative importance in the market decreasing by the rapid expansion of Sainsbury, Tesco and ASDA. It did not come as a surprise when, between 1982 and 1986, the three businesses were taken over by other companies. Looking at these three businesses, we can see that they were all subsidiaries of groups operating in various industries. International Stores was part of British and American Tobacco (BAT Industries), a company operating mainly in the tobacco industry. In the GRI, it operated with three identities: International Stores (which formed the core of its retailing activities), Mainstop (the superstore business) and Pricerite (the discounter). Following the appointment of Patrick Sheehy as Executive Chairman in 1982, a new strategy was set up at the corporate level. The objective was to focus on a smaller range of activities. The group divested of Pricerite and Mainstop in 1982 (to Argyll) and of International Stores in 1984 (to Gateway). In commenting on the sale of International Stores in 1984 to Dee Corporation, Patrick Sheehy said (Annual Report 1984: 6) "we believe that food retailing is a specialised business that does not fit into our-long term plans". BAT had taken over International Stores in November 1972.

Allied Suppliers was under the control of Generale Occidentale, a holding controlled by James Goldsmith. Goldsmith had little interest in developing a strategy of expansion for Allied. This is clear when we consider that between 1977 and 1982, £ 104m were extracted from the company, £ 33m of which were transferred from reserves.

We do not know much about the reason, which led to the selling of Fine Fare by ABF (a food manufacturer and a retailing company). However, we know that Fine Fare market share had increased from 3.4% in 1976 to 4.4% in 1980, to start a long decline until achieving 3.5% in 1985. Between 1980 and 1985, the group had also been closing the less profitable stores. The number of stores had decreased from 662 in 1980, to 419 in 1985. A likely reason for these groups divesting of their operations is that the management at the corporate level had lost interest in the GRI, probably because major investment were needed to improve the businesses, which management was unwilling to do.

The early 1980s also saw a major shakeout in ownership of medium-sized multiple grocers. Lennons, Amos Hintons, Key Market and others were taken over within a few years (Table 7.9). Many of these companies operated small supermarkets located in the city centres, and they had been badly hit by the price competition of the late 1970s. It also seems that after a decade, during which the concept of the out-of-town superstore had been seen with some reluctance by retailers, in the late 1970s to early 1980s, many companies in the industry developed the view that the future in grocery retailing was in the superstore business. Tesco had a strategy of developing a network of 400 superstores and Sainsbury had plans to open 15 large supermarkets per year.

ASDA was the only specialised superstore operator and had played a significant role in the development of this belief. ASDA, in the late 1970s – in a context characterised by price competition, was the company with the highest profitability and highest margins. However, what was most impressive was that ASDA was achieving these results and

still being shown by market research as one of the cheapest retailers for consumers (Brooks and Davies 1989).

Table 7.8 Some Financial Figures of ASDA, Sainsbury and Tesco

	Operating Profit (£ Mn)			**Return on Capital Employed** (%)			**Return on Sales** (%)		
Year	1978/79	1979/80	1980/81	1978/79	1979/80	1980/81	1978/79	1979/80	1980/81
ASDA Group	39.7	49.1	51.1	48.2	44.7	29.2	5.0	4.9	4.3
Sainsbury	30.8	40.5	54.5	15.4	17.4	21.1	3.1	3.4	3.6
Tesco	36.1	39.7	51.3	21.3	21.6	17.9	3.0	2.6	2.8

Source: Our Estimation on Datastream Data

However, the replacement of small supermarkets with a superstore network was not easy. Superstores presented advantages over supermarkets in terms of economies of scale and scope. However, the shift required some changes in the retailer's positioning in the market place, with the related risks of being unable to maintain old customers and/or to attract new ones. Furthermore, it required the development of new functions for the new lines on offer[2]. Finally, the financial resources for developing superstores were significant and the timing for developing superstores was long. Everything required a sound financial basis and a long-term view.

It appears that many medium-sized companies were not in the position to effectively move into the superstore business. Fitch Lovell disposed of Key Market in June 1983, and the management explained that the retailing required major investments and they were inhibiting the Group's excellent business in food manufacturing and distribution (Annual Report, 1983). The Managing Director of Laws stores, in commenting on the

[2] This has been confirmed by A. Grant during the interview. In commenting Argyll's strategy in the early 1980s, he stated: "we were very poorly positioned in 1982 to participate in that superstore development. Because Allied Supplier had very few good stores and it did not have the width of range, the own brand strengths, the in-house distribution you needed to".

take over by WM Low, said that Laws Stores was not large enough for "*necessary modernisation and expansion.*" (Textline)

Table 7.9 Corporate Activities in the early 1980s in the Grocery Retailing Industry

Year	Buyer	Company Acquired
1981	Argyll	Oriel Foods (part of RCA International)
1982	Argyll	Allied Suppliers (part of Generale Occidentale)
	Argyll	Pricerite and Mainstop (part of BAT Industries)
1983	Gateway	Key Markets (Part of Fitch Lovell)
	Gateway	Dee Supermarkets*
1984	Wm Low	Laws Stores
	Gateway	Lennons Supermarkets*
	Booker	Bishops
	Argyll	Amos Hinton
1985	Wm Low	Laws Stores
1986	Gateway	Fine Fare (part of ABF)
	Barker & Dobson**	Budgens (part of Booker)

* Merger ** Barker & Dobson changed its name to *Budgens Stores*

In this context, two companies Argyll and Gateway (which later became Dee Corporation), through multiple acquisitions, became significant players in the industry within a few years. Their strategy was to quickly build a significant presence in the industry and through the rationalisation of support functions to retailing activities (buying, distribution, finance, advertising and other central and middle management) achieve significant economies of scale and improve profitability in the short term, whilst developing a strategy for the future. Argyll was the first to address the problem of rationalisation. Its market share remained stagnant between 1984 and 1986, but through a rationalisation process, it quickly improved its profitability. An opposite strategy was followed by Gateway (Dee) which, in the same period, grew significantly without any logic. Size did not bring the benefit that was supposed to, as the company did not

achieve the economies it was expected. This eventually led to the company running into financial difficulties and being taken over by the Isosceles consortium in 1989, after a bid by Budgens had failed in 1987.

A Boom in the Development of Superstores

Changes in the industry continued in the second part of the 1980s. Consolidation continued as Hillards was taken over by Tesco (1987); Argyll acquired Safeway (1987), the UK arm of Safeway US; and Iceland took over Bejam (1989). However, this period was marked by a boom in the development of superstores.

It had traditionally been very difficult to get planning permission for the development of superstore, which had created unhappiness among some retailers. Lord Sainsbury, in reviewing the strategy of Sainsbury in 1983, complained that it had taken three years to get planning permission for a superstore at Ipswich:

> "Surely it is time for the process and procedures of planning to be examined to try to simplify and speed them up. ... The planning process needs to be more predictable and this could be achieved by closer definition of what should be permissible and of the considerations which should influence decisions. The world has much changed since the post-war period when the present planning system was first established" (Lord Sainsbury, Annual Report, 1983: 5).

Nevertheless, large retailers continued to find it difficult to obtain planning permission for large stores also because of the lobbying of local established retailers.

> "There is often concern with protecting existing trade in town centres rather than permitting developments of supermarkets in new locations. ... The argument that a new store development would impact on existing traders so often given as a reason for returning planning permission fails to recognise the facts of changing commercial life and changing consumer needs" (Lord Sainsbury, Annual Report, 1985: 8).

In July 1985, the Secretary of State for the Environment, in a Development Control Policy Note, commented that "since commercial competition as such is not a planning consideration, the possible effects of proposed major retail development on existing retailers is not a relevant factor in deciding planning applications and appeals." (Williams 1994: 185-186). This note came at a time where broader changes were taking place in the UK. The government was putting pressure on local authorities to reduce their spending and was encouraging them to sell unwanted land. Thus, the clarification of planning permission procedures was accompanied by an increasing availability of sites suitable for superstore development. Consequently, many companies increased their expansion programmes. In the late 1980s, Tesco, Sainsbury and Argyll were opening 20 new superstores a year.

Food retailing had traditionally been a cash generating industry, but as companies speeded up their expansion programmes, it suddenly became a cash consumption one. In 1991, all the major retailers went for share issue to finance their expansion programmes. This was also due to the significant investments made in information technology as well as to the development of central distribution depots, which linked with the retailers' strategies of developing own-label, profoundly transformed the supply chain.

Changes in the Supply Chain: The Establishment of Central Distribution Depots by Retailers

In the 1970s, Sainsbury and Marks and Spencer pioneered the development of centralised distribution networks (Key Note 1995). Instead of delivering the goods to the outlets, manufacturers delivered products to a central warehouse controlled by the

retailer. The retailer would then take care of delivering the goods to the outlets based on the demand. However, from the late 1980s, centralisation of distribution centres for major multiples became the norm. A prime motivation for the change was the need to improve efficiency, drive down costs and assume greater control over the distribution system. The main benefits of centralised warehousing include a reduction in inventory costs, improved scheduling and greater efficiency in picking and loading. Administration can be managed centrally. Furthermore, enhanced product availability, coupled with control over quality, increases customer service.

Before this centralisation, products were mostly delivered by suppliers or wholesalers from local distribution centres. Their deliveries involved multi-drop rounds with small quantities being delivered to numerous outlets within the region. In the past, there could be as many as 60 deliveries a day (Moore 1991). Centralised networks have resulted in retailers cutting deliveries to a dozen or less (Moore 1991). Lead times have gone down from 14 to 3 days, store and depot stock times have declined from 4 weeks to a week, and the number of lines carried has grown from 2,000 to 10,000 (Key Note 1995).

Table 7.10 Percentage of Groceries Through Centralised Distribution (Volume) in 1990

Retailer	Percentage of Stock Going through Centralised Distribution
Argyll	90
ASDA	80
Kwik Save	80
Wm Morrison	90
Sainsbury	90
Tesco	90
Waitrose	80

Source: Moore (1991)

The development of multi-temperature distribution depot has been accompanied by the development of multi-temperature vehicles. "One vehicle can be used instead of five, resulting in reduced capital costs, reduced congestion in loading bays, lower overheads and running costs and fewer distribution centres. Such technical advancements facilitate frequent deliveries of concise multi-temperature assignments to stores assuring the customer of freshness and availability." (Moore 1991: 19).

Changes in the Supply Chain: The Diffusion of Information Technology

However, changes in the supply chain have been more far reaching than a redefinition of roles between suppliers and retailers. This has been made possible by the rapid development of Information Technology.

> "As in other industries computer technology has gone deep - into process control; into warehousing and transport control and into store operation. For years we have seen at each stage computer applications emerging. But only now we see the beginnings of an integrated system approach. And the key to bringing this about must lie with scanning and the information which it produces" (Beaumont 1989: 12).

Main retailers have developed computer networks linking stores warehouses and the company's headquarter. The development of EPoS (Electronic Point of Sale) has enabled retailers to supply customers with itemised bills and to improve efficiency at the check-outs. It has enabled them to gather precise information on stock sales, which is used to inform management on sales trends for specific products, as well as for stock replenishment. A central store computer automatically calculates store stock requirements and generates order for delivery to stores. The store's computer is linked to the regional depot that receives order from each store and the distribution is prepared. At the same time, the retailer is linked through computer systems (EDI) with manufacturers, which transmit orders and invoices, saving costs and time.

The development of these Information Systems has enabled retailers to reduce stock levels and wastage, improve productivity at all levels and reduce the period in which products are out-of-stock.

> "Logistics systems are designed to view the supply chain as a whole - from procurement and material flows to customer deliveries and cash collection. Activities such as inventory management, warehousing and transport are all viewed as part of the process. Technology is increasingly being used to answer the complexities of getting food and other products to the customer on time and in peak condition" (Key Note 1995: 31).

Major multiples have tried to claim major influences on the vertical chain. They have tried to manage more "tightly, both competitively and co-operatively, the vertical relationships in order to enhance horizontal competitiveness" (Shaw and Dawson 1996: 56).

Another important element that has contributed to changes in the supply chain has been the development of retailers' own-label products. Initially developed by Marks & Spencer, Waitrose and Sainsbury, own-label products have traditionally been seen as a quality substitute to branded products. The development of own labels by retailers occurred for two reasons. Firstly, retailers have higher margins for own-label products than for branded products. Secondly, it creates difficulties for consumer to compare the prices of products.

Table 7.11 Own Label - Share of Sales

	1981	1994
Marks & Spencer	100.0	100.0
Sainsbury	54.0	65.8
Waitrose	47.0	56.0
Tesco	20.0	56.1
ASDA	7.0	40.5
Safeway	N/A	51.5
Somerfield	N/A	45.3
Kwik Save	0.0	13.4

Source: Fiori and Stellatelli (1983) for 1981; Key Note (1995) for 1994.

Price and Positioning

Price was a major factor in the high inflation 1970s, especially in the selling of staple food commodities and the determining of store choice. After the recession of 1981-82, the market focused back to the product. Brooks and Davies (1986) indicate that quoted research shows that price dropped from first to sixth position in consumer rating for the choice of stores between 1980 and 1984. Convenience, quality, range and store environment were more important variables. In this period, companies strategically tried to move away from price. Price competition had had good effects on market share but not on profitability and companies were keen to increase their profitability.

Table 7.12 Market Share of Main Companies in the Grocery Retailing Industry between 1984 and 1990

	1984	1985	1986	1987	1988	1989	1990
Sainsbury	16.7	17.6	18.4	18.6	19.0	18.9	19.6
Tesco	14.0	13.6	13.3	14.5	15.3	15.6	16.6
ASDA	9.8	9.7	9.6	9.7	9.4	9.2	10.4
Safeway*	2.7	3.0	3.6	4.1	5.1	6.6	8.0
Presto	2.4	2.4	3.0	3.2	2.6	1.7	1.1
Other Argyll	2.1	2.6	1.4	0.9	0.9	1.2	1.3
Total Argyll	4.5	5.0	4.4	8.2	8.6	9.5	10.4
Gateway	6.3	7.2	10.7	11.0	10.8	10.4	8.2
Fine Fare	3.7	3.5	N/C	N/C	N/C	N/C	N/C
Waitrose	1.3	1.7	1.6	1.6	1.6	1.5	1.5
Kwik Save	4.6	4.6	4.5	4.2	4.7	5.3	6.1
Total	63.6	65.9	66.1	67.8	69.4	70.4	72.8

Source: AGB (1996) Note: * = Independent until 1987

Between 1980 and 1995, most of the leading players attempted to make significant changes in their market positioning. The established UK discount operators of the 1970s, Tesco and ASDA, tried to change their strategic position and adopted a programme of store upgrading and broadening of ranges, thus emulating the up-market grocery multiples. With the acquisition of Safeway by Argyll, and the successive

conversion of Presto outlets into Safeway, came the rapid development of a further strong identity at the upper end of the market. Sainsbury also expanded the geographic scope of its operations. After the price competition of the late 1970s and early 1980s, retailers developed the concept of 'value for money', while the prices of the goods stayed the same, new services were offered to customers in the form of long trading hours, payment with credit and debit cards, crèches for children, cafeterias, post-offices, chemists and petrol stations. Customers therefore had the impression of receiving more for the same price.

A homogeneous offering among the key players resulted, typified by the formula of national coverage, quality product ranges, quality images, service and out-of-town superstore locations. This is exemplified by the Which report in 1992[3] (Table 7.13)

Table 7.13 Which Report on Consumer Perception of Retailers' Position

Low price		Quality of Fresh Food		Quality of Products		Best Range of Goods	
Chain	**%**	**Chain**	**%**	**Chain**	**%**	**Chain**	**%**
Kwik Save	96	Marks & Spencer	86	Marks & Spencer	91	Sainsbury	68
Tesco	45	Waitrose	72	Waitrose	75	Tesco	66
Gateway	38	Sainsbury	64	Sainsbury	67	ASDA	65
ASDA	31	Safeway	59	Tesco	52	Safeway	60
Sainsbury	30	Tesco	49	Safeway	51	Marks & Spencer	57
Safeway	20	ASDA	48	ASDA	45	Waitrose	54
Waitrose	8	Gateway	29	Gateway	31	Gateway	27
Marks & Spencer	6	Kwik Save	15	Kwik Save	23	Kwik Save	21

Note: Emphasis added on the companies examined in the next chapters;
Source: Which (1992).

The report indicates that the differences between retailers had significantly reduced in the 1980s. This was an opinion shared by analysts, as indicated by the following comment made in Retail Business (Economist Intelligence Unit 1990: 50): "While there

[3] 1,800 shoppers were asked to compare supermarket chains on a number of different factors. Price was the most important factor (33%), followed by range of products (30%) and quality (15%).

are still differences between the chains these are much less apparent than ten years ago and the consumer would probably perceive the difference between a new style Sainsbury superstore and an old style Sainsbury supermarket as being greater than the difference between a Sainsbury superstore and a Safeway one".

Because of the move upmarket by many retailers, discounters such as Kwik Save, which competes on price rather than range or service, had been left significant space to develop at the low end of the market. This move upmarket also created the conditions for the entry and development of a number of European discounters in the early 1990s.

The Entry and Development of Discounters

The period between 1982 and 1989 was a prosperous period for UK, but in 1990 the economy started to slow down and went into recession in 1991. This was to become the UK's worst recession in the post-war period and was to last for much longer than expected. The economy came out of the recession in 1994. Food retailing had traditionally been a "recession proof" sector. As recession hit the economy, prices of property, after booming in the second half of the 1980s, quickly went down. However, this was not the case for sites suitable for superstore developments, which remained high because of competition among large supermarket operators to acquire prime sites. Concern was expressed over the increasing price paid for new sites. In May 1992, WM Morrison announced a significant change to its accounting policies by depreciating its land assets. This came as their management recognised that the alternative use value of its sites might be much less than for purposes not related to food retailing: "In a high inflation environment this policy was considered appropriate as inflation offset any

diminution in the underlying value of the asset. We have now moved to a low inflation environment with many of the more recently acquired assets staring at uncomfortably high valuations" (Shiret, food retailing analyst at Credit Lyonnais Laing, on The Financial Times, 22/10/92: 19).

In the meantime, the trend towards edge-of-town sites had left retail space in many city centres. Locations previously occupied by large retailers had been taken by traditional city centres operators such as Kwik Save and Iceland. The former had consolidated its position as a national discount operator with 750 stores by 1991, the latter as a city centre frozen food specialist. However, in the early 1990s, a number of 'hard and soft' discounters, such as Aldi, Netto, and Ed made their entry in the UK grocery retailing market.

The concept of hard discounting was unknown in the UK. Hard discounters were characterised by very low prices and a narrow number of lines. Prices on some lines were up to 50% cheaper than supermarket operators. Initially, their entry was not seen as posing a threat to large retailers operating at the higher end of the market. The argument was that they were targeting a different market segment and operators such as Safeway, Sainsbury and Tesco, which targeted customers towards the higher end of the market, would not have been affected. Nevertheless, the situation evolved in a different way.

In Winter 1991, ASDA changed its price position in the market. The company had previously attempted to position itself at the upper end of the market, alongside Sainsbury, Tesco and Safeway. However, its attempts failed and the new management decided to return to its roots as an edge-of-town discount chain. In May 1992, Kwik

Save announced that it was reducing prices in response to competition from hard discounters. In January 1993, a report published by Verdict, the retail consultant, stated that discounters had been quickly consolidating their presence within the market. In May 1993, Gateway launched a cut price "Price Check" campaign. In Autumn 1993, Tesco, Sainsbury and Safeway launched a cut-price own label, covering 70 products, which was to replace tertiary brands. The management of these companies admitted, for the first time, the growing threat posed by discount operators. They also acknowledged that they had not reacted promptly to the recession and had not recognised the changing priorities of its customers.

The introduction of tertiary brands effectively neutralised the potential effect of the discounters. Shoprite, which within a few years had become a significant discounter, was taken over by Kwik Save. Argyll divested of its Lo-Cost business. However, the other discounters, the German 'Aldi' and 'Lidl' and the Danish 'Netto', were slowly but steadily expanding. These privately owned companies took into account that their early developments in the UK GRI would have been difficult, and they forecasted that they might have been making a loss in their first years.

The development of discount chains initially scared large multiples. Companies were unable to understand if the losses in sales were due to the effect of discounters or to saturation in the industry. There was also a scare that warehouse clubs would have taken a significant share of the market. Warehouse Clubs are based on a membership – edge-of-town - storehouse trading formula. They trade on strongly discounted prices (20-30% cheaper). They stock around 3,500 lines (compared to 20,000 in a Tesco store) of food and non-food, but food is available only in bulk packs and continuity of stock is not

guaranteed. They offer limited facilities. In the USA, they have been the fastest growing retail type with membership of over 21 million people.

In 1993 Costco, the US warehouse club operator, got the go ahead for the opening of the UK's first such warehouse. The opening was delayed after Tesco, Sainsbury and Safeway had appealed on the ground that the venture should have been assessed as a retail outlet rather than as a wholesaler. The appeal was overruled on the condition that warehouse clubs could only have a percentage of their sales going to the final consumer market (25%). CostCo is nowadays the only UK operator, after Nurdin and Peacock, the cash and carry operator, sold its outlets to Sainsbury in 1995.

Because of the development of discounters and warehouse clubs, many companies initially reduced their expansion programmes and set up strategies aiming at increasing their sales. If retailers in the 1980s had directed their efforts to the acquisition and development of new stores, in the early 1990s, they mainly tried to increase their sales. In pursuing this strategy, companies again tried to change their market position. ASDA went back to its price conscious image. Tesco, having managed to develop a quality image among consumers, tried to develop a more popular price strategy while maintaining its quality image. Safeway aimed at the middle class families.

After the initial scare of saturation, retailers soon understood that this was a one-off price-reposition in the industry and resumed their expansion strategies. Some companies maintained their focus on superstore development, others on city centre stores.

Table 7.14 Market Share of Main Companies in the Grocery Retailing Industry between 1990 and 1994

	1990	1991	1992	1993	1994
Sainsbury	19.6	20.0	20.5	20.5	20.6
Tesco	16.6	17.0	17.4	17.9	19.1
ASDA	10.4	10.9	10.7	10.7	10.7
Safeway	8.0	8.1	8.2	8.9	9.0
Presto	1.1	0.9	0.8	0.7	0.7
Other Argyll	1.3	1.3	1.2	1.1	1.1
Total Argyll	10.4	10.3	10.2	10.7	10.8
Gateway	8.2	6.7	6.3	6.8	6.9
Kwik Save	6.1	7.2	8.7	9.2	9.2
Waitrose	1.5	1.4	1.4	1.3	1.2
Total	72.8	73.5	75.2	77.1	78.5

Source: AGB (1996)

The development of discount operators, convenience stores and other chains that had taken the retail space left by operators moving to the edge-of-town, had demonstrated that it was possible to operate successfully in city centres. At the annual convention of the Institute of Grocery Distribution in October 1994, David Sainsbury suggested that the big groups had been mesmerised by the efficiency and popularity of edge-of-town supermarkets, and forgot that there would always be some business located in town centres. "The market did, however, work extremely effectively and a number of chains, including the discounters, moved in to fill the gap" (The Financial Times, 19/10/94: 8).

Table 7.15 The Development of Discounters in the UK Grocery Retailing Industry

Company	
Aldi	It started to operate in 1990. Since then, sales have risen to £ 547.7m in 1996. In 1995, it operated 152 stores.
Lidl	It started trading in 1994 with 17 stores. Since the sales have increased from £80m to £ 250m in 1996.
Netto	It started trading in 1990 with 10 stores. Since then sales have increased from £14.6m to £375m in 1996. In 1995, it operated 111 stores.

Source Various Documents

Initially prices were effectively cheaper for edge-of-town stores but increasing competition for scarce resources pushed up prices. When ASDA developed the concept

of out-of-town superstores in the UK, it was the only operator and the price of land was effectively cheaper for out-of-town sites than city centres ones, which positively affected profitability. However, as in the 1980s many large multiples focused on edge-of-town superstores, companies were competing for best sites and bidding up on prices. At the same time, prices for city centre sites went down as a result of the migration of many retailers to out of town sites, as a result the advantage initially offered by out of town sites compared to city centre significantly decreased.

Furthermore, in 1993, the Secretary of the Department of the Environment issued a guideline that planners should give priority to town development over other sites. Developers would have had to work harder to get planing permission for out-of-town stores if a more central site were available. However, companies are still opening edge-of-town superstores. Companies interested in developing superstores often help funding community projects as a condition of getting planning consent (e.g., building new roads, new bus routes, swimming pool and even football stadiums). These are called 'planning gains' and are entirely legal (Buckley in The Financial Times, 1995).

At the industry level, the price repositioning of many retailers and the strategies for increasing sales has resulted in further increases in concentration in the UK GRI. Smaller chains have been taken over or decided to divest of their interests in food retailing. In 1992, WM Jackson disposed of its supermarket business to Argyll and Kwik Save to concentrate on its convenience business. In 1994, WM Low was taken over by Tesco. In 1995, Merchant Retail Group divested of its superstore business by selling its superstores to various companies.

7.4 Conclusion

In conclusion, the history of the UK GRI over the past years has been characterised by the increasing importance of a limited number of multiples. What emerges from the analysis is also the importance of assessing changes in their complexity, i.e., to look at changes in firms' strategies, industry structure, consumers market as well as in the relationships between these entities.

Chapter 8 Argyll Group PLC

8.0 Introduction

The origins of Argyll go back to 1977 when James Gulliver with the collaboration of Alistair Grant and David Webster founded James Gulliver Associates (JGA), a holding company specialised in taking management control of companies by acquiring minority share. Before launching this venture, James Gulliver had been, between 1961 and 1965, with Urwick Orr, the management consulting firm; in 1965, he had joined, as managing director, Fine Fare (the grocery retailing part of ABF), where he became chairman in 1967. Gulliver was seen as being one of the most important factors in Fine Fare's success in those years. Alistair Grant joined Fine Fare in 1968 as director of business development after having had various marketing posts at Unilever, J. Lyons, and Connell May & Steavenson.

Grant and Gulliver left Fine Fare in 1972. In the same year, Gulliver, Grant and David Webster, an investment banker, acquired management control of Oriel Foods, where Gulliver had previously bought a significant minority share. A year later, Oriel was bought by RCA Inc. However, the three men stayed there until 1977 when they left to form JGA. Here, the first acquisition was a home improvements company. Later they began building their own food group by purchasing two foods companies Morgan Edwards and Louis Edwards, a Manchester meat business. At the same time, JGA took management control of Amalgamated Distilled Products (ADP), engaged in the marketing, distribution, and production of liquor products. The two food companies were integrated to form Argyll, which remained under the management control of JGA and soon became the take-over vehicle. The other two businesses were also under the direct control of JGA. The home improvement business was later divested, leaving only Argyll and ADP under direct management control of JGA.

8.1 1980-1985: Argyll under James Gulliver's Chairmanship

In 1980, Argyll was mainly a small manufacturing company involved in retailing. The declared programme was the development of a broadly based food group, both through organic growth and, where appropriate, acquisitions (Annual Report, 1981).

In the early 1980s, Argyll's strategy was to expand in the GRI. Between February 1981 and August 1984, Argyll acquired Oriel Foods, 67 Pricerite outlets, the much larger Allied Suppliers[1] from Generale Occidentale, 26 retail outlets from George Mellis and Son, 5 Mainstop superstores from BAT, 2 stores from WBG, and it finally took over Amos Hinton. Furthermore, it also attempted to take over Linfood (Gateway's name at the time). At the end of this acquisition programme (1984/85), Argyll was the sixth largest UK grocery retailer (after Sainsbury, Tesco, Coops, Gateway and ASDA). Most of the companies that it acquired were stagnant businesses with fragmented consumer franchises and a poor infrastructure. Initially, the policy was to maintain all the retailing fascias although a profit-enhancing programme was implemented as these companies were acquired.

[1] Allied Suppliers had estimated sales of £847m and operated 918 stores (1981 data).

Table 8.1 Argyll's Acquisitions: 1981 - 1984

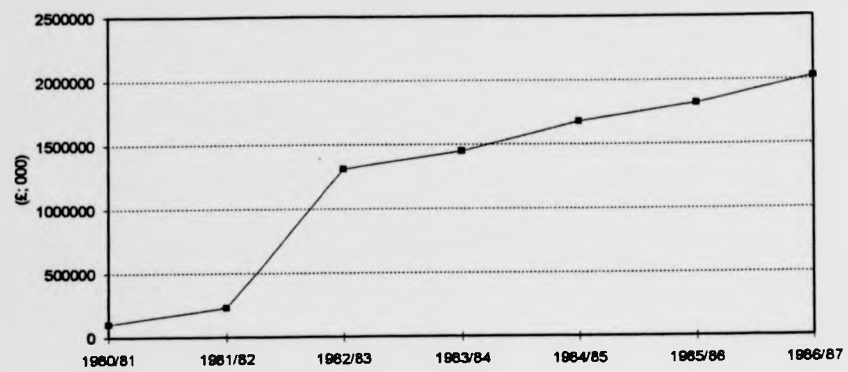
Year	Acquisition	Cost (£ m)
1981	Oriel Foods	19.5
	Patterson	0.9
1982	Pricerite	3.4
	Allied Supplies	101.0
1983	5 Mainstop Superstores	3.0
	26 George Mellis Stores	N/A
1984	6 Key Market Stores, and 2 development sites	9.0
	2 Stores from WGB	N/A
	Amos Hinton	25.3

Source Various Documents

At the end of 1985, Argyll's management announced, together with a three year expansion programme, the decision to concentrate on two fascias: Presto and Lo-Cost. Presto was set as the principal retail fascia. In the long term, Presto was supposed to compete for quality with the major industry players. Lo-Cost was set as an alternative to Presto, and it was to compete alongside Gateway and Kwik Save in the discount end of the market. The decision came as the company decided to make the most effective use of smaller stores with a more limited range concept, lower store investments and lower wages costs.

However, Argyll had not only been developing in the food retailing industry. In August 1983, Argyll merged with ADP. James Gulliver, chairman at the time, said that the future would have witnessed intensifying competition among the big food retailers. When the expansion programme came to an end, companies would then have had to seek means of diversification. From this perspective, the Argyll/ADP merger was a '*far sighted union*'.

Graph 8.1 Argyll Group: Sales 1981 - 1987



Source: Based on Data from Argyll Group Annual Reports

8.2 December 1985 – January 1987 The Failed Bid for Distillers and the Departure of James Gulliver

The merger with ADP was the basis for the bid by Argyll in December 1985 for Distillers (which had 79 brands of Scotch Whisky). However, it lost to Guinness in April 1986. "We had Distillers in view for three years. One of the reasons we have a drinks division is that that was going to be a springboard into Distillers, the same way early Argyll business was the springboard into Allied Suppliers" (Grant, in Financial Weekly, 11/12/86: 12-13).

The failure to acquire Distillers was a turnaround in the company's activities and its long-term strategy. Distillers was an international player that had lost market share over the years, but it was a cash-generating business that owned premium brands. At the time

the bid was made, the only "stars" in Argyll's portfolio were the retail side led by Presto and the drinks business with ADP. However, Argyll's drink division was too small, this being why Argyll wanted to acquire Distillers.

However, a few months after the failed bid for Distillers, Safeway US announced the sale of Safeway UK. Argyll showed immediate interest in buying the company, and as no one else was in the position to take it over, Argyll acquired Safeway UK in January 1987.

In the meantime (December 1986), James Gulliver stepped down as chief executive of Argyll but maintained his chair. Alistair Grant, previously managing director of the food retailing division, became the new chief executive. Gulliver also announced that he was going to leave the company within one year. His personal ambitions were to develop a major force in UK grocery retailing, but more than anything, to direct a major international consumer-products business. His ambition had been thwarted when Distillers was acquired by Guinness. It is said that Gulliver had always maintained a proprietorial attitude when he was chairman of Argyll, that he saw Argyll as his company and that much of the strategy of Argyll during the early 1980s was the result of his view on what the company had to do on the market. When Gulliver left in June 1988, Grant became the new chairman and chief executive of the company.

The acquisition of Safeway transformed Argyll's profile. Argyll's market share had been static over the previous two years as the company concentrated on improving profits and consolidating its retailing activities under the Presto and Lo-Cost fascia. In a time of much expansion by the major retailers, Safeway was the last major opportunity to catch up with the market leaders. Argyll, after the failure of the Distillers bid, needed a quality business.

Table 8.2 Argyll Group: Financial and Operational Statistics 1986/87

Group Sales (£; 000; after taxes)	2,024,953
Pre-tax Profit (£; 000)	79,721
Contribution of the Food Division to Total Group's Sales*	85.7%
Number of Outlets	Presto 540 Lo-Cost 207 Others 142
Total Sales Area (000; sq. ft.)	Presto 4,169 Lo-Cost 570 Others 142
Average Sales Area per Outlet (sq. ft.)	Presto 7,720 Lo-Cost 2,754
Market Position	Presto (medium) Lo-Cost (discount) Others (medium/low)
Market Share (1986)	Presto 3.0% Others 1.4%
Centralised Distribution, Information Technology, Own Label	not very developed

Note * Also comprising food manufacturing, wholesaling, frozen food retailing, off-licence chain.
Source Various Documents

In February 1987, one month after the acquisition of Safeway, Argyll pulled out of its drinks business. The decision was taken as the company recognised that it could not become a heavyweight contender in the international arena. It was a middleweight player; it would have floundered and continued to be squeezed between the low cost competition and the well-established more expensive brands. Another acquisition was out of the question since there had been further consolidation in the industry with Allied Lyons' purchase of Hiram Walker and Elder IXL's purchase of Courage.

By March 1988, the company was also operating 54 Galbraith Convenience stores in Scotland; Snowking, a frozen food distributor; Mojo, a cash and carry; Winterschladen, an off licence chain; and Vinters.

8.3 1987 – 1991: Safeway's Conversion Phase

As Argyll acquired control of Safeway, the decision was taken to operate in the market through three fascias: Safeway, Presto and Lo-Cost. Initially, 160 of the largest Presto outlets were to be converted into Safeway stores. At the same time, Argyll planned to improve and refine the Lo-Cost business. The management decided to convert Presto's stores to the Safeway's format, because Safeway stores performed better than Presto stores, both in terms of sales per square foot and profitability (Table 8.3).

Table 8.3 Presto and Safeway Stores at the Time of Argyll's Takeover

	Presto	Safeway
Annual Turnover (£)	5,500,000	8,000,000
Weekly Sales per square foot (£)	6.50	10.10
Annual Contribution to Profitability (£)	290,000	510,000

Source Argyll Group (1991)

After one year, the conversion programme was enlarged as the first conversions achieved excellent results. It was then decided that the company would concentrate on two fascias, Safeway and Lo-Cost. The Lo-Cost chain had given very good results in 1987/88 and 1988/89. Within a few years, the Presto outlets were to be converted into

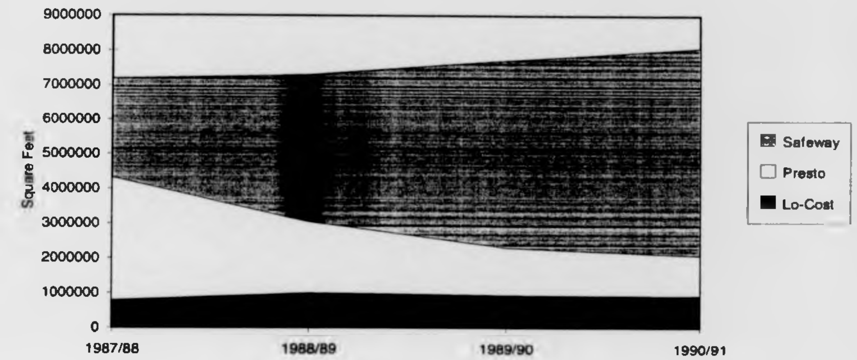
Safeway's or Lo-Cost[2]. Lo-Cost aimed to become a national chain competing with Kwik Save. However, one year later, in March 1990, Argyll decided to retain Presto as a third fascia operating in the middle segment of the market with circa 190 outlets in Scotland and the north-east. The reason was that the stores were too small to fit the Safeway format and too big to become Lo-Cost. Argyll initially expected that the remaining Presto stores would go into gentle decline, but the fascia held-up very well. The management recognised that it had underestimated the strength of the Presto name, especially in depressed areas where Presto was more in line with consumers' spending power than the more expensive Safeway. A programme was launched to revamp Presto. The stores would have emphasised general grocery rather than fresh produce.

By November 1990, Argyll completed the conversion programme. Over the following years, Argyll planned to focus on organic growth for the Safeway chain. It also planned to develop the Presto and Lo-Cost fascia. In the previous years, Presto and Lo-Cost had taken the back seat to Safeway development plans. However, the company's plan was to push these brands, as the exceptional returns achieved from the big edge-of-town Safeway superstores were expected to begin to tail-off. In May 1991, few months after Tesco and Sainsbury, Argyll made a share issue of £387million. In the same month, the company disposed of the Winterschladen chain of 45 off-licences and North-West Vinters (Liquorsave). All its manufacturing interests, which had become less and less important over time, had been disposed of by March 1988. At the end of 1989, the company had also announced its withdrawal from the freezer centres sector and converted all the existing Cordon Blue stores to the Lo-Cost fascia. The plan, at the end

[2] "The trick in food retailing is to aim at the broad mass market, but also to focus on the higher end" (Grant, in Financial Weekly, 10/90, 07/01/88: 40). Argyll's management thought that the Presto name and concept, which offered a narrower product range and only a modest involvement in fresh food, would have disappeared into the upmarket Safeway supermarket which emphasises high margin fresh foods,

of 1990/91, was to spend £1.5 billion in the coming three years in organic expansion of the three fascias.

Graph 8.2 Argyll Group: Sales Area 1988 - 1991



Source: Based on Data from Argyll Group Annual Reports

In September 1989, Argyll, Casino, and Ahold formed the European Retail Alliance (ERA). Its purpose was to formulate and implement plans to exploit opportunities in marketing, distribution, purchasing, production, and management information systems (MIS). The three companies exchanged shares. A merger between the members of ERA, which was initially an option, was later rejected, as a full merger would have created a company that was too large to manage. A joint buying company was formed in September 1989 together with other European groups (Dansk Supermarkets of Denmark; La Rinascente of Italy; ICA of Sweden; Migros of Switzerland; Mercadone of Spain. Over the following years, other companies joined the buying group: Allkauf of Germany; Hagan of Norway; and Kensko of Finland).

own label products, chilled produce and prepared dishes.

