

A development of the strategic group theory

- A proposal on the three strategic group categories and introducing the concept of distance into the analysis-

Manami MIYAMOTO

1-6-1, Nishiwaseda, Shinjyuku-ku, Tokyo
169-8050, Japan
Waseda University

ABSTRACT

In this paper, it proposes three strategic group categories that are "resource group", "execution group" and "market group", and proposes the concept of distance for the analysis. It is a critical development of the strategic group theory by M.E.Porter(1980).

A firm needs its competitive strategy, not only when determine entry to a certain industry, but also to cope with the competitors after the entry. To formulate the latter strategy, it should take into account the resource similarity (resource group), rivals' strategies (execution group) and the customers' selection viewpoints (market group) as well. And the concept of distance can be useful to express the changing relation among the companies in the changing situation.

Keywords: Strategic Group, Competition analysis, Group categories, Concept of distance

CONTEMPORARY SIGNIFICANCE OF THE STRATEGIC GROUP THEORY

A lot of Strategic Group studies have been examined to date; one of the most referenced practical theories on the occasion of formulating a strategy by the strategy planner in the firm is the Porter's Strategic Group Theory. He defines the *Strategic Group* as the group of firms in an industry following the same or a similar strategy along the strategic dimensions. He tries to explain why some firms are persistently more profitable than others and how this relates to their strategic postures mainly through the concept of the mobility barrier¹.

However, a firm needs to formulate a strategy not only to decide the entry to an industry but also to cope with the competitive circumstance after the entry. It would be just enough

¹ There are sometimes perplexities of verbiage in Porter's writings regarding "entry barrier" and "mobility barrier". In this paper, the factors which make firms difficult to enter in an industry are called "entry barrier" and the factors which make firms difficult to transfer amongst the strategic groups in an industry are called "mobility barrier".

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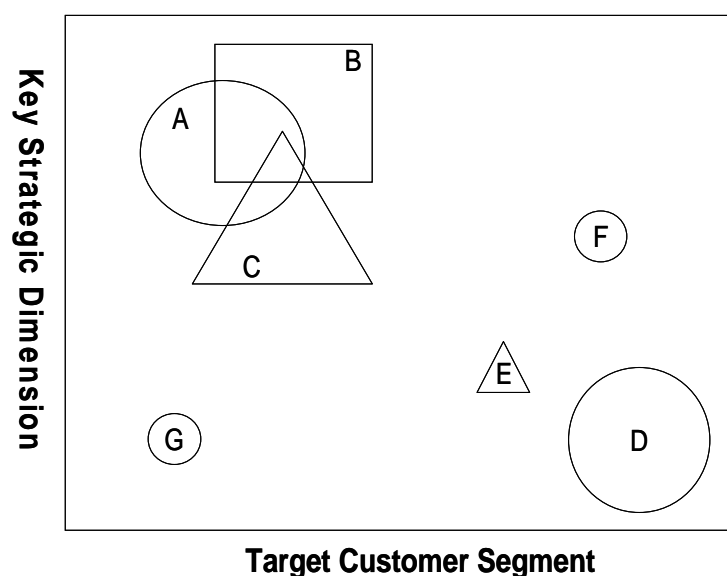
to examine the ease of entry at some point in time and to seek the way to enter the industry, if we assume that an industry is so static that once a firm succeeds in the beginning it can consistently sustain a high performance. While in fact, the competition can be observed inside of the industry or the member of the strategic group. And the results of the performances differ from each other. Facing this fact, after the entry, firms generally need strategies regarding how to cope with the situation which are against the changing rivals' strategies and the changing customers' selection criteria.

Porter describes the Strategic Group that it is an intermediate frame of reference between looking at the industry as a whole and considering each firm separately, and suggests that the thing which makes the difference between the performance results of the firm is the mobility barrier of the group. The suggestion that the existence of the plural strategic groups in an industry means that the competitive factors which construct the industry don't affect to all the firms equally and thus, the countervailing power to the competitive factors are variant by the each strategic groups. In other words, in terms of Porter, formulating competitive strategy is the identification and the choice of the advantageous strategic group for a firm to enter.

