INTRODUCTION

In a recent paper in the *Strategic Management Journal*, McGee and Thomas (1986) conducted a review of recent studies on strategic groups pointing out limitations with previous studies and suggesting areas for future research. While McGee and Thomas (1986) provide a comprehensive review of the literature on strategic groups, they have failed to recognize some of the weaknesses in this literature. This note points out the limitations of the McGee and Thomas (1986) paper, and highlights some of the omissions in their review of the contemporary theory and research on strategic groups.

LIMITATIONS

McGee and Thomas (1986) have erroneously reported that Oster (1982) assigned firms to groups in any year based on the advertising to sales ratio in that year. Oster specifically argued that advertising decisions were essentially made at the beginning of each year, perhaps, based on previous year sales and, therefore, she used advertising expenses as a ratio of previous year sales to assign firms to groups. She also checked for the long-term durability of the firm’s advertising investment strategy by comparing the effects on demand of the ratio of advertising to current sales and the effects of the same ratio based on previous year’s sales. If the ratio based on current sales has a larger impact on consumer demand than the ratio based on previous year’s sales, then there is no barrier, since an entrant could also adopt the same strategy. However, if the ratio based on previous year’s sales has a larger impact, then there exists a barrier which an entrant cannot scale. McGee and Thomas (1986) miss this point in their review.

With respect to the identification of sources of mobility barriers, McGee and Thomas (1986) commit both acts of commission and omission. It is not clear how industry supply characteristics lead to mobility barriers. They should lead to entry barriers, as Porter (1980) points out. Also market segmentation is, usually, not a firm decision. Segments exist. Firms only identify them; and attempt to serve them through market positioning, which could, of course, be a source of mobility barriers. In terms of acts of omission, McGee and Thomas (1986) ignore pricing, product design, product quality, the adoption of global strategies in marketing, manufacturing strategy (number, location and size of plants, sourcing, etc.), financial strategy and R&D strategy.

McGee and Thomas’ statement that ‘conventional portfolio theory argues that the pooling of uncorrelated risks reduces overall risk’, in support of diversification as a source of mobility barriers (1986: 153) through risk reduction is invalid since there is no support for this hypothesis (Montgomery and Singh, 1984; Copeland and Weston, 1979). Similarly, ownership differences have been shown (Stigler and Friedland, 1983) not to ‘affect the desired rate of return and the time horizon over which this is to be earned’. Further, McGee and Thomas suggest that ‘mobility barriers are a corollary to the existence of strategic groups’ (1986: 153; emphasis added). However, the entire literature on strategic groups
has argued that mobility barriers determine strategic groups.

Another example of internal inconsistencies in the McGee and Thomas paper is in Table 4 (1986: 154). ‘Uncontrollable variables’ are listed as possible strategic variables for defining strategic groups, though the authors explicitly, and correctly, argue earlier in their paper that only controllable variables should be used for this purpose.

OMISSIONS IN THE REVIEW OF THE EXTANT THEORY AND RESEARCH ON STRATEGIC GROUPS

Contrary to McGee and Thomas’ assertion (1986: 142) strategic groups is not only a supply-side concept, since there exist two demand-side explanations for the observed phenomenon of intra-industry profitability differences among firms. The first is based on consumer heterogeneity. It has two variants. Polymorphic equilibrium (Hallagan and Joerding, 1983, 1985) results when firms produce identical products but adopt different marketing strategies, attaining equal profitability. This ‘theory’, or explanation, is based on the premise that consumers have varying preferences for different types of promotional strategies. The second variant posits that consumers have identical preferences but they incur different costs in acquiring information (Butters, 1977; Salop and Stiglitz, 1982). Firms can then undertake marketing strategies which lower search costs for consumers but raise costs for the firm. Again, equal-profit firms with different strategies and costs can exist in equilibrium. The second explanation, based on ‘uncertain imitability’ (Lippman and Rumelt, 1982) is examined by McGee and Thomas (1986). While research on strategic groups has included marketing strategy variables, this inclusion has not explicitly been motivated by demand-side explanations for intra-industry profitability differences. Significantly, demand-side explanations do not rest on the existence of mobility barriers to explain intra-industry profitability differences. Clearly, it would be a rewarding exercise to study how firms may obtain a competitive advantage by devising strategies based on demand-side premises.

