

SOURCES OF COMPETITIVE ADVANTAGE FOR SMALL INDEPENDENT RETAILERS: LESSONS FROM THE NEIGHBORHOOD DRUGSTORE

Jeffrey E. McGee, The University of Texas at Arlington

Leonard G. Love, The University of Texas Arlington

Michael J. Rubach, The University of Central Arkansas

ABSTRACT

Driven by discriminating customers and increasing competition, small independent retailers are searching for new ways to gain and sustain competitive advantage. This paper reports the results of a study designed to complement the research literature by developing a typology of distinctive competencies used by small local retailers to address increased environmental turbulence and to compete with new, larger competitors. Results suggest that small retailers who develop a cohesive group of distinctive competencies have higher levels of performance than neighborhood retailers who develop no distinctive competencies. The most important finding, however, may be that independent retailers who focus on developing a broad range of distinctive competencies across many areas significantly outperform those firms that develop only one or a few competencies.

INTRODUCTION

There is no getting around it -- times are quite tough for many small independent retailers. The dynamics of changing demographics and consumer purchasing patterns, coupled with ever stronger competition, are putting increased pressure on the local merchant. Appearing everywhere are large merchandisers and discount chain stores. Moreover, so-called category killers like Home Depot, Barnes & Noble and Blockbuster Video have threatened many traditional bastions of independent retailing. In these increasing hostile and turbulent environments, retailers of all sizes are searching for new formulas to achieve competitive advantage.

Although the challenges facing small independent retailers are well documented, many local merchants are managing to survive and actually thrive. It is somewhat surprising, therefore, that little empirical research exists that systematically identifies the specific organizational resources and capabilities underlying the competitive advantage enjoyed by those local merchants outperforming their competitors. This paper seeks to address this shortcoming in the extant literature by reporting the results of a study that assessed the relationships between small retailer performance and the possession of distinctive competencies. Though a great amount of literature related to competitive advantage has been published over the last several decades, the current study is based on the premise that the sources of some competitive advantages are unique to this type of retailing. In other words, the nuances of small independent retailers may not be as evident when researchers examine similar issues in the context of manufacturing firms, non-retailer businesses, or even larger retailing firms or chains.

BACKGROUND

The means by which some businesses achieve and sustain a competitive advantage over other firms is the central research focus of strategic management. For nearly two decades, the dominant research paradigm has been Porter's (1980) competitive forces model which argues that the intensity of competition determines the profit potential for individual firms. Porter contends that a firm seeks a position in an attractive market that they can defend against both existing and potential competitors. Although the identification and development of the requisite capabilities are important, management's primary focus is on achieving a defensible low-cost or differentiation position, and on keeping rivals off balance through strategic investments, pricing strategies, and competitive signaling.

More recent research, however, has begun to recognize the use of resource-based capabilities in gaining and maintaining competitive advantage (Chandler & Hanks, 1994; Long & Vickers-Koch, 1995; McGee & Finney, 1997). Reaching back to the traditional strategic management concept of distinctive competence (e.g., Selznik, 1957; Andrews, 1971), the resource-based view argues that competitive advantage results from a firm's resources and its capabilities. Resources include capital equipment, worker and management skills, reputation, and brand names (Barney, 1991). Resources are not normally productive in and of themselves, however, and the firm's skill at effectively coordinating and using its resources constitutes the firm's capabilities. In other words, resources are the source of a firm's capabilities; and capabilities refer to a firm's ability to bring those resources together and deploy them advantageously (Day, 1994). While resources are relatively tangible, capabilities are less readily assigned a monetary value, and are often deeply embedded in organizational routines and practices, thereby making them less subject to imitation by present or potential competitors (Dierckx & Cool, 1989).

Every organization possesses a variety of capabilities that enable that firm to perform the activities necessary to provide its good or services. While some organizations may perform the requisite activities in only an adequate or even sometimes a poor manner, successful organizations presumably possess certain capabilities that allow them to perform key activities exceptionally well. These capabilities have been termed "distinctive competencies" and generally refer to the unique skills and activities that a firm can do better than its competitors (Selznik, 1957; Lado, Boyd, & Wright, 1992). When competition intensifies, the possession of these competencies should become increasingly important for the firm's continued success. Moreover, these are the distinctive capabilities that support a market position that is valuable and difficult to imitate.