Having disposed of its food manufacturing and drinks business, Argyll set its sight firmly on developing as a food retailer, eschewing all temptations to diversify. "The strategy now for Argyll is to be somewhat international by 1995 and to be quite international by the end of the decade. It's clearly difficult for us to be anything other than the third player in the UK food market. Tesco and Sainsbury are excellent businesses. I am looking at doing up to 3 major deals in the next 10 years. We know 40-50 things we are interested in and there will be 1 or 2 that become available... We are still open to the idea that we might be involved in non-food retailing in the UK. We would not look at anything that is not quality business. We would not look at fashion, nor anything that did not have scale and contributed strongly to our profits... In Europe we may through joint venture or merger, get into food retailing. We would also consider North America, but we are in no rush. We feel happy about our organic development for the next 3 years" (Grant, Argyll's Chairman, The Times, 22/09/90).

8.4 1991 – 1995: The Turbulent Years of the GRI

In March 1993, Argyll split its retailing operations into two divisions, a Safeway division headed by Pat Kieran, and a Presto/Lo-Cost division headed by Charles Lawrie. "Presto and Lo-Cost are important businesses with clearly defined objectives. The creation of the new division, directed by a board which will have as its objective the expansion of these activities through organic development of new stores and the provision of the resources necessary continually to improve their operations, is a timely

move" (JP Kinch, Argyll's Group Company Secretary, from Regulatory News Service, 03/03/93).

The group planned to accelerate the expansion programme. Argyll's plan was to open 25 Safeway stores a year until 1996/97 (four years) and to open 15 Lo-Cost and 4 Presto in 1993/94 (Annual Report 1993). However, nine months later, in December 1993, Argyll announced a revision of its expansion programme and other decisions that signalled a significant change in the group strategic direction. In order to fully understand how and why the group strategic direction changed, it is necessary to sum up a number of important events that had taken place in previous years.

In 1992, concern had been expressed over the increasing price paid for new sites. Argyll had in the past trumpeted its advantage as developer of cheap retail space. The average cost of new space for Safeway was being inflated by the development of a few expensive stores in prime locations. Argyll argued it was protecting positions of market leadership. The risk was that the company would have been drawn into an expensive - and ultimately fruitless - attempt to keep Sainsbury and Tesco off what it regarded as home turf. In May 1992, WM Morrison announced that it would start to depreciate its land assets. This came as Morrison's management recognised that the value of its sites might be much less when used for purposes not related to food retailing. "In a high inflation environment this policy was considered appropriate as inflation offset any diminuition in the underlying value of the asset. We have now moved to a low inflation environment with many of the more recently acquired assets staring at uncomfortably high valuations" (Shiret in The Financial Times 22/05/92: 19). According to Shiret, food retailing analyst at Credit Lyonnais Laing, the effect of adopting 'prudent' depreciation would have depressed Tesco's earnings per share in the year to spring 1993 by 21%, Sainsbury by 15%, and Argyll by 11%. Nevertheless, the latest of Safeway's flagships opened in 1992 and produced a healthy return on capital. Argyll still preferred, where possible, to concentrate on cheaper space. Sales growth at Safeway was keeping up with the best of the competition. By increasing its investment at the discount end of the market through Presto and Lo-Cost, Argyll was spreading its risk.

In 1991, UK was hit by recession. This was to be the worst recession that the UK experienced in the post-war period and lasted for much longer than expected. The UK only came out of recession in 1994. Food retailing had traditionally been a recession-proof sector and none of the major retailers was preoccupied with the impact of recession on their own business. However, the recession and the expansion of hard and soft discounters had to have a strong impact on the future strategies of large operators. In the early 1990s, a number of hard and soft discounters (including Aldi, Netto, Ed) made their entry in the UK. Until then, the concept of hard discounting was unknown in the UK. On some lines, prices were initially up to 50% cheaper than they were in supermarket operators. As their presence spread in the UK, other traditionally established retailers were to reposition on prices as they started to lose customers.

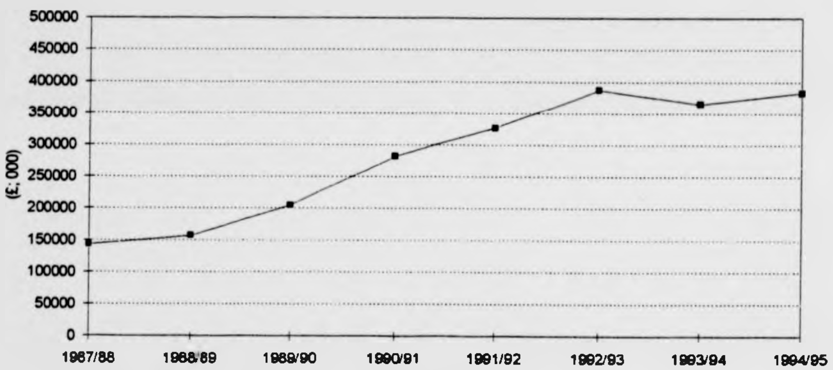
Change in Strategic Direction

At the beginning of 1993, overseas acquisitions at Argyll were not precluded but they were unlikely to be in food retailing. Argyll was more than seven percentage market share points behind Sainsbury and Tesco. Grant believed it was possible to narrow the gap. Safeway covered 40% of the population compared to 60% for Sainsbury. At the

same time, analysts affirmed that there were only a certain number of stores that could have been built before they would have started to cannibalise each other's sales and Argyll was planning to increase space annually by the same proportion as the best of the competition. Compared to the largest Tesco and Sainsbury, Argyll was in a weaker position for own-label products, which accounted for a lower proportion of sales. Safeway was reputed in the industry for its customer services and the quality of its product range but it needed to improve customers' perception that it offered good value for money. In January 1993, market research by Verdict Research declared that Safeway was the dearest of the grocery retailers. In May 1992, Grant had said "we cannot be the cheapest and provide the quality we do" (Supermarketing, 01/05/92: 18). In July 1983, analysts downgraded Argyll's forecasted profits. In July 1993, Archie Norman, chief executive of ASDA, stated that the 'halcyon days' for the UK food retailing were over, with a decline in growth and the industry facing increasing overcapacity. In August 1993, Tesco launched a cut-price own label, covering 70 products. This was to replace 'tertiary brands' and was four to five per cent cheaper than those of Sainsbury and Safeway. Sainsbury followed in November 1993. According to analysts, Tesco was trying to regain some of the ground it had lost to discounters and chains such as Gateway that had launched a promotion called Price Check in May 1993, when it reduced its prices as part of a recovery programme. However, in so doing, Tesco was taking away customers from Sainsbury and Safeway, and they had to respond by decreasing prices.

In December 1993, Argyll announced a three-point plan as a response to the difficult trading climate. Firstly, an 'everyday low pricing' campaign was launched at Safeway, lowering prices on 200 basic products. Secondly, the group cut its planned capital spending. Thirdly, it announced that it was going to write down the value of its properties. This was accompanied by the split of the role of the chairperson from that of the chief executive. Colin Smith, previously the finance director, became Argyll's new chief executive while Grant stayed as executive chairman. In February 1994, Argyll gave a profit warning, declaring that the year profits were going to be slightly below the previous year due to a fall in gross margins and like-for-like sales.

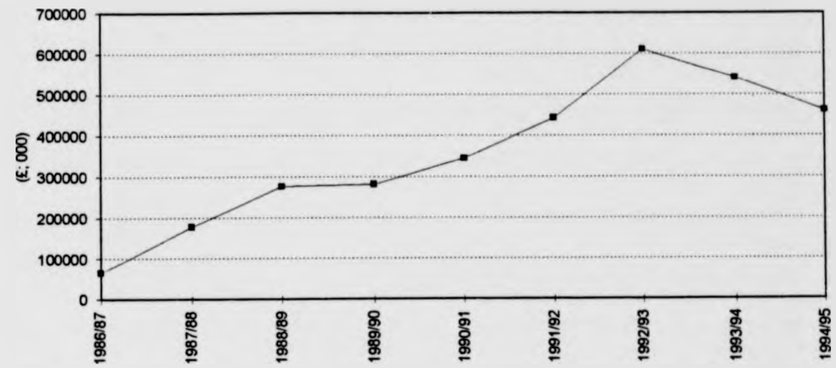
Graph 8.3 Argyll Group: Operating Profits 1988 - 1995



Source Based on Data from Datastream (it excludes exceptional charges)

In the year ending March 1994, for the first time, profits were lower than for the previous year. This was mainly due to the Presto and Lo-Cost chains, whose profits were down by 20%. Capital expenditure was reduced to £541 million from the planned £650 million. Capital expenditure was also set at, less than £500 million for 1995, £450 million for 1996, and £400 million for 1997. The main purpose for reducing capital expenditure was to bring spending more into line with net cash flows.

Graph 8.4 Argyll Group: Capital Expenditure 1987 - 1995



Source Based on Data from Argyll Group Annual Reports

The appointment of Smith to Group Chief Executive can be seen retrospectively as the entry of the company into the third phase of its management history, as well as the main factor behind the changes in the group's strategy. In January 1994, following the appointment of Smith to chief executive, Tony Frendo, managing director of Finance and Administration, resigned after 10 years with Argyll. He had hoped to be the new group chief executive. In October 1994, Simon Laffin, previously group financial controller assumed the duties of the finance director, although he did not take the title. In June 1995, George Charters joined the group as managing director for marketing and trading. He was previously director of Merchandise and Marketing at Boots The Chemist. Charters replaced Logan Taylor, a 17-year veteran of Safeway. Pat Kieran, chief executive of Safeway, retired at the end of 1995. All of these changes marked "a generation change", with many of the senior Safeway executives, who pre-dated the take-over, departing or retiring.

At the beginning of 1994, the group disposed of the Snowking frozen food distribution and the Mojo cash-and-carry operations. A review of the Lo-Cost business was announced, as the chain had to cut prices to strengthen its position in the discount market. Consultants were appointed to review all operations in the Safeway chain. The aim was to conduct an exhaustive review of the business, for significantly improving Safeway's marketing effectiveness and operating efficiency. The results of this review were announced in November 1994.

Between August and October 1994, the group divested its Lo-Cost discount chain and sold 28 smaller Presto outlets. The strategy for Presto was to concentrate its operations upon quality stores servicing well-defined smaller urban locations in Scotland and Northern England. In 1995, more of Presto's smaller stores were closed. In May 1995, the closure of 20 smaller Safeway stores was also announced. By June 1995, Argyll operated 106 Presto stores with an average sales area of 7,600 square feet (compared with 205 stores as at April 1994 with an average sales area of 5,500 square feet, and 378 Safeway stores with an average area of 21,900 square feet.

The review of the Safeway business in 1994 led to a programme called Safeway 2000. The traditional image of Safeway in the market had been one of a store for 'topping-up' the weekly shopping. Prices had generally been higher than in other chains. Safeway had been particularly successful in attracting 'singles'. Following the review, the management's objective was to make Safeway more attractive to family shoppers. Safeway 2000 aimed to consolidate Safeway's competitive position in the market. This programme was pursued in 1994 and 1995 and it continued in 1996. The company was trying to achieve this through changes in the ranges of products and services offered, accompanied by a more aggressive pricing policy and by more effective marketing. Changes in the management processes and its systems were introduced to support the

group's new strategy. This led to 4,800 redundancies in management at the store level. In October 1995, Safeway launched a national loyalty card.

Table 8.4 Argyll Group: Financial and Operational Statistics 1994/95

Group Sales (£; 000; after taxes)	5,814,600
Pre-tax Profit (£; 000)	375,300
Contribution of Safeway to Group's Sales*	85.7%
Contribution of Safeway to Group's Operating Profits*	91.3%
Number of Outlets	Safeway 378 Presto 169
Total Sales Area (sq. ft.)	Safeway 8,278,000 Presto 1,038,000
Average Sales Area per Outlet (sq. ft.)	21,900 Safeway 6,100 Presto
Market Position	Safeway (high) Presto (medium)
Market Share (1994)	Safeway 9.0% Presto 0.7%
Own Label Share of Sales (1994)	Safeway: 51.5%
Information Technology	developed
Centralised Distribution	developed

Source Various Documents

8.5 Argyll and Grocery Retailing at the end of 1995

The readjustment in prices by the largest operators neutralised the discounters' threat. In 1993/94, sales at Safeway's existing stores were 0.7% higher than in the previous year, including 0.5% inflation. However, results for the six months to October 1995 showed like-for-like sales up by 7.8% including 3.1% inflation, and a 4.7% volume increase. This was less than Tesco's 6% volume increase but well ahead of 2.2% decline at

Sainsbury. Nevertheless, in November 1995, Argyll warned that price competition was not over, especially on fresh foods.

By the time this case study was written in December 1995, the repositioning process had not concluded and we felt that was not going to be over until the largest operators had successfully completed their respective repositioning processes. ASDA had solved its identity crisis, and Tesco and Argyll had successfully overcome the problems brought by the discounters and by the recession. Sainsbury had not.

Chapter 9 ASDA Group PLC

9.0 Introduction

The origins of ASDA go back to the period that followed the end of the First World War. In 1920, J. W. Hindell, together with a group of farmers, formed a business partnership. The purpose of the partnership was to develop a wholesaling and retailing structure that, by controlling the distribution, would secure a market for the farmers' milk and dairy products.

Over the following two decades, the partnership consolidated its activities through internal expansion and acquisitions. When, in 1949, the partnership became a public company, under the name of 'Associated Dairies and Farm Stores Ltd', it included 26 farms, three dairies, two bakeries, 42 retail shops and pork butchering facilities. In the following 20 years, the company successfully continued to expand its operations in the food business, mainly in the Yorkshire and Midlands area.

In 1965, Associated Dairies had sales of £13.5 million and was highly profitable. In that year, the group entered the superstore business by acquiring a local food retailer and setting up a new business unit: ASDA Stores. Two large warehouse-like shops with big car parks were used to offer customers cut-price groceries, with limited fresh food and cheap non-food items. Although spartan in look and providing a limited range of goods, superstores offered significantly lower prices and appealed to the working class that constituted the greater part of the population where the superstores were located. The formula was an immediate success. Over the following years, supported by excellent results, operations were slowly but steadily expanded through the building of a network of superstores and large supermarkets in the north of England and Scotland.

By 1980, the group had significantly changed the balance of its business activities. The company was still involved in manufacturing milk and dairy products and in the processing and marketing of meat, but the importance of the original business had declined. From a group mainly involved in food manufacturing with some interests in retailing, it became a successful food retailer with some interests in food manufacturing and furniture retailing. The latter resulted from the acquisition, in 1978, of Wades Department Stores (a furniture and carpet retailer) and Allied Retailers [operating Allied Carpets (a chain of carpet retailers), Williams (a furniture retailer) and UKAY (a home furnishing super centres specialist)]. The group had a turnover of £999 million and a pre-tax profit of £49 million, with the superstore business contributing to more than 80% of group turnover and of its profits. ASDA Stores had a market share in the packed grocery market of 8.4% and was the third largest retailer in the industry behind Tesco and Sainsbury. However, it had the highest profitability. The company operated 75 superstores with an average sales area of 33,350 square feet. Located in edge-of-town sites, ASDA's stores had large parking facilities and 35 of its stores had petrol stations. Inside, stores had wide aisles and stock was made of branded grocery products. However, a wide range of non-foods products (clothing) was also available. Fresh food, fruit and vegetables and in-store bakeries were introduced in new superstores.

The success of the superstore business was due to many reasons. Although in the 1970s other companies had tested the superstore format, ASDA was the only company in the sector that operated edge-of-town superstores on a large scale. In an economy where

most retailers operated in city centres, the capital cost of an out-of-city building was significantly cheaper than that for the city centre. This, combined with the existence of clear economies of scale at the store level, gave ASDA a strong position as one of the most profitable large operators in the industry. Furthermore, ASDA's retail formula was particularly appealing to the consumers of the 1970s, who had benefited from the proliferation of the automobile (that gave them more flexibility in their shopping) yet whose finances had been badly hit by two economic recessions and by high inflation.

Table 9.1 The Associated Dairies Group: Financial and Operational Statistics 1980/81

Group Sales (£; 000; after taxes)	1,188,000
Pre-tax Profit (£; 000)	51,389
Contribution of ASDA Stores to Total Group's Sales*	> 80.0%
Number of Outlets	78
Total Sales Area (sq. ft.)	2,604,000
Average Sales Area per Outlet (sq. ft.)	33,385
Market Position	discount
Market Share	8.4%
Own Label Share of Sales (1981)	7.0%
Information Technology	Little
Centralised Distribution	No

Source Various Documents

In the late 1970s, notwithstanding strong price competition in the industry, ASDA was regularly shown by market research studies as the company among the major multiple food retailers with the lowest prices across the country. Its prices were, on average, ten percent lower than other main retailers. This was a remarkable achievement, especially when we consider that its operating margins on sales, at around four percent, were among the highest in the industry.

In 1981, Peter Firmston-Williams, Managing Director of ASDA stores, retired. He was replaced by John Fletcher (previously of Oriel Foods, with an MBA from Harvard Business School). The plan was to continue to open between four and six superstores a year and to expand in the south, particularly in the London area and Home Counties, where the company did not have any stores.

9.1 1981 - 1984: The Erosion of the Competitive Advantage

At the beginning of the 1980s, most large companies in food retailing were regional operators with portfolios of stores mainly located in city centres. Stores were often smaller than 10,000 square feet and mainly displayed grocery produce. Economies of scale at the store and group levels meant that small chains with a network of small stores had a high cost structure. The price campaign of 1978 weakened the competitive position of many of these companies. In the early 1980s, a new recession hit the UK and price was still an important variable for competitors and shoppers. In 1982, Tesco launched a new price campaign-"Checkout 82". This sparked off a new price war in the GRI. ASDA, whose volumes had also been going down, launched a strong advertising campaign stressing the competitiveness of its offer. The advertising campaign brought the desired results and in following years, ASDA continued to perform successfully.

However, the nature of competition in the GRI was changing. Since the mid-1970s, other companies had successfully experimented with edge-of-town superstores.

Superstores offered a flexible solution to the problem of obtaining planning permission for city centre stores that had characterised the industry over the 1970s. Tesco and Sainsbury were particularly active in opening new larger units. Since 1978, Tesco had been busy in replacing small city centre stores with large edge-of-town outlets. The objective was to have a network of 400 large superstores, sized over 40,000 square feet. At the same time, Tesco was trying to improve its market position: new stores displayed nice outfitting, wide aisles, a large variety of quality food and non-food produce, and enabled the company to provide better customer services. Sainsbury had also been replacing smaller stores with larger supermarkets since the beginning of the 1970s, and in 1979, its management announced its intention to increase its expansion plans to open around 15 large supermarkets a year. Whilst replacing city centre stores with larger edge-of-town units, the two companies were also slowly expanding the geographical scope of operations.

Increasing expansion by some retailers was accompanied by increasing consolidation in the industry. Low profits, resulting from price competition and the recession, and a changing scenario (requiring high investments and the acquisition of new competencies) provided a fertile ground for increasing consolidation. Argyll and Gateway were particularly active in buying small regional companies. Within few years, they became significant players in the industry. Gateway with its rapid acquisition programme became the third largest company in the GRI, it overtook ASDA in terms of market share. Changes in the industry structure were accompanied by changes in consumer priorities. Among consumers, price was an important variable but quality, product ranges and store environment were becoming increasingly important elements for consumers choice of where to shop.

In this evolving environment, little changed at ASDA. The company continued to expand its operations by opening stores, mainly in south England. By 1984, ASDA was operating 95 superstores, with an average sales area of 33,600 square feet. Although fewer stores than competition were opened, the increase in the sales area was keeping pace with the competition. At the operating level, ASDA's focus was mainly on price competitiveness. Some of the older stores had been refurbished and new stores had in-store bakeries, fruit and vegetable departments. At the same time, customer services were being improved. However, the superstore business operated in the same rudimentary fashion of the mid-1970s. The company had strong buying but very small marketing and merchandising functions. Only branded goods were on sale and were displayed by the manufacturers sales forces. There was little information technology and no centralised distribution system. Changes in the industry and in the consumer markets threatened the long-term prospects of ASDA in grocery retailing. The expansion by other major retailers in edge-of-town sites meant that the competitive advantage given by economies of scale at the store level could soon be lost. Further, the expansion by Tesco and Sainsbury in the north and by ASDA in the south was putting these companies in direct competition with each other. However, the superstore business continued to perform successfully, sales and profits continued to grow, with operating margins of the superstore business achieving the record level of 4.96% by 1984. In May 1984, John Fletcher, managing director of ASDA Stores since 1980, was ousted in a boardroom fight. Fletcher had opposed the development of an own-label brand for ASDA. The argument was that it was too late, as other retailers had successfully done that years before. His strategy to increase profits had been to increase gross margins. However, higher margins meant higher prices for customers, who had

started to shop around for better convenience. John Hardman, finance director of the superstore business since 1980, was appointed as new managing director of the superstore business.

Other Group's Activities

At the group level, other businesses did not perform as well as the superstore business. Acquisitions of the furniture retailers, at the end of the 1970s, had been made with the objective of balancing the portfolio. The management at group level was worried of increasing saturation in the GRI. In 1980, the activities and administration of Wades and Williams were merged. However, the performance of the non-food businesses was poor. In 1981, ten UKAY furniture superstores were sold to Harris Queensway and two were closed in 1982, completing the disposal of the business. In January 1985, Wades, the department stores business, was sold for £19 million. Allied Carpets also performed badly in the early 1980s, but by 1984, profitability was improving.

In April 1984, two small dairy businesses, Hexam Dairy and Lakeland Creamery, were acquired at a cost of £ 420,000 to strengthen the fresh food division, which performed well but whose importance at the group level had been decreasing over time.

9.2 1985 - 1987: Strategy Change at the Group and the Business Level

Strategy Change in the Superstore Business

When John Hardman was appointed managing director of the ASDA Stores in June 1984, a wide review of the superstore business was launched. The review indicated that customers were dissatisfied about the range and choice of products, customer service and the shopping environment. According to John Hardman, "the business was about to fall off the edge of a cliff" (from The Financial Times, 17/08/89: 14). He argued that ASDA had lost its consumer franchise and that the previous management's attitude was 'arrogant and ignorant', with no intention of adjusting the retail formula despite changing customer demands. Based on the review, it was decided to launch an organic programme of change to strengthen the position of the business. The main points of the programme were to: re-vitalise the store opening programme; redesign and refurbish the stores to make them more appealing to customers; develop a range of own label goods and bring in more fresh foods, while paring the non-food ranges; to bring in information technology; and build a dedicated distribution network.

Fresh management was taken on-board to implement the programme and significant changes were made to the organisational structure that had, until then, been kept small and lean. An information technology function was set up. The merchandising and marketing functions were significantly strengthened. New layers of management were set up to control operations. The property division, which in the past had operated at the

group level providing services to all the divisions, was closely aligned with ASDA's retailing aims. The plan was to be completed by 1990.

In the GRI, changes continued throughout the mid-1980s. In July 1985, a clarification of planning permission procedures by the government made it easier to get planning permission for building edge-of-town superstores. Consequently, many companies increased their expansion programmes. Consolidation in the industry continued as Tesco took over Hillards, Gateway acquired Fine Fare, and Argyll bought Safeway.

The Merger between ASDA and MFI

While these important changes were going on within the business unit, in May 1985, the Associated Dairies group merged with MFI to form the ASDA-MFI Group. MFI was the leading UK furniture retailer, trading from 127 large edge-of-town furniture centres with a total of nearly 4 million square feet of selling space. The principal lines were kitchen and bedroom furniture. In the previous five years, MFI had quickly grown and in the year to May 1984, recorded sales of £301 million and pre-tax profits of £39 million. The merger was valued at £615 million and involved a share issue.

For the management of Associated Dairies, there were various reasons behind the merger. Since the mid-1970s, it had worried about the dependence of the group on the food retailing business. "ASDA has for many years been the main contributor to Group profits, and in this context at the moment its contribution is in excess of 80%. It is logical, however, that the rate of growth experienced in the past cannot continue throughout the next decade, and furthermore in the opinion of your Board any attempt by the Group to acquire a major food retailing company would undoubtedly be blocked by the Monopolies Commission. Therefore when the unique opportunity arose to merge with MFI, your Directors considered this would complement ASDA, bringing together two outstanding teams who have a great depth of knowledge and experience in the art of operating retail stores from peripheral sites" (Noel Stockdale, Chairman, Annual Report, 1985: 7). Secondly, a number of senior executives at Associated Dairies were at retirement age, and the merger with MFI was to provide new management blood. It was also believed that there were many similarities in the physical characteristics and operating philosophies of the two businesses at the operating level, as both ASDA stores and MFI were operating large retailing centres in out-of-town sites. It was expected that the combined management was going to bring a broad spread of retailing skills, with particular emphasis on product development, marketing, location planning and employee motivation. Finally, benefits were to be obtained in the durable goods area with the carpet and furniture activities able to draw on joint strengths and expertise.

At the beginning of 1986, a management structure for the newly merged group was set up. Stockdale remained as group chairman. On his retirement, David Donne (non-executive director) was to become the new non-executive chairman. Roy Bousfield relinquished his position as Group Managing Director whilst continuing as Group Deputy Chairman and taking the responsibility as chairperson of the new Executive Board. Derek Hunt, previously chairman of MFI, was appointed as Group Chief Executive and Deputy Chairman with specific responsibility for the Household Furnishing Division (comprising MFI and Allied Carpets). John Hardman, previously managing director of ASDA Stores, was appointed Deputy chairman with responsibility for both the superstore division and Associated Fresh Foods. A few months later, in

October 1986, Stockdale retired after 47 years with the Group, the last 17 as executive chairman. He had played an important role in the initial phase of the development of ASDA Stores and in the merger with MFI.

The De-merger from MFI

The retirement of Stockdale signed the beginning of more change in the group's strategy. Within one year of his retirement, the group had significantly changed the composition of its portfolio, having disposed of its interests in food manufacturing and de-merging from MFI.

In order to understand these changes, it is necessary to go back a few years to the merger with MFI. At the time, the decision to merge was not shared by Hardman. His plan was to transform ASDA into a national chain competing alongside Tesco and Sainsbury in the higher end of the market. Since he had been appointed managing director of the division, he had argued that it was necessary to increase the expansion programme of the superstore business. However, Stockdale and the senior management at the group level had a different view of how the group was to develop, a view that led to the merger with MFI.

With the departure of Stockdale, a new situation arose in the group. While Hardman's plans for ASDA Stores had not gained the support of past senior management, this time his plans were backed by the new group chief executive, Hunt. However, the type of funding that the company needed could have only been provided by share issue or by the sale of some businesses. The former presented some problems, as the merger with

MFI had already required a share issue. In the early months of 1987, it was decided that Associated Fresh Foods would be disposed of (sale finalised in August 1987), but this only provided £84 million. For the development programme of the superstore division, it was necessary to sell MFI. In June 1987, it was announced that MFI and Allied Carpets were for sale. In November 1987 (one year after Stockdale had retired), MFI de-merged from ASDA in a leveraged buy-out of £718 million led by Hunt, with ASDA retaining a 25% minority interest in the business.

It is unclear whether Hunt backed John Hardman's strategy because of a shared view of what was best for the group or because the initial hopes a the development of management synergies between the two groups not being realised.

The decision to sell the Fresh Food businesses and de-merge from MFI had not been shared by all the senior management. In September 1987, Roy Bousfield and other executives and non-executives directors resigned. David Donne resigned in April 1988.

9.3 1988 - 1991: From the De-merger from MFI to the Departure of Chairman and Chief Executive

Having de-merged from MFI and disposed of Associated Fresh Foods, the group was left with Allied Carpets and ASDA Stores. The management decided to retain Allied Carpet because the offers received did not reflect the value of the business. The group raised £500 million from the various disposals, which were to be used to implement the

programme of expansion and consolidation of the superstore business. Plans were to spend £1billionn over the three years from 1988-1991.

At Allied Carpets, a new management team was set up under the leadership of Richard Harker. A complete strategic review was launched. In April 1989, Gillow, a furniture retailer, was acquired for £29 million to strengthen the carpet retailing operations. Operations between Allied Carpets and Maples were merged in April 1990.

The plan, set up in 1985 for the superstore business, continued to be implemented and was expanded. Between 1987 and 1989, the company opened 18 superstores adding more than 1 million square feet. Old superstores were refurbished with the new ASDA look. The household goods and clothing sections, which achieved 25% of the total superstore sales, were reviewed and more space was allocated to fresh produce (i.e. fruit and vegetables, fish and meat, bread). An internal centre for the development of own-label products was set up. Initially, own label products were substituted for branded products, but in 1990, new own-label products, exclusive to ASDA, were to be introduced. In April 1989, an agreement was reached with George Davies, the founder of the Next retail chain, whereby ASDA took a 20% in the George Davies Partnership's capital, which in return, took over responsibility for the design, buying and merchandising of ASDA's clothing and footwear ranges.

The property development function was transformed into a business unit: Gazeley. The new profit centre was to develop retail parks and shopping centres, providing sites on the most advantageous terms for ASDA and Allied Carpets, while renting or selling other retail space to other retailers.

At the beginning of 1989, an informal deal was made between the Isosceles consortium and ASDA, whereby the former agreed to sell about 60 Gateway superstores to the latter if it succeeded in taking over Dee Corporation (the third largest food retailer at the time). ASDA's management believed that the move would have enabled the group to recover the ground lost to competitors at the beginning of the 1980s, when, according to Hardman, the business had not kept the pace with the main competitors in the superstores expansion programme.

In February 1989, David Gransby, deputy chairman, resigned, completing the management changes triggered by the de-merger with MFI. A new management structure was set up, with Hardman relinquishing the position of chief executive and concentrating on that of Chairman, while Graham Stow took the group chief executive position. Bill Bailey joined Tony Campbell as joint managing director for ASDA Stores.

ASDA Performance and the Departure of John Hardman and Graham Stow

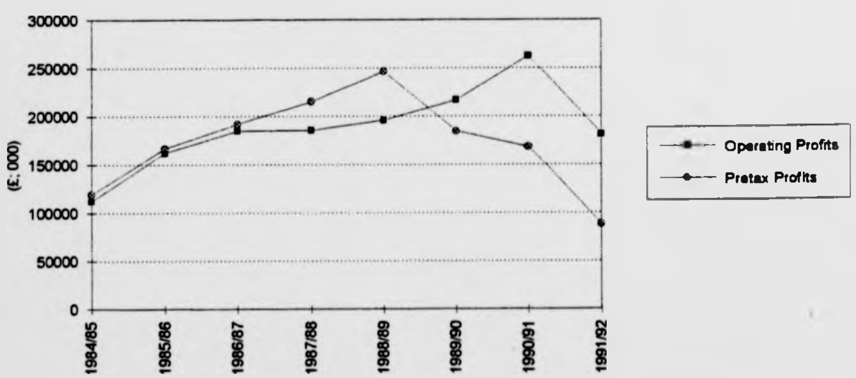
The strategy change led by Hardman initially gave positive results. Although the increase in volumes on a like-for-like basis was disappointing (two percent in 1987/88, and nil in 1988/89), operating profits and margins of the superstore business continued to grow. However, things were changing. In the Summer of 1989, the new central distribution network started to operate but with noteworthy difficulties. The group had invested circa £100 million and worked on it for more than two years. However, for eight weeks, the central distribution system was not able to supply its stores with sufficient fresh foods (which knocked about £20 million off sales). Eventually the stores

were able to carry the right levels of stock but this meant the company had to incur further costs of £16 million.

In September 1989, following the success of the Isosceles bid for Dee Corporation, ASDA finalised the acquisition of 60 Gateway superstores. The acquisition was to increase sales by an extra £1 billion, improving the company's buying power, filling the distribution network more quickly and leading to marketing economies. The Gateway stores were not located as well as ASDA average and their sales per square foot were only two-third of ASDA's own, leaving scope for a 50% improvement. The cost of the operation was of £705 million; stock in stores, valued at around £40 million, was bought separately. The deal was financed with a mix of short-term financial tools, mainly through bank borrowings. Because of the acquisition, ASDA became the third largest company in the GRI. However, within less than two years since the MFI de-merger, the group had spent all the cash and had a gearing of 116%. In December 1989, the group merged the Gazeley subsidiary with Arlington, the retail property development subsidiary of British Aerospace, to form a 50:50 joint venture, 'Burtwood House'. The newly formed company acquired 34 superstores and a retail site from ASDA, with a leaseback formula. The group raised £275 million in cash, which brought gearing down from 116% to 73%. However, there were some serious doubts about the group's internal financial capabilities to support its strategy in the medium-term. The acquisition of the Gateway superstores "came ... at a time when ASDA was committed to new store development which was depleting its cash balances and leading to a build-up in debt. ... The benefits of the store-opening programme were not likely to be felt until the year ending April 1992. In the interim ASDA would be unable to meet its capital expenditure from internal resources and would thus have no surplus to reduce debt" (Stephen Fidler, The Financial Times 13/02/90: 28). Furthermore, the sale and leaseback of 34 stores had reduced ASDA's "financial flexibility by diminishing its assets base" (ibid.). This was the analysis of Standard & Poor when they downgraded ASDA's commercial paper rating from A1 to A2 in February 1990.

The management hoped that the group's financial position would improve in the following years, as the programme of change was completed. However, this hope was not realised. In 1989, the economic climate worsened and in December 1989, a profit warning was given. Difficult trading conditions for non-food items (clothing and footwear) had resulted in a decrease of volumes on a comparable basis of ten percent for the first half-year, with flat sales in food.

Graph 9.1 ASDA Group: Profits 1985 - 1992



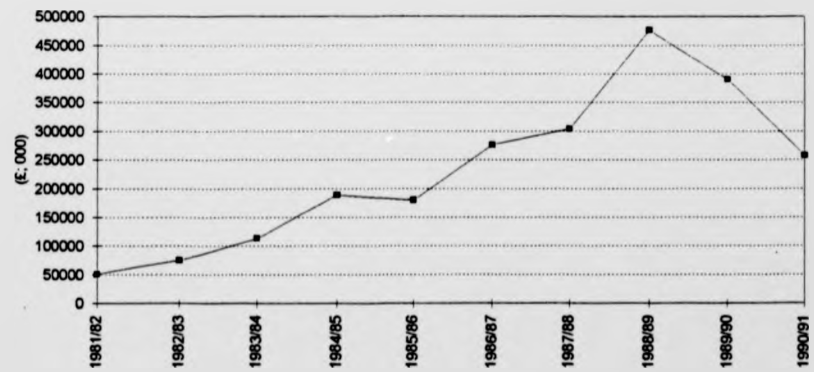
Source: Based on Data from Datastream (Pre-tax Profits excludes exceptional charges)

Disappointing results also came from the carpet and furniture retail business (Allied Maples) and the MFI associate. Results for 1989/90 were unsatisfactory. Turnover was up by 31% but pre-tax profits were down by 25%. The fall in profits was mainly due to high interest charges, weak furniture sales and distribution disruptions. To make things

worse, the management took possession of the Gateway stores only in mid-May 1990, much later than initially planned, which meant that the group was unable to recover the costs of funding the purchase price in the year.

Between May and July 1990, in a move to cut gearing, three superstore development sites and two properties were sold to Tesco for £73.75 million and in October 1990, a convertible Eurobond issue of £73 million was made. However, by January 1991, the group had a net debt of £ 900 million and gearing stood at 76%. The superstore business, operating profits for the half year, were up by 30.8% on turnover up by 42% and former Gateway stores contributed fully for the first time, making £28 million in operating profits, but their interest bill for the same period was of £42 million, on top of a capitalisation of interests of £16.3 million. Because of substantially higher interest charges and weak trading in its home furnishings businesses, group pre-tax profits were again down by 25%.

Graph 9.2 ASDA Group: Capital Expenditure 1982 - 1991



Source Based on data from ASDA Group Annual Reports

Management was confident of future prospects. "We will start unwinding our capital expenditure programme as we come through this year and we are fully confident that by the end of 1992 we will have our gearing in a highly satisfactory position" (John Hardman, in The Financial Times, 10/01/91: 22).

However, the situation did not improve in the following months and in June 1991, a few days before disclosing results for the 1990/91 financial year, Hardman and Stow, respectively group chairman and chief executive, resigned. Their sudden and unexpected departure was due to increasing pressure from institutional shareholders, unhappy at the poor performance of the group. When results were disclosed sales and operating profits were up, by 25.8% and 20.9% respectively but pre-tax profits were down by 8.9%. Again, the main reasons were high interests charges and poor performance by other businesses.

Godfrey Messervy, ASDA's non-executive director, replaced Hardman as Chairman. His main task was to find a replacement for the two executive directors. In September 1991, Patrick Gillam became the new ASDA chairman. His appointment came as it was disclosed that profits and dividends for 1991/92 were going to be lower than initially forecasted in the previous year. The performance of the businesses had not improved but the main problem was a precarious financial situation. In 1989, management had financed the acquisition of 60 Gateway superstores with short-term debt, rejecting its financial advisors' recommendation to raise additional equity finance. With £600 million of debt becoming due for repayment within one year, the group was about to breach its banking covenants. "At the moment the company has an unbelievable debt profile. It is a recipe for disaster" (Patrick Gillam, ASDA chairman, in The Financial Times, 01/10/91: 26).

In October 1991, a share issue of £357 million was approved at the extraordinary general meeting (EGM). The share issue reduced debt from £931 million to £574 million, and gearing from 72.1% to 36.6%. The success of the share issue was a necessary condition for the company to re-negotiate a £200 million syndicated loans with NatWest and the Swiss Bank Corporation, which occurred in the following weeks. At the EGM, the appointment of a new chief executive was also announced. Archie Norman, previously finance director of Kingfisher with an experience as a partner of McKinsey, was to try to reverse the group's fortunes. In the meantime, 415 jobs were to be cut at ASDA Stores and Allied Retailers' headquarters, which was to lead to cost savings of around £8 million a year.

ASDA's Position in the Industry

ASDA's management had tried to compete with Tesco and Sainsbury in the upper end of the market but ASDA did not have the brand name, the managerial resources and the asset base of its main competitors. The group was undercapitalised in relation to its strategic needs, and the poor performance compared to main competitors since 1989 did not enable the group to raise funds through share issue. High gearing, generating high interest charges, also meant that by June 1991 only 37 ex-Gateway stores had been fully converted into the ASDA format, with consequently diminished benefits from the conversion programme.

However, there were other substantial problems. ASDA's stores were positioned in parts of the country where customers were earning wages below the national average. In an attempt to catch up with the size of main competitors, the 60 Gateway superstores had been acquired but analysts argued that ASDA paid much more for shops that were less advantageously positioned than ASDA stores and had been considered by all the other major operators in the GRI.

At the operating level, while the company had initially claimed success in the programme of change, market analysts were not sure whether ASDA's appeal was still based on low prices (as evidenced by the regular price campaigns) or whether it had moved upmarket. When, in the late 1980s, market reports indicated that ASDA was losing market share to Tesco, Kwik Save and Morrison in the Yorkshire heartland, it was clear that, while failing to attract the better off customers, ASDA was losing its traditional customer basis at the lower end of the market.