SEPARATION ABOUT RESOURCE, STRATEGY AND CUSTOMER REACTION

Porter proposes to draw a strategic group map using the concept of the strategic group in order to figure out the major competitive issues (1980). This map is a two-dimensional diagram which takes the major strategic dimensions as variables. The two variables are considered as the strategic dimensions which affect the competition among the groups that is to say the mobility barriers. However, when the firms formulate strategy of their own, not only the resources which they possess but also the executed strategies of their rivals and the customers comparison and the choice at the time of the buying decision should be included as the referential information as well. These factors may affect each other. In parallel, it is need to take into account that there is a possibility that the customers acknowledge are not based on the actual resources of the firms nor the substantial strategies formulated inside of the firms but the surface which can be seen from the outside of the firms. That means when we examine a strategy of the firm, the resource based view, the strategic execution point of view and the customer's reaction point of view do not always indicate the same perspective. Thus, it is required to add the examination about how these viewpoints are related to each other.

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**Figure 1. Strategic Group Mapping and Intergroup Rivalry
(Source:M.E. Porter 1980)**

ISSUES OF PORTER'S STRATEGIC GROUP THEORY

During fierce competition or in an industry where there is fierce competition, some difficulties arise when Porter's theory is applied. First, there are too many factors within the axis of the strategic dimension. In fact, when strategists in the firm try to draw the strategic group map, this situation is nearly equal to be given no road map at all. In relation to this, Porter suggests that "Strategic variables used as axes must be selected (totally) by the analyst", "An industry can be mapped several times", and "There is no necessarily right approach".

Secondly, the strategic dimensions which he takes as examples are not always the unique mobility barriers of the strategic groups. This means that his argument: "different strategic groups carry with them different levels of mobility barriers, which provide some firms with persistent advantages over others" still leaves some ambiguity².

Thirdly, in spite of the fact that the final decision on the result of the competition is left to the customers' choice of the products, Porter's theory does not include how the customers acknowledge firms and the executed strategies by the firms. This suggests that he has an

² The strategic group theory has a premise that there are some sorts of firewalls between firms. The discussion regarding whether these firewalls get higher or lower or become obscure would require another discussion with a viewpoint of unstable situation between neighboring industries .

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implicit premise that the strategy formulation is always conducted only by the supplier's perspective and his logic.

Finally, the biggest issue regarding Porter's strategic group theory is the difficulty in discussing a firm's shift amongst the groups over time. This lack of consideration is fatal in an industry where rivalry relations change frequently. The reason for this is that the mobility barrier in his argument treats the relationships between the groups as if they are almost static.

Therefore, his strategic group map is like a snapshot of the industry at a specific point in time, which cannot illustrate the changing state of affairs. In fact, firms shift amongst the groups consistently, and, therefore, it is important to realize these changing patterns of the strategic group.

THREE REFERENCE GROUPS

When a firm formulates a strategy, the factors which should be taken into account are; the "resource group" by the similarity of the mobility barrier, "execution group" by the similarity of the executed strategy and "market group" by the customers' market comparison at the time of the buying decision.

These factors affect the rivalry and the strategy formulation. These three groups have the following characteristics:

1. Some of the firms belong to each group.
2. The firms which construct each group are not always the same.
3. These groups have referential relationships that impact each other.
4. According to the change of major competitive points (the dimension of the competition and the appeal point to the customer), group membership and rivalry participation also changes.

Firms which compete in the market are able to achieve their goals by successfully belonging to or transferring amongst these reference groups.