The best test of the distinctiveness of a capability is whether it allows the firm to offer superior customer value or permits the business to deliver products or services to customers in an appreciably more cost-effective way. Wal-Mart's cross-docking system is a well-cited example of how an inimitable capability led to a convincing distinctive competence (Stalk, Evans, & Shulman, 1992). While Wal-Mart has the same resources (e.g., retail space, employee skills, equipment) as many other discount chains, it is distinguished by its unique capability to manage its resources for maximum productivity.

This retail chain's sophisticated cross-docking system provides Wal-Mart with substantial cost advantages by improving its ability to reduce shipping and handling costs.

The interaction between competitive advantage and distinctive competencies is well researched and results generally suggest that those firms that develop and exploit their distinctive competencies generally outperform firms that do not (Conant, Mokwa, & Varadarajan, 1990; Hambrick, 1983; McDaniels & Kolari, 1987). Yet, the extant literature has generally focused on large organizations (e.g., Snow & Hrebiniak, 1980) or in non-retailing industries such as manufacturing (e.g., Acar, 1993; Chandler & Hanks, 1994). As a consequence, we know very little about the role that distinctive competencies play in providing a competitive advantage for the small independent retailer.

There are, however, two important research streams that have begun to examine the role that resources and capabilities play in the success of smaller retailing firms. The first of these has been produced by Conant and his colleagues. Conant, Smart, and Solano-Mendez (1993) found that smaller firms that chose to compete with clearly defined strategies outperformed those firms with a less clearly defined focus. They did not, however, examine the direct relationships between distinctive competencies and firm performance. Smart and Conant (1994) found a significant relationship between the entrepreneurial orientation of firms and the possession of a wide assortment of distinctive competencies but again stopped short of measuring any direct relationship between those distinctive competencies and performance.

The other research stream, undertaken by McGee and his colleagues, has examined the relationship between distinctive competencies and competitive advantage for small, local retailers. McGee (1996) found that the arrival of a large, national retailing chain had a negative impact on the performance of smaller, existing retailers in the area. More importantly, his subsequent research found that these local retailers responded to the mass-merchandisers arrival by intensifying their focus on their own store's capabilities (McGee and Finney, 1997). McGee and Finney (1997) found a positive correlational relationship between the possession of specific distinctive competencies and superior firm performance, as did McGee and Love (1997). These studies, however, looked at the competitive situation *after the arrival* of a large national discount chain into the local competitive environment which may limit the generalizability of their findings; and, unfortunately, neither of these studies could establish whether the effects were temporary or more long-lasting, due to the cross-sectional nature of the studies.

A search of the existing literature, therefore, reveals a limited body of research that applies the concept of distinctive competencies to the study of competitive advantage for small retailing firms. The relatively few extant research studies do not examine explicitly the empirical issue of what specific distinctive competencies may allow independent merchants to achieve and maintain competitive advantage. In the sections that follow, this paper will identify distinguishable areas of distinctive competencies using taxonomy-building procedures. These procedures produced four "generic retailing types" that reflect the sources of competitive advantage for the small independent retailers. These four retailing types were then compared across a composite performance measure to

determine which areas of distinctive competencies, if any, lead to competitive advantage. The results are presented and discussed along with their implication for both practitioners and researchers. Finally, future research suggestions are offered.

RESEARCH DESIGN AND METHODOLOGY

Industry Setting

The traditional independent retail pharmacy industry was selected as the domain of this study. Members of this industry grouping are typified by the community drugstore that delivers traditional pharmacy services and whose nonprescription inventory goes beyond health care items to include other merchandise lines traditionally associated with pharmacy sales, such as cosmetics and beauty aids, stationary, tobacco, candy, greeting cards, photographic supplies and similar items (Lipowski, 1992). Pharmacies whose principle activity involved dispensing medication and who carried a minimal nonprescription inventory were excluded from this industry domain.

This industry was selected because communities across America have long depended upon their local drugstore for medication, over-the-counter (OTC) products, sundry items, and medical advice. In many small towns and rural areas, the local pharmacist is not only a respected small businessperson, but also the primary allied healthcare professional. Most such local pharmacists owned the small, retail pharmacy in which they work. Until the last several decades when their importance began a precipitous decline, these independently owned retail establishments ruled the pharmacy marketplace.