ASDA had been trying to catch up with more up-market operators but the structure of the industry and the positions of competitors had deeply changed over the 1980s. Tesco and Sainsbury had continuously invested in their businesses and had expanded and consolidated their market position. From 1987, Sainsbury increased the number of new stores opened from 15 to 20. Argyll, since acquiring Safeway at the beginning of 1987, had successfully converted its Presto stores to the more up-market Safeway format while also extended the scope of its operations.

The move up-market by most retailers, while crowding the upper end, left space at the lower end, where only Kwik Save and Lo-Cost were significant discount operators. As the economy started to slow in 1989, consumers moved toward cheaper operators. The result was that ASDA, together with Gateway, were squeezed into the middle, between discounters and other more up-market large food retailers (Sainsbury, Tesco, Safeway). To make things worse, in the late 1980s, a number of European "hard" discounters made their entry into the UK GRI.

9.4 1992 - 1995: A New Programme of Change

In December 1991, six months after the departure of Hardman, Archie Norman took office as the group chief executive. Following Hardman's departure, the group had performed poorly, with 50 of the group's 204 superstores losing six percent of their sales to competition. One of Norman's first moves was to launch a price freeze for the Christmas period. This was maintained over the following months, with the successive introduction of cheaper lines introduced in the worst performing stores. The move aimed to stop the haemorrhaging of customers towards main competitors. Following the initiatives to cut prices, market research studies showed ASDA as offering more competitive prices than at any time since 1987.

At the same time, a new team of directors was formed. The old management team that had been brought in by Hardman following the MFI de-merger was almost completely replaced. In January 1992, Phil Cox was appointed as new finance director. In March 1992, Allan Leighton was recruited from Mars as marketing director. In the following months, new personnel and retail directors were appointed. By 1994, the only executive director who was left from the old guard was Tony Campbell (trading director).

In January 1992, the management explained that the group was to focus on improving operations in the superstore business and re-establishing financial stability. Details of how this was to be achieved were to be examined. "We are not coming in a swashbuckling way and saying that we have the magic formula for ASDA. What we have to do is look at the assets of the business and see whether there is potential for doing something better with them" (Archie Norman, The Financial Times, 16/01/92: 23).

The new management recognised that the company had lost the "me too" battle fought in the second part of the 1980s against the industry leaders Sainsbury and Tesco. The objective was thus to develop a formula that would ensure future prosperity. The most urgent problem was the poor performance of ASDA's 49 older stores (some of them 25 years old) where sales slipped six percent in the half year. There was an open question as to whether it was worth investing heavily in these outlets. One possibility was to launch a cut-price discount format, but this would lead to some of the worst performing stores being closed. The main concern was over what the impact of still expanding competitors on ASDA's operations would be, as between January and June 1991, Tesco, Argyll and Sainsbury had all made capital right issues to finance their expansion plans in the retailing sector.

The new management team spent the first few months learning all about the business before embarking on this new strategy. All aspects of the Group and its businesses were examined. The financial options and product offering were reviewed with the help of McKinsey. The management also worked with Andersen Consulting to maximise information technology benefits and to introduce direct product profitability techniques. The cost-cutting exercise, which had started in 1991, was continued. In May 1992, 500 management jobs at the store level were cut because of the cost benefits resulting from centralised distribution. In July 1992, it was decided to contract out much of the group's legal, insurance and employee savings work.

Restructuring Operations

In July 1992, on the disclosure of results for 1991/92, the restructuring plan was presented. Its main objectives were to: revitalise the stores (with more imaginative and

effective store refurbishments), the product ranges (with more regional ranges, increased emphasis on fresh foods, and greater product innovation) and the customer image; to improve the pricing strategy; to launch a new format discount store; and, to change the organisation structure by combining productivity benefits with simplified reporting. The plan aimed to give ASDA a distinct position in the grocery marketplace. Superstores would continue to stock a wide range of non-food items, but the layout of these departments would be significantly altered. The management believed it was possible to break out into a virtuous circle whereby improved productivity would increase price competitiveness, restoring customer flow and sales volumes, leading to better buying terms and increased profitability. The control of marketing was to be taken back from manufacturers. Although some changes had been introduced since 1985, decisions about what to promote and when was still in the hands of manufacturers. In the following three years, ASDA also planned to redesign 140 of its 200 stores; new stores were to put more emphasis on the values associated with the company's new strategy.

In the meantime (in June 1992), ASDA opened its first new limited range discount store format: Dales. The store was an old 34,000 square feet ASDA superstore. The experiment was to be monitored carefully and important strategic decisions were going to be taken, based on the results achieved. If successful, the formula would be extended to 20 to 30 locations.

Results for 1991/92, indicated that operating profits were down by 31% because of high operating costs, promotions and tightening margins. Exceptional charges for £451 million led to a pre-tax loss of £364.8 million. Exceptional charges mainly referred to a write-down of the value of the 60 Gateway superstores, which the previous management had put on the book at cost rather than value. Other exceptional charges were for the rationalisation at ASDA and Allied Maples.

Following the flotation of MFI in July 1992, the group disposed of its 25% shareholding in MFI for £73 million. In October 1992, it sold two development sites and one store to competitors raising a further £47 million.

In November 1992, a price campaign was launched using the 'ASDA Price' slogan, previously used in the early 1980s. The objective was to re-establish the company's leadership as the lowest priced national superstore retailer. Gross margins that had constantly been rising since 1985 (because of the need to finance the expansion programme) were intentionally reduced throughout the recovery programme. The strategy review indicated that the loss of value competitiveness was one of the key factors behind the business problems encountered during Hardman's chairmanship.

In January 1993, ASDA made a second capital right issue in less then two years, raising £347 million. This followed better than expected interim results for 1992/93. ASDA had a legacy of 'first generation' superstores in the north of England that did not stand up well to competition from new stores opened by rivals. They needed to be renovated, re-sited or rebuilt, to protect their market shares. The revamp of two stores in 1992, at a cost of £2 million, had resulted in a 20% increase in sales in the same stores. The management also planned to re-site about 15 of the oldest ones (at a cost of between £12 million and £20 million each) and rebuild five to 10 stores on existing sites (costing about £9 million each and involving closure of the stores for about eight months).

Furthermore, as time between buying a site and opening a store is two or three years, the group needed to look to financing spending in 1995. "We can finance (capital spending) this year and next from trading, ... but in three years time the business would be getting smaller" (Archie Norman, The Financial Times, 29/1/93: 9).

Following the capital right issue, the syndicate loan with NatWest and the Swiss Bank Corporation was renegotiated again with better conditions for the company. By mid-1993, net debt has been reduced to £76 million. Like-for-like sales growth of two percent in 1992/93 was better than any of the big three.

Notwithstanding the improving performance of the business, Norman, ASDA's chief executive, was pessimistic about the future prospects of the industry. Rumours of saturation had existed in the industry since the late 1980s, and with the entry of European discounters, the threat was now price competition. In November 1992, at the Marketing Society, Norman said that the continuous expansion of large food retailers, low inflation and slow growth in demand meant that the industry was set for a less profitable future with increasing saturation: "It is hard to understand why people believe the current situation is sustainable." He believed that discount retailers were "only at the first stage of development" (The Financial Times, 19/11/92: 26). In July 1993, he restated that food retail growth was in decline, with increasing over-capacity and competition from cut-price discount operators: "We are planning on the basis that the halcyon days in the UK grocery industry in terms of profitability are over" (The Financial Times, 03/07/93: 9). Because of increasing saturation in the GRI, the ASDA format was unlikely to grow. "It is unlikely that we will increase significantly our selling space of over 8 million square feet, instead we will concentrate on upgrading the quality and resilience of what we have and continue to improve the service which our stores provide to their local communities" (Patrick Gillam, Chairman, Annual Report, 1994: 5). Once the renewal programme was completed, ASDA would rely for profit growth on constantly improving its performance, along the lines of Marks and Spencer, rather than through constant expansion as Sainsbury and Tesco were doing. Group expansion was more likely to be in the Dales format.

The first experiments of the Dales format had been very encouraging with sale increases at around 50%, enough to offset the lower margin they achieved. With around 7,000 lines, the format drew from both limited range discounters and conventional superstores. Compared to other discounters, there were more lines and more emphasis placed on fresh food which accounted for about a third of the range. The low cost and margin structure enabled the management to put prices on a similar level to those at Kwik Save, about 12% lower than the big three superstore operators.

Changes in the Industry Structure

Rumours of saturation and the threat of the expanding presence of discounters had been initially dismissed by all the other main food retailers, but the expansion of hard discounters came at a time of severe economic recession in the UK. The combination of these elements, together with the price repositioning by ASDA and the move by consumers towards cheaper operators, generated a "domino" effect in the industry. In May 1993, Gateway launched an advertising campaign (Price Check), focusing on the competitiveness of its price. In August 1993, Tesco launched a cut-price own label, covering 70 products replacing 'tertiary brands'. Tesco recognised the threat of discounters and explained that the campaign aimed to regain some of the ground lost to

discounters and to chains such as ASDA and Gateway. The move opened a four to five percent gap between Tesco's cheaper brands and those of Sainsbury and Safeway. In November 1993, Sainsbury followed Tesco with the introduction of cheaper brands. Sainsbury management also announced that future growth would have to come mainly from other group businesses. In December 1993, Safeway also lowered prices on 200 basic products and announced a cut in its capital-spending programme. In January 1994, Tesco announced cuts in its expansion plans. The price reposition by the big three had little effect on ASDA that had already changed its price position in the market. In October, its response was to freeze prices until January.

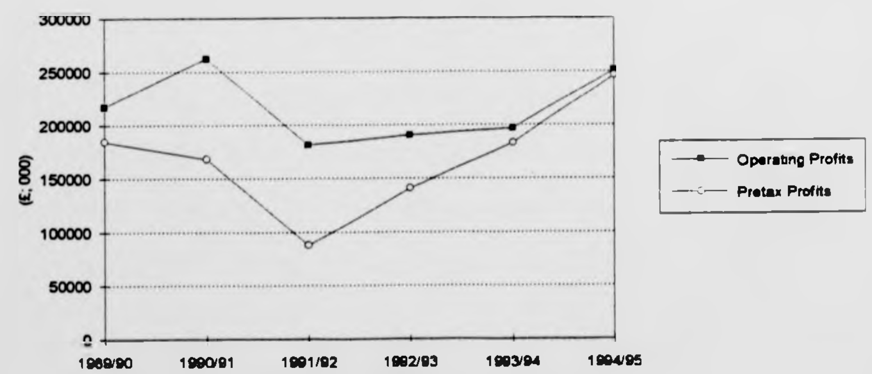
In December 1993, ASDA's interim results were at the top end of market forecasts, with a 14% increase in operating profits and a nine percent increase in volumes from existing stores. The recent events in the industry seemed to confirm Norman's hypothesis of market saturation and expanding discounting operators set to take market share away from superstore operators. However, Norman also argued that ASDA had found a "profitable route".

The programme of recovery successfully continued over the following years. After closing the group last manufacturing interests (a loss-making sausage company) in April 1993, ASDA sold Allied Maples to Carpetland in December 1993. ASDA had spent £100 million in trying to improve operations since the late 1980s with little result.

In January 1994, Allan Leighton was promoted from Marketing director to Retailing director. Since joining ASDA in March 1992, he had effectively brought the group back to a more price-led retailing by repositioning ASDA's own-label and by reintroducing the 'ASDA Price' advertising campaign. He was to take over the last phase of the recovery programme of store refits, while retaining responsibility for the Dales discount chain.

Results for 1993/94 showed operating profits up by 3.4% with like-for-like sales on a comparable basis up by 8.9%. However, the group reported exceptional costs for £309 million that generated a pre-tax loss of £126 million. Exceptional costs were for the sale of Allied Maples (£130 million) and a property write down (£179 million). Between 1993 and 1994, all the main food retailers reviewed their depreciation policy and made a property write down. Superstore developments were overvalued in comparison to market property prices. Since the late 1980s, the prices of property had been going down. However, this had not been the case for sites that were suitable for superstore development where prices had continued to increase because of the bidding up among superstore operators.

Graph 9.3 ASDA Group: Profits 1989 - 1993



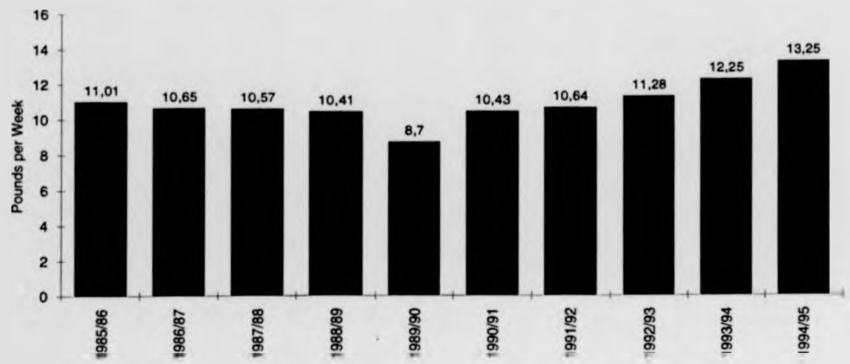
Source: Based on Data from Datastream (Pre-tax Profits excludes exceptional charges)

<u>Ending the Three Years, Restructuring Programme</u>

By June 1995, the recovery programme launched in 1992 was completed. ASDA was the best-valued superstore and in the year; 'Farm Stores', a new own brand at exceptionally low prices, had been introduced to strengthen its price position. The group operated 203 superstores (7 Dales and 196 ASDAs), with an average sales area of 40,400 square feet. In three years, significant results were achieved. The number of customers shopping at ASDA had gone up from 3.8 million in 1992, to 5.2 million in 1995. The business had outperformed the industry in like-for-like sales for 32 months and ASDA had closed the gap in market share on Argyll. In 1994/95, turnover increased by 8.2%, but operating profit was up by 27.6% and like-for-like sales were up by 7.4%. Gross margins went down to maintain the leading price position, but because of higher productivity, operating profits were up. Total capital expenditure was £204 million but for the first time since 1988 and the company had positive net cash at the end of the year.

Since 1992, the group had undergone a period of physical and managerial transformation. At the organisational level, several layers of management were removed and staff was divided into 25 teams each covering different product areas. Each team had its area of business and was given weekly and daily sales figures. At the store level, the company was strongly focused towards active selling and less authoritarian management. Julian Richer, whose discount hi-fi chain, Richer Sounds, holds the world record for sales per square foot, was hired as a consultant to provide ideas on how to increase sales per square foot.

Graph 9.4 ASDA Stores: Sales per Square Foot 1986 - 1995



Source: Based on Data ASDA Group Annual Reports

A new 10-point three-year programme was unveiled. A 'market hall' atmosphere, similar to that used by Morrison, was to be introduced in stores to make ASDA a 'fun' place to shop. Fresh food, bakery and butchery departments were to be improved. There would be greater emphasis on sales of own-label and the 'George' clothing brand. Non-food items only accounted for 15% of sales but they were growing faster than the mainstream grocery business. Norman also announced that ASDA was to resume store building, opening six superstores a year, with capital spending set to increase to £250 million annually. After many years of attacks on other main retailers for their "head-in-the-sand" attitude to market saturation, the management changed its mind over expansion policies. In September 1995, Norman defended the decision to re-start building ASDA stores. The rate of opening had slowed since planning restrictions had been tightened, which provided the management with some reassurance about their physical expansion strategy. It was also announced that ASDA was looking for sites in Northern Ireland.

ASDA's management change of mind reflected a change the mood among food retailers. They understood that in the 1992/93 period, they had experienced a one off repositioning in price rather than market saturation. With the introduction of 'value' lines, large supermarket/superstore operators neutralised the threat of discounters, and by continuing expansion, were to take market share from independent operators. This was confirmed by the fact that most retailers were having positive increases in like-for-like sales. Further, Tesco, after announcing a stop in its expansion programme in 1993, went back on its decision in 1995. Despite the 1993 announcement, the group was to expand its ASDA format rather than the Dales one, which had been performing well but did not grant the profit margins of the ASDA format.

Table 9.2 ASDA Group: Financial and Operational Statistics 1994/95

Group Sales (£; 000; after taxes)	5,285,301
Pre-tax Profit (£; 000)	246,200
Contribution of ASDA Stores to Group's Sales	99.5%
Contribution of ASDA Stores to Group's Operating Profits	98.3%
Number of Outlets	203
Total Sales Area (sq. ft.)	8,210,000
Average Sales Area per Outlet (sq. ft.)	40,440
Market Position	discount
Market Share (1994)	10.7%
Own Label Share of Sales (1994)	40.5%
Information Technology	developed
Centralised Distribution	developed

Source Various Documents

9.5 ASDA at the End of 1995

"Corporate strategies are often a matter of post facto rationalisation. So it has been with ASDA. The company's dedication to improving sales from existing space largely reflects the lack of any alternative. With the weakest of the big grocery brands and severe financial restraints in the past, ASDA was forced to stop opening new stores some time ago. So it sought another means of salvation. Fortunately, its emphasis on permanently low prices and increased productivity has anticipated the needs of the 1990s perfectly well. ASDA is therefore at present registering the strongest like-for-like sales increases in the sector. It is, of course, easier to make such gains from a low base. But one should not dismiss the real progress being made" (Lex, The Financial Times, 01/07/94: 20).

This comment in the Lex Column well summarises ASDA's strategy since 1992. In the second part of 1995, the group continued to perform well. In December 1995, ASDA reported its highest increase in like-for-like sales among the market leaders (nine percent) for the first 1995/96 half. As part of the company's strategy to increase sales of non-food items, in the second part of 1995, the company launched a fierce campaign aiming at halting the net book agreement and the retail price maintenance on vitamins, succeeding in the former but not in the latter.

In August 1995, ASDA bought back all its superstores by acquiring, for £88 million, British Aerospace's share in Burwood House, a joint venture set up in 1989. Burwood House had net assets of £250 million and owned 34 ASDA superstores, 4 shopping centres and a number of development sites. The four shopping centres were to be sold.

Chapter 10 J. Sainsbury PLC

10.0 Introduction

Sainsbury was founded in 1869, when John and Mary Sainsbury opened their first outlet in London. The history of the company and its strategies are intimately linked to the Sainsbury family's philosophy about business. The company was wholly owned by members of the family until 1973 when it was floated on the London Stock Market. Today, members of the Sainsbury family still own 43% of the issued shares and David Sainsbury, a fourth generation descendent of the company's founders, is the group's chairman and chief executive. Sainsbury is, with Tesco, a market leader in the UK GRI.

Since the beginning, quality produce and customer service characterised Sainsbury shops. In 1882, a branch in Croydon was opened using advanced design and materials. The walls, floor and counter fronts were tiled, the countertops were marble slabs and customers were seated on bentwood chairs. The stores, nice outfitting, services and quality food attracted prosperous customers. To obtain quality food, Sainsbury established close relationships with suppliers, and controlled and distributed stock from a central depot. The company performed successfully but expansion was slow. By 1940, the company operated 249 shops, mainly in the London area. During the Second World War, several branches were bombed and by the end of the war, sales were half that at the pre-war level. Alan and Robert Sainsbury, grandsons of the founder, started a recovery programme by opening other stores. In 1950, the first self-service shop was opened. During the 1950s and 1960s, the company expanded its operations. The number of outlets went down from 244 in 1950 to 225 in 1970, but smaller counter service outlets were replaced by larger self-service supermarkets. At the same time, to support the expansion programme, facilities of central depots were expanded and the distribution system was computerised. By 1970, about half of the 225 Sainsbury's stores were supermarkets. The slow conversion was mainly due to the high capital investment required. In 1969, John Sainsbury became chairman and chief executive. At the time, Sainsbury was a large regional operator, with only 20% of the population living within an accessible distance from a Sainsbury outlet. However, higher sales per outlet compared to the industry average made Sainsbury one of the largest operators in the industry by sales behind Allied Suppliers and Tesco. In 1973, Sainsbury was floated on the Stock Market. In 1974, during a difficult period for the UK economy, the government put a cap on the company's gross margin. In the following years, the company started a diversification programme. "This decision was taken at a time when a combination of economic instability and the government's discriminatory attitude to food retailing threatened to curb the growth of the core business" (Williams 1994: 212). In 1975, Sainsbury and British Home Stores (BHS) formed a 50/50 joint venture, launching Savacentre, a hypermarket chain. Sainsbury retained control of all food-related operations, leaving non-food lines to BHS. The first Savacentre outlet was opened at the end of 1977. In the early years, the venture was very much in an experimental phase. By March 1980, two Savacentres were operating. In 1979, Sainsbury also started a joint venture with GB-Inno-BM (GIB), a Belgian retailer, known for its leadership in merchandising products and 'Do It Yourself' (DIY). Sainsbury owned 75% of the new company and GIB the remaining 25%. The objective of the joint venture was to operate a home and garden (DIY) chain in the UK.

Throughout the 1970s, in the traditional grocery retailing business, the company continued its programme of replacing old smaller stores with larger new ones, while slowly expanding the geographic scope of operations by opening new outlets in other regions. The main obstacles to Sainsbury's development programme were the difficulties in obtaining planning permission for new town centre stores. In December 1974, partly as a response to planning permission problems, Sainsbury opened its first edge-of-town store. In 1979, John Sainsbury announced that the company had plans to open 15 new supermarkets a year in the following years. By 1980, Sainsbury operated 231 outlets with an average size of 11,975 square feet, compared to 225 with an average size of 4,670 square feet back in 1970. In 1980, Sainsbury also operated outlets in South Wales, Yorkshire and South West.

In the 1970s, Sainsbury also entered the rapidly growing frozen food market. Sainsbury's chain of freezer centres operated independently of the main supermarket business. Old counter service branches that were too small for conversion to supermarket trading were used for this purpose. The first freezer centre was opened in 1974. However, one year later, the company decided that when possible it would integrate freezer centres into supermarkets. There were 21 freezer centres in 1980.

Within the GRI, the second part of the 1970s was characterised by strong competition. In June 1977, Tesco dropped trading stamps, first introduced in 1963, and launched one of the most successful retail price promotions under the name 'Operation Checkout'. Prices of products were cut by three to four percent on average. This was the beginning of a period where competition among grocery firms was mainly based on low prices. All the other main chains reduced prices to maintain customer loyalty. In January 1978, Sainsbury launched a price initiative called "Discount '78". Items were reduced in price by as much as 15%. The discount scheme proved very successful and by December 1978, the increase in sales had been in the order of 25%. Many independent stores and small chains, unable to compete on prices, were being either driven out of the market or taken over by larger firms. Over this period, Tesco surpassed Sainsbury to become the largest operator in grocery retailing by sales.

Table 10.1 J. Sainsbury PLC: Financial and Operational Statistics 1980/81

Group Sales (£; 000; after taxes)	1,531,196
Pre-tax Profit (£; 000)	62,025
Number of Outlets	237
Total Sales Area (sq. ft.)	2,978,000
Average Sales Area per Outlet (sq. ft.)	12,570
Market Position	High
Market Share (1980)	12.5%
Own Label Share of Sales (1981)	54.0%
Information Technology	Developed
Centralised Distribution	Developed

Source Various Documents

10.1 1980 -1986/87: Continuing the Programme of Change

In the first part of the 1980s, the UK GRI was still in a state of flux. As recession hit the UK economy, price was still an important variable for competitors and shoppers. In 1982, Tesco launched "Checkout '82", cutting prices between from three percent and 25% on around 1,500 food items. This started a new price war in the GRI that eased as the economy situation improved. However, if price was the most important competitive

weapon in the short term, most companies' longer-term strategies were to improve their competitive position by opening larger stores in edge-of-town sites.

Sainsbury continued its programme of updating its retail portfolio, replacing old stores with larger new ones and refurbishing some old branches while also slowly expanding its geographical scope of operations. Expansion was done organically rather than through acquisition. "We have always believed in expansion through investment within the Company rather than by acquisition. We do not seek greater size for its own sake, but we do set the highest priority in constantly updating the business so that we may better meet our customers' needs. It has always been our policy to close outdated stores whenever we can build a replacement supermarket or to expand and modernise stores when possible" (John Sainsbury, Chairman, Annual Report, 1985: 5).

New, larger stores enabled the company to broaden the product range and provide more services to customers. The company was thus less exposed to price competition in the traditional grocery market. In the industry, most companies had stores operating in city centres, which were often of small size, displaying mainly grocery produce and with little customer services. The absence of economies of scale for small stores also meant that costs for stores in the city centres were proportionally higher than for edge-of-town stores. Only a few companies operated on edge-of-town sites. In 1982, the last counter service shop was closed and this completed the change over to self-service that had begun in 1950. In 1981, Sainsbury surpassed Tesco to again become the largest food retailer in the industry by sales. In the first part of the 1980s, despite difficulties in getting planning permission, the company opened 15 to 17 new stores a year. The programme was financed internally and with funds generated by the sale of old dismantled stores. Its programme of replacing smaller units with larger ones was supported by higher operating margins, productivity and sales achieved in the new larger stores. In May 1984, the company was honoured by the Food Marketing Institute of America as "The Outstanding Supermarket Chain".

<u>The Diversification Programme</u>

The company continued its diversification programme throughout the early 1980s. In 1981, the first Homebase home and garden centre, resulting from the joint venture between Sainsbury and GIB, was opened. "The new company, ... was ... able to combine (GIB's) international expertise with Sainsbury's experience of British Retailing. The setting up of Homebase represented Sainsbury first venture into retail business totally unrelated to food" (Williams 1994: 214). The launch of Homebase was viewed with scepticism by some city analysts, who believed that the market for DIY was already saturated. Homebase's success was greater than expected. Consequently, further expansion was planned with confidence. By the end of 1986, there were 28 Homebase stores. In January 1987, a new depot was commissioned to serve Homebase. Fifty percent of goods were be handled through Homebase's own distribution centre. The system was, at the time, unique in the DIY industry. There were plans to open 25 further Homebase stores by 1990. "The Sainsbury trading philosophy is reflected at Homebase in the quality and value of its product range and its dedication to customer service. Homebase is following the Sainsbury tradition of developing its own label products" (Annual Report 1987: 8).

In November 1983, Sainsbury acquired a 21.2 % share in Shaw's, a supermarket chain

operating in New England (US). As part of its diversification programme set up in 1977, Sainsbury had decided to acquire a minority interest in a US company in order to learn more about American food retailing before purchasing a controlling interest. Consultants had been employed to help in the search for a suitable company.

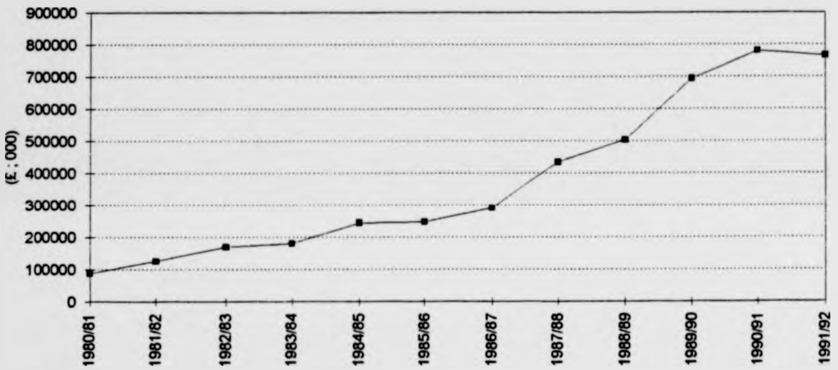
In the early 1980s, Savacentre took a back seat and by the end of 1986, only six hypermarkets were operating.

10.2 1988 – 1991: Consolidating the Superstore Business

As in the past, in the late 1980s, Sainsbury continued to expand within the UK GRI. The policy was still to replace old city centre stores with larger edge-of-town ones while slowly expanding its geographical coverage in the UK market. Edge-of-town stores achieved higher sales, operating margins and returns-on-investment compared to city centre ones. In 1987, the management announced its intention to increase the average number of new stores to be opened each year from 15 to 20. This came because of changes in governmental policies that made it easier to obtain planning permission. At the same time, more sites suitable for superstore developments became available because of changes in Britain's economic infrastructure.

Sainsbury's capital expenditure continued to grow at constant rate. The company financed its expansion plans with its cash flows, profits sale and leaseback and investment bonds. Investment in new stores was accompanied by investment in information technology and own-brand products, which had traditionally played an important role in the company's strategy. Compared to its main competitors, Sainsbury was better positioned in terms of brand name, own label, information technology, and distribution systems. In 1989, the company celebrated its tenth successive year during which profits increased by more than 20%.

Graph 10.1 J. Sainsbury Plc: Capital Expenditure 1981 - 1992



Source Based on Data from Sainsbury's Annual Report

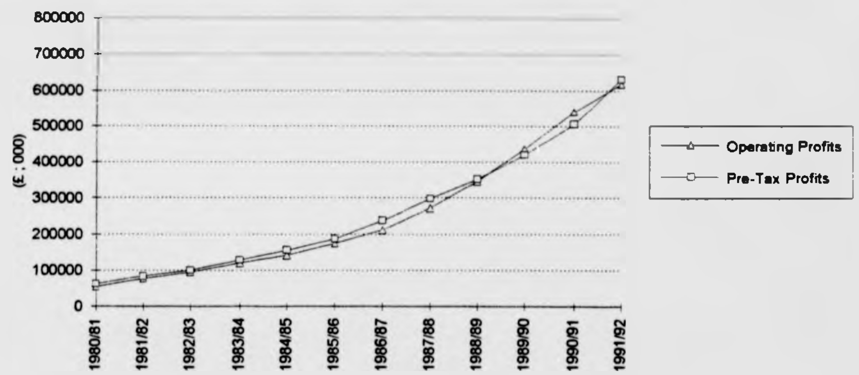
Since the price war in 1982, shoppers had become more concerned about value for money and services than price. Sainsbury had a long established tradition of quality food, value for money and a nice shopping environment, but competitors, attracted by higher profit potential, were trying to position themselves at the same end of the market.

In the UK GRI, Sainsbury's competitors, whilst trying to improve their market position, were also successfully expanding the scope of their operations. If the early 1980s had been characterised by price competition and consolidation of the industry, in the late 1980s, Sainsbury's competitors (Tesco, ASDA and Argyll) were engaged in large expansion programmes and opening new large edge-of-town stores. This was achieved

at the expense of independent retailers whose total number continued to decline over the 1980s.

Sainsbury had been among the first companies to target this market segment on a broad scale, but others were trying to do the same, consequently increasing potential competition. This trend was not followed by all companies. Budgens, Iceland and Kwik Save preferred to stay and expand in city centres.

Graph 10.2 J. Sainsbury Plc: Profits 1981 - 1992



Source: Based on Data from Datastream

The Diversification Programme

Sainsbury continued its diversification programme during the late 1980s. In July 1987, the remaining share of Shaw's was acquired. After the acquisition in 1983 of 21.2% of the capital, Sainsbury had increased its holding to 28.5% in 1986 and to 49.4% in the early 1987. Shaw's had been founded in 1860 and had a similar history to Sainsbury of quality food and good price, with particular strength in computer technology. When

Sainsbury first invested in 1983, Shaw's had 41 stores. The acquisition was not welcomed by the city. The US had a £250 million highly fragmented grocery market, with each region having its favourite chain. Few retailers, like Safeway US, A&P and Kroger, were operating nation-wide. As Sainsbury gained complete control of the company, a strong development programme was set. At the end of 1987, Iandoli, a small chain of 10 stores also operating in New England, was acquired and, in the following year, integrated under the Shaw's fascia. In 1990, drawing on Sainsbury's experience for quality control and buying methods, Shaw's launched its own brand, with the same slogan used at Sainsbury's: 'good food costs less'. By 1990, all existing stores had been converted to scanning. Shaw's was also one of the first companies to set up a centralised distribution network of depots and to change it to contract distribution systems.

During the 1980s, the number of Savacentres grew slowly. This was primarily due to difficulties in finding suitable sites and in obtaining planning permission for very large hypermarkets. In March 1989, the 50% share owned by Storehouse was acquired by Sainsbury for £123 million. Savacentre was planning a £200 million development programme over the following three years. Storehouse was not interested in further investment in the business. To ensure continuity, while the management built up expertise in clothing, a five-year agreement was made with Storehouse to supply Savacentre, through BHS, with textiles and other non-food lines. BHS products were gradually phased out following the launch of the Sainsbury Lifestyle range of own brand clothing.

DIY was one of the major growth sectors of the 1980s. Between 1985 and 1990, the

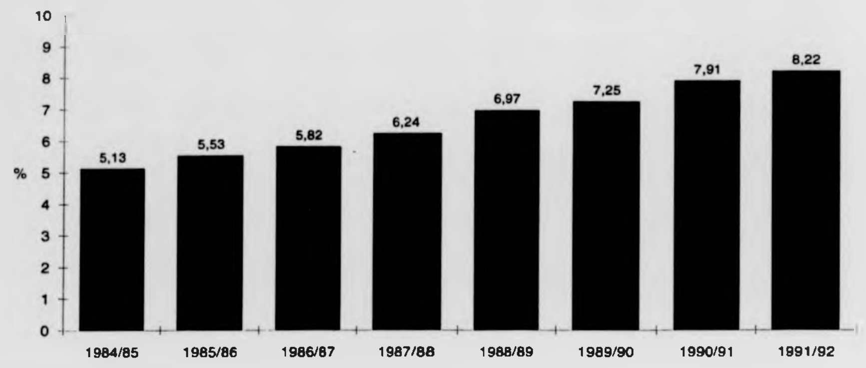
number of DIY superstores almost doubled from 560 to 1,019. At the same time, DIY retailers' gross margins increased from 30% to 34.5%. (Central Statistical Office's Retailing Inquiry, from The Financial Times, 15/09/94: 24). In a heterogeneous market, with products ranging from cement and construction to gardening products, Homebase positioned itself at the upper end of the market, with a 'soft' range (decorative and gardening products). The company had expanded organically and, similarly to what it had previously done in the supermarket chain, it developed a quality own-brand and its own central distribution system. By the time the fiftieth store was opened in 1989, it was the fourth largest DIY retailer in terms of sales. The plan was to continue to expand operations.

10.3 1992 – 1993: The Turbulent Years of Grocery Retailing

<u>Sainsbury's Position in the Market</u>

At the beginning of 1991, Sainsbury was the market leader in UK grocery retailing and was on the way to establishing itself as a true national operator with its first outlets Scotland and in North Wales opening in 1990. This was accompanied by increasing sales, profits and operating margins. Economies of scale, tight control of costs and increased productivity, resulting from investment in information technology contributed to increased profitability.

Graph 10.3 Sainsbury's Supermarkets: Operating Margin 1985 - 1992



Source: Based on Data from Sainsbury Annual Reports

In November 1992, Sainsbury announced its best interim results for five years. In the same month, Lord Sainsbury, chairman since 1969, retired on his 65th birthday. He was succeeded by his cousin, David Sainsbury, who had been working with the company since 1963. The new chairman made it clear that there would be no 'cabinet reshuffle' as a result of the change in chairing: "We share very similar views on the direction of the business and very similar values. We have a clear strategy and I have been involved in developing that strategy" (David Sainsbury, Chairman, from Williams, 1994: 211). He highlighted: "Food retailing is a very dynamic and a very competitive business. It is a market of changing fortunes. We are leaders now and it is absolutely my intention to have a bigger lead when I cease to be chairman. But we will only do so by changing our business. I am certain we will be a very different business in 10 years' time." (David Sainsbury, Chairman, from The Financial Times, 11/06/94: XXII).

The Grocery Retailing Market at the Beginning of the 1990s

Sainsbury had successfully transformed itself from a large regional operator with stores located in city centres to a national operator with large city centre supermarkets and large edge-of-town superstores. However, several events occurred in the early 1990s, which had significant consequences on competition in the GRI and on Sainsbury's strategy.

In the early 1990s, some of Sainsbury main competitors were in trouble. Gateway had been taken over by Isosceles and was struggling under a high debt burden. ASDA was also having problems in digesting a large acquisition of Gateway's superstores and changing its own market position. In January 1990, Verdict Research, the retail consultant, published a report affirming that price competition was unlikely in the near future. Only Sainsbury and Tesco would have had any chance of fighting a price war. The focus was to stay on quality rather than price. However, things soon began to change. In 1990, the British economy started to slow and in 1991 went into recession. In the meantime, the trend towards edge-of-town sites left retail space in many city centres. Locations previously occupied by large retailers were taken by traditional city centres operators such as Kwik Save and Iceland. The former consolidated its position as a national discount operator with 750 stores by 1991, the latter as a city centre frozen food specialist. However, in recent years, a number of 'hard and soft' discounters, such as Aldi, Netto, Lidl and Ed had made their entry into the UK GRI. Initially, their entry was not seen as posing a particular threat to large retailers operating at the higher end of the market. The argument was that discounters were targeting a different market segment. Hence, operators such as Safeway, Sainsbury, and Tesco, which targeted customers at the higher end of the market, would not be affected. However, things were to work a different way.

In the winter of 1991/92, ASDA changed its price position in the market. The company had previously attempted to position itself at the upper end of the market, alongside Sainsbury, Tesco and Safeway, but its attempts failed and the new management decided to return to its roots as an edge-of-town discount chain. In May 1992, Kwik Save announced that it would be reducing prices in response to competition from hard discounters. In September 1992, Tesco produced disappointing interim results. In some parts of the country, Tesco had losing market share to discounters and had responded by offering cheaper lines. In November 1992, Norman, chief executive of ASDA, warned that the 'halcyon days' of grocery retailing were at an end. In January 1993, a report published by Verdict, the retail consultant, stated that discounters had quickly consolidated their presence within the market. In May 1993, Gateway launched a cut-price "Price Check" campaign. In August 1993, Tesco launched 'Tesco Value', a cut-price own label, covering 70 products, which was to replace tertiary brands. In September 1993, Tesco produced disappointing half-year results, with lower than expected profits and lower margins. Tesco management acknowledged, for the first time, the growing threat posed by discount operators. They also acknowledged that Tesco had not promptly reacted to the recession and that they had not recognised the changing priorities of its customers. Tesco's repositioning opened a gap of four to five percent between the price of its basic products and those of its competitors such as Sainsbury and Safeway.

Change in Strategic Direction

Unlike Tesco, Sainsbury operations had not been directly hit by discounters and results in 1992 and 1993 were in line with expectations. However, the price repositioning exercise by Tesco had left a gap that could have consequences in the longer term. It was not surprising, therefore, that in November 1993 Sainsbury announced that it was repositioning on price by launching a new "Essential-for-Essentials" own-label discount brand covering 300 popular lines. In this way, Sainsbury closed the gap that Tesco had opened two months earlier. Furthermore, the management recognised that there had been big and long lasting changes in the grocery market and announced a review of the company's strategic direction. Expansion in the traditional core grocery retailing activity was to remain at the same level, with a fall only planned for the end of the decade. However, in future, the company was to step up expansion plans for other types of retailing, at home and overseas. Two months later, in January 1994, Sainsbury produced a disappointing Christmas trading notice and announced £365 million in property write-down and changes in depreciation policies. This followed similar moves taken by Safeway and Tesco between December 1993 and January 1994. Safeway and Tesco also declared their intentions to cut expansion plans and Tesco reported plans to build smaller and cheaper stores.