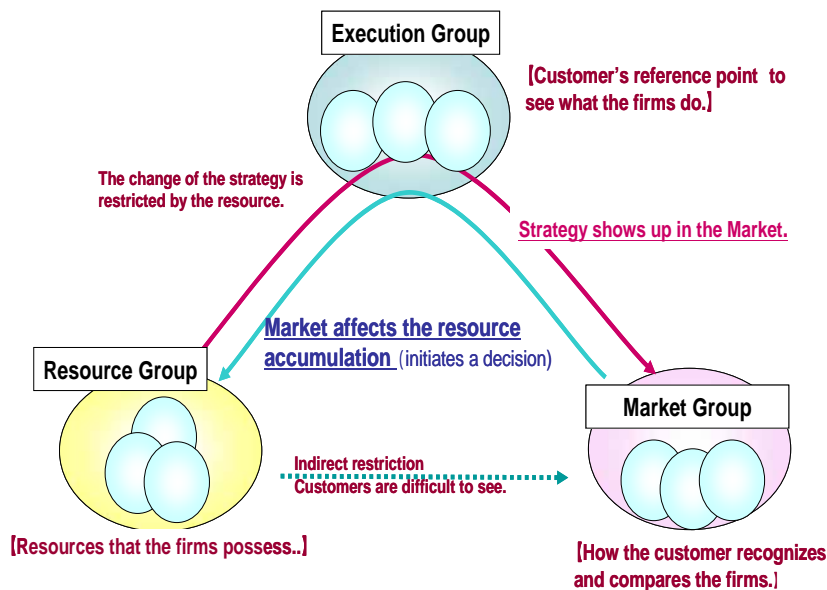


Figure2. The impact on the three groups and the strategy

INTRODUCING THE CONCEPT OF DISTANCE

This paper proposes the concept of distance in order to realize how the competing firms belong to these groups.

In order to analyze the strategic group, the strategic group map of Porter displays enclosed plural firms with a closed borderline according to some extent of the similarity of the strategic dimension, such as the mobility barrier.

However, the more customer targets overlap within a market, the more difficult it is to draw the borderline which divides firms from being inside and outside of the group. Moreover, a firm which takes a different strategy at some point in time might change their strategy and follow the same strategy as its rival according to the phase of rivalry, or in other cases, it might take several kinds of strategies in parallel. This means that to identify the existence of the strategic group and decide which group the firms belong to in Porter's way is not practical for the strategy planner.

In contrast, since distance is the amount of space between two points, it can be measured from a starting point. When a firm formulates its strategy, the measurement from the starting point is not something obscure but rather its goal, its customer or its own strategy for instance. The firm itself is like a "subject". Therefore, it is rather suitable to formulate more realistic and preferable strategies utilizing the concept of distance which measures the extent of difference of the resource, executed strategy and the customer perception of

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the rivals. In this paper, these are called “resource distance”, “executed strategy distance” and “market distance”.

CASE STUDY: JAPAN’S INTERNET SERVICE PROVIDING INDUSTRY

The industry which is able to apply the concept of distance effectively has characteristics as follows. First, firms compete for customers so fiercely that the frequent shift of the firms among the groups occurs continuously. Consequently, the relative relationship of the firms in the market changes frequently, which is to say, industries with low mobility barriers. Japan’s ISP (Internet Service Provider) industry during the five year period 1998-2003 provides the setting for this study. It looks at seven major Japanese ISPs which engaged in fierce competition for customers: OCN, DION, ODN, @Nifty, BIGLOBE, Yahoo!BB, Plala. In the course of examination, OCN, provided by NTT Communications Corporation, is the starting point of the distance measurement.

(1) Resource Distance

Resource distance is able to measure through the possessed resources of firms, which are recognized as useful in order to formulate sustainable competitive advantage and the strategy (recognized resource). In this study, whether or not the firms possess the resources of the telecommunication services and the IP facilities to provide their own original services are selected as factors to be measured. If we want to figure out the difference between the firms more minutely, looking at other factors of the recognized resources would makes this possible.

Table 1. Resource Distance from OCN

	1998	1999	2000	2001	2002	2003
Nearest Rank 1	DION	DION	DION	DION	DION	DION
Nearest Rank 1	ODN	ODN	ODN	ODN	ODN	ODN
Nearest Rank 4	Plala	Plala	Plala	Plala	Plala	Plala
Nearest Rank 5	BIGLOBE	BIGLOBE	BIGLOBE	BIGLOBE	BIGLOBE	BIGLOBE
Nearest Rank 5	Nifty	Nifty	Nifty	Nifty	Nifty	Nifty
Nearest Rank 5				Yahoo!BB	Yahoo!BB	Yahoo!BB

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(2) Executed strategy Distance

The measurement of the executed strategy distance measures how the competing firms react to their rivals. Concretely, it can be measured by the numerical conversion according to the scoring rules on the new products and services which they released. All competitive elements such as pricing, service menus etc. are measured from the date of the announcement of the new service. For instance, with an ADSL service, each ISP releases new pricing and higher-speed services as the rivalry counter actions. The score, which can be regarded as the distance, is calculated from the date when OCN discloses the service to the dates when the other ISPs release their counter action. The ISPs, which quickly follow OCN, are considered in the short distance and the ISPs which don't follow or follow slowly are in the long distance. The closer the distance, the more the firms have greater similarity on the executed strategy and so are competing under a strong influence.