McGee and Thomas (1986) do not recognize a basic weakness with the theory of strategic groups when they write that ‘Hunt observed that there were three sources of asymmetry between firms within the “white goods” industry: the extent of vertical integration, degree of product diversification and differences in product differentiation. This asymmetry resulted in four strategic groups: . . . ‘ (1986: 142; emphasis added). Consider, for example, that each of the three sources of asymmetry referred to above can be operationalized as a dichotomous variable: high–low. This implies that there could potentially exist at least $2^3=8$ unique combinations of the three sources. Possibly, some combinations may be infeasible; but that is not the point here. Of greater interest (to me at least) is to understand why there exist only four groups (in the above example) where there could, in fact, be eight. Further, how can researchers (or practitioners) theoretically predict how many groups with what combination of the ‘sources of asymmetry’ will exist in any given industry. McGee and Thomas (1986), as all the other researchers in this topic, completely ignore this issue.

McGee and Thomas (1986) rightly recognize the need to include firm characteristics such as the extent and nature of diversification and vertical integration as sources of mobility barriers. They suggest that nature of diversification refers to whether it is ‘related’ or ‘unrelated’. However, this aspect of the nature of diversification is only part of the story. Different bases of diversification, such as shared resources, shared raw materials, shared distribution channels or shared customers, in effect reflect different strategies, and could lead to differences in economic performance. Firms may choose a particular basis, or a particular combination of bases, for diversification. McGee and Thomas’ (1986) review of the literature on strategic groups does not deal with this issue of strategic choice as it relates to strategic groups.

Another significant problem with extant research on strategic groups, not discussed by McGee and Thomas (1986), is the tendency to view firms as following ‘pure’ diversification strategies, i.e. either related or unrelated, for example. But firms, in general, do not follow ‘pure’ strategies. To some extent, and on some base, they may be related diversifiers, but they may also be unrelated on other bases. What is needed is a way of capturing the extent of both
related and unrelated diversity in the firm.

Previous research on strategic groups has either largely ignored bases of diversification or has been unable to separately capture this aspect in the measures of diversification used. The specific bases for diversification used by a firm and, additionally, the specific industries in which a firm competes, confer unique competitive advantages which other firms may not obtain, and which define the unique strategic position of the firm. No study on strategic groups, that I am aware of, even remotely considers these two issues.

A serious shortcoming in some of the work on strategic groups, not recognized by McGee and Thomas (1986), is the use of performance or firm output, measures as dimensions to identify strategic groups. Prime examples are Porter (1979) and Caves and Pugel (1980), who each used firm size. However, strategic group theory seeks to explain differences in performance or firm outputs. Measures of performance used as group defining variables is a tautology. Large firms may be large not because they have qualitatively different strategies than small firms but simply because they have used those strategies more effectively. Therefore, small and large firms could be in the same strategic group (Oster, 1982). In fact, McGee and Thomas (1986) posit firm size as a firm characteristic which is a source of mobility barriers. Further, firms following different strategies could attain the same performance levels. An analytical exposition which clearly demonstrates this possibility is given by Karnani (1984), where it is shown that Porter’s (1980) generic strategies—low cost and differentiation—are continuously substitutable and firms may exhibit the same profitability (be on the same isoprofit line) and yet adopt different positions on the isoprofit curve in terms of the chosen trade-off between low cost and differentiation.

In conclusion, though McGee and Thomas’ (1986) review of the literature on strategic groups is useful, it omits examination of several critical issues related to strategic groups. It is hoped that future research in this area will address them.

REFERENCES