As at Tesco and Safeway, management at Sainsbury had initially argued that discounters did not pose a real threat to large operators. However, as at other companies, management did not expect that the expansion of discounters would provoke a "domino effect".

The Other Businesses

The decision to consolidate other businesses did not come as a surprise. All the other retail businesses had been performing very well and, since 1992, an increasing proportion of group capital expenditure had been devoted to the development of the retail subsidiaries as the management declared its intention to consolidate the diversification programme.

In the US, Shaw's had gone through a difficult period between 1989 and 1992, as New England's economy went through a recession. As the economy recovered, performance started to improve with operating profits in 1993/94 up by almost 50% on sales that had increased by only 6.7%. Since the acquisition in 1988, Sainsbury had been transferring its expertise in centralised distribution, internal computer systems, and own-label development to Shaw's. The own-label development was a remarkable achievement since, in the US, own-label traditionally signified low quality. Shaw's managed to transmit the message to customers that own-label could also represent quality. Own-label products accounted for 25% of sales by 1993, compared with the 14% average for US food retailers. Value-adding services such as pharmacies had also been introduced. The company expanded its operations and operated 87 stores in 1994, with a sales area of 2.7 million square feet compared with 60 stores in 1988 with sales area of 1.6 million square feet.

Savacentre was also successful, with progressively improving operating profits. Since the acquisition of the 50% share from Storehouse, three new outlets had been opened and the sales area had increased by almost 50%. Savacentre's systems for

administration and buying had been integrated with those of Sainsbury, whilst retaining a separate marketing identity and operating responsibility.

The best performance was, however, achieved by Homebase. The business continued to expand with higher sales and operating margins. This was achieved despite, since 1990, the DIY market had been depressed by a housing market recession and fierce discounting since 1992.

10.4 1994 – 1995: Consolidation of the Diversification Programme

Between 1994 and 1995, in line with what had been announced at the end of 1993, Sainsbury made three important moves aimed at consolidating its diversification programme.

In October 1994, Sainsbury acquired a $325 million (£205 million) stake in Giant Food, a supermarket chain based in Washington DC and also operating in Maryland and Virginia. Giant was the 15th largest US food retailer. Sainsbury acquired 16% of the equity but controlled 50% of the voting rights, together with the possibility of electing three of Giant's seven board directors. Sainsbury acquired the share from family members of one of the founders of Giant. The remaining 50% of voting shares was still in the hands of the other founder of the business, Israel Cohen. Giant Food dominated the Washington DC grocery market with a 44% market share. In 1993, it had sales of $3.57 billion and pre-tax profits of $151.8 million. David Sainsbury, chairman of

Sainsbury, commented: "This is very much a first step. ... We will see how things develop. We regard the North American market as one of the major areas of growth for the group in the future" (The Financial Times, 04/10/94. 21). Giant was founded in 1935 and had a trading philosophy similar to Sainsbury, emphasising customer service and value for money. Giant planned to expand into the surrounding states of Delaware, Pennsylvania and New Jersey; taking the chain into states where Shaw's was also planning to expand. Giant and Shaw's made a good fit. Combined, the two companies had a turnover of $6 billion and a strong position in seven out of 10 of the US's most prosperous states. However, Sainsbury was still examining expansion options in continental Europe.

In January 1995, Sainsbury acquired, at a provisional cost of £290 million, Texas, the homecare subsidiary of Ladbroke. Texas was the second largest DIY retailer in the UK with sales of £658 million in 1994 from over 240 stores. There was little overlap between the Texas and Homebase chains. The plan was to integrate Texas into Homebase's operations, making Homebase Britain's second largest DIY operator behind B&Q. Homebase would reach a market share of about 10%, with sales of more than £900 million from about 260 stores. Profitability would benefit from substantial economies of scale in buying, own brand development, advertising and head office support.

Finally, in June 1995, Sainsbury announced its move to Northern Ireland, where it planned to invest £100 million in building seven edge-of-town superstores. The Ulster grocery market was dominated by three chains: Wellworths, Stewarts and discount chain Crazy Prices. In the longer term, the management would also take into consideration the possibility of extending operations to the Republic of Ireland. The first store started operating in summer 1996.

Improving Profitability and Consolidating the UK Grocery Retailing Business

Reducing prices on the kind of basic products sold by the discount chains neutralised the discounters' threat. Operating margins fell because of the price repositioning but gross margins soon stabilised. Following its repositioning on price in November 1993, Sainsbury management was mainly concerned with improving profitability. Between 1993 and 1994, the company extensively reviewed the supermarket's operations. The purpose was to improve the efficiency and efficacy of operations. As a result, the company restructured store management, reorganised the management of the logistics function, rationalised the system for purchasing goods and services not for resale, simplified the construction of new stores and reduced the need for clerical support by the introduction of new systems. The review led to the loss of 650 jobs and savings of around £50 million a year.

At the same time, in April 1994, Sainsbury management announced that a new town centre format called *Sainsbury's Central* was to be launched. This followed a similar successful experiment by Tesco, which had launched the *Tesco Metro* format in June 1992. Whilst, since the early 1980s, Sainsbury had been replacing smaller city-centre stores with larger edge-of-town superstores, more than 100 of Sainsbury's 340 stores were still on the high street. Three stores were to be converted to the new format and, if successful, other stores would then be converted. The new-style shop was to provide a service geared to the needs of town-centre shoppers. Shops were to be refitted, the product range slimmed down and tailored to meet city centre needs, space was to be made for new delicatessen, fresh hot foods and meat counters. The refitted stores would have an average size of 12,000 square feet, about half the size of an edge-of-town superstore. The decision to revitalise city centre stores was due to a number of reasons. The government had given guidelines for stricter planning permission policies for edge-of-town superstores and had implemented policies aimed at a revitalisation of city centres. Further, discount operators and other chains, that had taken the retail space left by operators moving to the edge-of-town, had demonstrated that it was possible to operate successfully in city centres. At the annual convention of the Institute of Grocery Distribution in October 1994, David Sainsbury suggested that "the big groups had been mesmerised by the efficiency and popularity of edge-of-town supermarkets, and forgot that there would always be some business located in town centres. ... 'The market did, however, work extremely effectively and a number of chains, including the discounters, moved in to fill the gap' " (The Financial Times, 19/10/94: 8).

In July 1994, Sainsbury bid against Tesco to acquire WM Low, a Scottish chain of 57 supermarkets. WM Low had been badly hit by the expansion of discounters and the repositioning of large operators. The acquisition would have consolidated Sainsbury presence in Scotland where the company had only two superstores and a market share of 4.6%. However, Tesco acquired the company for £257 million after it increased its offer.

In November 1994, Sainsbury announced that tougher government planning restrictions were starting to bite. The group expected to open only 12 new stores of the 20

previously planned for 1995. However, a higher proportion of capital expenditure was going to be invested in refurbishing older stores.

In March 1995, Sainsbury bought Nurdin and Peacock's three warehouse clubs outlets. The warehouse club retail concept had been introduced in 1993 by CostCo, the third largest US Warehouse Club operator that had acquired two sites in the UK. Initially, it was thought that the Warehouse Club would have been a credible threat for supermarket operators, but the retail formula did not encounter the expected success. Nurdin and Peacock's withdrawal left just one significant UK operator, CostCo Europe, which operated in two places and had plans to expand.

In April 1994, Sainsbury formed retail partnerships (SEDD) with the Italian Esselunga, the French Docks de France (owner of the Mommouth hypermarket chain) and the Belgian Delhaize 'Le Lion'. The partnership aimed to form a strong buying group, but the companies were also committed to work as a multi-functional alliance where all members would exchange knowledge in areas such as information technology and systems, and co-operate in marketing and distribution. The groups were said to be 'culturally alike' and all retained a strong family influence (the partnership was the development of links previously established with Docks de France). Sainsbury and Docks de France jointly opened an off-licence in Calais in April 1994.

<u>Sainsbury's Position in the UK Grocery Retail Market</u>

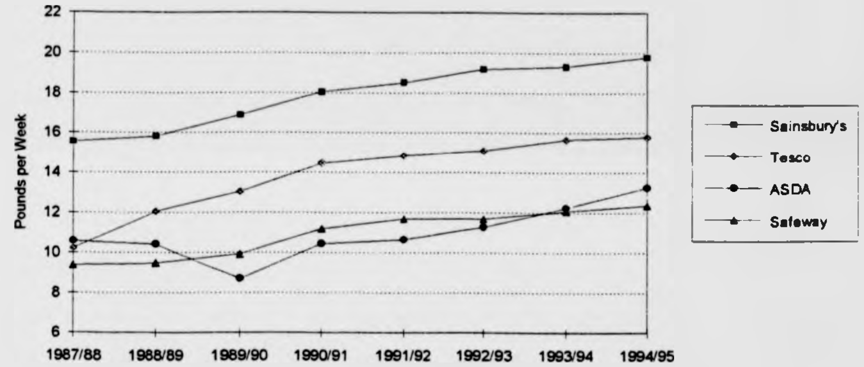
Results for 1994/95 were positive, with strong results coming from Sainsbury's other businesses. Assisted by Docks de France, a major review of hypermarket format was carried out at Savacentre, which resulted in a new look and a more 'hypermarket' trading style. Plans for the following years were to open one Savacentre a year. The management believed that the expansion of Savacentre would be easier because most of its developments involved a major element of urban regeneration, strongly favoured by local authorities (Annual Report 1995). The UK supermarket business accounted for 87% of the group's operating profit and 80% of its sales. However, over the previous three years, Savacentre, Homebase and Shaw's had increased their sales by 31.2% and their operating profits by 74.2%. In the traditional supermarket business, operating profits were up, mainly because of cost savings achieved through the review of the supermarket business. However, like-for-like sales on a comparable basis were down by 0.5%, with the trading statement for 1995/96 also showing like-for-like sales down on the previous year.

In June 1995, Sainsbury launched a new advertising campaign aimed at portraying Sainsbury as a warmer and friendlier place to shop. The focus was on services: extra bag packers; checkout improvements; and better facilities for mothers and babies, the elderly, and the disabled. However, the results achieved were poor. In October 1995, interim results at Tesco showed that the company had increased its volumes by six percent. The following month, Sainsbury reported a decline in the same period of 2.2%. Things were not working according to plan and Sainsbury was still losing market share to its main competitors.

In the late 1980s, large operators in the UK GRI were following the same strategy of expanding their operations by building large superstores. In contrast, from 1993, firms started to follow different strategies. ASDA, Safeway and Tesco, having reviewed their

expansion plans, mainly focused on gaining market share and increasing like-for-like sales. In September 1994, Safeway launched a new own label range covering 100 goods at low price, called "Safeway Savers". In October 1994, ASDA announced a "No Nonsense" price freeze on 7,000 items until January. In February 1995, Tesco, followed by Safeway in October 1995, launched a nation-wide loyalty card scheme. All these measures were aimed at attracting more customers and increasing volumes.

Graph 10.4 Sales per Square Foot 1988 - 1995



Source Based on Data from ASDA. Argyll. Sainsbury and Tesco Annual Reports

At Sainsbury, there was little scope for improving volumes as most of its stores were trading at full capacity. Sainsbury still had less retail space than its main rival Tesco, but higher sales per square foot, higher operating margins and a higher return on capital invested than anyone else in the industry. Its rivals had traditionally lagged behind and it was expected that they would catch up with Sainsbury in the long term. However, financial analysts were very critical about Sainsbury's management and, in particular, its marketing campaigns. Sainsbury had traditionally been very conservative in its marketing campaigns and seemed to be having difficulties compared to competitors. Analysts accused the management of not adjusting to the new competitive climate and of not being as aggressive in its advertising campaign as some of its competitors who were building on their success by continuously introducing new marketing initiatives.

10.5 Sainsbury at the beginning of 1996

Poor results and pressure from institutional shareholders brought some changes in the company's management. In November 1995, a new marketing director, Kevin McCarten, previously at Woolworth and Procter & Gamble was appointed. He replaced Ivor Hunt, who had resigned in October over criticism of Sainsbury's marketing campaigns. In January 1996, a new management structure was announced. The roles of chairman and chief executive were to be split. David Sainsbury stayed on as executive chairman, responsible for the group's strategy. There were to be two chief executives responsible for the two newly created divisions of the group. One group comprised the UK supermarket and hypermarket businesses. The other included Homebase and the overseas operations. Following changes in the management structure, David Quarmby, joint managing director, resigned and David Bremmer, previously chief executive of Watson & Philip (cash and carry operator), was appointed as chief executive of the 'other retailing interests' division.

At the beginning of 1996, the main worry was whether Sainsbury was going to recover the lost ground. According to Harris International Marketing, the retail consultancy, Sainsbury was still the UK's most popular grocer, in terms of the number of shopping families and shopping trips, it attracted each week. However, Tesco and ASDA both increased shopper numbers substantially over two years. In January 1996, Sainsbury

launched an aggressive marketing campaign aimed at regaining its position. Sales improvements were still behind those of Tesco and Safeway but the company was no longer losing out to the main competitors.

Table 10.2 J. Sainsbury PLC: Financial and Operational Statistics 1994/95

Group Sales (£; 000; after taxes)	11,357,000
Pre-tax Profit (£; 000)	808,200
Contribution to Group's Sales	Sainsbury's Supermarkets 79.6% Savacentre 5.8%
Contribution to Group's Operating Profits	Sainsbury's Supermarkets 87.2% Savacentre 4.5%
Number of Outlets	Sainsbury's Supermarkets 355 Savacentre 10
Total Sales Area (sq. ft.)	Sainsbury's Supermarkets 9,338,000 Savacentre 864,000
Average Sales Area per Outlet (sq. ft.)	Sainsbury's Supermarkets 26,304 Savacentre 86,400
Market Position	high
Market Share (1994)	20.6%
Own Label Share of Sales (1994)	65.8%
Information Technology	Developed
Centralised Distribution	Developed

Source Various Documents

Competition in the industry will remain tough over the next few years. However, competition has always been very tough. Sainsbury's management has demonstrated over the decades the value of its long-term perspective and its ability to maintain leadership in the market by slowly but steadily building and renewing the business. They have also demonstrated their capability to transfer the knowledge developed in UK grocery retailing to other businesses and other markets. The main challenge for Sainsbury in the future will be to maintain these characteristics in the presence of a multiplicity of large businesses operating in diverse geographic areas.

Chapter 11 Tesco PLC

11.0 Introduction

Tesco's beginnings are linked to the career of Jack Cohen, a serviceman of the Royal Flying Corps. In 1919, Cohen opened a small grocery stall in the East End of London. Within few years, he had become a successful trader and was soon wholesaling for other traders. In 1931, he founded Tesco Stores Limited. In the following years, under Cohen's guidance, the company grew to become one of the main operators in grocery retailing. Cohen's expansion strategy was accompanied by a 'pile it high, sell it cheap' retail formula that made Tesco a very popular brand at the low end of the market. Cohen remained in charge of company activities until the early 1970s. Under his guidance, the company continued to expand its scope of activities.

By 1972, Tesco had 790 stores around the UK and was, with Allied Suppliers and Sainsbury, among the largest operators in grocery retailing. The company had a market share of around seven percent and operating margins of about six percent. However, its performance had been declining in the previous few years. In 1973, following the resignation of Kreitman, Leslie Porter was appointed as Tesco's chairman, with Ian MacLaurin as managing director. In the following years, Tesco's market share remained static and operating margins started to go down. Tesco had a serious image problem among consumers. The company had, in the past, mainly focused on expansion, without developing adequate support systems such as distribution and central buying. At the same time, it had paid little attention to changes in the consumer market. Hygiene

standards were low and shops were seen as over-crowded with all sorts of items. In the 1960s, the company had entered the non-food business by adding clothes lines into its food shops. However, "Home 'n' Wear" was the least profitable line and took considerable space in Tesco retail outlets. Furthermore, competition at the low end of the market had become stiffer because of the expansion of ASDA and Kwik Save.

In 1977, in an attempt to improve competitiveness and to increase sales, in a period when consumers were spending less on food purchases, Tesco dropped trading stamps[1] and launched one of the most successful retail price promotions, under the name 'Operation Checkout'. Prices of products were cut by three to four percent on average. This was the beginning of a period where competition among grocery firms was mainly based on low prices. All the other main chains reduced prices to maintain customer loyalty. Many independent stores and small chains, unable to compete on prices, were either being driven out of the market or taken over by larger firms. This initiative increased the company's market share from 10% to 12% and Tesco became the largest operator in grocery retailing. However, market share had been gained at the expense of operating margins.

During the same period, as part of the strategy of aiming to improve competitiveness and profitability, Tesco management also embarked on a massive restructuring programme. The objective was to move to a middle-up position in the market, away from the low-quality low-price image that Tesco had traditionally had. The strategy involved basing operations around a smaller number of larger stores. Small unprofitable stores were being closed and investments were to be made in buildings around 400 large superstores sized over 40,000 square feet, which had, in previous years, shown a higher profitability. Tesco's "Home 'n' Wear" department, which accounted for 38% of sales area in 1978 (Retail Business 1981: 31), was rationalised. New Tesco's superstores included: in-store bakeries, self-service restaurants, wine and spirits departments, petrol stations, garden centres, Do-It-Yourself (DIY) departments and fresh produce (fruit and vegetables, cheese, fish, meat). In the traditional dry grocery business, the focus was to be on quality and choice. Large superstores were to make food shopping a more pleasant activity for shoppers and to provide more services to customers. Investments were also to be made in distribution systems and own-label products.

Table 11.1 Tesco PLC: Financial and Operational Statistics 1980/81

Group Sales (£; 000; after taxes)	1,820,656
Pre-tax Profit (£; 000)	35,591
Number of Outlets	554
Total Sales Area (sq. ft.)	6,840,000
Average Sales Area per Outlet (sq. ft.)	12,347
Market Position	low end of the market
Market Share (1980)	13.4%
Own Label Share of Sales (1981)	20.0%
Information Technology	Little
Centralised Distribution	No

Source: Various Documents

In a period characterised by high costs for rents and property of the city centres outlets, the move towards out-of-town superstore made a lot of sense. Large out-of-town property was less expensive and superstores were cheaper to run. Profit growth depended on the success of the policy aiming to generate higher volumes and a reasonable return on the capital spent.

[1] Tesco firstly introduced Green Shield trading stamps in 1963.

In 1979, Tesco diversified abroad, by acquiring '3 Guys Ltd', an Irish supermarket chain which became 'Tesco Stores Ireland' in 1980. Tesco also considered the possibility of diversifying in the USA, but decided against the project.

11.1 1980 - 1985: The Difficult Years of Strategy Change at Tesco

In 1980, Tesco was in the middle of its repositioning strategy. Between 1977 and 1980, 226 outlets were closed, 39 were opened, and 17 outlets were acquired from Cartiers Superfoods, a chain operating in Kent. Tesco had 552 stores, with a total area of 6.2 million square feet and an average size of 11,250 square feet. The company was still the market leader in the dry grocery market with a market share of 13.4%. However, operating margins had gone down to 2.6%.

At the beginning of 1980, Tesco announced a five-year plan to 'expand dramatically' its total selling area (Porter, Tesco's Chairman, Annual Report, 1980: 3). The objective was to have eight million square feet of larger units by the February 1984. Investments in central distribution facilities, information technology, as well as improving older stores through refitting and refurbishment, were to be continued. The management also planned to expand operations in Ireland. However, at the same time this plan was announced, the UK economy slowed and went into recession. In a highly competitive environment, price was again to become a key competitive variable. Tesco's strategy was at risk. There was a danger that in an attempt to move towards a middle-up position in the market, the traditional consumer base would erode without securing a new one. By late 1981, food sales started to go down. In May 1982, in an effort to regain sales, Tesco launched "Checkout '82", cutting prices between 3% and 25% on around 1500 food items. This touched off a new price war in the GRI. Once again, competitiveness was maintained at the expenses of operating margins.

In the early 1980s, the company did not expand at the same rate as originally planned. Investments were regularly lower than what had initially been suggested. Tesco's expansion programme required high borrowing levels. In a high inflation - high interest rates period and with low operating margins, interest rates were depressing pre-tax profits. In 1981, Tesco share price reached an all time low at around 45 pence which valued the company at less than 50% of its asset value. The financial market, which had not looked favourably on Tesco 'Operations Checkout' in 1977, had maintained a sceptical attitude about the company's ability to turn its performance around.

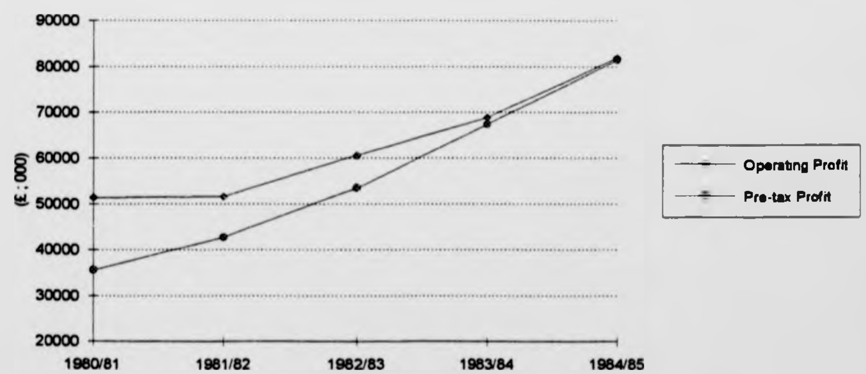
In 1981, Sainsbury overtook Tesco to become the largest operator in the industry by sales. Sainsbury was also following an expansion program in the market, but its operating margins had improved since mid - 1970s and like-for-like sales had been growing at a faster rate than inflation. Within the market, Sainsbury had an established reputation for quality of produce and services to customers.

In 1982, Tesco experimented with a second fascia. The decision was taken in order to make the most effective use of smaller stores which did not fit Tesco's new format and which, according to original plans, were to be closed or sold. The new fascia, "Victor Value", was a discount chain, operating with a limited range concept. Its stores had a size of up to 9,000 square feet. They required lower store investments and were cheaper to run. "Victor Value ... uses former Tesco stores which have become too small or

uneconomic to continue trading under the parent company's name. In the normal course of events, such stores would have closed and been sold. The Victor Value project, ... has proved an effective way of utilising such premises with the benefit of Tesco's back-up resources" (Annual Report 1985: 13).

By February 1984, sales area was 7.4 million square feet, compared with 8 million square feet planned in 1980. Although results from the new investments in larger stores (improved services and range of products, information technology and distribution facilities) generally supported the company's strategy, operating margins had remained at around 2.5%. However, Tesco's image in the financial and consumer market was slowly but steadily improving. Volume gains in existing stores were at six percent and profitability was improving mainly because of lower interest charges. Good progress had also been made in the rationalisation programme, where Tesco hoped to achieve significant economies.

Graph 11.1 Tesco: Profits 1981 - 1985



Source: Based on data from Datastream (pre-tax profits excludes exceptional charges)

At the beginning of 1985, the plan was to continue expansion and the repositioning programme. The focus remained on building large superstores with a selling area of 40,000 square feet able to accommodate all activities. Stores with a selling area of 20,000 square feet were also being searched for. "The core of the company's business is, and will continue for the foreseeable future to be, in its traditional market place - the High Street. Although many existing Tesco stores cannot conform to the company's present superstore development criteria, they are nevertheless very successful. ... From time to time a store inevitably becomes uneconomic and it is sold for redevelopment or to be occupied by another trader" (Annual Report 1985: 8). The rationalisation and refurbishment programme was continued. Plans were also made to expand the operations of Victor Value. "Victor Value improves slowly but surely and we look forward to its making a relevant contribution to our business" (Annual Report, 1985: 4). To provide funds for the development programme, a £145 million right issue was launched in April 1985.

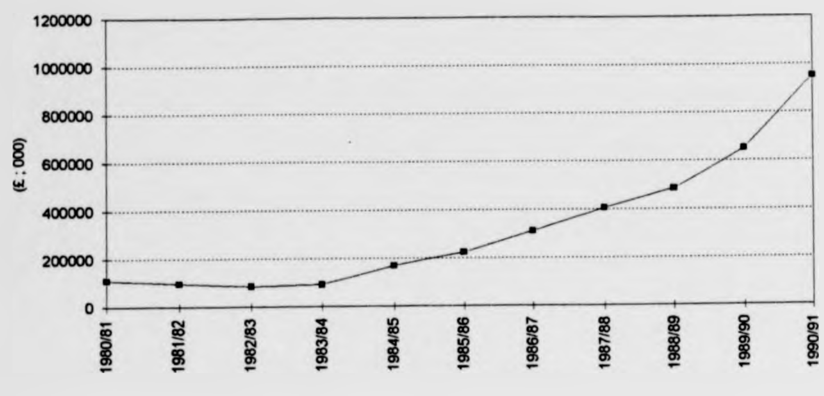
11.2 1985 - 1990/91: The Superstore Development Phase

In 1985, Tesco's chairman, Leslie Porter, retired and Ian MacLaurin was promoted as the new executive chairman. David Malpas, previously managing director of 'trading', became the new group managing director. The changes in the executive board also brought about some marginal adjustments in the company's strategy. While the programme concerning the Tesco fascia remained the same - organic expansion - the company disposed of Victor Value and the Irish operation. Victor Value, which had

grown to 45 stores, was sold in February 1986 to Bejam Group for £5.25 million. "Victor Value, ... was moving further away from Tesco in terms of store image and market place identity. The sale reflects our resolve to concentrate on the mainstream superstore business" (Ian MacLaurin, Annual Report, 1986: 4). The Irish Operation was sold in May 1986 "because this business was not fulfilling our expectations and continuing losses left us with no alternative but to withdraw from this market, which is currently overprovided with food retailing space" (Ian MacLaurin, Annual Report, 1986: 4-5).

In the years that followed, Tesco continued to expand. In 1987, Tesco acquired Hillards, a grocery chain based in Yorkshire. In the following years, plans were regularly revised and expanded: "contrary to the general market fears of saturation, all our detailed research has led the Board to conclude that there is substantial profitable opportunity for new superstores and so our development program is being increased to 790,000 sq. ft in 1989/90, and we envisage at least this level in 1990/91" (Reid, Finance Director, Annual Report 1989: 7). The decision to further expand the activities was reinforced by the success of large out-of-town stores, which achieved, on average, higher sales per square foot than stores in city centres. This combined with a better margin mix and the economies of scale, produced higher net margins: "currently, our conforming stores, including new space, are producing a net margin of around 9%. The higher margins are required to provide good return on the substantial cost of investing in today superstores in terms of site cost, building, quality fixtures and fittings and extensive customers facilities" (Reid, Annual Report 1990: 9).

Graph 11.2 Tesco: Capital Expenditure 1981 - 1991



Source Based on Data from Tesco Annual Reports

Between 1985 and 1991, Tesco invested £3.03 billion in new stores, technology, own-label products and distribution systems. Capital expenditure achieved the maximum level of £952 million in 1990/91 (it was £170 million in 1984/85). In the same period, total sales area grew from 7.4 million square feet to 9.7 million square feet. The number of outlets reduced to 384 but average size was around 23,300 square feet, more than double the size they had in 1980 (11,250 square feet). New stores were profitable in their first year of trading, and on maturity, they were showing higher operational and financial results in terms of sales and return on capital. Internal re-organisation of functions, investment in technology and distribution significantly increased productivity. The investment programme was financed by a mix of financial tools such as internal resources, convertible eurobonds, a loan from a syndicate of banks and sales of some property development to property companies with a leaseback formula. Tesco's operating margin went up to 6.24% in 1990/91.

In the second half of the 1980s, Sainsbury maintained its leadership terms of sales[2]. Concentration within grocery retailing continued to increase. This was partly due to the take-over of some companies within the industry but also to the large expansion programmes of most large operators within the industry. A more liberal attitude to large shopping developments was taken by planning authorities from the end of 1985, which supported this trend. Competition within the industry remained tough but it was mainly on criteria other than price. Quality, choice and services had moved to the top of consumers' list of priorities. Sainsbury and Safeway (which had become an important player since it had been taken over by Argyll) were perceived by most to be a better brand and had a better customer profile. However, Tesco was narrowing the gap.

11.3 1991/92 - 1994/95: The Turbulent Years of Food Retailing

In 1990, some of Tesco's main competitors were in trouble. Gateway had been taken over by Isosceles and was struggling under a high debt burden. ASDA was also having problems in getting over a large acquisition of Gateway's superstores and in changing its own market position. In January 1990, Verdict Research, the retail consultant, published a report affirming that price competition was unlikely in the near future. Only Sainsbury and Tesco would have had any chance of fighting a price war. The focus was to stay on quality rather than price. However, things began to change over the next few years.

[2] Sainsbury had a smaller sales area than Tesco but higher sales per square foot.

In 1990, the British economy started to slow and in 1991 went into recession. This was to become the UK's worst recession of the post-war period and lasted for a much longer period than expected. The UK only came out of the recession in 1994. Food retailing had traditionally been a recession-proof sector. Tesco's management was initially confident about the company's future prospects: "despite the economic climate, and lower food price inflation, our food sales are holding up well and we are maintaining our real volume growth.' ... 'no business can be totally immune from the changed economic climate and our management will be facing this challenge during the year" (MacLaurin, Annual Report 1991: 5).

As recession hit the economy, prices of property, after booming in the second half of the 1980s, quickly went into decline. However, this was not the case for sites suitable for superstore developments, which remained high because of competition among large supermarket operators to acquire prime sites. In 1992, concern was expressed over the increasing prices being paid for new sites. In May 1992, WM. Morrison announced a significant change to its accounting policies by depreciating its land assets. This came as its management recognised that the alternative use value of its sites might be much less than for purposes not related to food retailing.

In the meantime, a number of 'hard' and 'soft' discounters (Aldi, Netto, Ed) had entered the UK grocery retailing market. Their entry was not, however, seen as posing a particular threat to large retailers operating at the higher end of the market: "We welcome the advent of Aldi and others to come. We can live quite happily in our part of the market and they can live in theirs" (Malpas, Tesco's Managing Director, from The Financial Times, 20/09/90: 28).

Tesco's Strategy

In the early 1990s, Tesco's strategy remained the same - expansion within grocery retailing: "there is no sign at the moment of this so-called saturation level. We have scanned the whole of the UK a few months back and found that there were in excess of 200 sites we would like to trade from. There is still enough opportunity for the foreseeable future" (MacLaurin in The Financial Times, 20/09/90: 28). In May 1990, Tesco bought three superstore development sites from ASDA. In January 1991, Tesco made a right issue of £572 million: "The size of the issue is to take account of the expansion of our existing businesses. We have no current plans to diversify" (MacLaurin in The Financial Times, 30/01/91: 1). The company planned to open 2.35 million square feet of new selling space between 1991 and 1993, requiring an investment of circa £1.4 billion. "It is our policy only to develop quality sites which can deliver significant returns on investment. The return on capital being achieved in our conforming stores continues to underpin our substantial investments programmes and demonstrates our view that there is an adequate supply of potentially profitable sites for the foreseeable future" (Annual Report, 1991: 6). In 1991, Tesco opened its two-hundredth superstore. However, the company was expected to look for alternative solutions in the market. "Britons now live, on average, only 11 minutes from a decent-sized supermarket; 90% of the population live within 10 minutes of a Tesco store; 73% within 15 minutes of a Sainsbury" (The Economist, 13/06/92, 323). Going back to city centres was seen as a viable strategy as relative costs of running high street food stores were again becoming favourable. Changing trends in demographics and travel, the growing importance of offering frequently purchased fresh foods and the current availability of cheap sites were elements adding to this trend. In June 1992, Tesco opened its first 'Metro' shop, in Covent Garden. Metro was a format designed to meet the needs of city-centre shoppers.

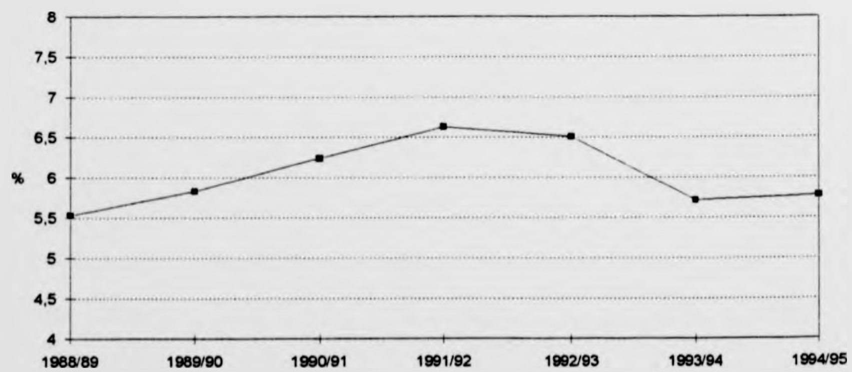
Change in Strategic Direction

In 1992/93, sales on a like-for-like basis were down by 0.9%. The objective in the short term was to sharpen performance in existing stores through improved standards of service to customers, more attractive promotions, competitive prices and value for money. The expansion programme was to be kept at the planned levels. However, the financial market and market research companies were sceptical about maintaining similar expansion plans: "Retailers will have to restructure their businesses to cope with a permanent era of low margins, according to a report from the Verdict retail consultancy. The report sees weak demand and overcapacity continuing to depress the sector's profitability for the foreseeable future" (Thornhill, The Financial Times, 23/10/92: 14). In January 1993, a report by Verdict Research stated that supermarket operators were building outlets more quickly than the grocery market was expanding. In March 1993, rumours spread in the market that CostCo, the third largest US Warehouse Club operator, had obtained two sites in the UK. In May 1993, Gateway launched a 'Price Check' campaign that signalled a repositioning on price. According to Verdict Research, growing competition from discount operators was leading to lower retail food prices in many parts of the country. Tesco launched 'Tesco Value' a cut-price own label in August 1993, covering 70 products, which was to replace tertiary brands. Its purpose was "to more effectively communicate the value Tesco has always given" (Leahy, Tesco Marketing Director, The Financial Times, 03/08/93: 6). In September 1993, Tesco's half year results were disappointing, with lower than expected profits and lower

margins. MacLaurin acknowledged, for the first time, the growing threat posed by discount operators. He also acknowledged that Tesco had not promptly reacted to the recession, nor had it recognised the different aspirations of its customers. Tesco's repositioning on price opened a gap of four to five percent on basic products between it and competitors such as Sainsbury and Safeway. Compared to the main competitors, Tesco was more exposed to sales of low-margin petrol and non-food items such as clothes. Its stores were located in some of the economically worst hit areas of the country. At the same time, Tesco's stores, compared to its main competitors, had been more expensive to develop and they were producing lower return on capital invested. "We have more customers in the younger age groups - between 25 and 40 - who by and large have been affected worse by the recession than senior citizens" (McLaurin, Tesco's Chairman, The Financial Times, 23/09/92: 23). The long-term perspective did, however, remain good. Hughes, analyst from Nomura said that: "If the economy begins to recover more quickly than forecast ... then Tesco will be one of the biggest beneficiaries in the foods sector" (The Financial Times, 23/09/92: 46).

In November 1993, Sainsbury followed Tesco by indefinitely cutting the price of 300 of its most popular own-label products. In December 1993, Argyll announced cuts in capital spending, store expansion and a new accounting policy that depreciated buildings at a rate of 2.5% per year. In January 1994, Tesco announced a review in its plans. Changes mainly concerned superstore development plans: "It is widely understood that there is a diminishing number of profitable prime superstore sites available" (MacLaurin in The Financial Times, 20/01/94: 22). "We have carefully reviewed the prospects for superstore development in the light of changing trading conditions in the food retailing industry, the number of superstores opened in recent years by the major operators, and tighter planning policies. As a result, we decided to revise our forward programme and to increase our rate of re-investment in existing stores. In the UK we expect to open 821,000 sq. ft next year including 4 Tesco Metro stores in prime high street sites. We expect thereafter that the total will decrease to around 600,000 sq. ft in 1995/96 and 450,000 in 1996/97. At around 20 new stores a year" (MacLaurin, Annual Report, 1994: 2-3). Tesco also announced that it would change its amortisation policy and depreciate buildings over a 40-year period. The management recognised that it had paid 'premiums' for much of its land above its alternative use value and decided to amortise those premiums over 25 years. In February 1994, Tesco announced cuts of 800 full-time jobs in head office and distribution staffing in the following six months.

Graph 11.3 Tesco Stores: Operating Margin



Source Based on Data from Tesco Annual Reports

The repositioning on price, accompanied by an aggressive advertising campaign brought positive results. In 1993/94, operating margins went down from 6.51% to 5.72%, but the negative like-for-like sales trend had been reversed. "There has been fierce competition between the superstore majors as consumers have become more

demanding than ever about value for money. Price has become increasingly important as a competitive tactic as superstore operators have also sought to reduce or eliminate the price differential established by the discounters on a limited range of basic groceries" (Annual Report, 1994: 16).

<u>New Strategic Developments</u>

In the meantime, Tesco diversified abroad. In May 1993, the company acquired 85% of Catteau's capital for £158 million. Catteau was a family-owned company operating 90 stores in the Lille region (North East of France). Catteau had sales of £341 million. "We have been looking for a suitable European partner for some years. Catteau ... met our criteria. It is a successful food retailing company of the right size, with an excellent track-record of profitability and growth; it offers potential for further expansion; it has a strong management team in the Catteau family and the senior executives, who will continue to run the business; and Tesco will be able to offer the local management the benefit of our buying, distribution and systems skills" (MacLaurin, Annual Report 1993: 4). " 'Over the next months and years, we will get to know how a French retailer works,' says Sir Ian. ... According to Sir Ian, Tesco has been studying opportunities overseas for the past 5 years. After considering the US, he said, 'we favour the European route' " (De Jonquieres, The Financial Times 19/12/92: 7). In 1994, Tesco also acquired 57% of the capital of Global TH, a Hungarian food retailing company operating 44 stores in the North West of Hungary, at a cost of £15 million. Tesco had provided the company with technical and operational advice for over two years. By the end of 1994, Global TH opened its first 14,000 square feet store under the Tesco brand in Hungary. The plan was to open 20 supermarkets over the next five years. In

December 1994, the control of Catteau in France was brought to 100%. Investments had been made in centralised distribution, retail operations management, and systems development. Future plans for the French operations were to expand the scope of operations.