Table 2. Executed Strategy Distance from OCN

	Dial up	Phone Charge included	Fixed Price Dial up	ADSL	Package with IP Phone	Optical Fiber
Nearest Rank 1	DION	DION	BIGLOBE	DION	DION	Nifty
Nearest Rank 2	Plala	Plala	DION	ODN	ODN	Plala
Nearest Rank 3	BIGLOBE	ODN	Nifty	Yahoo!BB	Nifty	ODN
Nearest Rank 4	Nifty	BIGLOBE	Plala	Nifty	Plala	DION
Nearest Rank 5	ODN	Nifty	ODN	Plala	BIGLOBE	BIGLOBE
Nearest Rank 6				BIGLOBE		

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(3) Market Distance

Market distance shows the extent of substitution among the products and services from the customers' point of view, which means the extent of awareness about the firm as the candidate when the customers choose the products. If you ask questions such as "Which products did you compare when you made the buying decision?", or "What was the buying determinant when you chose the firm's products?" in the general market research, it is possible to measure the market distance with these data. If customers are more conscious of comparing certain ISPs with OCN, this can be considered the shortest distance. Firms can recognize the change of the customers' acknowledgement by ordering the measurement results over time, which can lead to inferences about relationship between the executed strategies.

Table 3. Market Distance from OCN

	1998	1999	2000	2001	2002	2003
Nearest Rank 1	no comparison	no comparison	no comparison	no comparison	no comparison	no comparison
Nearest Rank 2	nifty	nifty	ODN	ODN	other	DION
Nearest Rank 3	other	ODN	DION	other	YahooBB	YahooBB
Nearest Rank 4	BIGLOBE	DION	other	DION	ODN	ODN
Nearest Rank 5	ODN	BIGLOBE	nifty	nifty	DION	nifty
Nearest Rank 6	DION	other	BIGLOBE	BIGLOBE	nifty	other
Nearest Rank 7	Plala	YahooBB	Plala	YahooBB	BIGLOBE	BIGLOBE
Nearest Rank 8	YahooBB	Plala	YahooBB	Plala	Plala	Plala

SUMMARY

The summary of this paper is as follows.

- (1) A rival analysis about a competitive industry with the precedent and the following should be measured by the distance from the starting point in accordance with the competitive elements, which show the extent of difference between itself and the rival.
- (2) An industry that this paper considers applicable is an industry which has a low mobility barrier or a low imitation barrier, or one whose technology improvement is quite dynamic, e.g. Japan's ISP industry.
- (3) Through this measurement, it is possible to analyze the changed relationship between the firms over time.(Fig3)
- (4) A firm is able to draw up a practical strategy utilizing three categories: the resource barrier (the "Resource Group"), the "Execution Group", which shows the difference

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between the executed strategy, and the “Market Group”, which shows customers’ comparison at the time of the decision.

(5) With these three categories of analysis and the cross-referencing, a firm can exploit the strategic group concept in a practical way.

(6) If a competitive dimension changes, each distance between the firms and the effective resources for the competition also changes.

(7) Each distance between the firms in Resource, Executed strategy and Market are not always consistent, which means the differences in the size of the distance can change between categories.(Fig.4)

(8). It is important for a firm to enhance its strength, decide investment and initiatives which lead to most effective results by recognizing the existence of the distance and the gap among the groups.