Today, the neighborhood drugstore struggles to compete with a variety of retailing outlets. Large discount chains, along with supermarkets and mass-merchandisers with in-store pharmacies now dominate the pharmacy marketplace. While total sales have increased for all pharmacies, the market share served by independent pharmacies has declined from nearly 100 percent in 1935 to less than 25 percent today. The number of independent operators has decreased by nearly 25 percent, from more than 50,000 to fewer than 40,000, during the last decade alone (Maline, 1997).

Survey Procedure

A modified version of Dillman's (1978) "total design method" was used in this study to enhance response rate and response quality. An initial survey-booklet including a cover letter and a postage-paid return envelope were sent to 700 randomly selected independent pharmacies in a major southwestern state. The cover letter explained the overall goals and objectives of the research project and how the data would be used. A reminder postcard was subsequently mailed to all potential respondents approximately one week after the initial mailing. In addition, a second booklet with a second cover letter was sent to all nonrespondents approximately three weeks after the reminder postcard.

Prior to distributing the questionnaires, the survey instrument was pretested on eight independent pharmacists to determine if there were any interpretation difficulties. These

pharmacists were not a part of the study sample. No problems were detected and the pretest respondents were not troubled by any of the questions or by their ability to rate their pharmacies.

Measuring Distinctive Competencies

Distinctive competencies, the primary focus of this study, were measured using an adaptation of the instrument developed by Conant, et al (1993) and subsequently used by McGee and Finney (1997). Some of the Likert-type scale items focused on planning process variables while others focused on marketing effectiveness. This dual focus is consistent with distinctive competency scales employed by other researchers (e.g., Hitt and Ireland, 1985). The multiple-item, perceptual scale employed in this study required respondents to comparatively rate their organization against competitors on twenty-seven items of distinctive competencies. Twenty-one of the items (e.g., handling customer complaints, effectiveness of pricing strategies, employee training) were evaluated on seven-point scales with values ranging from 'Much worse' to 'Much better.' Six of the items (e.g., quality of customer service, awareness of store strengths) were evaluated on similar seven-point scales with values ranging from "Much higher" to "Much lower."

Measuring Organizational Performance

Pharmacy performance was also operationalized and measured using subjective self-report data. Respondents were asked to compare their financial performance to other pharmacies on the following four dimensions: 1) gross profit, 2) net income after taxes, 3) net income after taxes over the past three years, and 4) overall pharmacy performance/success, using the same seven-point Likert scales previously described. Although the merits and potential shortcomings of this measurement approach have been debated in the extant literature, substantive empirical research has demonstrated that subjective assessments of organizational performance are highly consistent with objective performance data both internal (Dess & Robinson, 1984) and external (Venkatraman & Ramanujam, 1987) to the organization.

RESULTS

Survey Response

The three-step survey mailing resulted in the return of 286 surveys. Adjustments to the original sample size of 700 resulting from questionnaires that were undeliverable (e.g., business had closed, or no forwarding address provided), reduced the number of independent pharmacists who may have participated to 658. In addition, 16 surveys were excluded from the study because of omitted items. Thus, a total of 270 surveys were available for analysis, representing a 41 percent response rate.

Ninety-three percent of the respondents described themselves as pharmacist/owner, 4 percent as pharmacy manager, and three percent miscellaneous/other titles. Respondents also indicated that, on average, their pharmacies generated slightly more than \$1 million

in annual sales, employed an average of six people, and occupied roughly 17,000 square feet. These characteristics compare quite favorably with industry wide statistics (NARD, 1997), thereby increasing confidence in the study's generalizability.

Analysis

Since this was an exploratory study, one of its major objectives was to provide a taxonomy of distinctive competencies used by small retailers. The first step in developing this taxonomy was a factor analysis. This technique was used, as suggested by Hair, Anderson, Tatham, and Black (1992), because it is an effective tool for determining whether the data can be condensed or summarized into a more parsimonious set of factors while at the same time revealing underlying relationships or patterns in data. The 27 retailing competencies and four performance measures were factor analyzed using a principal components factor analysis with varimax (orthogonal) rotation.