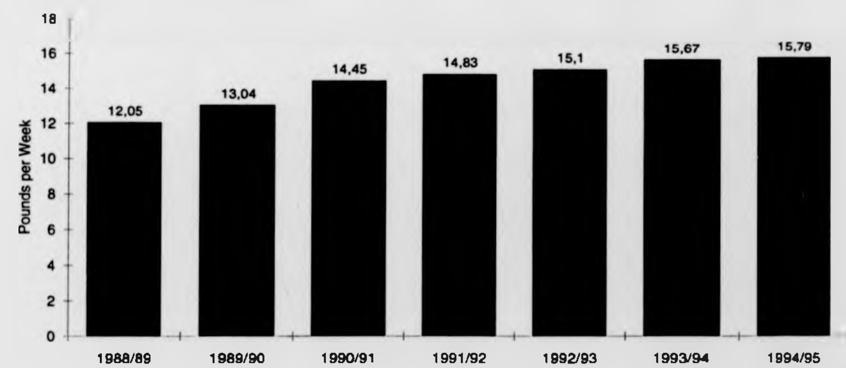
In 1994, the focus remained on price. The decrease in prices on basic products sold by supermarket operators had neutralised the discounters' threat. Still, an uncertain climate remained in the industry. In 1993, new recommendations were introduced for tighter planning permission on out-of-town developments. In a highly competitive market, grocery retailers needed to look for alternatives to expansion of out-of-town developments. Tesco had already been experimenting with a city centre retail format (Metro) since 1992. In April 1994, Sainsbury also announced the launch of a new town-centre format called Sainsbury's Central, designed to provide for convenience and top-up shopping. In May 1994, after the 'Superstore' and the 'Metro', Tesco experimented with a third format, 'Tesco Express', which consisted of stand-alone roadside petrol stations with 2,000 square feet convenience stores attached. Later in the year, Tesco also defined a fourth format, between the Superstore and the Metro formats - 'Compact', which was designed to offer the range of Tesco superstore products on a smaller scale.

In August 1994, Tesco took over WM. Low, a Scottish chain of 57 supermarkets, for £257 million. Tesco's acquisition came after the initial bid launched in July had been topped up by Sainsbury, forcing the management to further increase the price of its bid.

As the economy moved out of recession in 1994, Tesco's performance improved considerably. Aggressive marketing campaigns brought positive results and like-for-like

sales grew at a faster rate than inflation and competitors. By the end of the year, Tesco management had regained its confidence. "I believe that these results show that there is still much scope for growth in food and grocery retailing in the UK for those who read market trends accurately and trade flexibility" (MacLaurin, Annual Report 1995: 2). Tesco had identified 80 potential sites in the UK for its Metro stores and estimated that 30% of grocery spending was still in high-street shops. "That is clearly an opportunity for us. We have the technical skills to run quite small stores profitably now" (MacLaurin, The Financial Times, 04/08/94: 15).

Graph 11.4 Tesco Stores: Sales per Square Foot 1989 - 1995



Source: Based on Data from Tesco Annual Reports

11.4 Tesco and Food Retailing at the end of 1995

In February 1995, Tesco launched a card (Clubcard) nation-wide, giving special discount to regular customers. The scheme was strongly criticised by some of the main competitors as being a form of "electronic green shield stamp". However, its success meant that Sainsbury and Safeway responded with similar schemes in the following months.

In August 1995, expansion plans for Tesco Metro were enlarged as recently opened 'Metro' shops had performed successfully. In September 1995, it was also announced that Tesco was going to expand in Northern Ireland. A Tesco Metro was to open in central Belfast. This followed a similar move by Sainsbury in June 1995. In November 1995, Tesco also acquired, at a cost of £8 million, 79% of Savia, a Polish food retailer operating 36 stores, with a total selling area of 190,000 square feet.

In September 1995, half-year-results were excellent, with sales in the UK stores up by 25%, and volumes were up by 6%, more than Safeway's 4.7% and the 2.2% decline at Sainsbury's. However, a 0.3% decrease in the gross margin suggests that competition on prices was still on. In 1995, Terry Leahy, two years after joining the main Board as marketing director, became deputy managing director. Tim Mason was appointed as the new Marketing Director. At the end of the year, the future Tesco's board was announced. In 1997, Ian MacLaurin (chairman) and David Malpas (managing director) were to retire. Terry Leahy was to become Tesco's chief executive, and John Gardiner (deputy managing director) was to be appointed as non-executive chairman. Leahy had been appointed in October 1992 to strengthen the marketing function, which had been compared unfavourably by some critics to that of Sainsbury's. He had been behind the success of the Tesco Value brand, the Clubcard and other successful marketing initiatives.

Table 11.2 Tesco PLC: Financial and Operational Statistics 1994/95

Group Sales (£; 000; after taxes)	10,101,000
Pre-tax Profit (£; 000)	595,200
Contribution of Tesco to Group's Sales	95.6%
Contribution of Tesco to Group's Operating Profits	97.2%
Number of Outlets	519
Total Sales Area (sq. ft.)	12,641,000
Average Sales Area per Outlet (sq. ft.)	24,900
Market Position	medium-high
Market Share (1994)	19.1%
Own Label Share of Sales (1994)	56.1%
Information Technology	developed
Centralised Distribution	developed

Source: Various Documents

Tesco was one of the first companies to understand that changes in consumer behaviour, planning permission and city centres property prices were creating new possibilities in the market. With its four formats, catering for the different needs of customers, Tesco is also the only company with a fully articulated strategy to address new opportunities. However, as a typical Tesco Metro is only a quarter the size of a new superstore, moving back into the high street will not offer the same scope for growth as superstore expansion did in 1980s. Recent government regulations to discourage further out-of-town retail development have been criticised as they discriminate in favour of those already operating by sheltering them from fresh competition, whilst increasing threats for traditional city centre grocery retailers. Competition in the industry will remain tough in the next few years, especially given Argyll's divestment of Lo-Cost to concentrate on Safeway, and the successful comeback of ASDA. Recent Tesco success has mainly been at the expense of its main rival, Sainsbury. This indicates that if a gap between the two main companies in the industry still exists, it is not perceived by most of the consumers. In the next years, it will be interesting to see how Sainsbury will respond to Tesco's challenge.

Chapter 12 Discussion

12.0 Introduction

In Chapter seven, we analysed the changes that have occurred in the GRI since the end of the Second World War. Chapters eight to eleven described the strategies of the four largest firms operating in the UK GRI between 1980 and 1995. Having analysed the strategies of the four companies separately, the objective of this chapter is to discuss the two themes and research questions developed in Chapter five in the light of the information gathered through the empirical research. The first theme aims to analyse the mechanisms characterising the dynamics of industrial and business change. The second theme analyses similarities and differences among firms relative to a number of issues of importance to strategic groups' research. An important introduction to the discussion will be the following brief review of Lewis and Thomas' (1990) study of strategic groups in the UK GRI.

12.1 Strategic Groups Research on the UK GRI

This section analyses the content of an article published by Lewis and Thomas (1990)[1] on strategic groups in the UK GRI. This article contains the results of a typical strategic

[1] This research served as a basis for the development of other papers on strategic groups in the UK GRI (e.g., Carroll *et al.* 1992, Lewis and Thomas 1994; Carroll *et al.* 1994).

groups study. Therefore, it will be a useful basis for subsequent discussion of firms' strategies and industry structure in the GRI.

The objective of Lewis and Thomas' (1990) paper was to test the hypothesis that a relationship between strategic groups and financial performance exists. Three different techniques were used to identify strategic groups, reflecting the researchers' concern that findings in the existence of a relationship between strategic groups and performance may be equivocal because of the methodological techniques used. The UK retail grocery sector was described as "a static market where considerable consolidation is continuing to take place"[2] (387). The industry was chosen because although "dominated by a small number of large multiples, they differ from each other along a number of merchandise, store portfolio, and service dimensions. **We would therefore expect to be able to identify a number of distinct groups**" (387, emphasis added). The 1982-86 period "was chosen because it represented a stable strategic period" (ibid. 395).

Table 12.1 Strategy Variables in Lewis and Thomas' Research

Number of Stores
Average Size of Stores
Advertising Expenditure / Sales
Number of Food Lines
Proportion of Own Label Lines

Source Based on Lewis and Thomas (1990)

A distinction was made between multiples, independents and co-operatives, which, as we argued in Chapter seven, represents a customary way to distinguish firms in the industry. Lewis and Thomas specifically focused on the multiples, and in particular, on

[2] It can be noted that the term **static** is defined in the Collins English Dictionary as «not active or moving; stationary», and in management research is directly related to the market being in equilibrium. The latter is defined in the Collins English Dictionary as «any unchanging condition or state of a body, system, etc». These are two important conditions for the measurement of the relationship between strategies and performance.

the 16 largest retailers which formed about 60% of the sales of the industry. A number of variables representing firms' strategies were also identified (Table 12.1) and firms were clustered into groups. Various techniques were used to cluster firms (Table 12.2). The first technique used the "relative size" of a firm as a proxy for strategic group membership based on Porter's (1979) paper. A second used strategic dimensions reflecting "firms' scope and resource commitments" based on Cool and Schendel's (1987) paper. Initially, seven variables were identified, reflecting firms' scope and resource commitments. As high correlation was found between some variables, they were subsequently reduced to five variables (Table 12.1).

Table 12.2 Strategic Groups in the UK GRI

Clustering Approach Used	Results
Size (sales)	Marks & Spencer, Tesco, Sainsbury Dee, Argyll, ASDA Waitrose, Safeway, Kwik Save, Fine Fare, Iceland, Budgen, WM Low, Hillards, WM Morrison, Bejam
Five Strategy Variables	Marks & Spencer Argyll Kwik Save, Dee, Budgen Iceland, Wm Low, Bejam Hillards, Tesco, Sainsbury, Fine Fare Safeway, Waitrose Wm Morrison, ASDA
Factors	Marks & Spencer Dee, Argyll Bejam, Kwik Save, Iceland Budgen, Fine Fare, Wm Low Hillards, Tesco, Sainsbury, Wm Morrison Safeway, Waitrose ASDA
Discernible Strategic Groups	Marks & Spencer Dee, Argyll Hillards, Tesco, Sainsbury (Wm Morrison) ASDA (Wm Morrison) Safeway, Waitrose

Source Based on Lewis and Thomas (1990)

According to the clustering method used, Lewis and Thomas found that a number of companies changed their group membership (Table 12.2). However, "a core of stores occupying clearly distinguishable groups is discernible" (ibid.: 391).

Lewis and Thomas did not find unequivocal results about the relationship between strategic groups and financial performance. However, they argued that research should be extended longitudinally to allow for an examination of the difficulties firms may face in shifting strategic group membership. They specifically referred to Argyll and Dee Corporation. Argyll's acquisition of Safeway to augment its upgrading "will not involve the transformation of the newly acquired stores. There is thus less learning involved in Argyll's strategy. Argyll's strategy for moving up-market appears to be more soundly based than Dee's" (ibid.: 391). Furthermore, a longitudinal analysis would provide richer evidence of the extent of intra and inter group rivalry.

Within the context of this research, the analysis of Lewis and Thomas's (1990) paper aims to show the characteristics of a typical strategic groups piece of research which, in this specific case, has been made by using data related to the UK GRI. What emerges is that:

1. the focus was on the relationship between strategic groups and performance or the dynamics of groups' structures. The observable variables were deemed to be the determinants of firms' performance;
2. attention was on groups rather than on firms;
3. attention was on asset endowments deemed to represent firms' strategies; and
4. the industry was seen as static and in equilibria.

In the following sections, we discuss the questions outlined in Chapter five, given the information gathered through the empirical investigation.

12.2 Theme 1: Analysis of the Mechanisms Characterising the Dynamics of Industrial and Business Change

12.2.1 Question 1 How do changes in firms' strategies relate to changes in the industry structure? Are firms responsible for the process of change or do they react to changes in the external environment?

Strategic groups theory is silent on the origins of changes in competitive structure. This question aims to provide an in-depth examination of the characteristics of strategic change in the industry. The objective is to understand the characteristics of industrial and business change, to see how industrial change relate to business change, and to understand the relationships between firms and the external environment.

In management research, there has been a long debate about the role of strategy choice versus environmental determinism. We want to understand to what extent the external environment influences firms' strategies and how firms influence the external environment. However, it will also be important for understanding the synchronism existing between industry and firms' strategic changes. This will enrich our understanding of the relationships existing between the strategies of firms competing within a similar environment.

In the following section, we analyse this issue by looking separately at changes in industry structure and firms' strategies. This is the basis for a further analysis of the relationships between firms' strategies and industry structure.

12.2.1.1 The Dynamics of Industry Structure

In traditional strategic groups research, the structure of an industry is seen in equilibria, broken at some points in time when changes in the structure of the industry take place. Our analysis indicates that the dynamics of firms' strategies and industry structure are characterised by the existence of simultaneous continuity and change. Our approaches to strategy analysis are wrong in dichotomising continuity and change. We can see much continuity in the analysis of firms' strategies and industry structure and indeed many important elements remain important over time. However, there is also continuous change taking place in the industry structure as well as in firms' strategies.

In the analysis, we noticed how important changes have taken place in the structure and nature of the industry. We have seen how, since the end of the Second World War, the number of grocery retailers and grocery outlets has been continuously decreasing. We have progressively passed from an industry composed of firms mainly offering dry food products to customers to an industry composed of firms offering a wide range of food, household products and other services. Thus, the traditional distinction between grocery retailers and other food retailers has progressively diminished in importance.

There has always been a differentiated approach to retailing. In the past this took the form of specialist shops (butchers, greengrocers, bakers, etc.) and grocery shops. Today,

differentiation has changed. With the transition from specialists to large multi-product retailers, retailing has lost, to some extent, its character of specialisation and differentiation. However, more differentiation exists in the grocery category, which encompasses retailers in the corner shop to those of the hypermarket. The development of superstores and hypermerkets has brought more differentiation in terms of store choice within the grocery category. Furthermore, the expansion of store size has created the condition for more differentiation in terms of product ranges.

However, there has also been continuity in the importance of some characteristics of industry structure. Retailers still perform their retailing function in a similar way. Customers visit a shop where they can choose among a variety of products and the retailer's role is to maximise sales (and profits) by attracting the highest number of customers. This is done through the combination of a number of marketing variables concerning location, price, choice, ambience, and services.

Another element of continuity concerns the distinction between multiples, independents and co-operatives. According to this classification, important distinctive elements can be identified. Co-operatives have institutional characteristics that considerably influence the dynamics of their strategies. Co-operatives operate under statutes that state saying that they are not profit-making companies. They are not quoted on the stock market and cannot raise external funds in the same way as other quoted companies. It is therefore possible to say that this classification still distinguishes important differences among retailers.

We can therefore see how the dynamics of the industry structure are characterised by contemporaneous continuity and change. Changes in the characteristics of the industry have been progressive rather than immediate.

In the analysis, we have identified a number of elements that play an important role in the changes occurring in the industry structure: firms' strategies, consumer markets, legislation and technology. In the following sections, we assess the relationship between changes in these variables and industry change.

12.2.1.1.1 The Role of Firms' Strategies on Industry Changes

The GRI is characterised by a stable consumer market, with expenditure on food not growing significantly since the 1960s. In a stable market, companies have few strategic options: divestment, price competition, market growth and market penetration. Large grocery retailers do not want to compete directly. In a mature market, this would lead to price competition and take profits away. Price competition in the multiple sector is a short-term strategy aimed to increase sales. Examples are the price campaigns of Tesco in the late 1970s and early 1980s. Market growth is a difficult strategy to follow, given the trend towards controlling our diets and eating out. Firms' strategies are generally aimed at penetrating their market geographically as well as at expanding their range of products and services.

Large multiples have followed, over the past two decades, a geographic flanking strategy (Duke 1991). They have expanded the geographic scope of their operations and taken market share away from weaker companies. Large companies have competed indirectly by opening new stores where weaker companies were present. This is clear if

we consider that large multiples all have had positive "like-for-like sales", which would not occur if these companies were competing directly. Sometimes large retailers have entered in price competition. However, because this is an unprofitable option, no operator in the industry has an interest in price competition, especially in a situation where large retailers are still growing. For a long time, there have been rumours of saturation in the industry but until newly established shops are profitable and like-for-like sales for most large operators are positive, companies will continue to build new stores. Positive like-for-like volume sales are an indicator for large retailers that cannibalism does not exist among large operators and that they all take sales from smaller retailers.

The obvious victims of expansion strategies by a number of retailers have been weaker retailers, specifically independent retailers, whose share of the market has been constantly decreasing. Co-operatives have also been the victims of multiples' strategies. The effects have been slow because the market is geographically dispersed and population is sparsely distributed.

Firms' strategies have, therefore, influenced the industry structure. However, there has also been an impact on the nature of the industry. Large companies have also pursued a strategy that aims to expand the ranges of products and services available to customers. In this way, they have enlarged the basis of competition among retailers. They have, therefore, developed an element of differentiation. This has been possible because of the progressive development of large supermarkets and superstores located on edge-of-town sites, providing shoppers with all the services they need in a specific place.

12.2.1.1.2 Consumer Market, Firms' Strategies and Industry Change

In order to understand the changes in the industry, it is also necessary to look at the role played by the consumer market and by the changes in the consumer markets.

By looking back at some characteristics of British society in the 1950s and 1960s, we can understand and justify the structure of the industry at the time. In 1960, 99% of households used to shop once a week, and of these, 23% went everyday and another 36% twice a week (Economist Intelligence Unit 1961). Thus, almost 60% of population were food shopping at least twice a week. By 1969, only 61% of British Households had a refrigerator (Retail Business 1973), which meant that food had a short life and shopping had to be done often. Only 58% of households owned a car, driven by men, while shopping was done by women. Therefore, it is not surprising that retailing was concentrated in city centres where it was easily accessible for consumer[3]. Over the past 30 years, the consumer market has significantly changed. Refrigerators, microwaves, deep freezers and cars have become widespread facilities. There has been a shift towards equal roles for women and men. The result has been that shopping has significantly changed. Consumers tend to go shopping less often and spend more. However, there has also been a shift towards convenience food. "Time pressures have ... resulted in consumers wanting to spend less time shopping and to do it less frequently. Greater affluence enabled consumers to buy refrigerators and freezers, which enable to store foods longer and reduce the need to do a daily shopping. For

[3] In commenting a study made by Fine Fare on the relationship between distance travelled and turnover at the Fine Fare superstore in Aberdeen, Retail Business argued: «It is noteworthy ... that around half (56%) of the Aberdeen store's turnover derives from an area within walking distance of the store. If at all representative, this factor would seem to indicate the value to superstores of a heavy local resident population within their inner catchment» (Retail Business 1973: 26). We also note that 74% of household shopping at the store were within a three miles distance from the superstore.

packaged groceries, weekly shopping has become the norm, with more affluent shoppers tending to shop even less frequently for basic items" (AGB 1996: 7).

From the analysis of changes in the consumer market, two interesting elements emerge for the analysis of the dynamics of firms' strategies and industry structure in the GRI.

- First, the analyses of changes in the consumer market are necessary conditions to explain how and why multiples with their strategies have taken market share away from other retailers and why the industry structure has changed over time.
- Second, clear advantages for multiples did not exist *a priori*. If this were the case to start with, then changes would have happened instant. The reality is one of "becoming" rather than of "existing". Multiples have become important because of the combination of their strategies and changes in the consumer markets; multiples were not important to start with.

12.2.1.1.3 The Dynamics of Industry Structure and Governmental Policies

The analysis also indicates that government intervention had an important effect on the dynamics of the industry structure.

In the 1960s, the abolition of the Retail Price Maintenance (RPM) created the possibility for companies to adopt a differentiated approach to price. Thereafter, companies were able to develop their strategies based on a policy of price differentiation. Public policies in 1985 and 1993 contributed first to the development and later to the restriction of edge-of-town developments. The most recent guidelines protect operators that, over the past years, developed a consistent network of superstores but not companies that have traditionally been operating in city centres. Following the sharp decline in city centre developments, large operators have been re-discovering, since the early 1990s, the potential for doing business in city centres.

Government policies have therefore created asymmetries in competition, with city centres operators unable to invest in edge-of-town development, while edge-of-town operators are able to do so in city centres.

In the 1970s and 1980s, retailing in city centres had become very expensive because of planning permission constraints and high competition for the best sites. This is why companies pushed for a relaxation of planning permission. However, competition between companies for the best edge-of-town sites and falling prices for city centre commercial property (resulting from the decline in the number of companies and stores operating in retailing, as well as from the migration to edge-of-town stores), means that the gap between city centre retailing and edge-of-town superstores significantly narrowed in the 1990s.

However, if governmental policies affect the dynamics of the industry structure, firms also play an important role in the process that leads to the decision to be taken. The adoption of government policies followed a long period of public debate about the usefulness and the implications of the above-mentioned policies. This was the case for the abolition of the RPM, as well as for changing planning permission policies. Companies and lobbying groups have exerted significant pressure on government. In both cases mentioned above (RPM and liberalisation of planning policies), there has been pressure from companies.

In 1961, Tesco put the price of "Bex Bissell Shampoo Master" below the resale price. British Xylonite, the manufacturer, took legal action. Tesco restored the resale price, but with a poster-sized apology to customers:

Figure 12.1

BEX BISSELL SHAMPOO MASTER	
Because the manufacturers have taken legal action to maintain resale price	
You Have to Pay	67/6
They Only Cost Us	36/-
Showing 87.5% Profit Equals	31/6
Our Price was only 47/6, Saving You	£ 1
This is What RPM Means to You!	

(Source: Powell 1991: 99)

These campaigns were widely publicised in the media, creating awareness of the existence of the issue, which was later addressed by the government.

Another important example of companies influencing government policies occurred in the early 1990s. At the time, some warehouse club operators were investing in the UK. CostCo got planning permission for the development of a warehouse club. Tesco, Sainsbury and Argyll got together and went to court arguing that warehouse club operators received their planning permission as wholesaling operators. Hence, they could not retail to mass consumers. Alternatively, they had to be considered as retailers and therefore needed to go through the lengthy procedure of obtaining planning permission characterising grocery retailers. The result was that warehouse clubs could only have a percentage of their sales going to the mass consumer market (25%).

12.2.1.1.4 Technological Change and the Dynamics of the Industry

By looking at the characteristics of the UK GRI, we cannot say that it has been characterised by significant technological breakthrough. Although, experiments have been undertaken in relation to the development of home shopping through computer terminals, retailing is still characterised by customers visiting a shop and choosing what to buy among a variety of products. However, retailing has significantly changed as a result of technological innovations that have been developed in other sectors. Specifically, the development of the food processing industry has had important consequences for the development of convenience food that is distributed through the GRI. This has contributed to the development of the grocery industry at the expense of specialist shops. More recently, the development of Information Technology has also influenced the way of doing business within the industry. Retailers have a centralised control of the distribution system as well as of the sales of product, which has significantly affected internal operations as well as relations in the supply chain. These elements have played an important role on the dynamics of firms' strategies and industry structure.

12.2.1.2 The Dynamics of Firms' Strategies

Having analysed the characteristics of the dynamics of the industry structure, we now focus upon the characteristics of the dynamics of firms' strategies.

In strategic groups analysis, strategies are seen as static. When analysed longitudinally, firms' strategies are in equilibria with the industry structure. When the equilibria end, firms change their strategies.

In the analysis of the characteristics of the industry structure, we have argued that continuity and change have been characteristics of the UK GRI. The same can be said about firms' strategies. What emerges is that in the analysis of firms' strategies we can always identify these two interconnected elements of continuity and change.

Tesco and Sainsbury's are of the four companies analysed those with the longest history in the industry. In the period considered, they have remained market leaders. In the 1980s and, to a lesser extent, in the 1990s, they have continued their programmes of replacing old, smaller stores with larger retail units. Hence, it is possible to identify important elements of continuity in the strategies of Tesco and Sainsbury. However, it is also possible to identify important changes in their strategy. Both companies have significantly increased their total sales area and the geographic scope of their operations. While at the beginning of the 1980s, Tesco and Sainsbury were mainly operating through a network of small city-centre supermarkets, by the mid-1990s, both had a network of large supermarkets and superstores located in city centres and edge-of-town locations. The larger sales area of their outlets also enabled them to expand their range of products. We can therefore see continuity and change in Sainsbury and Tesco's histories.

Table 12.3 Argyll, ASDA, Sainsbury, and Tesco: Financial and Operational Statistics in 1980 and 1995

	Argyll	ASDA	Sainsbury's	Tesco
Group Sales (000)				
1980/81 (aft taxes)	102,000	1,188,000	1,531,200	1,820,656
1994/95 (aft taxes)	5,814,600	5,285,300	11,357,000	10,101,000
Pre-tax Profit (000)				
1980/81	1,600	51,389	62,025	35,591
1994/95	375,300	246,200	808,200	595,000
Number of Outlets				
1980/81	0	78	Sainsbury's 237 Savacentre 4	554
1994/95	Safeway 378 Presto 169	203	Sainsbury's 355 Savacentre 10	519
Total Sales Area (000 sq. ft)				
1980/81	0	2,604	Sainsbury's 2,978 Savacentre 275	6,840
1994/95	Safeway 8,278 Presto 1,038	8,210	Sainsbury's 9,338 Savacentre 864	12,641
Average Sales Area per Outlet (sq. ft)				
1980/81	n/c	33,385	Sainsbury's 12,570 Savacentre 68,750	12,347
1994/95	Safeway 21,900 Presto 6,100	40,400	Sainsbury's 26,304 Savacentre 86,400	24,900 (exc. Metro and Express Stores)
Market Position				
1980/81	n/c	Discount	Sainsbury's (high) Savacentre (high)	Low
1994/95	Safeway (high) Presto (medium)	Discount	Sainsbury's (high) Savacentre (high)	Medium / High
Market Share				
1980	n/c	8.4%	12.5%	13.4%
1994	10.8%	10.7%	20.6%	19.1%
Own Label Share of Sales				
1980/81	n/c	Marginal (7.0%)	Important (54.0%)	Marginal (20.0%)
1994/95	Important (51.5%)	Medium (40.5%)	Important (65.8%)	Important (56.0%)
Centralised Distribution				
1980/81	n/c	No	Developed	No
1994/95	Developed	Developed	Developed	Developed
Information Technology				
1980/81	n/c	Little	Developed	No
1994/95	Developed	Developed	Developed	Developed

Source Based on Various Documents

The same can be said about ASDA. If we look at the average sales area of retail units at the beginning and end of the period (Table 12.3), what emerges is that ASDA has maintained its focus on large retail units and has expanded the total sales area and number of retail units. The company has also maintained its traditional focus on the discount end of the market. However, having analysed the history of the company in Chapter nine, we know that ASDA has gone through two large programmes of change, it would actually be more appropriate to speak of several changes. In the early 1980s, after 15 years of continuous expansion, a new managing director was appointed and there was a change in the strategy at the business level. The main objective was to maximise profitability. The new managing director did not believe that the company could play an important role in the GRI and the expansion programme was slow. In 1984, a new managing director for the ASDA Stores business unit was appointed, who stressed the importance of expanding the geographic scope of the activities and the need to change the market position by following what Tesco had done. In 1985, the group merged with MFI, but two years later, the company de-merged from MFI and set up its strategy looking firmly at the GRI. In 1989, the company acquired 60 Gateway stores. In 1991, the chairman and chief executive resigned after a series of profit warnings. In autumn 1991, the new chairman and chief executive were appointed and the company initially put a halt to the expansion programme and decided to re-focus on the discount end of the market. In 1995, the company announced a new expansion programme.

What we see is a succession of relevant events characterising the history of this company within a relatively small span of time. These changes have had real impact on the company's performance and its competitiveness in the market. However, these changes have occurred amid elements of continuity resulting from past strategy, enabling the company to go back to its roots - as a discounter - in the early 1990s.

Changes are even more evident for Argyll, which came to exist in 1977. The rapid growth within a small period tends to highlight change rather than continuity. However, there is continuity as the senior management has been there since the company's inception, and before going into this venture, had important experience in the GRI.

We can therefore see the issue of continuity and change. However, but this will be addressed in more detail in the following section as we analyse the relationship between strategy stocks and strategy flows.

12.2.1.2.1 The Dynamics of Firms' Strategies: Strategy Stocks and Strategy Flows

In Chapter four, we argued that no distinction had traditionally been made in strategic groups analysis between asset endowments (strategy stocks) and firms' strategic investments (strategy flows). Having analysed the strategies of these four companies, we believe this is an important distinction for the analysis of the dynamics of firms' strategies, and specifically, for the analysis of the issue of continuity and change.

Firms' asset endowments represent the "hard" part of firms' strategies and from the part where it is possible to identify the continuity of firms' strategies. Strategy flows represent the dynamic part of firms' strategies. They represent the changing part of firms' strategies.

The analysis of Tesco's strategy in the period considered, indicates how important can be to distinguish between the two issues. In the late 1970s, Tesco wanted to change its

position in the industry and its way of doing business. To achieve this objective, changes were needed in the store portfolio, the company's support activities and its approach to customers.

In the analysis of elements such as the average size of Tesco's retail outlets in the early 1980s, we can see an element of Tesco's strategy stock. By analysing the investments made (e.g., the new sales area opened and the average size of new retail outlets), we can see an element of the strategy flow (the changing element). By then comparing the average size of the new retail outlets in year (x) with the average size of outlets in the year (x+1), we can see the small impact that the strategy flow had in that specific year. However, the continuous amount of investment made over a longer period of time eventually led to significant changes in the strategy stocks (Table 12.4).

Table 12.4 Tesco Stores Statistics

Year	Total Sales Area (sq. ft.)	Number of Stores	Average Store Size (Sales Area) (sq. ft.)	Sales Area Opened in the Year (sq. ft.)	Average Sales Area of Stores Opened in the Year (sq. ft.)	Number of Stores Opened in the Year
1979/80	6210000	552	11250	524000	16500	32
1980/81	6840000	554	12347	747000	32500	23
1981/82	7203000	544	13241	532000	31000	17
1982/83	7425000	489	15184	584000	33400	17
1983/84	7362000	461	15970	241000	25300	9
1984/85	7415000	441	16814	352000	36800	9
1985/86	7502000	395	18992	568000	37100	15
1986/87	6997000	337	20763	432000	34900	12
1987/88	8220000	379	21689	582500	34300	17
1988/89	7986000	374	21353	557500	34800	16
1989/90	8442000	379	22274	757000	34400	22
1990/91	8956000	384	23323	831000	41550	20
1991/92	9661000	396	24396	950500	39600	24
1992/93	10352000	412	25126	859000	34400	25
1993/94	11006000	430	25595	790000	30400	26
1994/95	12641000	519	*24900	**830000	25150	33
1995/96	13397000	545	*25600	**673000	29300	23

Note: * = Excluding Metro Stores; ** Excluding Tesco Express

Source: Tesco Annual Reports 1988-1996

In relation to strategy flows, we have to bear in mind that what we see *ex-post* is only the final result of the dynamic part of firms' strategies. Mintzberg's model (which represents the difference between intended and realised strategy, with part of the strategy being abandoned and an emergent part) well describes the dynamics of the strategy process (Figure 12.2). In the analysis of Tesco's history we have seen how, at the beginning of the 1980s, the management aimed to increase the sales area by a much higher rate than it actually did. A part of the plan had to be revised as a result of some emerging issues (high interest rates resulting from high gearing were depressing profitability).

Figure 12.2 Mintzberg's Strategy Model

Source Mintzberg and Waters (1982)

A complete assessment of changes in firms' strategies requires an analysis of both strategy flows and strategy stocks. Firms' strategy stocks have an important influence upon firms' strategy flows. The analysis of Tesco and Argyll is again indicative of this issue. Both companies had a network of small stores; although the companies aimed to have a larger network of stores, the existence of a number of small stores was critical

for Tesco's decision to set up of the Victor Value retail chain at the beginning of the 1980s, as well as to the launch of the Metro concept at the beginning of the 1990s. In the case of Argyll, the existence of a small network of stores was critical for the launch in 1985 of the Lo-Cost retail chain, as an alternative to Presto that instead was to make use of larger stores. Thus, we can see the important influence of strategy stocks upon firms' decisions. However, we cannot talk about past strategies determining future behaviour. If this were the case, we would not witness innovations in firms' strategies. Management plays an important role in defining the future direction and in adjusting the strategy based on new opportunities and threats rising in the external environment[4].

Finally, strategy stocks play an important role in the strategy process and their importance needs to be properly valued for the success of the change programme. ASDA had significant problems when attempting to change its market position. The reasons are various: management incompetence, competition and its asset endowments not reflecting the characteristics of the market it was targeting. ASDA superstores were positioned in relatively bad geographic areas. The company had a discount reputation among consumers. The management did not value properly the characteristics of the company's assets and changes in the external environment.

We have therefore seen the importance of distinguishing between strategy stocks and strategy flows, a distinction that stresses both continuity and change as intertwined elements that characterise the dynamics of firms' strategies.

[4] This is an issue that has already been addressed in management research in the form of the debate between strategy choice and environmental determinism. The dispute between Child (1972) and Aldrich (1979) is well known. In this context, we can say that the main problem lies in the dichotomization of the terms. In reality, decisions are the result of the history of the company, of the pressure from competition, and of management creativity. We may talk, instead, of constrained choice, where the ideas/direction developed by management about the company's future are constrained by past resources and by the external environment.

12.2.1.3 The Relationships between Changes in Firms' Strategies and Industry Structure

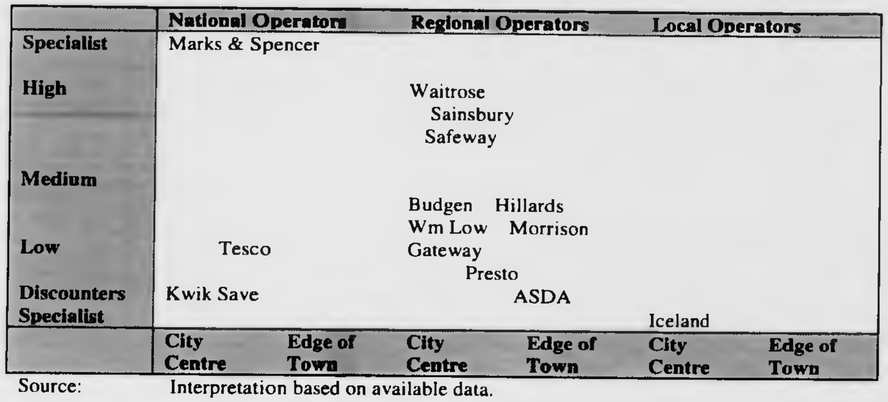
Having separately analysed the mechanisms characterising the dynamics of firms' strategies and industry structure, in this section we analyse the relationships between changes in firms' strategies and the industry structure.

It is possible to affirm that the existence of heterogeneity among grocery retailers linked to changes in the external environment and firms' strategies, continuously create changes in the structure of the industry. These changes threaten the position of established firms and create opportunities for other firms. There is, therefore, an interrelationship between changes in firms' strategies and industry structure. They influence each other; as this process occurs in time, it is difficult to establish a primary determinant (it is a bit like the question of the chicken and the egg).

The interrelationship between firms' strategies and industry structure is evident when we consider that in the 1980s, a significant number of large retailers tried to move to the higher end of the market by developing larger stores, offering services to customers and developing own-label products. Brand tends to be important and consumers tend to be more loyal, at the higher end of the market. Companies operating in this end of the market will be protected from potential entry, as new retailers do not have the consumer franchise and reputation of existing retailers. This is not the case for retailers operating at the discount end of the market where brand has little value and price is the most

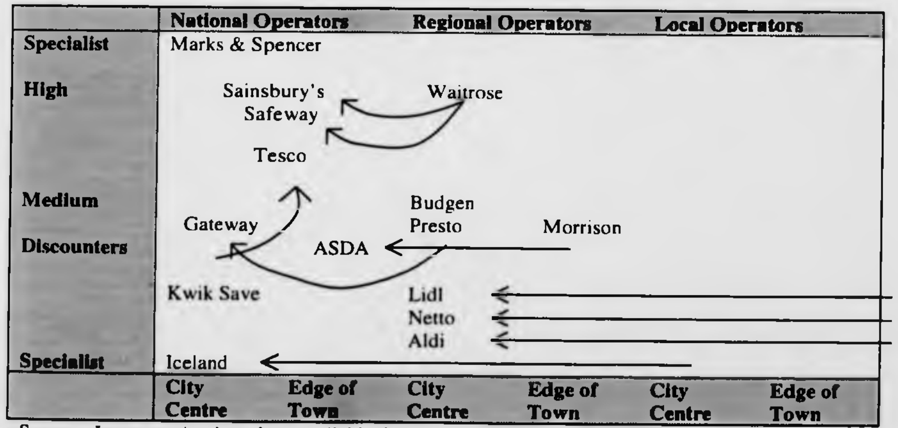
important variable. Existing companies are therefore under the threat of the development of new discount operators.

Figure 12.3 Retailers' Position in 1980



Source: Interpretation based on available data.

Figure 12.4 Retailers' Position in 1995 and Relative Changes compared to 1980



Source: Interpretation based on available data.

In pursuing their re-positioning strategies, companies closed city centre outlets and opened edge-of-town ones. Expansion policies of some companies had important consequences on the industry structure. Larger stores negatively affected small retailers;

this is clear when we consider the decline in their numbers of operators and outlets. However, new opportunities have also emerged for other retailers. The decline in the number of operators and the move to edge-of-town sites has created space for new discounters who have seen the possibility for profitable development in the industry. They have been helped in their strategies by the fact that the price of city centre sites decreased while that for edge-of-town superstores increased, thus contributing to level the price competitiveness between the two forms of retailing. The changes in the market position described here have also been described in research as the "wheel of retailing" (Markin and Duncan 1981).

Because of the interrelationship between firms' strategies and industry structure, it is therefore easy to explain the domino effect that has taken place at the beginning of the 1990s and to partly explain the difficulties that ASDA has had in changing its market position.

The domino effect of the 1990s was the result of an excessive gap between the average price of goods supplied by new entrants in the industry (hard and soft discounters) and the average price of goods supplied by extant companies. Companies positioned at the lower end of the market were affected first but as they adjusted to the new competitive climate, new differences emerged between them and other companies positioned in the higher end of the market. The re-positioning of companies continued until all the companies operating in the industry narrowed the gap.

ASDA had some problems in moving towards the higher end of the market because this part of the market had successfully been taken by other operators. At the same time, its

successful strategy of going back to its discounter image was also helped by the absence of similar retailers in the industry.

It is therefore possible to see how changing firms' strategies have had important consequences on a changing industry structure and have produced effects whose results could not have been foreseen. These effects affected the dynamics of firms' strategies. If a single firm had followed a strategy of edge-of-town superstore development, there would not have been major changes in the industry but as this policy was systematically followed over a long period of time by many companies and it was accompanied by a continuous decline in the number of retailers and outlets in the industry, some unbalances were created in the market, with opportunities for new companies to rapidly build a presence in the market, even in the presence of increasing concentration. In this context, a specific firm could be responsible for introducing an important innovation that starts a process of important change in the industry. However, that firm cannot completely control this change process, and at a later stage, may be a victim of it. Researchers are therefore wrong to dichotomise the issue of firms starting the process of change and reacting to external change. When analysed longitudinally, the same firm can be, over different historical periods, both an active and passive participant in the change process. In this context, the case of ASDA is particularly interesting.