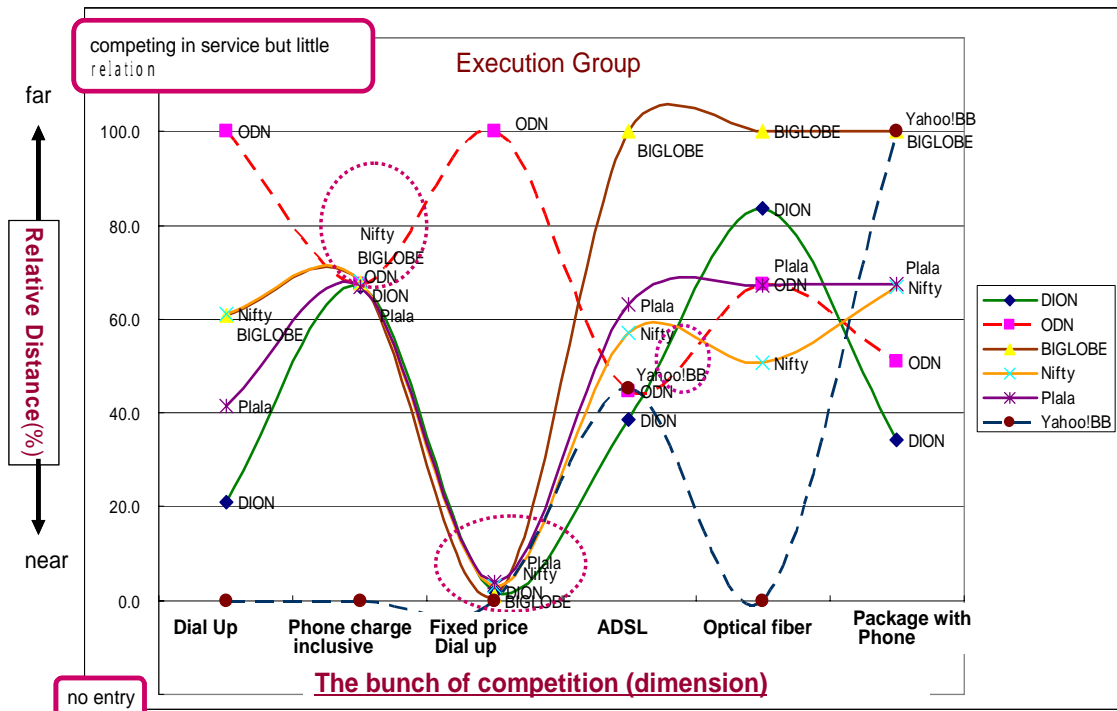


Figure3. Distance from OCN by Competitive Dimension

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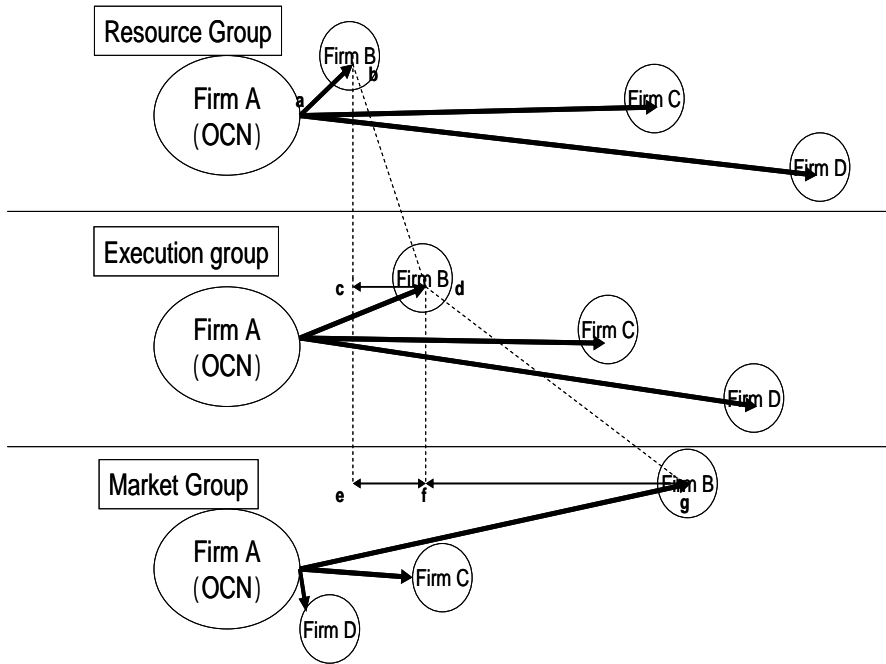


Figure4. Pattern diagram of the distance gap among the group

Future Discussion

It should be noted that some points have been left undiscussed for future study. First, it is necessary to examine whether the framework which this paper proposes is also applicable to a static market whose relative relation is not always changing³. Secondly, further refinement of the metric variable quantification as distance is required. Thirdly, the clarification regarding the distances and the gaps among the three groups in relation to the firms' performance and organization is expected. These three discussion points will contribute to the study of the competitive strategy at the time of dynamic competition. This study is based from the point of view of a company inside; however, future research should examine where these discussion points and conclusions fit amongst other competitive strategy studies.

³The case of a market with uniform and stable customer needs and an industry which has a high imitation barrier (Negoro 2005) would not require discussions regarding the issues which are addressed in this paper.

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