Five factors were retained and are presented in Table 1. Factor 1 -- "service image" -- represents a commonly cited source of distinctive competence for small retailers. In particular, local drugstores emphasizing this factor believe their level of customer service, ability to effectively handle customer complaints, and the quality of their products were the primary sources of competitive advantage. These pharmacies also believed that their knowledge of current customers and their store's overall image were important. Advertising effectiveness was one of the predominant features of the second area of distinctive competence -- "promotion and presentation." However, independent pharmacists emphasizing this factor would also appear to possess superior public relations skills and to be keen merchandisers. These businesses placed a relatively greater emphasis on new product selection. Factor 3 -- "performance" represents the performance construct. As expected, all four performance variables loaded quite heavily on this factor. Local drugstores emphasizing the fourth factor -- "segmentation" - perceived their knowledge of potential customers and their ability to effectively segment and target customers as the primary sources of competitive advantage. Finally, the fifth factor -- "control of retailing" -- represents independent pharmacies who believed their source of competitive was primarily rooted in their ability to contain costs, control and evaluate overall retail programs, and to establish effective pricing policies.

The next step in the typology development process involved a cluster analysis. This multivariate technique groups variables on the basis of similar characteristics (Aldenderfer & Blashfield, 1984; Hair et al., 1992). All of the distinctive competency components incorporated in the four factors were entered into a non-hierarchical cluster analysis. Non-hierarchical cluster analysis was preferred because it is less susceptible to outliers or other anomalies in the data and therefore less likely to produce misleading results (Hair et al., 1992). A four cluster solution was selected on the basis of minimal distance between the clusters and clarity of the results. Both of these are acceptable criteria for determining the number of clusters (Hair et al., 1992). The four cluster solution resulted in a pseudo F-statistic of 122.8 and a cubic clustering criterion of 11.9. The cluster profiles are described in Table 2.

Cluster one represents small retailers who attempted to develop and maintain strengths in each of the four areas of distinctive competencies. These "well-rounded" retailers might be said to leave little to chance and did not ignore any major competency. Cluster two represents retailers who were the polar opposite of those in cluster one. Pharmacies labeled "lacks capabilities" do not make any concerted effort to develop or maintain any of the patterns of distinctive competencies. In cluster three, "promotion and presentation," firms placed a relatively greater emphasis on advertising, public relations activities, and store layout. Finally, the pharmacies in the fourth cluster, "control and cost containment," focused primarily on competencies involving cost containment and tight control over the store. These firms tended to compete primarily on price.

Table 1
Principal-Components Factor Analysis of Distinctive Competencies

Factor Loadings*						
	Factor 1 Service Image	Factor 2 Promotion & Presentation	Factor 3 Performance	Factor 4 Market Segmentation	Factor 5 Control of Retailing	Communality
Quality of Customer Service	.74					.61
Handling of Customer Complaints	.67					.53
Store Image	.62					.66
Quality of Products	.58					.40
Knowledge of Current Customers	.55					.40
Allocation of Financial Resources	.52					.58
Public Relations Effectiveness		.57				.46
Advertising Effectiveness		.52				.35

Table 1 Cont.

Selection of New Products		.50				.46
Awareness of Store Strengths		.48				.43
Civic Involvement		.45				.36
Putting Plans Into Action		.44				.46
Store Layout/ Merchandise Presentation		.42				.32
Net Income			.89			.81
Gross Profit			.85			.74
Overall Performance and Store Success			.78			.67
Total Sales Growth			.62			.50
Accuracy of Sales and Profit Forecasting				.61		.54
Ability to Segment and Target Markets				.55		.48
Ability of Differentiate Store Offerings				.52		.39
Knowledge of Prospective Customers				.51		.43
Knowledge of Industry Trends				.40		.25
Effectiveness of Cost Containment					.65	.55
Control and Evaluation of Retail Program				.40	.64	.70
Effectiveness of Pricing Strategies		.40			.63	.64
Eigenvalues	3.46	3.19	2.93	2.56	2.16	

*These five factors accounted for 64.0% of the total variance

Table 2
Cluster Profiles
Pharmacies in Hostile Environments (n = 270)

Cluster 1: Well Rounded (n = 93)

The retailers in this group focused on developing and maintaining all capabilities. No capabilities were ignored and most are treated as important.