ASDA went into grocery retailing in the mid-1960s, by developing a new retailing formula built around two concepts: one of superstore and one of discount. Around this formula, it established its success and developed. In the 1970s, the group continued to invest in the superstore business and was highly successful. However, in the 1980s, the group ran in difficulties as other companies were expanding their network of superstores.

Companies running into difficulties or stopping their development are a necessary requisite for change in the players operating in an industry. This is clear when we consider that firms established at different times have become important players in the UK GRI. Argyll went into the market in the early 1980s, at a time when many companies were willing to dispose of their interests in food retailing as a result of the strong price competition of the late 1970s, as well as because of the necessity for change in the nature of the service provided to customers.

12.2.1.4 Summary

Having analysed the issues in detail, we can briefly summarise the main research findings before moving to analysis around the second research theme. What emerges from the research is that:

1. The dynamics of firms' strategies and industry structure are characterised by two interconnected elements of continuity and change. It is not possible to say that firms' strategies and the industry structure are static or continuously changing. Continuity and change are two important interrelated characteristics of firms' strategies and industry structure.
2. Firms' strategies affect the dynamics of the nature and structure of the industry.
3. The dynamics of the industry and competition influences the dynamics of firms' strategies.

4. It is necessary to study longitudinally the changes in firms' strategies, industry, consumer markets, technology and government policies in order to understand the dynamics of firms' strategies and industry structure.
5. Strategy is a complex concept. By distinguishing between strategy flows and strategy stocks, intended and realised strategy, our understanding of its complexity and of its dynamics improves.
6. Top management, competition and firms' strategy stocks play an important role in the dynamics of firms' strategy flows.

12.3 Second Theme: Similarities and Differences among the Four Firms Analysed

The second theme of this research assesses the importance of similarities and differences among comparable firms operating within the industry. The existence of important similarities in firms' competitive positions in the industry is a key issue in strategic groups research.

Given Table 12.3, it is possible to start a comparative analysis of the four companies. By comparing the data for 1994/95 with that for 1980/81, it is clear that the four companies followed a strategy of market penetration. Their sales areas increased. In 1995, Argyll, ASDA and Sainsbury also operated more outlets than in 1981 while Tesco operated fewer outlets in 1995 but their average sales area was larger than in 1981. The trend has been towards larger retail units. Sales and profits have significantly increased, indicating that the expansion of these four companies has been profitable. Having given a brief overview of the four companies, let us now look at the similarities and differences that exist among them.

The analysis starts with Argyll, whose story appears particularly remarkable. At the beginning of the 1980s, Argyll was a small company, not involved in the GRI. Within 15 years, it has become the third largest player in the industry. In achieving this position, the strategic path which was followed was significantly different from the other three companies, especially in the first part of the 1980s when the company expanded through acquisitions [Sainsbury's expanded only through internal developments. Tesco made two acquisitions (however, their role has been marginal to the development of the company, the main source being internal development). ASDA developed internally but also made one big acquisition (the Gateway superstores from Isosceles)]. If a comparison is to be made, especially for the period between 1981 and 1987, the comparator for Argyll is Dee Corporation (previously Linfood and subsequently Gateway). This similarity between the two companies has also been noted by Lewis and Thomas (1990), who, in their study, clustered the two companies as part of the same strategic group. In the first half of 1980s, both companies were active buyers of businesses operating in GRI and within few years, they built a significant presence in the industry. However, significant differences also existed between Dee and Argyll. Soon after acquisition, Argyll's management restructured operations by eliminating the duplicate structures. In 1985, following its acquisition programme, Argyll announced an expansion programme and the decision to concentrate on two of the eight fascias that the company was operating. Dee Corporation continued its acquisition programme without rationalising its retail portfolio or eliminating duplicates in the organisational structure and functions. Dee was therefore operating with many

fascias. Synergies and economies of scale, which could have been achieved by centralisation of some functions, were not achieved. This was one of the elements responsible for the problems encountered by Dee in the second part of the 1980s.

In understanding the emergence and development of Argyll, it is important to analyse the management background of the senior executives. For a long period of time (over the 1960s and 1970s), Gulliver and Grant worked together at Fine Fare. They left in 1972 to found, together with David Webster, Oriel Foods, successively sold to RCA Inc. They got back to grocery retailing by buying back Oriel Foods in 1981. They were therefore very experienced in the GRI and had many contacts within the sector.

In the initial view of Argyll's management, the acquisition programme in the GRI ended in 1985. At the time, the objective was to strengthen the drink business. However, the failure to acquire Guinness in 1986 and the decision of Safeway US to sell its British subsidiary led to a change of strategy at the corporate level on what strategic direction to take. Subsequently, the company decided to focus its interests exclusively on food retailing and to sell its interests in the drink business and other retailing activities. Between 1987 and 1995, Argyll followed a strategy of internal development for its activities in the GRI. Thus, a second element of importance is that <u>in the strategy process, events external to the firm can lead to notable changes in the strategic direction of a company</u>. Some objectives may be abandoned as result of external events, while the rise of new opportunities also can bring changes in strategic direction.

At the end of 1995, Argyll operated in the industry with two fascias: Safeway and Presto. The first represents the core activity of Argyll, producing 86% of sales in

1994/95 and 91% of the operating profits. The analysis focuses therefore on Safeway. Safeway is positioned at the higher end of the grocery market alongside Sainsbury and Tesco. At a competitive level, there are many similarities between Safeway and Sainsbury. The two businesses have a similar total sales area, a similar number of retail units and their units are also similar in average sales area. However, Sainsbury produces much higher sales and profits.

Table 12.5 Safeway and Sainsbury's Supermarkets: Financial and Operational Statistics 1994/95

	Safeway (Argyll)	Sainsbury's Supermarkets
Sales (£; incl. taxes; 000)	5,325,500	9,597,200
Operating Profit (£; 000)	349,600	784,300
Operating Margin	6.56%	8.17%
Number of Stores	378	355
Total Sales Area (sq. ft.)	8,278,000	9,338,000
Average Sales Area per Stores (sq. ft.)	21,900	26,304
Market Position	High	High
Average sales per sq. ft (incl. taxes; £ per week)	12.37	18.53

Source: Based on Various Documents

Sales per square foot are an important element of difference between the two companies. At the end of 1995, Safeway achieved only 67% of what Sainsbury achieved from its sales area. Not surprisingly, the primary objective of Safeway was to increase its sales per square foot, to change its image among consumers from being a place where to shop for topping in the weekly shopping, to being a place where consumers would do their weekly shopping. This has not been an easy task, as David Webster argued during the interview: "learning how to trade superstores effectively, which is where we are now, is a more complex process than many imagine." On the

other hand, this was not as important to Sainsbury's management, whose main objective was to expand the geographic scope of operations. Therefore, we can identify two significant differences in strategic behaviour at the business level.

In order to understand the differences between the two businesses, it can be useful to analyse the histories and paths they followed after the Safeway acquisition in 1987. Until December 1986, Safeway had been the UK subsidiary of Safeway USA. Established in the mid-1960s, the company had been growing slowly in the early 1980s (Table 12.6).

Table 12.6 Safeway: Financial and Operational Statistics in the Five Years before the Acquisition

	1982	1983	1984	1985	1986
Sales (£ incl. taxes)	502 m	597 m	705 m	844 m	1,040 m
Operating Profit	16.3 m	22.8 m	26.3 m	28.8 m	41.5 m
Operating Margin	3.25%	3.82%	3.73%	3.41%	4.00%
Number of Stores	98	104	110	121	131
Total Sales Area (sq. ft.)	1,207,000	1,338,000	1,468,000	1,708000	1,946,000
Average Sales Area per Stores (sq. ft.)	12,316	12,865	13,345	14,116	14,855
Market Position	High	High	High	High	High
Average sales per sq. ft (incl. taxes; £ per week)	8.00	8.58	9.24	9.50	10.08

Source: Argyll Annual Reports

In January 1987, the business was sold to Argyll. Argyll was operating in the UK food retailing industry with two retail brands: Lo-Cost and Presto. Argyll's management decided that larger Presto stores would be operating under the Safeway retail brand. Some 160 stores were converted to the Safeway format; an expansion programme of building new stores was also set up for Safeway. After the take-over in 1987, management was mainly concerned with the conversion programme. Safeway stores were performing better than Presto stores, both in terms of sales per square foot and profitability (Table 12.7).

Table 12.7 Financial Statistics of Presto and Safeway Stores at the Time of the Safeway Acquisition

	Presto	Safeway
Annual Turnover	£5,500,000	£8,000,000
Weekly Sales per square foot	£6.50	£10.10
Annual Contribution to Profitability	£290,000	£510,000

Source: Argyll 1991

In order to explain the rapid expansion of Safeway in the late 1980s, it is necessary to consider that Argyll had an assets base that could be used for the Safeway format. It is difficult to explain the strategic dynamics of the Safeway business without making reference to the corporate strategy and the other retail fascias the company was operating. Having decided to convert a part of the Presto's stores into Safeway, the primary objective of Argyll's management was to ensure the smooth conversion of Presto's stores into the Safeway format and to further expand the Safeway network of superstores by building new stores. Since the end of 1985, it had become easier to build superstores following the clarification and simplification related to planning permission procedures. All the large retailers were rapidly strengthening their presence by building superstores. Expanding the geographic scope of operations and building new superstores was seen by Argyll's management as a valid way of increasing sales and profits. By expanding its presence in the market, the company also consolidated its position in the market and made entry less attractive to other firms. In 1993, Safeway started to lose sales to competitors (sales per square foot remained the same, but this does not consider inflation; Table 12.8), a worrying signal. In the meantime, the situation changed; it became difficult to get planning permission for new superstores.

The strategy review in 1994 indicated that the new priority of Safeway management was to increase sales.

Sainsbury, on the other hand, has traditionally had very high sales per square foot. The objective of Sainsbury management in the 1980s was to expand the scope of operations in the industry by building superstores in new geographic areas and by replacing smaller supermarkets with superstores. Growth had been slow but steady. Sainsbury management preferred internal expansion to acquisitions. Continuous investments were made in each of the areas that were reputed as important at the competitive level. The main challenge for Sainsbury in the 1980s was to transform itself from a city centre specialist operating at a regional level to a national retailer operating in city centres and edge-of-town sites without affecting its up-market image. The management managed this transition process very well. Sales per square foot had been slowly but steadily increasing in the same period.

Table 12.8 Safeway: Financial and Operational Statistics 1988-1995

Safeway	1988	1989	1990	1991	1992	1993	1994	1995
Sales (£; inc. tax; 000)	1,400,000	2,071,000	2,806,000	3,497,000	3,905,000	4,424,000	4,868,000	5,325,500
Oper. Profit (£; 000)	N/A	105,600	158,800	222,500	275,300	336,200	329,200	349,600
Operating Margin	N/A	5.10%	5.65%	6.36%	7.05%	7.60%	6.76%	6.56%
Number of Stores	176	240	291	310	322	345	365	378
Total Sales Area (sq. ft)	2,873,000	4,265,000	5,436,000	6,011,000	6,424,000	7,143,000	7,753,000	8,278,000
Average Sales Area per Stores (sq. ft)	16,324	17,771	18,680	19,390	19,950	20,704	21,241	21,900
Market Position	High	High	High	High	High	High	High	High
Average sales per sq. ft. (incl. taxes; £ per week)	9.37	9.47	9.91	11.19	11.69	11.69	12.07	12.37

Source: Argyll Annual Reports and Various Documents

Table 12.9 Sainsbury's Supermarkets: Financial and Operational Statistics 1988-1995

Sainsbury's Supermarkets	1988	1989	1990	1991	1992	1993	1994	1995
Sales (£; incl. taxes; 000)	4,421,100	4,903,600	5,644,800	6,515,200	7,347,900	8,276,900	8,864,600	9,597,300
Oper. Profit (£; 000)	276,000	341,800	409,000	515,700	603,800	715,900	697,000	784,000
Operating Margin	6.24%	6.97%	7.25%	7.92%	8.22%	8.65%	7.86%	8.17%
Number of Stores	283	292	291	299	313	328	341	355
Total Sales Area	5,463,000	5,964,000	6,434,000	6,951,000	7,632,000	8,303,000	8,827,000	9,338,000
Average Sales Area per Stores	19,304	20,425	22,110	23,247	24,383	25,314	25,886	26,304
Market Position	High	High	High	High	High	High	High	High
Average sales per sq. ft (incl. taxes; £ per week)	15.56	15.81	16.87	18.03	18.51	19.17	19.31	19.79

Source: Sainsbury Annual Reports and Various Documents

Having analysed Argyll, we now look at Tesco. Again, it is particularly interesting to compare Tesco's history with that of Sainsbury. In their analysis of strategic groups in the UK GRI, Lewis and Thomas (1990) classify the two companies as being part of the same strategic group. Our analysis shows that important similarities and differences exist between the two businesses:

- Sainsbury and Tesco have been, over the period, the two largest operators in the industry with similar market share, both at the beginning of the 1980s and by the end of 1995.
- Over the period, the two companies followed a strategy of market penetration whilst also replacing smaller units with larger ones.
- Both at the beginning and at end of the period, the two companies operated with stores of similar sizes.

- Of the four companies, Tesco and Sainsbury are the two oldest operators. In the 1970s, they had set up the policy of building larger units that enabled them to enlarge the product and service range offered to customers. However, at the beginning of the 1980s, the two companies still had a network of older stores that needed to be replaced by larger units.

In analysing the similarities in their investment strategy, the age of the two companies seems to be an important element for consideration. The oldest companies were traditionally city centre operators (in contrast to ASDA which started to operate in the mid-1960s and was always an edge-of-town operator), they therefore tended to have a network of smaller stores than some of the newer companies.

However, it is also possible to note important differences between Tesco and Sainsbury. At the beginning of the 1980s, Tesco had a much larger sales area than Sainsbury (which reflected its broader geographic scope of operations and its past strategy of aiming to be a national operator), but a much lower sales per square foot. Over the period under examination, these differences narrowed, but at the end of 1995, they were still important. It is not surprising, therefore, that following the readjustment of competitive positions in 1993, the priority for Tesco management was to increase sales whilst at Sainsbury the objective was to further expand the geographic scope of operations.

Further differences exist in the market position of the two companies. Sainsbury traditionally has had a quality image among consumers; Tesco used to have a low-price, low-quality image among consumers. In the 1980s, Tesco pursued a programme of change aiming at improving its image in the consumer market. Notable investments were made to support the new strategy: the development of quality own-label lines, better ambience in shops and services to customers. At the beginning of the 1980s, Tesco did not have centralised buying functions or distributions systems and little information technology. The company made many investments in these areas in the 1980s. Sainsbury had always been paying a lot of attention to these issues. Sainsbury had been responsible, with Marks and Spencer and Waitrose, for developing the concept of quality own-label products for the mass consumer market. Sainsbury had also traditionally had a centralised distribution system and had pioneered the utilisation of information technology in retailing.

Table 12.10 Tesco and Sainsbury's Supermarkets. Financial and Operational Statistics 1980 and 1995

	Tesco	Sainsbury's Supermarkets	Tesco	Sainsbury's Supermarkets
	1980/81	[illegible]	1994/95	1994/95
Sales (£; incl. taxes; 000)	1,916,400	1,589,200	9,655,000	9,597,300
Operating Profit (£; 000)	51,300	64,400	561,000	784,300
Operating Margin	2.68%	4.05%	5.81%	8.17%
Number of Stores	554	241	519	355
Total Sales Area	6,840,000	2,978,000	12,641,000	9,338,000
Average Sales Area per Stores	12,347	12,357	24,900 (excl. Metro and Express Stores)	26,304
Market Position	Low	High	Medium - High	High
Average sales per sq. ft (incl. taxes; £ per week)	5.02	10.26	14.69	19.76

Source: Based on Tesco Annual Reports, Sainsbury Annual Reports and Other Documents

As for Sainsbury, much has already been said. For its story and competitive position in the early 1980s, the most appropriate comparator for Sainsbury would be Waitrose, the grocery retail arm of the John Lewis Partnership. However, the comparison with

Waitrose would be more appropriate for the early 1980s than for the end of the period under consideration. Waitrose has, similarly to Sainsbury, an upper end image among consumers and a reputation for quality own-label products. Also similar to Sainsbury, Waitrose was operating city centres stores in the South-East of England. However, in the period from 1980 to 1995, Waitrose followed a significantly different strategy from other large grocery retailers. Whilst most of large retailers were engaged in large expansion programmes of edge-of-town superstores, Waitrose decided to maintain its position in the market of city centre retailer operating in the South-East. It did not significantly expand the scope of the operations. Because of the significant difference in the investments' strategies followed by the two firms, at the end of the period, there were significant differences in their asset structures[5]. For the strategy followed in the 1980s and 1990s, the most appropriate term of reference is Tesco. However, the analysis of the similarities between the two companies has just been made.

Finally, we can look at ASDA. It is more difficult to find a comparator for ASDA than for the other companies. Established in the mid-1960s as the superstore arm of a food manufacturing business, ASDA established its position and reputation from the beginning as a superstore business operating at the discount end of the market. The company successfully developed in the 1970s and, although small in terms of sales and sales area, it had the highest profitability in the business. This was the result of the successful development of a business idea. As we have seen in our examination of ASDA's history, the company was the first to develop the concept of edge-of-town superstores on a large scale. Initially, there were a number of cost advantages associated

[5] It is not clear why Waitrose's management decided not to expand the scope of its operations in food retailing. What can be noted is that the company is a partnership of employees. Therefore, it is particularly difficult to raise capital on the stock market to expand operations. Its particular status makes it also very difficult to find published material on this company.

with this idea. Edge-of-town sites were significantly cheaper to develop and run than city centre sites. Most retailers operated in city centres. In a context characterised by strict planning permission, the consequence was a rise in the cost of the available city-centre commercial sites. This was not the case for edge-of-town sites. However, from the end of the 1970s, more companies started to pursue this strategy. This was particularly the case for Tesco, which, in the strategy set in the mid-1970s, had an initial long-term objective to replace its network of stores with some 400 superstores. Sainsbury also pursued a strategy of replacing smaller stores with larger supermarkets and superstores. However, in taking the initial idea developed by ASDA, these companies further explored it, by developing superstores for a different market segment, by developing information technology, and centralised distribution systems. This influenced ASDA's strategy, which later attempted to imitate the strategies followed by other firms. It evident therefore, how it can still be very important to compare the ASDA's strategy with those of its competitors.

Based on the analyse made, it is possible to try to respond to other research questions posed in Chapter five.

12.3.1 Question 2 What are the similarities and differences in the strategies of comparable firms within the industry?

The concept of strategic groups asserts that firms within the same strategic groups are similar in all relevant aspects. Because of these similarities, firms have similar performance and will follow a similar investment and competitive strategy. Caves and

Porter (1977) argue that these similarities emerge from a similar history of investment and strategic behaviour, as well as from recognition of the interdependence among firms of the same group.

In the industry analysis Chapter, we saw that a traditional way to distinguish between retailers is to distinguish them in multiples, co-operatives and independents. Important strategic differences can be identified for each of these forms and we could argue that mobility barriers exist between these groups. By classifying firms in this way, we would be able to speak about the rising power of multiples and the decline of co-operatives firms. However, we cannot talk of *multiples* as a strategic group as argued by population ecologists. Speaking of multiples as a strategic group would lead us to assume that multiples initially 'collectively' recognised the existence of asymmetries within the industry and 'collectively' decided to compete against other types of grocery retailers (independent and co-operatives) and other types of food retailers (specialists). Our analysis indicates that each retailer has been operating in a very individual way. This is clear when we examine longitudinally the similarities and differences among multiples. If we consider the largest multiples operating in the GRI in 1970, and compare them to those operating in 1995, we see that most of the large companies of the 1970s have disappeared and that many large companies of the mid-1990s either did not exist in the 1970s or had marginal positions in the industry. This demonstrates, in our view, that a 'collective' mind-set called multiples did not exist as such, as otherwise, we would be able to observe a similar structure in the two periods.

The existence of important differences between multiples is also confirmed by Lewis and Thomas (1990) who focused on multiples (which could be argued to have similar characteristics). They found important differences among multiples, which led them to recognise that those firms could be clustered in different strategic groups. However, when we look at two firms, as we have done here we find differences that are important in explaining the dynamics of firms' strategies.

Tesco and Sainsbury were put in the same strategic groups by Lewis and Thomas (1990), and it is often argued that important similarities exist between the two companies. Our analysis indicates that both companies have followed a strategy of expansion and have replaced small retail units with larger ones. Both developed a large range of products and a successful own-label. Further, they have increased their control of the supply chain. However, there were significant differences in terms of their respective strategies. Sainsbury has traditionally had a reputation for good products and customer services and has been positioned at the high end of the consumer market. Tesco has been a discount operator, providing mainly branded goods at the low end of the market. Sainsbury has had among the highest sales per square foot in the industry whilst Tesco's was much lower. Moreover, Tesco was more geographically spread than Sainsbury.

Because of these differences, we have found that firms followed a different strategic behaviour. In the 1990s, Tesco's strategy has mainly aimed at increasing the sales per square foot. Sainsbury was a regional operator until the early 1980s. In the 1990s, its objective was to continue to expand the geographic scope of its operations by opening superstores in new geographic areas. However, Sainsbury has traditionally had a very high level of sales per store. A strategy aiming at increasing sales per store could have created problems as its shops would have been regarded as being overcrowded by customers. This also explains the differences in the type of advertising campaign chosen

by the two companies in the mid-1990s. Sainsbury's advertising campaign was criticised because it was not as aggressive as Tesco's. This is probably true but it is also true that Tesco needed to increase its sales more than Sainsbury.

Other important differences include their diversification strategies. In the 1980s, Tesco divested of its business venture in Ireland to concentrate on UK business. This decision was reversed at the beginning of the 1990s when the group started a geographic diversification programme in Europe. Sainsbury's diversification strategy was set up in the 1970s and has been slowly pursued over the past 20 years. It has developed a DIY chain in the UK and has diversified geographically by buying two chains in the USA.

The two companies also have different approaches to expansion in the UK GRI. Tesco has traditionally been prompt to expand through acquisition. For a long time, Sainsbury has been reluctant to make acquisitions in the UK GRI, preferring an internal development option.

The problem with strategic groups theory is that it stresses similarities and gives little attention to the differences. The problem with any clustering technique is that it places excessive emphasis on similarities. Consequently, there is a natural tendency to re-ification (we argued about this in Chapter four when we discussed the epistemological characteristics of strategic groups research). What emerges is that, although similarities are important, so are the differences. For an understanding of the dynamics of firms' strategies, we cannot ignore the differences in firms' strategies, these being found in their asset structure, operational issues and other characteristics. Differences among similar firms are important for analysing differences in the strategic behaviour of similar firms. It is not a case of saying that similarities are more important that differences. It is a matter of recognising the importance of *both* similarities and differences.

12.3.2 Question 3 How did firms come to develop their respective strategies? Are there important similarities in their origins and strategic investments over time?

Although important similarities exist among the four companies at the end of the period, our analysis indicates that the companies have very different histories in terms of how they developed their position in the market.

Within strategy research much attention has been given to the issue of the origins of firms, and to the similarities and differences in their approaches. This has been a key concern for strategic groups analysis as well as for population ecologists. Caves and Porter (1977) argue that firms operating in the same strategic groups probably have similar origins and histories of investment strategy. In population ecology, a considerable attention is also paid to the period of establishment of a specific group as it is assumed that this determines some fundamental characteristics that continue throughout the life of the companies. The *institutionalisation* of these characteristics might create inertia in the company. Therefore, if the company is forced to change its ways of operating, it may face significant barriers created by the institutionalisation process.

The four companies have significant differences in terms of their origins and in the paths followed to get to their position in the UK GRI. They all followed an expansion strategy, a necessary requisite to becoming a large grocery retailer. However, the timing and mode they followed differed significantly. Argyll, ASDA and Tesco came to the grocery market much later than Sainsbury. Argyll was the exceptional case, coming to the market only in early 1980s, more than a century after Sainsbury. Nonetheless, these companies managed to build a significant presence in the UK GRI in much less time. This has been possible because of the continuous change taking place in an apparently mature industry, which (as we discussed earlier) continuously threatens the positions developed by some firms whilst creating opportunities for others.

Historically, there has been a variety of means for developing a significant presence in the market. Tesco, ASDA, and Argyll have developed their presence through both internal expansion and acquisition of existing businesses. However, Sainsbury has developed its presence in a planned way without making acquisitions. The company has traditionally replaced stores reputed to be inadequate for new trading conditions with new stores that met the company's definition of new trading standards. In analysing the slow growth of Sainsbury compared to many of its competitors, we have to consider that, although it was formed in 1869, the company was only quoted on the stock market in 1973. Today, the Sainsbury family still controls 43% of the issued capital. It is not surprising that the company has been growing slowly as, for a long time, its expansion programme has been financed through internal funds. This situation changed under the chairmanship of Lord Sainsbury, who became chairman in 1969, brought the company onto the stock market in 1973 and set up a strong expansion programme. We can compares it with Argyll, which was created in 1977, was always on the financial market and, within a small period of time, managed to build a significant presence in the GRI. However, this has only been possible because Argyll's management made great use of the financial market as a means of raising funds to finance both its acquisitions and the expansion programme, and because there were favourable external conditions for doing so (i.e., companies to take over and favourable planning conditions).

Thus, the four companies have some significant similarities in their respective positions in 1995 but their origins and developments are characterised by significant differences. The issue then becomes, how and why do these companies come to develop comparable positions at a certain point in time?

We cannot say that they have a comparable market position because they recognised specific opportunities at a specific point of time. What emerges from the empirical research is that, over a period, companies developed a cue about a strategy for the future, a cue that was reinforced both by a positive feedback from investment decisions and positive results for companies following similar strategies. This has been possible because a significant amount of information is available from secondary sources on the UK GRI and also because, as discussed earlier, there have not been important technological innovations in the GRI that have transformed the industry and that could be protected by patents.

The importance of the feedback effect in the development of the *strategy flows* is clear when we consider that as the development of hard discounters started to affect the performance of large retailers, the management of Tesco and Argyll, unable to

understand the reasons and the scale of the effects, announced cuts in their expansion programmes.

12.3.3 Question 4 Are there reference points in the industry influencing management in its strategic decisions about investment strategies?

In strategic groups theory, it is argued that some groups are more profitable than others, and because of their higher profitability, the firms in other groups will try to copy their strategies. At the same time, firms operating within the same group influence each other's strategic investments. In order to enrich our understanding of the dynamics of firms' strategies and industry structure, we need to understand more about the potential existence of points of reference within the industry for firms' management.

This is perhaps the most complex of all the issues analysed here because it relates to how firms develop their strategy, as well as the analysis of the influence exercised by the competitive environment upon management. In an analysis of strategic groups, the industry is seen as being in equilibria and information is available to all firms. The condition of equilibria and the availability of information enables firms' management to develop cues about the competitive structure and other firms' strategies. On the basis of this , management develops strategic plans for their own firms.

What emerges from the research is that there is not a single reference point in the industry. There is no specific group that has got the best strategy in absolute terms, as suggested in strategic groups theory but rather a multiplicity of reference points.

Strategy is a complex issue. It is the coming together of decisions referring to different functions performed in the company. Because of these complexities, reference points are multiple. At any time, the reference point for a firm's management can be company A for store layout, B for distribution systems, C for own-label and so on. For Tesco management, at the end of the 1970s, ASDA was the reference point for store concept, Sainsbury and Waitrose for own-label and quality of products. Thus, there is not a single firm that is a reference point but a multiplicity of firms.

Furthermore, at firm level, the reference points for the same issue can be many. The companies analysed consider what other large companies are doing at the level of the business. However, when they have to take their decision about where to open outlets, they prefer to take away sales from weaker companies. Therefore, reference points are both similar and dissimilar firms.

The issue of reference points becomes even more complicated if we consider that the industry and firms' strategies have not been static. Because strategy is a process in time and firms' strategies and industry structure are stable yet also changing, reference points tend to change. At the beginning of the 1980s, Sainsbury was the reference point for many companies operating in the industry, in terms of market position as well as of its own-label, information technology and distribution system. Tesco was among these companies but as Tesco changed its position, it also became a reference point for other companies (e.g., ASDA). We can therefore talk of some sort of *dynamic imitation* where the original idea is taken from outside but further developed. What emerges from the research is that this is not imitation in a traditionally defined sense, one firm being the innovator and other firms 'copying' the innovation. Because strategy is a process

over time, imitation tends to be accompanied by further innovation. Companies develop ideas that were originally proposed by others. This is done by integrating elements that have been developed in the external environment, and combining firms' specific resources and the vision management has about its firm's strategy to the idea from outside. This has been the case for Tesco strategy since the late 1970s, Tesco took the idea of edge-of town superstores, initially developed by ASDA, and developed it with own-labels, information technology, distribution, and customer services. This implies that a firm may develop something new.

Until now, we have looked at the cognitive structure of single firms. The research indicates that the environment influences top management in its decision process, and that external reference points exist. However, it also stresses the complexity of this issue. There are multiple reference points for firms' strategies in the external environment but reference points change over time because of continuous change in firms' strategies and industry structure. Does this imply that no similarities exist among the cognitive structures of the firms operating in the industry? Does the analysis of cognitive structure have to be made only on specific firms? In the analytical response to the next question, we address this issue.

12.3.4 Question 5 Are There Similarities in the Cognitive Structures of Firms Operating in the Industry?

The existence of similarities in the cognitive structures of firms operating in an industry is a theme that strategic groups share with cognitive communities. In cognitive analysis, it is argued that there are well defined cognitive structures in the competitive environment and that they play an important role in the dynamics of firms' strategies and industry structure (e.g., see Porac *et al.* (1989) on the Scottish Knitwear Industry).

As we have already seen, at the end of the period under study, important similarities existed between the firms in terms of store network, distribution systems, own-label and information technology. Over the past two decades, they all expanded successfully by opening new large supermarkets and superstores and by taking market share away from other companies. If important similarities existed between the firms analysed here, it is because these companies followed a similar investment strategy in the past. Intuitively, we would expect some important similarities in the cognitive structures of these companies to exist. The examination of the dynamics of the cognitive structures of companies analysed in relation to the effects that the development of the hard discounters had at the beginning of the 1990s provide the opportunity to analyse the issue in more details.

In the late 1980s, the management of Sainsbury, Tesco and Argyll (Safeway) thought that discounters did not represent a threat for large operators "We welcome the advent of Aldi and others to come. We can live quite happily in our part of the market and they can live in theirs" (David Malpas, Tesco's managing director, from The Financial Times, 20/09/90: 28). Their cognitive structure changed when they noticed that they were losing market share to other companies. They then themselves had to cut price in response to competition from newly established hard discounters. The companies reacted by introducing value lines and announcing cuts in their expansion programmes. As we have seen in the analysis of Sainsbury's history, David Sainsbury (The Financial

Times, 19/10/94: 8) argued that: "the big groups had been mesmerised by the efficiency and popularity of edge-of-town supermarkets, and forgot that there would always be some business located in town centres ... 'The market did, however, work extremely effectively and a number of chains, including the discounters, moved in to fill the gap' " . *Ex-post*, we can say that after ignoring discounters for a long period, these companies initially over-reacted. What emerges is that the management of Argyll (Safeway), Tesco and Sainsbury did not expect to lose market share and they did not know whether lower sales were due to saturation in the market or to a one-off repositioning due to the entry of discounters. This ambiguity was due to widespread rumours of saturation in the market. ASDA was, in particular, a strong supporter of the hypothesis of saturation, with Archie Norman (chief executive) accusing other companies of a head-in-the-sand attitude towards the development of new stores. We argue that there was an initial over-reaction by large retailers. By 1995, most of large retailers had understood that lower sales were due to a one-off repositioning in the market as new stores were still profitable and they announced new expansion programmes. ASDA itself announced new expansion programmes. Norman's initial statements probably reflected a tactical move rather than a true belief that the market was saturated. Superstore developments take time because of planning permission and building, and in the late 1995, ASDA was already opening new stores. This indicates that ASDA publicly argued that saturation had occurred yet privately did not believe it. A more plausible reason is that ASDA did not wish for other companies to expand at a time when it was unable to do the same. As financial constraints were hampering ASDA's expansion programme, the company tried to stop others from expanding.

Because a wide number of information sources are available on the GRI, similarities exist in the cognitive structure of companies. Relative stability in the external environment and positive feedback tend to strengthen management's cognitive structure. If feedback is contradicting the cognitive structure, or messages are ambiguous, uncertainty threatens the established cognitive structure. New stability will come from the management receiving expected feedback.

However, this does not mean that a unique cognitive structure exists within the industry or within the same firms. The existence of a multiplicity of cognitive structures is evident when we consider who a firm argues its competitors are. In the theory of strategic groups, the firm is seen in relatively simplistic terms, and it is assumed that the entire firm has the same cognitive structure. However, if we consider the manager of store X located in city Y, we would expect that its cognitive structure of competition is going to be very much influenced by companies operating in the same geographic area, with the importance of competitors changing according to its size and the geographic proximity. This mental structure is going to differ from that of an area manager or a chief executive who looks at competition from the point of view of someone considering between 200 and 400 stores. This has been confirmed by a study by Hodgkinson and Johnson (1994) on the mental models of competitive strategies in the UK GRI. Their research indicates that there are further differences in the cognitive structure of competition within the same company, showing that an objective cognitive structure does not exist but also that cognitive structures change within the same company. A similar argument can be used in the analysis of the cognitive structure of chief executives according to the company size. If the focus of the analysis is on large multiple operators, it seems normal that it is on what is going on at the industry level. If

one takes a corner shop, the cognitive structure will probably be simpler and will only consider the companies operating in the same city or village. Therefore, it seems plausible to argue that some similarities exist in the cognitive structures of firms operating within the industry. However, this structure is complex in its nature and changes over time because of the combination of markets rumours and the effects of competitors' activities. In terms of concluding remarks on the analysis of reference points to firms' management and cognitive structure, we can say that this is a much more complex issue than has been proposed in strategic groups research.

12.3.5 Question 6 Is it possible to identify unequivocal determinants of firms' performance in a way that they can be quantified and clear relationships between these determinants and firms' performance can be drawn? If this is the case, is it possible to use successful past strategies as a recipe for strategy formulation?

At the basis of strategic groups research, there is a hypothesis that it is possible to classify firms' strategies into variables without missing out significant information, It is possible to define clear cause-and-effect relationships between these variables and performance, and this analysis can be used as a recipe for strategy formulation.

In the analysis of the dynamics of firms' strategies and industry structure, it was argued that it is difficult to explain the dynamics of firms' strategies and industry structure by looking only at firms' strategies. It is also necessary to analyse the dynamics of the industry and the external environment (consumer market, technology and government policies). However, this may not be the case for the analysis of firms' performance; and the analysis of variables related to firms' strategies may be sufficient for the analysis of the determinants of firms' performance and their dynamics.

Determinants of firms' performance and whether we can use past performance to indicate what the profitable options might be, are two interrelated issues that are difficult to tackle. In examining them, we cannot use econometric techniques because these techniques require the existence, *a priori*, of a well-defined theoretical framework. The analysis starts with an examination of the performance of these companies. It will then examine whether the determinants of firms' performance can be identified, and finally, there will be an assessment of whether or not this exercise can be fruitfully used by management to identify the best strategy to follow.

12.3.5.1 Performance

Before starting to measure the performance of these companies, we should define what we mean by performance. By using "survival rate" as an indicator of the relative success of these companies (as in population ecology), it could be argued that the four companies have all been successful. However, as we are more interested in a detailed analysis of the relative performance of the companies. Thus, we will look at financial data.

In deciding which variables to consider, some problems emerge. We could be looking at business units only: Tesco, Sainsbury's Supermarket, ASDA and Safeway. However, for Safeway, it would be difficult to explain the growth in sales without referring to the fact that the assets of other business units (Presto) were converted to the Safeway

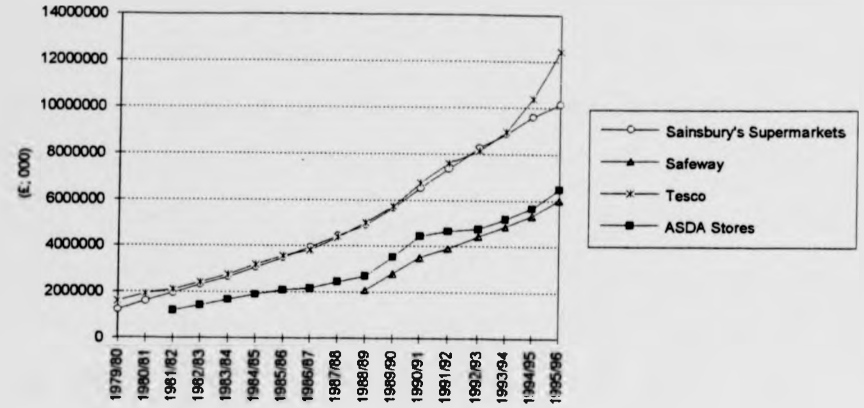
format. Furthermore, by looking only at Safeway, we would not consider possible economies existing at the corporate level for functions such as buying, distribution systems and store developments. The same can be said for Sainsbury supermarkets and Savacentre (the hypermarket format of Sainsbury). However, by looking at data at the corporate level, it would be difficult to understand the dynamics of profitability for specific businesses.

Bearing in mind this first set of problems, it was decided that we would examine three variables: (a) sales of the business unit, (b) return on sales of the business unit (ROS; operating margins) and (c) the return on capital employed (ROCE) of the group. The longitudinal analysis of the companies' sales gives an insight into the firms' capacity for growth. Operating margins reflect the capacity of the company to grow in a profitable way, and highlight the operational efficiency of the business. The ROCE gives an overall picture of the company and of the group's capacity of earning a good return on the capital engaged in its activities. According to retailers, ROCE is more important than the return ROS (at the beginning of the 1990s, many retailers were accused of making excessive profits as their operating margins were among the highest in Europe. Retailers then argued that, although it was true that operating margins were among the highest, ROCE did not differ much from that of firms operating in other European countries).

Analysis of graphs 12.1, 12.2, 12.3 and 12.4 shows a number of interesting issues.

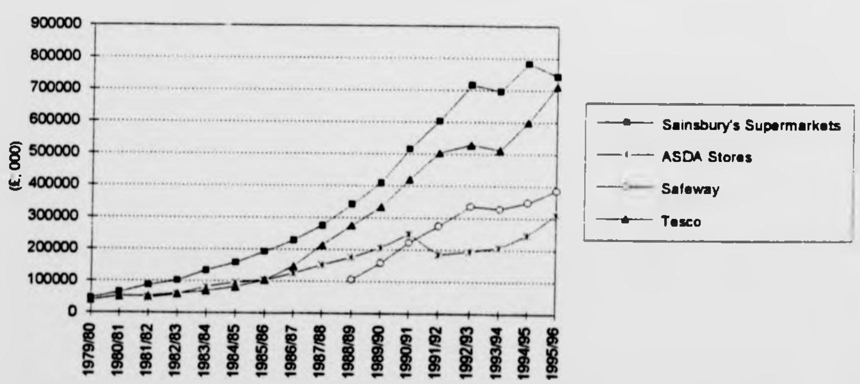
Overall, we can see that sales and profits have been increasing over this period (Graph 12.1. 12.2).

Graph 12.1 Sales 1980 - 1996



Source Based on Data from Argyll, ASDA, Sainsbury and Tesco Annual Reports

Graph 12.2 Operating Profits 1980 - 1996

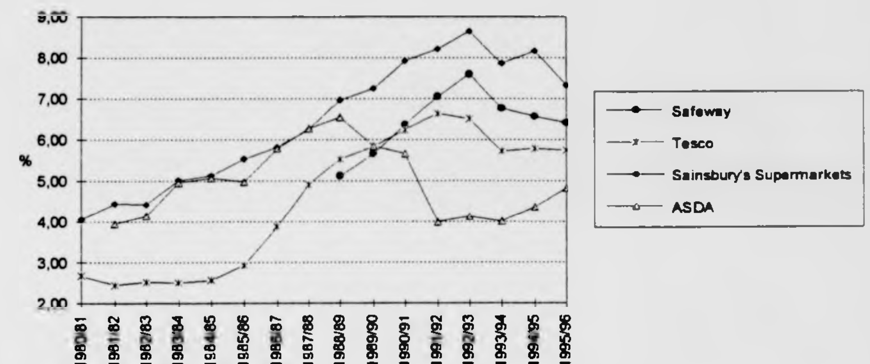


Source Based on Data from Argyll, ASDA, Sainsbury and Tesco Annual Reports

This indicates that the expansion strategies followed by these companies over the period have been profitable. Because concentration in the industry increased, over the period, and the four companies increased their market share, it could be argued that these

companies took advantage of their dominant position to earn extra-profits. However, the analysis of the companies' ROCE (Graph 12.4 although it refers to the group level, sales from the grocery retail divisions account form most of sales) shows that, despite the increase in concentration, there was not an increase in relative profitability. Therefore, we can exclude the possibility that there has been collusion among these firms.

Graph 12.3 Return on Sales 1981 - 1996



Source Based on Data from Argyll, ASDA, Sainsbury and Tesco Annual Reports

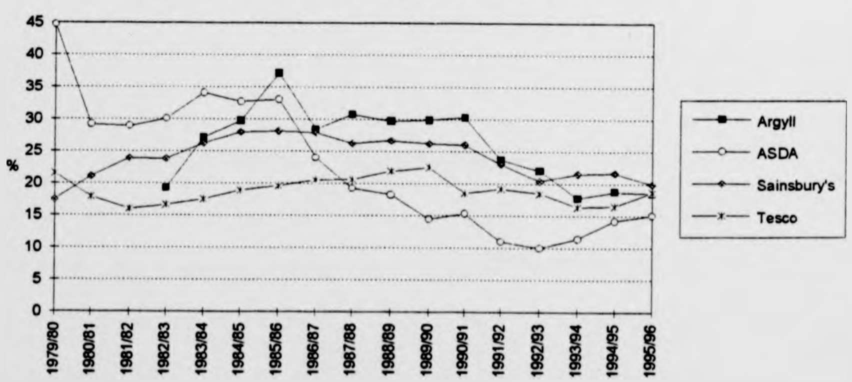
By looking at the trends of ROS over time, other interesting elements emerge:

1. There is not always a constant positive relationship between growth of sales and growth of profits. The analysis shows that, in the 1980s, there was a positive relationship between increases in sales and increases in operating profits. However, since the beginning of the 1990s, there have been companies that have increased their sales. However, profits have not always followed. It is therefore problematic for us to draw a constant positive relationship between an increase in sales and an increase in profitability.
2. The graphs also show that all the four companies had a moment of difficulty at the beginning of the 1990s. However, we can note that (a) the scale of the difficulty was

different for each company (ASDA was the hardest hit), (b) the timing of the difficult period was different for each firm, (c) their reactions to the difficult period differed significantly.

These elements show the problem with generalising. What emerges is that there are important differences in a somewhat similar effect. The companies have all increased sales and profits, yet their trends tend to differ. Strangely, the highest volatility came when the business units had become more similar in terms of asset endowments (all the companies have a centralised distribution system, own-label, offer similar services and range of products to customers and have a similar network of stores and sales area).

Graph 12.4 Return on Capital Employed 1980 - 1996



Source Based on Data from Datastream

By comparing the ROCE of the four companies, we do not see the same growth that we saw for ROS and operating profits in absolute terms. There has actually been a relative decline since the late 1980s (probably due to the high investments made in not yet mature superstores). What emerges is that there are important differences between these companies (in terms of ROCE) in the first part of the 1980s. However, since 1986/87,

ROCE has followed a similar trend and since 1990/91, there has been a convergence in the relative profitability of Sainsbury, Argyll, Tesco and ASDA. In the early 1990s, we therefore have a ROCE situation that contrasts to the findings of the analysis of operating profits. While there was convergence in the former, there was volatility at its maximum, for the latter.

12.3.5.2 The Determinants of Profitability

Having analysed the profitability of the companies, we can now see if it is possible to identify the determinants of their performance.

Lewis and Thomas (1990) identify a number of variables that were reputed to significantly represent firms' strategies. These were: number of store, average size of stores, advertising expenditure on sales, number of food lines and proportion of own-label lines. According to the theory of strategic groups as developed by Caves and Porter, based on these variables, we could identify a number of groups. Firms in these groups would have similar origins, follow similar strategic behaviour and have similar performance.

There is no doubt that these variables play an important role on firms' performance. However, they do not exclusively account for the elements determining firms' performance. For example, by comparing Tesco and Sainsbury at the beginning of the 1980s, we know that Sainsbury was achieving higher sales and profits from a smaller number of stores and from a smaller total sales area (Table 12.10). This was the result of their reputation established over the years, as well as of attention to product quality and customer services. Furthermore, if we look at the profitability trend of the two companies in the early 1990s, we see that large retailers had to cut their gross margins the recession and because of the development of discounters. However, Tesco was affected in a stronger way and earlier than Sainsbury. It had been argued that this was due to Tesco having a weaker market position than Sainsbury and to Tesco having a younger customer base. Younger people had been hit more by the recession and were trading down. Some also forecasted that Tesco would have picked up quicker as soon as the recession ended. Hence, we can see the complexity of drawing relationship between various variables and performance.

What emerges is the complexity of the determinants of firms' profitability and its dynamics, and the necessity of a detailed analysis for understanding the dynamics of firms' performance. This does not happen in strategic groups research where the variables are seen as the only determinant of firms' profitability.

The complexity of firms' performance is also made clear by the analysis of ASDA's performance over the same period. Despite a number of stores and the total sales area continuously increasing, the company deciding to develop an own-label and centralised distribution system, the profits did not always increase (Graph 12.3 for ASDA ROS). Through the case study, we know that at the beginning of the 1980s, the managing director did not believe that the company would survive in the long term and its objective was to maximise short-term profitability. The group initially improved its performance by increasing margins. Later, this price policy had an effect in terms of losing customers, and an unsuccessful programme of change, linked to a recession and the development of new discounters, decreased profitability further. This led to a

reposition strategy and a successful programme of change. Financial difficulties, bad management, competition, operational difficulties and disenfranchised customers all combined to contribute to the relative decline of profitability in the late 1990s.

It is not possible to explain ASDA's performance without referring to the broader context and considering variables other than firms' strategies. Asset structure has been an important influence. This is clear when we analyse the relatively successful performance of ASDA in the 1990s. We can see that an important network of superstores, linked to the traditional discount image, low competition in the targeted market, management capabilities and good timing were responsible for good company performance. However, what re-emerges is the complexity of the determinants of firms' performance.

Therefore, we can see that strategy, in terms of asset endowments, is important for firms' performance. However, strategy is not a holistic concept. By looking at the variables that refer to firms' strategies, it would not be possible to understand the elements determining a firm's success and its dynamics. Firms' strategies, quantified into variables, do not include all the elements responsible for firms' performance. Firms' histories, corporate level (financial ability) and at the business level elements, the management, external factors and so forth all influence the dynamics of firms' performance.

However, if it is difficult to identify the determinants of firms' performance, the complexity of the issue increases when the analysis is carried out over time.

At the beginning of the 1980s, firms with a centralised distribution system may have had better performance compared to other firms that did not have such a system. However, as other companies started to develop similar systems, this element for potentially creating a difference disappeared. This variable thus changed in importance over time. The same can be said for own-label products and superstores. There could have been cost advantages that later disappeared. Therefore, in order to say whether a factor creates a competitive advantage, a detailed longitudinal analysis is required. Nonetheless, it is difficult to say when a variable identified as important is mature for producing higher profitability, and when imitation takes place and means that this variable no longer plays a role in creating differences in performance.

Thus, the analysis showed that the performance of a firm is due to its strategy and other elements: management, competition, imitation and innovation. These elements are highly interrelated and it is very difficult to identify individual elements that are responsible for the dynamics of firms' performance.

12.3.5.3 Strategic Groups as an *Ex-Ante* Technique for Analysing the Strategic Options Available to Firms

In the development of the concept of strategic groups at Purdue, it was thought that strategic groups could be used as a technique to examine *ex-ante* the different strategic options, with a view that if a strategic option was seen as profitable, that would be the strategy to follow.

What emerges from the analysis is that even if it is possible to identify the variables responsible for firms' performance, they can not be used to indicate what the successful options are for future strategies.

ASDA attempted to change its competitive position and failed because of a combination of elements (poor management, operational inefficiencies and a poor financial base). However, Tesco was also in financial difficulties in the early 1980s. These two stories also led to different results because of the different historical periods of time in which the strategies were proposed and implemented. Tesco's decision to move up-market came at a time when the economy was prosperous and consumers were putting elements other than price at the top of their priorities. Tesco also had little competition in the consumer market it was targeting. Its decision was also indirectly supported by other firms' decision's to no longer compete on price. Tesco was therefore seen as being competitive on price and able to maintain its existing customers while changing its market position.

ASDA did not succeed because of poor management, financial weaknesses and because when the company decided to move upmarket, this end of the market was already occupied by other companies. Safeway, Sainsbury, and Tesco had expanded and were consolidating their position in this area. Further, ASDA's competitors had opened new superstores in wealthier areas when changing their store portfolios while ASDA superstores were positioned in relatively poorer geographic areas. Finally, consumer priorities were again changing, but this time in the opposite direction. Price was moving on top of consumer priorities.

Conditions had completely changed and ASDA management did not recognised this. However, ASDA's strategy of going back to its roots as a superstores discounter operator at the beginning of the 1990s was successful because of a combination of favourable external conditions and top management ability. They refocused on the discount segment at a time when the economy was in recession and customers were again sensitive to prices. Further, there were not many companies operating with large superstores at the discount end of the market.

"Choice is the daughter of time" and does not exist in absolute terms. Companies continuously make choices, but each time, the available options are different and/or have different implications. Because firms are never the same and changes are continuously taking place in the environment and because performance is determined by elements inside and outside the firm, it does not make much sense to use the past strategies of other firms in a recipe for strategy formulation.

12.4 Summary of Research Findings

Having discussed all the research questions highlighted in Chapter five, we will now summarise the findings. This will form the basis for assessing the limits of strategic groups research.

The empirical research confirms the fundamental hypotheses that heterogeneity exists between firms operating within an industry, and that important similarities also exist among competing firms. The empirical research also reveals other interesting issues:

1. The first theme assessed the mechanisms characterising the dynamics of industrial and business change. In traditional strategic groups research, firms' strategies and industry structure are seen as being in equilibria and in disequilibrium changes in the structure of the industry and in firms' strategies take place. Longitudinal research into strategic groups uses a multi-static approach. Our analysis indicates that the dynamics of firms' strategies and industry structure are characterised by the existence of simultaneous continuity and change. Changes are progressive rather than immediate. There are also underlying continuous dynamics characterising the industry structure. Although organisational types have remained the same (multiples, co-operatives, and independent), their fundamental characteristics have significantly changed. We cannot say that there have been revolutionary inventions in the GRI. However, retailers' strategies, combined with changes in the environment, have been such that the nature of retailing has completely changed over the past 25 years. In such a context, it is difficult to talk of the GRI or firms' strategies as static. It is more appropriate to say that the main characteristic of the industry has been its dynamism. This is an issue that has already been highlighted by strategy process research. Pettigrew (1985) argues that strategic change should be regarded as a continuous process which occurs in a given context.
2. The concept of strategic groups argues that all the information we need to study the dynamics of firms' behaviour and industry structure are to be found in strategic groups. The analysis indicates that strategic groups is not a holistic concept.

   First, continuous changes in the consumer market, firms' strategies, industry structure, technology, in combination with government policies, create the basis for the entry and development of new firms with new strategies. This is not considered when using strategic groups as a technique to analyse the strategy option available to firms' management.

Second, there are strategic options that are not taken into account when conducting strategic groups research. The concept of strategic groups only looks at the past and assumes that, in absence of relevant industrial change, firms will reproduce past strategies. This research shows that firms are innovative in their strategies, introducing important elements that would not be taken into account if the analysis were only based on past strategies.

Third, in order to understand and explain the dynamics of firms' strategy and industry structure, we need to examine both firms' strategies and the external context. These two elements are complementary, as they both have features that are exclusive.

3. Firms' strategies, industry structure, and consumer market influence each other to the extent that a primary determinant factor cannot be identified. Firms' strategies impact on the industry structure and changes in the consumer market and industry structure impact on firms' strategies by threatening some retailers and creating opportunities for other retailers.
4. Continuity and change characterise the dynamics of firms' strategies. It is useful to distinguish between strategy stocks and flows. Flows from the changing dimension of firms' strategies. Decisions about strategy flows are taken in a competitive environment characterised by uncertainty. Because strategy is a process over time and management does not have complete control of the external environment, initial objectives may not be realised. There is unpredictability in the strategy process,

which can, itself, work in favour or against a firm. We could therefore incorporate an element of luck in the strategy process[6].

5. Similarities as well as differences exist between comparable firms and are important for the dynamics of firms' strategies. However, it is difficult to argue that similarities overarch differences to produce homogeneous groups. Differences between firms are in the nature of firms. Because the consumer market is heterogeneous and changing, because the competitive structure is varied and changing, because firms are continuously making investment strategies, because there are not stable equilibria and there are differences in management, firms cannot reach a situation of absolute identity, as assumed in strategic groups research.
6. The companies examined here came to develop similar positions in an industry from significantly different positions. However, strategic similarities arose from firms' management recognising similar opportunities over a period of time and developing a similar view with regard to their future asset endowments. Thus, although the investments differ in nature and there are differences in the pace of these investments, over a long period of time, similar investments have produced similarities among firms. However, the companies had some specific characteristics (both in terms of asset endowments as well as in terms of management views and capabilities) which enabled them to take advantage of the external changes. Therefore, the relative position of a company at any point in time is important for

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[6] Barney (1986: 1234) has addressed the issue of luck in the strategy process: «Even well-informed firms can be lucky in this manner. Whenever *actual* returns to a strategy are greater than *expected* returns, the resulting difference is a manifestation of a firm's unexpected good fortune.»
During one interview, the issue of luck in the strategy process emerged. When talking about the strategy change in Argyll in the 1985 – 1987 period, one interviewee said: «I think it is sometimes terrible difficult to rationalise these decisions. ... There were two issues; if we could have bought Distillers, then that was a unique opportunity, so I think that we should put that on one side. I think that as far as our existing food business was concerned, it was a good food business, but it was not a great food business, …so what we saw was the opportunity to buy Safeway's, which gave us the brand, and to build that brand through an organic development programme, building superstores. So it would have been a very difficult thing to build a business the size and quality of what we have got today if we had not been able to buy Safeway.

the dynamics of its strategy as well as for the development of similarities among competing firms.

7. There are reference points for firms' management but these are complex in character, as there may be different reference points for different elements of firms' strategies and they change over time.
8. There are similarities and differences in terms of the cognitive structures of management. Cognitive structures seem to develop over time as a result of feedback reinforcing the cognitive element. When the feedback does not reinforce the cognitive structure, the management may ignore it for a while. However, if it stays then there is a period of high uncertainty during which the management observes the external environment, how the situation evolves and hence it makes corrective manoeuvres. After a while, a new cognitive structure may develop. However, this is a complex issue as differences in terms of cognitive structures may exist within firms, as well as among firms competing in the industry.
9. Although a number of variables may define a firm's strategy, it is difficult to define a relationship between these variables and profitability. Firms' profitability at a specific point in time is the result of firms' investment over a long period of time. Investment that may have been successful because of firms' decisions and also because of favourable external conditions for these investments. There are many elements impacting upon firms' performance. It is, therefore, difficult to draw a relationship between strategy and performance. A detailed analysis is needed to understand the dynamics of firms' performance.
10. It is problematic to use past strategies as an *ex-ante* technique to analyse strategy options available to firms. First, past strategies do not embrace all the new options

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We could have built Prestos superstores, but they would have not been, in a brand sense, as strong as Safeway. So you could argue that we were just lucky, that Safeway became available.»

available to firms because they do not take innovations into account. Second, external situations, which were favourable in the development of a past strategy, may have changed over time. Sainsbury and Tesco make considerable profit, in an absolute sense, because they have a large floor space and a large network of stores of relatively large size. However, these companies have a large floor space because they have taken a decision to invest over a long period of time and because this was possible (i.e., with availability of many sites for superstore development, favourable planning permission, little existing competition). These conditions are much less likely. We therefore note the difficulty of drawing a relationship between strategy and performance, as well as using strategic groups as a technique to examine strategy options available to firms.

12.4.1 How do the Research Findings Impact upon the Concept of Strategic Groups?

The research shows important limits in the theory of strategic groups and its ability to explain the dynamics of firms' strategies and industry structure. The theory of strategic groups is based on assumptions and hypotheses that show clear limits in the analysis. Strategic groups, as developed by Caves and Porter, appears to be a superficial concept which tries to address too many issues at the same time. This analysis shows the complexity of issues such as the dynamics of firms' strategies and industry structure, the strategy concept, similarities and differences among firms and the complexity of the elements determining firms' performance and its dynamics. Further, there are clear problems in using strategic groups as a technique to identify the most profitable options available to firms. The concept of strategic groups has been very appealing in strategy research for a number of reasons. However, we do not think that significant progress can be made by continuing to undertake research which is based on a theoretical framework that contains significant flaws, both at the theoretical and when assessed in practice.

12.4.2 Research Findings and Other Theoretical Approaches

In Chapter five, we have saw how the development of other theoretical approaches has contributed to further questions on the relevance of strategic groups research. These approaches have not been the primary focus of this empirical research. However, given the extensive review in Chapter five, we can make inferences from the research findings on these approaches. This indirectly contributes to a better understanding of their potential and limitations. In this section, we will briefly analyse how the issues that emerged can impact on the approaches analysed in Chapter five.

The empirical findings seem to confirm the limits of population ecology of organisation as a means of explaining the dynamics of firms over time. Population ecology approaches are concerned with the dynamics of the population of firms in the same environment. However, the analysis is limited to death and birth rates rather that seeking to explaining how and why the nature of firms, resources and the external environment change over time. The empirical research indicates that what could be identified as organisational species have significantly changed over time; and a necessary pre-requisite for understanding the dynamics of organisational species is the

study of the nature of change over time. This is never considered in population ecology studies. Furthermore, as the focus is on species, population ecology fails to understand the importance of similarities and differences among comparable firms. Finally, the empirical research shows that adaptive and selective mechanisms both characterise the dynamics of firms' strategies and industry structure, and the exclusion of one will seriously impair further development in the strategy field.

With regard to cognitive analysis, empirical findings confirm the importance and complexity of cognitive issues. There is no objective environment, and research findings confirm that managerial cognition plays an important role in the dynamics of firms' strategies. This indicates the importance of studying the dynamics of cognitive structures. In Chapter five, we argued that, having recognised that the importance of managerial cognition, the new challenge for cognitive research is to develop a better understanding of the dynamics of cognitive structures. The empirical research here confirms the importance of conducting longitudinal analysis for understanding the dynamics of management cognition. Ambiguity and uncertainty seem to play an important role in the dynamics of cognitive structure, and significant advancements could be achieved by considering the role of ambiguity and uncertainty in the dynamics of cognitive structures and firms' strategies. However, we can re-emphasise that cognitive research, on its own, is unlikely to bring significant results to the study of the dynamics of firms' strategies, industry structure and firms' performance. Thus, while we may think that further research in the cognitive sub-field of research will be important, the most significant results are likely to be achieved by researchers of other sub-fields that take into account cognitive research.

With regard to the resource based view of the firm, the research shows that firms' resources (strategy stocks) play an important role in the dynamics of firms' strategies. However, we again think that the RBV of the firm is too introspective and looks too much to the past. Thus, there is a failure to address the important issue of understanding the dynamics of the strategic relevance of firms' resources, as well as of changes in the competitive environment. Past resources play an important role in the dynamics of firms' strategies. However, innovations in strategy play an important role in the dynamics of firms' strategies. This is not considered in the RBV of the firm. Further, there is nothing in the RBV that helps us understand the dynamics of firms' performance.

The most important research finding related to the evolutionary theory of firms' strategies. Many hypotheses related to the characteristics of the competitive environment and to the dynamics of firms' strategies, are confirmed by the empirical research. First, the empirical research confirms that the dynamics of firms' performance and firms' strategies can be easily explained in terms of elements creating potential rents and those which preserve it (isolating mechanisms). This analysis requires an examination of firms' characteristics and behaviour, as well as of the dynamics of the external environment. Therefore, the focus of the analysis should be on both firms and the interface between firms and the external environment.

Second, the empirical research also shows that there are continuous dynamics at play in firms' strategies and the industry structure. This has important consequences for the utilisation of past strategies to assess *ex-ante* strategy options available to firms. Choice is the daughter of time. It is difficult to reproduce past strategies because they have resulted from a unique combination of managerial activities and favourable internal and

external conditions. These elements, combined with the existence of ambiguity and uncertainty characterising the strategy process, imply that it is easier to explain strategy *ex-post* and that econometricians are economic historians (see Chapter 5). Hence, we believe that history is an important variable that should have a key place in strategy analysis and formulation.

Finally, the research confirmed that strategy stocks play an important role in the dynamics of firms' strategies. That is, it showed the importance of firms' histories for the dynamics of their strategies, as indicated in the analysis of the organisational characteristics of evolutionary approach.

In Chapter five, it was argued that the main limits of the evolutionary theory of firms' strategies are in dealing with a undifferentiated competitive environment as well as in understanding the mechanisms characterising the dynamics of firms' strategies and industry structure. The empirical research shows the importance of firms' relative positions in the competitive environment, the importance of similarities and differences between comparable firms and the importance of comparative analysis.

On the basis of these research findings, it is possible to say that the evolutionary theory of firms' strategies has the potential to become a much more important approach in the strategy field. This issue will be addressed in more details in the next chapter.

Chapter 13 Conclusion

13.0 Introduction

In Chapter one, it we stated that the key objective of this study was to analyse the limits of strategic groups research in its for analysis and explanation of the dynamics of firms' strategies and industry structure. In the first part of the research, our analysis focused on the origins of the concept of strategic groups and its developments. What emerged was that the concept of strategic groups developed independently in SM and IO. However, its development has been marked by the use of a theoretical framework that was initially developed in IO, and by a method that is deterministic in nature. As such, it is characterised by a simplification of the complexity of firms' strategies, industry structure, and their dynamics. The underlying view of firms' strategies and industry structure which has resulted from strategic groups research has been the object of, direct and indirect, critiques in the strategy field. In the 1980s, a number of research streams have emerged that tried to further develop the theoretical basis of strategic groups by highlighting firms' specificities in a group structure. However, some fundamental problems exist with this approach. Other research developed which looks at the relationships between firms' strategies and competitive structures from different perspectives (population ecology, cognitive research and the evolutionary theory of firms' strategies). However, each research approach has its own limitations and strategic groups remains an approach that addresses a number of interesting issues in strategy research in a comprehensive way. However, it is built on the assumption that it is

possible to identify groups structures in an industry and a performance relationship exists between groups and performance. While some researchers recognise that groups structures exist in an industry, important doubts still exist as to the relationship between groups and performance.

The review of the theory and past empirical research left us with a situation of uncertainty, which led to the development of two themes for this empirical research. The first theme involved the analysis of the dynamics of firms' strategies and industry structure; the second assessed the importance of similarities and differences among a number of firms. The objectives were to: (a) empirically assess the limits of strategic groups as a theoretical and practical mean to study firms' strategies, industry structure and their dynamics, and (b) develop a better understanding of these fundamental issues for strategy researchers.

In the empirical research, the historical developments of the UK GRI and the strategies of a number of firms over a certain period was studied. This formed the basis for the discussion in Chapter twelve on the issues outlined in Chapter five.

The objective of this final chapter is to assess how this research has contributed, and may lead to further contributions, to the development of a better understanding of the importance of similarities and differences between firms, as well as to understand the dynamics of firms' strategies and industry structure.

13.1 Strategic Groups Research and the Research Findings

At the end of the last chapter, it was argued that the concept of strategic groups has been very appealing within strategy research for a number of reasons. However, no significant progress can be made by continuing research which uses a theoretical framework that contains significant flaws both at the theoretical and empirical levels.

At the end of Chapter two, it was stated that the theory of strategic groups, as developed by Caves and Porter, should have been considered as the starting, rather than the end point of research programme on the firms' strategies and firms' performance. However, the development of empirical research which studies the relationship between strategy and performance, and an incremental approach to strategic groups research, has led to the "structurisation" of Caves and Porter's theory of strategic groups as a complete theoretical framework. This has been made worse by the failure of critical research on strategic groups to deliver alternatives to strategic groups.

However, if the tendency in strategic groups research has been towards an increasing simplification of the strategy construct, the trend over the past 20 years, outside mainstream strategic groups research yet within the strategy field, has been towards highlighting the complexity of firms' strategies. A strange mechanism has been at work within the strategy field that has contributed to re-establish the balance in research, which looks at the dynamics of firms' strategies and industry structure. Thus, if, on the one hand, we have a shift in strategic groups research towards an increasingly simplistic and deterministic approach, on the other hand, the strategy field has been characterised by an increasing differentiation of research interests. Cognitive research, population

ecology and evolutionary theory of firms' strategies, directly or indirectly, have all criticised some of the fundamental assumptions characterising strategic groups research and have proposed different ways of looking at firms' strategies and competitive structures in an industry and their dynamics. In different ways, they show the complexity of strategy issues. In this context, it is not surprising that the most important critiques to strategic groups have made indirect, i.e. by researchers not using a strategic groups approach.

However, each of the approaches, which were analysed, has its own limitations, and compared to strategic groups, none contemporaneously consider the same wide range of issues that was initially considered in strategic groups research. Notwithstanding their limitations, the development of other research frameworks has created a theoretical plurality that was needed as a basis for the development of further strategy research on these issues. In Hegelian terms, they have created the anti-thesis to strategic groups, and therefore the necessary conditions for improving our understanding of the dynamics of firms' strategies and industry structure. They have created the necessary conditions for *synthesis* (See Appendix 1).

The issue therefore becomes one of recognising the historical role of strategic groups research and the need to move forward. Strategic groups should be used as a starting point for the development of research which further explores the issues highlighted by strategic groups theory. This is what the remainder of this conclusion will be concerned with: to see how our knowledge of the dynamics of firms' strategies and industry structure has increased through this study and to assess how the findings can be used fruitfully both, in management research and by firms management.

13.2 Towards a New Approach to the Study of the Dynamics of Firms' Strategies and Industry Structure

We can start from the analysis of issues that have been highlighted by strategic groups research and confirmed by the empirical research. Strategic groups theory has helped developing the following issues:

1. There has been a decline of the idea that a best strategy exists for firms competing in the same competitive environment. Firms can profitably follow different strategies. In strategic groups research this is shown by the existence of groups of firms following different strategies.
2. Important similarities as well as differences exist among firms competing within the same environment. In strategic groups research it is possible to cluster firms so that similarities would be more important than differences. This analysis shows that, among similar firms, there also are important differences.
3. Asymmetries are potentially associated with differences (multiples and Co-operatives have different characteristics that may create differences in terms of a firm from a group being more able to take advantage of opportunities emerging in the environment more than firms from another group).
4. There are mechanisms inhibiting firms from changing their strategy. In strategic groups, mobility barriers rest at a group level. We think that the starting point should be single firms rather than groups.
5. Firms' relative position is important for the dynamics of their strategies. Caves and Porter argued about the possibility of entry paths in an industry and that groups are not all dissimilar in the same way. They indicated the existence of a sort of industry structure with firms having various positions. Analysis confirmed the importance of relative position as well as industry structure. This was clear when we found that some large retailers (Tesco, Sainsbury) were more able to take advantage of the liberalisation of superstore development in the mid-1980s than other companies because of their relative size.

These are important issues that have been confirmed by our research. Because of the historical nature of the research, these findings transcend the problems highlighted in strategic groups theory. Strategic groups research is therefore important in developing these issues in the strategy field. From the empirical research, other interesting issues emerged which are important for developing a framework for the analysis of the dynamics of firms' strategies and industry structure. The empirical research showed that:

1. *Firms' strategies and industry structure are characterised by continuity and change.* These two elements are interrelated. The study clearly indicated that there were slow but continuous changes in firms' strategies and industry structure. However, because these elements came on an established structure, their impact tended to be marginal. It is not contradictory to talk of concomitant continuity and change. For example, in a changing structure, it is possible to see continuity in the organisational forms (multiples, independents, co-operatives) - or in the presence of certain firms in the industry. However, it is also possible to see that there are continuous dynamics characterising firms and industry. These dynamics are necessary for phenomena such as the entry and development of new firms at different times.
2. *The dynamics of firms' strategies impact upon the dynamics of the industry structure. However, changes in the industry structure create opportunities for the development*

of other firms that threaten the positions of established firms. One old unresolved debate in management research concerns strategy choice and environmental determinism. The analysis showed the existence of an intermediate position. Choice does not exist in absolute terms; it is constrained by the external environment. Choices exist because of the entrepreneurial activities of firms' management. Constraints also result from the history of the firm, the management background (with their respective routines) the competitive structure and competitors' behaviour.

3. *Because of the changing nature of the industry and its competitive structure, it is possible for firms to develop a significant presence in an industry, even when an industry is reputed to be mature.* The issue of changes always creating new opportunities in the market is clearly exemplified here by the development of discounter chains in the early 1990s and by the development of Argyll in the 1980s and 1990s. Baden-Fuller and Stopford (1993) also argue that it is possible for companies to succeed and develop an important presence in industries reputed to be declining or mature, where higher profits can only be gained through rationalisation processes.
4. *We can note the importance of detail in explaining the dynamics of firms' strategies and industry structure.* It is possible to describe, in broad terms, the dynamics of firms' strategies and industry structure. However, there is a significant difference between describing the dynamics of a phenomenon and understanding the mechanisms responsible for them.

   According to the theory of strategic groups, "what is seen is what there is" (i.e., it is possible to describe and explain the dynamics of firms' strategies and industry structure through variables and know what is responsible for what). This research shows the importance of an in-depth analysis for the understanding of the

mechanisms driving industrial and business change. As discussed earlier, multiples were not important to start with. They became important. However, it is possible to understand this only through in-depth analysis. A superficial analysis will only find that the share of multiples in the GRI has increased over time. It will not say or explain how it was done. In this research, it was shown that changes in the consumer market, firms' strategies and governmental policies were a necessary condition. The analysis of Argyll also shows the importance of detail. The initial objective of Argyll's management was to create a group operating in grocery retailing and the drink business. Argyll's management saw the possibility for developing an important presence in the drink business. However, their objectives were not realised because they lost the bid to Distillers to Guinness (i.e., reflecting importance of external environment). This important opportunity disappeared, external conditions changed because many companies realised the existence of important opportunities in the drink industry and no further opportunities to develop an important presence in the drink business were foreseeable. At once, a new opportunity arose in the UK GRI: Safeway US decided to sell its UK subsidiary that was later bought by Argyll. Thus, (a) Argyll would have not taken over Safeway if its bid to Distillers had succeeded and (b) Safeway would have not been sold if Safeway US had not had a management buy-out as a response to a hostile bid that led to the it and, as a consequence, the management had to sell its UK business to reduce gearing. This shows the importance of an in-depth analysis for analysing and explaining the dynamics of firms' strategies.

5. *Similarities and differences exist among comparable firms and are important for the dynamics of firms' strategies. However, each firm is a unique entity.* Important similarities exist in some firms characteristics. These may be their asset endowment,

strategy flows and management views of the competitive environment. However, important elements are firms-specific and are responsible for differences in firms' investments or position in the consumer market. Indirectly this means that maps recognising similarities and differences among firms are important, but in analysing general concepts such as multiples, edge-of-town operators, or family controlled firms, it is necessary to recognise the specificities of a firm. As we said earlier, it is detail that makes it possible to identify mechanisms responsible for the dynamics of firms' strategies.

6. *Strategy is a complex issue and complex relationships exist among its parts.* Researchers need to recognise that strategy is a complex issue; this is fundamental to an understanding of the dynamics of firms' strategies. Differences between intended and realised strategy, and between strategy stocks and strategy flows, are important for understanding the dynamics of firms' strategies. Further, at any specific point in time, firms with apparently different strategy stocks may invest in similar strategy flows. Firms with similar strategy stocks may have different strategic investments. This implies that different types of maps may be proposed for the analysis of the dynamics of firms' strategies (e.g., strategy stocks and strategy flows).
7. "*Strategy is not everything*". A good strategy will not automatically lead to victory. "Napoleon is ... reputed to have said 'No strategy ever survived a battle'." (Wensley 1985: 415). Strategy is not a holistic term including all the internal and external dimensions of the firm. Other non-strategic dimensions may play a role in the dynamics of firms' strategies and performance. This does not mean that a firm does not need a strategy. As Rumelt *et al.* (1994) argue, strategy is a critical influence in the success or failure of the enterprise. However, in order to study the dynamics of firms' strategies, firms' performance, industry and competitive structure, we need to look at elements other than a firm's strategy, and particularly, the dynamics of the competitive structure and the external environment, and to their interrelationships with changes in firms' strategies.

   Here, an important similarity exists with the view of firms' strategies in the evolutionary theory of firms' strategies. As we saw in Chapter five, Rumelt (1984:568) argues that "a firm's strategy may be explained in terms of the unexpected events that created (or will create) potential rents together with the isolating mechanisms that will act to preserve them. If either element is missing, the analysis is inadequate." Therefore, stressing the importance of analysing both firms' strategies and the external environment. The main difference with Rumelt's view relates to the importance of a firm's relative position in the competitive structure. In the empirical research, we saw that there were opportunities in the superstore development business. However, firms were not in the same relative position in the industry to take advantage of this opportunity in the same way.
8. *Because strategy is a process over time, the dynamics of the process plays an important role on the success of a firm's strategy.* The process strongly influences the dynamics of firms' strategies and performance. By definition, strategy is a concept that requires the existence of another entity (other firms). Management cannot control the entire environment. Furthermore, continuous changes are taking place in firms' strategies and the competitive environment. Because of this "state of becoming", there is uncertainty in the strategy process. It is in the process that management plays a determinant role. Once a decision is taken, management has to follow the dynamics of the process in order to manage uncertainties threatening the success of its firm's strategy.
9. *Firms' management plays an important role in the strategy process, both in defining*

where the company is going in terms of strategy and in making sure that the strategy process is successful. This issue is linked to the previous one. The empirical analysis showed that management was been very important in developing firms' strategies as well as in limiting the negative effects of the external environment on other firms' strategies. Because of the "state of becoming" mentioned above, and because management cannot control the internal and external environment, there is always a risk associated with investment. However, management can try to limit the risks by intervening in the external environment. This is clear when we consider the case of ASDA. In the early 1990s, Archie Norman (ASDA chief executive) said that the market was saturated and that competitors had a 'head-in-the-sand' attitude towards superstore development. However, a few years later ASDA resumed its plan for superstore development. Norman intervened in the competitive environment to limit the negative effects of other operators' development plans by trying to influence the financial market to take a negative view of these plans and encourage them to pressurise companies to not pursue them.

10. *It is important for firms' long-term survival that they continuously renew their activities.* Firms that stop to renew their activities also start to decline. Renewal does not mean to completely change the way of doing things but to aim to improve operations, either by cost reduction or by improving the attractiveness of the company to consumers. The ASDA case study shows that its management, through entrepreneurial activities, created something completely new (a discounter superstore operator) and for a long period of time, it was the only company pursuing this idea. The company was an important innovator in the industry. This innovation came on an existing competitive structure but did not revolutionise it. In a heterogeneous and geographically-dispersed consumer market, there was space for other businesses (city

centre operators and up-market operators). However, the idea originally developed by ASDA was later used by other companies that, in developing it, further innovated it. In the early 1980s, ASDA stopped to innovate, marking the beginning of a period of relative decline. It has been argued that the decline of the co-operative system has been due to a similar reason. Co-operatives developed the concept of supermarket in the UK GRI but then stopped innovating. Bamfield (1987) argues that a lot of rationalisation was made in the co-operative system. However, this only worked in the short term. Because there was not a drive towards building something new. The co-operative system started to decline. We agree with Hannan and Freeman (1977) that inertia is responsible for firms' decline. However, we disagree with their view that inertia characterises all firms of a specific type in the same way. We also disagree with their assertion that changes mainly occur in the external environment. Within market-based economies, changes also come from witnin firms, and entrepreneurial activities.

11. *Ex-post analysis of past strategies may be used to analyse the strategy options available to management but in a complete different way than has traditionally been argued in strategic groups analysis.* Market opportunities are located in time and because of the heterogeneity that characterises firms, these opportunities are not available to all firms [*this is an example of the uniqueness of market opportunities*: Safeway was on sale in 1986/87. Thereafter, there were no other Safeway available. An *Example of opportunities not being available to all firms*: Is when, Gateway had taken over Fine Fare and could not afford another take-over. Argyll was in the best position to take over Safeway). Because of continuous changes in firms' strategies and competitive structures, opportunities also change. Recipes do not recognise any role to time and history. Recognising history implies an understanding that

opportunities are context-specific. This specificity is given by the competitive structure and firms' positions at that particular point on time. However, this does not mean that market opportunities have a very short life. Our analysis indicated that take over activities lasted in the UK GRI for a long period of time, which means that it was possible to develop a significant presence in the UK GRI by taking over companies for long period of time (four to five years). Another example of market opportunities lasting for a long period of time is given by superstore development. (It has also to be noted that although it has become much more difficult to build superstores, this does not mean that no other companies can become an important superstore operators in the future. Indeed, this is what WM Morrison is undertaking to do).