Cluster 2: Lacks Capabilities (n = 31)

The retailers in this group were the polar opposite of those in the previous group. No particular emphasis was paid to developing or maintain any of the competencies.

Cluster 3: Emphasizes Promotion and Presentation (n = 41)

The retailers in this group focused primarily on promotional and presentation activities. These pharmacies placed a heavy emphasis on advertising, public relations, and store

layout and appearance. They placed considerably less emphasis on any of the other capabilities.

Cluster 4: Control and Cost Containment (n = 105)

The retailers in this group focused primarily on developing and maintaining capabilities in cost control and tight control over pricing. These pharmacies can be said to compete with a cost-leadership generic strategy. The other capabilities received considerably less emphasis.

Table 3(omitted).

An ANOVA was then used to assess the performance differences among the four identified "retailing types." Performance was measured using the construct developed in the previously described factor analysis, and statistically significant differences were detected ($p < .001$). Moreover, a Tukey-Kramer paired comparison produced identifiable patterns of performance. "Well rounded" retailers outperformed all other retailers. "Control and cost containment" and "promotion and presentation" outperformed those firms in the "lacks capabilities" category, but were essentially equal to each other. There was also a significant difference between "well rounded" retailers and those that focused on a single group of competencies. In other words, the "well rounded" retailers reported higher levels of performance than all other groups of retailers. Retailers who chose to develop and exploit a single group of competencies reported higher levels of performance than those retailers who lacked all or nearly all of the competencies, but still reported lower levels of performance than those retailers who focused on all competencies.

DISCUSSION

The results of this study suggest that it is quite possible for small, local retailers to compete successfully in turbulent and highly competitive environments. Even against new, larger and more threatening competitors while simultaneously facing radical environmental change (e.g., 3rd party reimbursement plans). The key seems to be constant vigilance in developing and maintaining all types of distinctive competencies. The most insightful finding may be that the development of only one or a few distinctive competencies is not significantly better than a total lack of competencies. This may be where small retailers differ most markedly from large firms. Mass-merchandisers can often thrive with only one or a few well-developed distinctive competencies such as the use of sophisticated inventory management systems or savvy advertising campaigns.

The current study's results are at odds with prior research that suggested that the development of a few distinctive competencies, particularly customer service, may lead to higher performance (e.g., McGee & Finney, 1997). The findings of this study suggest, instead, that superior customer service may simply be the price of entry into the competitive environment. That is, superior customer service is now demanded by customers to such a degree that providing it simply allows the firm to remain in business but no longer provides a competitive advantage. The availability of alternate retail outlets allows the customer to seek out other merchants when the level of customer service at

one merchant or another does not suit them. The exploratory findings of this study, therefore, suggest that a firm cannot be successful without a high emphasis on customer service, but that success requires a focus on the development and maintenance of organizational capabilities in all areas. For practitioners, this is a very tall order to fill, but apparently necessary.

This paper is not without limitations. For example, it reports the results of a cross-sectional study. The study was also one that was conducted in a single industry, using self-reported subjective measures of distinctive competencies and organizational performance. Although the generalizability of findings from single-industry studies do have some limitations, such studies also provide the desirable feature of a high degree of control over market and environmental peculiarities. The advantages and disadvantages of self-reported subjective measures have been discussed at length in the research literature and do not need to be elaborated here. Finally, this study is somewhat exploratory in nature, and it remains for other researchers, therefore, to replicate these results. Such replication should, preferably, be done in a longitudinal study.

In sum, the results of this study support the substantive linkage between the resource-based capabilities of a firm and competitive advantage. The findings suggest that the performance of small, independent retailers appears to be positively correlated with the possession of distinctive competencies. Future theory-building research can now evaluate the predictive relationships of these distinctive competencies to firm performance. Small, local retailers have some guidance in competing in a changing environment. Their job will not be easy, but these small firms can compete -- if they know how.