The issue, then, is of understanding potential market opportunities and whether and how past strategies can be used to develop future strategies. It is here that the management plays a determining role and this has been shown by our research. Companies have important reference points in the industry and what other firms do, plays a part in the decision taken. However, firms need to be creative in theirs imitation activities, indeed we spoke of dynamic imitation, where firms further develop ideas originally proposed by other firms. In our view, this has a number of implications. Any managerial analysis must recognise (a) the specificities of any historical period, (b) the similarities and differences existing between firms, (c) understand when and how external conditions are changing; and, (d) be aware of its firm's history and strategy stocks.

This position is somehow different from the evolutionary theory of firm strategies. The use of past strategies for the development of future ones is very problematic in the evolutionary theory of firms strategies. Instead, we argue that there may be a

period during which some past successful strategies can be important reference points for the development of similar strategy. However, much depends on the specific position of the firm in the competitive structure.

12. *The nature of prescriptive analysis.* The issues exposed above also have some prescriptive characteristics. Prescriptive elements in strategic groups research emerged in terms of the strategy to follow to increase performance. This research showed a prescriptive element in a different way. Rather than indicating the successful strategies, it showed that the dynamics of firms' strategies and the competitive environment are complex in nature and therefore top management is in the best position to make sense of it and act on it. It leaves autonomy to top management but also suggests a number of factors that management has to take into account.

    This is a position that has already been taken by researchers of the evolutionary theory of firms strategies.

These are issues about which we can start thinking in order to develop a better framework for the analysis of the dynamics of firms' strategies and industry structure. However, further research needs to be undertaken. Obvious directions are to develop stronger links with strategy process research and the evolutionary theory of firms' strategies, as important similarities and possible complementary elements exist between these approaches.

We believe that if an important alternative is to be provided for the concept of strategic groups, this will eventually come from the evolutionary theory of firms' strategies as important common elements exist in these research findings and the assumptions and hypothesis characterising this theory (continuous dynamics characterising firms' activities and the external environment, the importance of ambiguity and uncertainty in the strategy process, the importance of internal and external processes for explaining the dynamics of firms' strategies and their performance, and difficulties in using past strategies as recipes for strategy formulation). The main contribution that this research may give to the development of evolutionary frameworks concern clarification of the nature of industrial and business change, showing the complexity of firms' strategies, indicating the importance of attention to detail in research and firms' relative positions in explaining the dynamics of their strategies.

At another level, the research also shows the importance of historical analysis, an area that finds little convergence in the strategy field (for example, there have been several special issues of the *Strategic Management Journal* on various subjects, but none have been dedicated yet to historical analysis in strategy research).

13.3 Conclusion

Weick (1990) argues that the job of a researcher of management and of companies' strategies is similar to that of a cartographer. Both draw maps to make sense of the territory and its dynamics.

A map is the result of a process of abstraction[1] and classification of elements of the territory. The difference between the map and the territory is that the territory concerns

[1] Weick (1990) argues that an abstraction process is a continuous activity of selecting, omitting, and organising the details of reality so that we can experience the world as patterned and coherent.

the *world of events and things* whilst the map is the *world of words* about events and things (Weick, 1990). The distinction between a map and a territory serves the specific purpose of warning us not to treat nouns as anything but crude static rendering of a much more complex changing territory. The content of maps consists largely of differences that are presented in a simple and logic manner in order to be accessible to the most people. Maps are important because (i) they are surrogates of space, (ii) they put people in their space both literally and figuratively, (iii) they capture time and (iv) they emphasise classification and assignment of things to classes.

The content of a map varies according to (a) the standpoint taken when drawing the map and (b) the purpose the map was been built for. Maps are references to the people using the map. Once people are aware that maps are the results of an abstraction process and there exist differences between maps and territories, people can improve the content of the maps. "The map prefigures their perception, and they see what they expect to see. But, as discrepancies accumulate, they pay closer attention to what is in their immediate experience, look for patterns in it, and pay less attention to the maps." However, it is necessary to have a map. "It takes a map to make a map because one points out differences that are mapped into the other one" (Weick 1990: 5). The main problem is that the distinction between maps and territory sometimes disappears in managerial life. "The map is not the territory when the territory is described with particulars, but it is more like the territory when those particulars are ignored and treated as non existent" (ibid.: 4).

Researchers using strategic groups to study firms' strategies and their dynamics are mapping firms' strategies and the competitive structure. The territory comprises firms operating in an industry. The problem with strategic groups is that a map is supposed to contain all the important information. According to strategic groups theory, there is no difference between the map and the territory. However, we have seen that firms' strategies and competitive structures are complex concepts and a single map cannot show this complexity. Furthermore, strategy is not a holistic concept. It does not include the entire firm or all of the firms' decisions or its past, present and future. Further, it does not include all the external elements that may influence the success of a firm's strategy.

Having said this, it is not possible, at this time, to substitute the concept of strategic groups with another concept that addresses the same number of issues at the same time. There are many interesting issues in the concept of strategic groups, but each need to be further investigated. Only knowledge of both the detail and general trends can lead us to better understand and explain the dynamics of firms' strategies, industry structure, and performance.

Before being able to build a good map, it is necessary to have good knowledge of the characteristics of the elements that are being mapped. In this research, we started to develop this. The analysis of the dynamics of firms' strategies and industry structure is an issue that has recently attracted a lot of attention in strategy research. The 1997 Summer Special Issue of the *Strategic Management Journal* was dedicated to *The Interactions of Organizational and Competitive Influences on Strategy and Performance*. Henderson and Mitchell (1997: 5), in their introduction, wrote: "there has been much debate in the strategy literature as to whether organizational capabilities or market competition are more important in shaping firms' actions and outcome but this

debate has generated surprisingly little consensus". They also argued that the inconclusive nature of much of the existing research is probably because "organizational capabilities, competition, strategy and performance are fundamentally endogenous" (ibid.: 6). Hence, interactions between these elements exist at multiple levels. They continue by saying, "of course, researchers in ... strategic management ... have in principle long recognised this endogeneity. But for a mixture of reasons our understanding is still at a very rudimentary stage" (ibid.: 6). In summarising the papers of this special issue, Henderson and Mitchell note that what emerges is that both organisational capabilities and firm's environment drive strategy and performance. However, firms and the environmental levels also have reciprocal relationships and there is a dynamic between the internal and external elements, characterised by a continuous influence. Therefore, they conclude:

> "We suspect that longitudinal studies that expecially focus on the nature of these organizational and environmental interactions as they evolve over time, and that pay particular attention to the ways in which capabilities and environmental conditions shape each other, are thus likely to be particularly fruitful for both theory and practice." (ibid.: 12).

This research started to analyse these issues in detail. Areas that need further investigations include (1) strategy and competitive processes, (2) reference points, cognitive structures, and strategy formulation, and (3) the relative positions of firms in a competitive structure and the dynamics of their strategies.

The concept of strategic groups will be an important starting point for further work that has to be undertaken in a critical fashion. Maps that refer to different issues can be made, but we also need to link them. It is on the links that more research needs to be carried out.

Appendix 1 The Researcher and the Research

A1.0 Introduction

In this study, personal preferences shaped research interests and the research question in way that had strong influences on the research method. At the same time, my own preferences have been largely influenced by both the undergraduate degree I have done in Italy and the continuation of my studies in England.

My first degree is in *Economia Aziendale*, badly translating to Business Economics. The problem with the term Business Economics is that is seen as a borderline subset of Economics. In the Italian university system, *Economia Aziendale* is a field of study that encompasses three main branches: administration, organisation, and economics. The degree had a bias toward theoretical discussion. Students were often asked to compare and contrast theoretical approaches. In *Economia Aziendale*, there is a fundamental belief that (a) theories cannot have an absolute value and (b) that theories have a meaning only if they can support firm's management in their administrative tasks.

The study of various theoretical positions provided me with a strong basis for the continuation of the studies and taught me to be sceptical of any single, specific and supposedly superior theoretical or methodological approach. However, whilst sound knowledge was developed through comparing and contrasting approaches, few skills were acquired in analysing the work of specific authors (we rarely read the work of specific authors). Furthermore, this type of degree did not teach me much pragmatism. This was

acquired during my stay in England, where the way of studying at university concerns reading, understanding and critically assessing specific works and authors. However, critique has to be pragmatic and take into account the real problems existing in research. During my stay in England, I have acquired a more pragmatic spirit in research.

I believe that the combination of the more discursive approach of my Italian degree and the more specific and pragmatic approach of the British system have shaped my research interests and the method I chose in this research.

A1.1 Epistemological Underpinnings of the Research

The approach taken in this research derives from Hegelian philosophy and critical theory, and is emancipatory in character. Among the different types of emancipatory approaches, this research is questioning in its nature and incremental in objective (Alvesson and Willmott 1996).

A1.1.1 The Hegelian Idea of Dialectics

Dialectics has its origin in the philosophy of Socrates and Aristotle. For a long time, dialectics had a negative connotation as it was seen as useful for highlighting contradictions in the logic used in speeches.

In the philosophical thought of Hegel, dialectics does not limit its range of action to logic, but assumes an ontological meaning. Dialectics characterises the process shaping the development of the world. The dialectical development of the world is characterised by three elements: the *thesis*, the *anti-thesis* and the *synthesis*. The *thesis* represents the system of positive aspects relating to a specific issue. This issue can be dominant in society and accepted by the majority. The *anti-thesis* represents the system of critiques relating to the same issue. The *anti-thesis* is not negative in its purpose. Its objective is positive in that it aims to overcome the negative elements characterising the specific issue. *Thesis* and *anti-thesis* are both real and their coming into conflict will lead to *synthesis* that represents the re-conciliation of the *thesis* and *anti-thesis*. The reconciliation is ontologically superior to that of the thesis and anti-thesis, as it considers the issues highlighted by both. With the *synthesis*, the dialectical cycle is closed. However, this is temporary as each a dialectical cycle is followed by another. The continuous dynamics of the world mean that the *synthesis* will become a *thesis* and will give rise to new divisions represented by the *anti-thesis*. These divisions will again be reconciled into a new *synthesis*. There is circularity in the positivism characterising the dialectical process of Hegel. There is no perfection in absolute terms. The intellect and ideas have an important role in Hegelian thought as they are necessary to develop the anti-thesis. The philosophy of Hegel has had an important impact upon philosophy, and especially upon the development of Critical Theory.

A1.1.2 Critical Theory

Although critical theorists recognise the importance of ideas, they also recognise that knowledge, which orients human behaviour, is not only based on ideas. Habermas

(1972) defined as the illusion of pure theory the belief that "perfect, a-historical, disembodied knowledge can be produced by imperfect, historical, embodied (human) beings" (Alvesson and Willmott 1996: 50). The fundamental ontological position is that a best way does not exist and knowledge cannot be separated from the politics driving its production. There is a symbiotic relationship between knowledge and politics. "Whatever is deemed to be objective knowledge, whether by scientists or lay persons, is conditioned by power relations in which competing ideas, methods and findings are developed and sanctioned as authoritative forms of knowledge" (ibid.: 49). This positions critical theorists in contrast with the Weberian idea of 'value-free knowledge' and conception of science where the main objective is the refinement of a methodology for discovering the truth about some parts of reality.

Critical theory has often been accused of nihilism. However, it is fundamentally emancipatory in character, and its research programme is fundamentally positivist. Central to critical theory is the understanding that, in the form of critical reflection, reason can be a stimulus and medium of human emancipation. Differences exist among the central figures in critical theory. However, there is a shared vision of the possibility of promoting and guiding emancipatory change through the mobilisation of the transformative power of reason. (Alvesson and Willmott 1996). As in Hegel's philosophy, critical theory has kept alive the Enlightenment idea that critical reason can be mobilised to transform society. It "retains a belief in the possibility of applying reason to dissolve, and not just to expose, forms of irrationality" (ibid.: 48).

Burrell and Morgan (1979) posited critical theory as being part of a *radical humanist paradigm*, where a subjectivist philosophy of science approach is combined with a radical change theory of society.

Figure A.1 The Four Sociological Approaches
Adapted from Burrell and Morgan (1979)

	Radical Change		
Subjective	Radical Humanist	Radical Structuralist	**Objective**
	Interpretativist	Functionalist	
	Regulation		

Subjective philosophies of science assume that social phenomena are fundamentally different from natural phenomena and cannot be analysed through supposedly objective instruments. Subjective philosophies understand the social world as being continuously constructed, reproduced and transformed through inter-subjective processes of communication. Oppositely, objectivist philosophies assume the existence of a reality 'out there' that can be faithfully captured or mirrored by the application of scientific methods.

Critical theory also falls into the radical theories approach to society. Radical theories of societies assume that contradictory pressures for transformation condition social relations. This is in contrast with theories of regulation, which assume that modern societies and their organisations are characterised by order rather than by conflict.

Burrell and Morgan recognise that they have problem in locating critical theory, given its inter-paradigmatic characteristics. This is particularly important because Burrell and Morgan (1979: 297), while recognising that "it is through the dialectic that the objective

and subjective aspects of social life are thought to be reconciled" also contend that the four paradigms are incommensurable. The main consequence of this approach is that this protects each of them from external critique and impedes the development of a synthetic approach. However, this idea of incommensurability is against the Hegelian idea of *dialectics*, as well as against the idea of emancipation through the criticism of theories, which is fundamental to critical thinking. If we believe in the enlightening spirit of research, then until better means of analysis are developed, we must be aware of the strengths and the weaknesses of the theory, methodology and technique we use for the purpose of improving them.

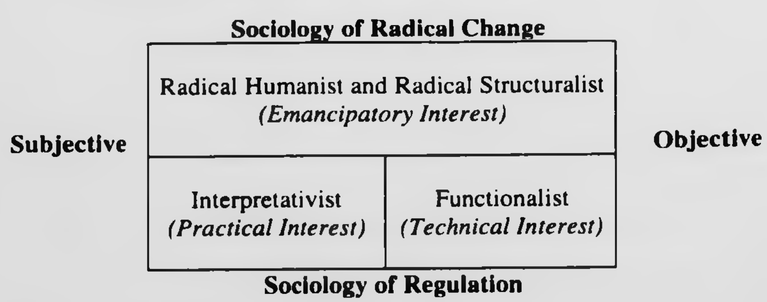
Oliga (1988) argues that in critical thinking, it is possible to solve the problem of incommensurability in Burrell and Morgan's framework by incorporating Habermas' *interest constitution theory*. In this theory, Habermas (1972) recognises the existence of different types of knowledge and cognitive interests. Specifically, he argues that individuals have (i) a technical interest for prediction and control, (ii) a practical interest for communicating and (iii) an emancipatory interest in assessing forms of domination. These forms of interests are, in Habermas' view, individually necessary for the acquisition of knowledge and they represent the relationship between human beings and nature. Therefore, they are not to be regarded as alternative but rather as complementary. Analogous research interests exist within social sciences. "The approach of the empirical-analytic sciences incorporates a *technical* cognitive interest; that of the historical-hermeneutic sciences incorporates a *practical* one; and the approach of critically oriented sciences incorporates the *emancipatory* cognitive interest that, as we saw, was at the root of traditional theories" (Habermas 1972: 308). Oliga (1988) argues that strong similarities exist between the classification proposed by Habermas and that proposed by Burrell and

Morgan, and it can be useful to overlay Habermas' interest constitution theory with Burrell and Morgan's classification.

The *technical* interest for prediction and control relates to the interaction between the humankind and the nature. It constitutes empirical knowledge and can be compared with Burrell and Morgan's functionalist paradigm. The *practical* interest for understanding refers to human communicative interaction and constitutes historical-hermeneutic knowledge, which has parallels with the interpretative paradigm. The *emancipatory* interest refers to social relations of power, domination and alienation and constitutes critical knowledge, which has parallels with both the radical-humanist and radical-structuralist paradigms of Burrell and Morgan (1979).

Using Habermas' theory, the various approaches are therefore no longer to be seen as alternatives but as complementary. This interposition is extremely important in the context of this research as it enables us to look at research that has been typical of the functionalist paradigm. The three different kinds of knowledge imply different methodological approaches: empiricism, hermeneutics, and critical methodologies.

Figure A.2: Matrix of the Combination of Burrell and Morgan's (1979) Sociological Approaches with Habermas' (1972) Interest Constitution Theory
(Adapted from Rivest 1997)



Poststructuralist theory, and in particular, the work of Foucalt on power, truth and subjectivity, warns of the possibility that the critique of ideologies can be separated from relations of power (Alvesson and Willmott 1996). It is important to be cautious of 'emancipatory' projects as they have the potential to become a new source of domination. Indeed, Burrell (1994) argues that this idea of enlightenment is fundamentally modernist and positivist in character.

There is always a dilemma for researchers who are conscious of the possible consequences and misinterpretations of their research. Bearing in mind the critiques of Poststructuralist, I do not believe that a 'grand' emancipatory project is possible. I believe that the spirit of critical theory is fulfilled in a better way by an emancipatory study that is *questioning* in its characteristics, and *incrementalist* in its change effort. The *questioning* approach has been defined by Alvesson and Willmott (1996: 176) as "principally directed at challenging and critiquing dominant forms of thinking. Dominant ideas ... are met with suspicion and are scrutinized." The objective is incremental as we favour "a gradualist or reformist approach to emancipatory transformation" (ibid.: 177). This is clear when we look at the objective of this research, which has led to the specification of a number of more detailed research questions.

Compared to the work of Hegel, critical theory is much more focused on the role of power supporting the thesis and the difficulties characterising the recognition of the anti-thesis. Because we can only advance hypotheses about why strategic groups has become such a widespread concept for the analysis of similarities and differences existing between firms competing in the same industry, the reader, may initially have the impression that this research is much closer to the original Hegelian approach. The thesis would be that strategic groups *is* a valid concept for the analysis of firms' strategies and industry structure; the anti-thesis, that strategic groups *is not* a valid concept for the analysis of firms' strategies and industry structure. Through the research, we would look for the synthesis. However, because, we are aware of the importance of power in the development of dominant issues, we can say that the approach taken is characteristic of critical theory.

Appendix 2 An *Ex-post* Analysis of the Research Technique

A2.0 Introduction

In Chapter six, we expressed some anxiety about the research technique decided on for the empirical research. A key question was whether the use of newspaper articles would form a sufficient basis for the reconstruction of the histories of the companies. However, having undertaken two interviews in one company, we were reassured about the validity of the research technique. The objective of this appendix is to describe what has been learnt from the use of the research technique. It is thus an *ex-post* assessment of the technique used in the research.

A2.1 Characteristics

The use of newspaper articles provided an accurate basis for the development of the companies' case studies, and *ex-post*, we believe that it was the right technique for this research. The following are some of the benefits that have emerged:

1. *Accuracy of data*. Newspaper articles give a very accurate account of the evolution of events characterising firms' strategies, especially for longitudinal studies such as this, which considers a 15-year time span for the analysis of firms' strategies. Newspaper articles provided an ideal basis for the development of case studies, better than would have been the case with other sources such as interviews.

Interviews rely upon interviewees' memory and personal views, which can bring bias or distorted facts from recollection. For example, in one of the interviews, we asked about the precise organisational changes that had taken place in the early 1990s. These changes were quite important because they signalled that the company was taking a specific strategic direction. However, the manager was unable to recall the date of this event. The interviewee said: "In fact, I have forgotten. Was it only March 1993?" To the manager the event seemed to management much further back in time because many relevant events had taken place in the following months, significantly affecting its firm's strategic activity. Although this event did not occur at other times, it seemed to us that the use of newspaper articles was an accurate basis for writing the case studies.

Furthermore, it was possible to talk about particular and important details in the interviews, without going through the whole story, mainly because we had already developed the case study and the interviews' main role was to see whether or not what we had reconstructed about the firm's strategy made sense. We doubt that this would have been the case if the case study had not already been developed. We believe that without the case study as a basis for the discussion, the interview would have been much more superficial in character. Therefore, there was, indirectly, a stronger validation of the research technique, as even a detailed interview did not bring any new insight to the analysis made.

2. *Better understanding of the relationships between firms' strategies and external environment.* As already said in Chapter six, there are many articles on each of the companies analysed here, as well as on competitors. This enabled us to develop a good view of what the companies were doing in terms of both strategy and performance, and, at the same time, to have a feeling of what competitors were

doing. This has been particularly important for understanding the interrelationships between firms and the external environment, as well as for understanding the importance of the specific historical period for the analysis of firms' strategies. These are elements whose complexity did not emerge during the interviews. It seems that in the interviews, the complexity of these interrelationships between firms and external environment was simplified. We do not know to what extent this was due to the limited time of the interviews, a possible *ex-post* rationalisation of the strategy process or fading memory.

3. *Better understanding of the continuous dynamics characterising firms' strategies and the external environment.* The quality and quantity of articles available and the fact that they were used in a longitudinal type of research helped us to understand the continuous dynamics characterising firms' strategies and the competitive environment. Decisions and actions are continuously taken and external events often affect firms' strategies and actions, which means that strategy is a continuous process. Furthermore, as newspaper articles also report rumours about important strategic decisions (e.g. potential mergers, acquisitions and diversification), firms' complex histories emerge with the intended strategy, emerging strategy, abandoned strategy and realised strategy. In interviews, the complexity of firms' strategies and the fundamental uncertainty characterising it also emerged (e.g., during the interview, one of the interviewees was asked his opinion about a change in strategy. He replied: "I think it is sometimes terribly difficult to rationalise these decisions" and continued by explaining the complex system of decisions, actions and events that led to the result). However, given time and resource constraints, interviewees tended to simplify the issue and we did not learn about the complex system of events and actions that eventually led to something. Further, there is a tendency to

talk more about what happened rather than about what could have happened. Therefore, the role of potential strategic actions tends to be marginalised.

A2.2 Limitations of the Study

The use of newspaper articles is a valid technique for the analysis of the dynamics of firms' strategies and industry structure from an external point of view. However, this technique can provide very limited insights into the internal dynamics of firms' strategies (i.e., differences in a firm's management view as well as the internal processes of reconciliation of different views).

An internal analysis of the dynamics of the strategies of the four firms based on observation and the analysis of internal data (as would be the case in a typical strategy process research) could have been useful for highlighting the internal complexities of the strategy process the political characteristics of the dynamics of firms' strategies. From this analysis, we only got a hint of the dynamics of internal processes of firms' strategies. However, it has to be said that internal observation would not have been easy given the longitudinal characteristic of the research. Furthermore, the focus of this research is on the external rather the internal dynamics of firms' strategies, justifying the research technique.

Future research may take this issue into account and propose to use the two techniques at the same time, that is, the use of newspaper articles to study the dynamics of firms' strategies and the competitive environment, and internal observation to study the internal dynamics of firms' strategies.

A2.3 Generality of the Research Technique

This technique was particularly appropriate for studying the dynamics of firms' strategies and industry structure in the UK GRI, an industry with a high profile in the consumer market and where operational issues have a high strategic content. Much information was available and it was possible to understand, through the analysis of newspaper articles, the dynamics of firms' strategies at the business level as well as the dynamics of the competitive environment. These represent very specific conditions that may not be found in other industries, thus limiting the use of this technique in other research contexts.

Appendix 3 List of the Largest Companies Operating in the UK Grocery Retailing Industry in 1980 and 1995

1980	1995
ABF (Fine Fare)	Aldi
Amos Hinton and Sons	Argyll
Associated Dairies (ASDA)	ASDA
BAT (International Stores)	Budgens Stores
Bejam	Co-operative Retail Services
Bishops Foods Stores	Co-operative Wholesale Society
Booker McConnell (Budgen and Rusts)	Iceland
Co-operative Retail Services	John Lewis Partnership (Waitrose)
Co-operative Wholesale Society	Kwik Save
Fitch Lovell	Lidl
Generale Occidentale (Allied Suppliers)	Marks and Spencer
Hillards	Netto
Iceland	Sainsbury's
John Lewis Partnership (Waitrose)	Somerfield Holdings (Previously Gateway, and Dee
Kwik Save	Tesco
Laws Stores	WM Morrison
Lennons Supermarkets	
Linfood (Later Gateway, the Dee Corporation)	
Marks and Spencer	
Normans (Later Merchant Retail Group)	
RCA International (Oriel)	
Safeway	
Sainsbury's	
Tesco	
WM Jackson and Sons	
WM Low	
WM Morrison	

Appendix 4 Argyll Group: Financial and Retailing Statistics

	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	*1987/88	1988/89	1989/90	1990/91	1991/92	*1992/93	1993/94	1994/95	1995/96
Tot Sales (Inc. Taxes)	N/A	N/A	N/A	1371890	1515614	1755560	1905580	2128200	3409900	3696400	4143300	4757500	5039300	5539000	5982900	6217700	6500000
Total Sales	22814	102030	229759	1310542	1448284	1676952	1818747	2024953	3236268	3500870	3920000	4496102	4729199	5196301	5607699	5814602	6069398
Operating Profit (Adj)	200	1600	7047	30839	44724	56802	66915	85288	143302	156846	205300	282100	327000	387000	365200	382900	418000
Pre-tax Profit incl. Assoc. (Adj)	N/A	N/A	N/A	25852	40283	53122	64601	79721	156987	178743	227500	290800	360500	415200	365200	375300	401700
After Tax Profit (Adj)	N/A	N/A	N/A	23253	17916	27991	37667	51819	102042	116183	147900	193500	244400	277500	240600	248100	264700
Capital Expenditure	N/A	N/A	N/A	34000	42500	69000	76400	65700	177300	276200	281100	344100	442200	610800	541200	461000	423500
Ratios																	
Return on Equity (%)	N/A	N/A	N/A	27.0	16.0	22.9	32.5	30.6	23.2	22.5	21.7	23.7	16.9	16.9	13.5	14.1	13.6
Return on Assets (%)	N/A	N/A	N/A	6.7	9.6	10.2	10.6	9.9	14.2	12.7	13.3	14.5	13.2	12.8	11.4	11.5	11.4
Return on Capital Employed (%)	N/A	N/A	N/A	19.3	27.1	29.7	37.2	28.4	30.8	29.7	29.9	30.3	23.7	22.0	17.7	18.8	18.5
Safeway																	
Sales of Safeway (Inc. Taxes)	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/C	1440000	2071000	2805800	3496600	3905000	4423900	4867800	5325500	6031100
Contribution to Total Sales (%)	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/C	42.2	56.0	67.7	73.5	77.5	79.9	81.4	85.7	92.8
Operating Profit of Safeway	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/A	106000	158800	222500	275300	336200	329200	349600	386400
Contribution to Tot. Op. Profit (%)	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/C	N/A	56.4	70.7	79.0	84.1	86.9	90.2	91.3	92.6
Total Sales Area (Sq. Ft.)	N/C	N/C	N/C	N/C	N/C	N/C	N/C	2006000	2873000	4265000	5436000	6011000	6424000	7143000	7753000	8278000	8416000
Number of Stores	N/C	N/C	N/C	N/C	N/C	N/C	N/C	133	176	240	291	310	322	345	365	378	370
Aver. Sales Area per Store (Sq. Ft.)	N/C	N/C	N/C	N/C	N/C	N/C	N/C	15083	16324	17771	18680	19390	19950	20704	21241	21899	22746
Presto																	
Total Sales Area (Sq. Ft.)	N/C	N/C	N/C	1986000	2213000	2291000	3420000	4169000	3520000	2041000	1356000	1157000	1132000	1232000	1122000	1038000	848000
Number of Stores	N/C	N/C	N/C	136	150	152	306	540	488	270	227	215	212	216	205	169	109
Aver. Sales Area per Store (Sq. Ft.)	N/C	N/C	N/C	14603	14753	15072	11176	7720	7213	7559	5974	5381	5340	5704	5473	6142	7852
Lo-Cost																	
Total Sales Area (Sq. Ft.)	N/C	N/A	N/A	N/A	474000	480000	562000	570000	801000	1003000	935000	913000	888000	954000	992000	0	0
Number of Stores	N/C	N/A	N/A	N/A	152	149	200	207	288	353	320	298	285	274	271	0	0
Aver. Sales Area per Store (Sq. Ft.)	N/C	N/A	N/A	N/A	3118	3221	2810	2754	2781	2841	2922	3064	3116	3482	3661	0	0
Others																	
Total Sales Area (Sq Ft)	N/A	N/A	N/A	N/A	1893000	2265000	1001000	301000	0	0	0	0	0	0	0	0	0
Number of Stores	N/A	N/A	N/A	N/A	751	781	466	142	0	0	0	0	0	0	0	0	0

Note: * = 53 weeks; 1980/81: 15 months; Source Datastream and Annual Reports of Argyll Group

Appendix 5 ASDA Group: Financial and Retailing Statistics

	*1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	*1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	*1991/92	1992/93	1993/94	1994/95	1995/96
Total Sales (Inc. Taxes)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2907000	3813500	4772400	4904100	4991800	5282800	5682600	6531100
Total Sales	999000	1188000	1310000	1519144	1755220	1934165	2516600	2667100	2728600	2708600	3550200	4468102	4529102	4613801	4882199	5285301	6042301
Operating Profit (Adj)	49111	51119	52277	69028	94815	112062	162000	185100	185660	195900	217000	262400	181400	190400	196800	251100	316700
Pre-tax Profit incl. Assoc. (Adj)	49983	51389	59032	78437	104583	119114	166700	192000	215460	246800	184700	168300	88200	140800	183100	246200	304600
After Tax Profit (Adj)	23285	24667	26742	36149	54808	66363	100700	124800	138660	160400	120100	111100	59100	94700	117300	161900	211900
Capital Expenditure	52100	52900	50700	75600	113400	188600	179700	276000	304000	476600	390900	257700	172400	190000	242000	204000	349000
Ratios																	
Return on Equity (%)	21.3	13.7	13.2	15.6	22.2	22.9	23.4	24.2	16.1	17.0	11.1	9.7	5.3	6.0	8.5	10.8	12.8
Return on Assets (%)	19.6	15.5	15.4	16.7	19.4	17.5	18.3	16.1	14.1	13.4	6.8	5.9	3.4	4.9	6.9	8.7	9.3
Return on Capital Employed (%)	44.7	29.2	28.9	30.1	34.1	32.7	33.1	24.0	19.3	18.3	14.5	15.3	11.0	10.0	11.4	14.2	15.1
ASDA Stores Division																	
Sales (Inc. Taxes)	N/A	N/A	1190482	1410474	1650990	1884300	2074000	2156300	2436400	2694300	3526200	4425600	4648800	4751000	5181000	5655000	6495000
Contribution to Total Sales (%)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	92.7	92.5	92.7	94.8	95.2	98.1	99.5	99.4
Operating Profit	N/A	N/A	47000	58400	81917	95483	103000	124900	152700	176100	206000	250600	185600	196100	207600	246800	312800
Contribution to Tot. Op. Prof. (%)	N/A	N/A	89.8	84.6	86.4	85.2	63.6	67.5	82.2	89.9	94.9	95.5	102.3	103.0	105.5	98.3	98.8
Total Sales Area (Sq. Ft.)	2501000	2604000	2677000	3019000	3195000	3406000	3555000	3892000	4431000	4975000	7795000	8160000	8241000	8099000	8134000	8210000	8436000
Number of Stores	75	78	80	90	95	101	104	111	120	129	199	204	206	201	202	203	206
Aver. Sales Area per Store (Sq. Ft.)	33350	33385	33460	33540	33630	33720	34180	35060	36920	38570	39170	40000	40000	40300	40270	40440	40950

Note: * = 53 weeks; Source: Datastream and Annual Reports

Appendix 6 J. Sainsbury: Financial and Retail Statistics

	1979/80	1980/81	1981/82	*1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Tot Sales (Inc. Taxes)	1226600	1589200	1950500	2315800	2688500	3135300	3575200	4043500	5009500	5915100	7257000	8200500	9202300	10269700	11223800	12065400	13499000
Total Sales	1189995	1531196	1875846	2213412	2574800	2998700	3414100	3857100	4791500	5659000	6930398	7813301	8695500	9685500	10583199	11357000	12627000
Operating Profit (Adj)	40473	54537	76627	94981	119800	141400	173800	211300	271800	346200	436900	541000	618300	726400	778200	838300	804000
Pre-tax Profit incl. Assoc. (Adj)	43799	62025	83349	100241	128300	155500	186800	237800	298600	352300	420700	505700	632200	735200	770000	808200	764000
After Tax Profit (Adj)	21024	29772	40008	48116	64100	85500	112600	148900	189600	227200	280200	342300	433100	489900	515900	533300	505000
Capital Expenditure	N/A	88000	125800	169600	181000	245000	247000	291000	435000	503000	693000	780000	766000	787000	769000	492000	759000
Ratios																	
Return on Equity (%)	8.9	10.2	11.5	11.6	13.5	15.4	17.2	19.1	18.5	19.4	20.1	20.5	16.2	16.1	17.0	16.1	14.6
Return on Assets (%)	10.4	12.8	13.2	12.6	13.9	13.3	13.5	14.8	13.9	12.4	12.6	13.2	13.5	14.0	14.1	13.9	11.4
Return on Capital Employed (%)	17.4	21.1	23.9	23.8	26.2	27.9	28.1	27.9	26.2	26.7	26.2	26.0	23.1	20.4	21.6	21.7	19.9
Sainsbury's Supermarkets																	
Sales (Inc. Taxes)	1226600	1589200	1950500	2301900	2653500	3071300	3488100	3936300	4421100	4903600	5644800	6515200	7347900	8276900	8864600	9607300	10157800
Contribution to Total Sales (%)	100	100	100	99.4	98.7	98.0	97.6	97.3	88.3	82.9	77.8	79.4	79.8	80.6	79.0	79.6	75.2
Operating Profit	45400	64400	86600	101900	133000	157500	192900	229000	276000	341800	409000	515700	603800	715900	697000	784000	744000
Contribution to Tot. Op. Profit (%)	100	100	100	100	99.5	99.2	99.0	98.7	93.2	91.6	86.8	88.2	90.7	91.2	87.6	87.2	87.1
Total Sales Area (Sq. Ft.)	2766000	2978000	3282000	3564000	3944000	4325000	4692000	5034000	5463000	5964000	6434000	6951000	7632000	8303000	8827000	9338000	9767000
Number of Stores	231	237	245	251	262	271	280	283	283	292	291	299	313	328	341	355	363
Aver. Sales Area per Store (Sq. Ft.)	11970	12570	13400	14200	15050	15960	16760	17790	19304	20425	22110	23247	24383	25314	25886	26304	26906
Savacentre																	
Sales (Inc. Taxes)	N/A	N/A	N/A	N/A	N/A	N/A	278900	288700	292800	329200	365800	478400	544400	609100	658700	697700	751200
Contribution to Total Sales (%)	0	0	0	0	0	0	0	0	0	0	5.0	5.8	5.9	5.9	5.9	5.8	5.6
Operating Profit	N/A	N/A	N/A	N/A	N/A	N/A	12600	16900	20100	?	17300	23200	28400	36300	38000	40900	34400
Contribution to Tot. Op. Profit (%)	0	0	0	0	0	0	0	0	0	0	3.6	3.9	4.2	4.6	4.8	4.5	4.0
Total Sales Area (Sq. Ft.)	138000	275000	356000	356000	356000	424000	433000	433000	436000	543000	665000	798000	798000	798000	864000	864000	1034000
Number of Stores	2	4	5	5	5	6	6	6	6	7	8	9	9	9	10	10	12
Aver. Sales Area per Store (Sq. Ft.)	69000	68750	71200	71200	71200	70667	72167	72167	72667	77571	83125	88667	88667	88667	86400	86400	86167

Note: * = 56 weeks; Source Datastream and Annual Reports

Appendix 7 Tesco PLC: Financial and Retail Statistics

	1979/80	*1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	*1986/87	1987/88	1988/89	1989/90	1990/91	*1991/92	1992/93	1993/94	1994/95	1995/96
Tot Sales (Inc. Taxes)	1601000	1916400	2102000	2404000	2744000	3176700	3556400	3806500	4365700	5003400	5726200	6730700	7595600	8128500	9246700	10877000	13028000
Total Sales	1530608	1820656	1994400	2276600	2594500	3000400	3355300	3593000	4119098	4717699	5401898	6346301	7097398	7581500	8599898	10101000	12094000
Operating Profit (Adj)	39683	51332	51500	60600	68900	81904	104100	145100	203700	262900	316800	398000	479500	551700	557600	617000	724000
Pre-tax Profit incl. Assoc. (Adj)	36461	35591	42700	53500	67400	81504	122900	166500	224000	265300	326600	417100	545000	583200	564800	595000	681000
After Tax Profit (Adj)	17501	17084	20496	25700	32600	44404	72100	108600	145200	175600	212300	271100	365100	390700	378400	402000	458000
Capital Expenditure	98000	111000	97000	86000	93000	170000	225000	312000	407000	485000	651000	952000	852000	653000	779000	771000	649000
Ratios																	
Return on Equity (%)	8.9	7.2	7.3	8.0	9.7	11.7	12.2	15.7	16.7	17.0	16.9	12.6	14.9	14.2	13.7	12.9	12.8
Return on Assets (%)	7.7	6.9	7.2	7.7	8.8	9.4	10.9	13.2	13.4	13.1	13.5	11.4	13.1	12.9	11.4	10.1	11.0
Return on Capital Employed (%)	21.6	17.9	16.0	16.6	17.6	18.9	19.6	20.6	20.7	21.9	22.6	18.5	19.2	18.5	16.4	16.5	18.7
Tesco Stores																	
Sales (Inc. Taxes)	1601000	1916400	2102000	2404000	2744000	3176700	3556400	3806500	4365700	5003400	5726200	6730700	7595600	8128500	8966500	10380000	12430000
Contribution to Total Sales (%)	100	100	100	100	100	100	100	100	100	100	100	100	100	100	97.0	95.4	95.4
Operating Profit	39700	51300	51500	60600	68900	81700	104100	147700	214400	276500	334000	420000	503300	528800	513000	600000	713000
Contribution to Tot. Op. Profit (%)	100	100	100	100	100	100	100	100	100	100	100	100	100	100	98.5	97.2	98.5
Total Sales Area (Sq. Ft.)	6210000	6840000	7203000	7425000	7362000	7415000	7502000	6997000	8220000	7986000	8442000	8956000	9661000	10352000	11006000	12641000	13397000
Number of Stores	552	554	544	489	461	441	395	337	379	374	379	384	396	412	430	519	545
Aver. Sales Area per Store (Sq. Ft.)	11250	12347	13241	15184	15970	16814	18992	20763	21689	21353	22274	23323	24396	25126	25595	**24900	**25600

Notes: * = 53 weeks; ** = excluding Metro and Express Stores Source: Datastream and Annual Reports

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