REFERENCES

- Acar, A. (1993). The impact of key internal factors on firm performance: An empirical study of small Turkish firms. *The Journal of Small Business Management*. Oct: 86-92.
- Aldenderfer, M. S., & Blashfield, R. K. (1984). *Cluster analysis*. Newbury Park, CA: Sage.
- Barney, J. (1991). Firm resources and sustained competitive advantage. *Journal of Management*. 17 (1): 99-120.
- Chandler, G.N., & Hanks, S.H. (1994). Market attractiveness, resource-based capabilities, and venture performance. *Journal of Business Venturing*. 9: 331-349.
- Conant, J. S., Mokwa, M. P., & Varadarajan, P. R. (1990). Strategic types, distinctive competencies, and organizational performance: A multiple measures-based study. *Strategic Management Journal*. 11: 365-383.
- _____, Smart, D. T., & Solano-Mendez, R. (1993). Generic retailing types, distinctive competencies, and competitive advantage. *Journal of Retailing*. 69(3): 254-279.

Day, G. S. (1994). The capabilities of market-driven organizations. *Journal of Retailing*. 58: 37-52.

_____, & Westley, R. (1988). Assessing advantage: A framework for diagnosing competitive superiority. *Journal of Marketing*. 52(2): 1-20.

Dess, G. G., & Robinson, R. B. (1984). Measuring organizational performance in the absences of objective measures: The case of the privately-held firm and conglomerate business unit. *Strategic Management Journal*. 5: 265-273.

Dierkx, I., & Cool, K. (1989). Asset stock accumulation and sustainability of competitive advantage. *Management Science*. 35 (12): 1504-1511.

Dillman, D. A. (1978). *Mail and telephone surveys: The total design method*. New York, NY: John Wiley and Sons.

Hambrick, D. C. (1983). Some tests of the effectiveness and functional attributes of Miles and Snow's strategic types. *Academy of Management Journal*. 26 (1): 5-26.

Hair, J. F., Jr., Anderson, R. E., Tatham, R. L., & Black, W. C. (1992). *Multivariate data analysis*. (3rd Ed.) New York, NY: MacMillan.

Hitt, M. A., & Ireland, R. D. (1985). Corporate distinctive competence, strategy, industry, and performance. *Strategic Management Journal*. 6: 273-293.

Lado, A. A., Boyd, N. G., & Wright, P. (1992). A competency-based model of sustainable competitive advantage: Toward a conceptual integration. *Journal of Management*. 18: 77-91.

Long, K., & Vickers-Koch, M. 1995. Using core capabilities to create competitive advantage. *Organizational Dynamics*. 24 (1): 6-22.

Maline, N. (1997). Exploding Rx market propels retailers to new height. *For the Pharmacist*. (May): 10-18.

McDaniels, S. W., & Kolari, J. W. (1987). Marketing strategy implications of the Miles and Snow strategic typology. *Journal of Marketing*. 51 (4): 19-90.

McGee, J. E. (1996). When Wal-Mart comes to town: A look at how local merchants respond to the retailing giants arrival. *Journal of Business and Entrepreneurship*. 8 (1): 43-52.

_____, & Finney, J. B. (1997). Competing against retailing giants: A look at the importance of distinctive marketing competencies. *Journal of Business and Entrepreneurship*. 9 (1): 59-70.

_____, & Love, L.G. (1997). "Only the Strong Survive: A Resource Based View of How Small retailers Successfully Compete with Giant National Discount Chains." Paper presented at Academy of Management Annual Meeting in Boston, MA.

NARD. (1997). NARD -- Lilley Digest.

Porter, M. E. (1980). *Competitive strategy*. New York, NY: Free Press.

Selznik, P. (1957). *Leadership in administration*. New York, NY: Harper & Row.

Smart, D. T., & Conant, J. S. (1994). Entrepreneurial orientation, distinctive marketing competencies and organizational performance. *Journal of Applied Business Research*. 10 (3): 28-38.

Snow, C.C., & Hambrick, L.G. (1980). Strategy, distinctive competence, and organizational performance. *Administrative Science Quarterly*. 25(2): 317-336.

Stalk, G., Evans, P., & Shulman, L. E. (1992). Competing on capabilities: The new rules of corporate strategy. *Harvard Business Review*. 70 (March/April): 57-69.

Venkatraman, N., & Ramanujam, V. (1987). Measurement of business economic performance: An examination of method convergence. *Journal of Management*. 13: 109-122.