Conflicting Approaches to Competitive Analysis

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Introduction

The highly competitive environment nowadays has forced the company to be more focus on the strategy in order to stay competitive or at least survives in the industry. There are some approaches taken to develop appropriate strategy for a company to suit into its environment. The strategy would enable management to make proper and quick decision to maintain the company's performance. Information provided would enable strategy formulation and overcome competitive pressures in business (Ratnatunga, 2004). This paper will be comparing and contrasting two approaches in corporate strategy and then discussing the roles of strategic management accounting information in relation with the corporate strategy issues.

Competitive Analysis Approach (Porter's Model)

According to Michael Porter's ground breaking 1979 theory, there are 5 forces that influence a firm's competitive strategy. Four forces -- the bargaining power of customers, the bargaining power of suppliers, the threat of new entrants, and the threat of substitute products - combine with other variables to influence a fifth force, the level of competition in an industry. This 5 forces analysis is just one part of the complete Porter strategic system. The other elements are strategic groups (also called strategic sets), the value chain, the generic strategies of cost leadership, differentiation, and focus, and the market positioning strategies of value based, needs based, and access-based market positions (Porter, 1979).

Porter's model outlines the primary forces that determine competitiveness within an industry and illustrates how those forces are related. The model suggests that in order to develop effective organizational strategies, managers must understand and react to those external forces within an industry that determine an organization's level of competitiveness within an industry (Porter, 1991). It is a firm's competitive position within a particular industry – its power relative to these direct competitors – that basically determines the future profits it may withdraw, or losses it may incur, from that business (Porter, 1980).

Financial accounting, however, conventionally depicts profits arising on a period basis without acknowledgement of changes in competitive position. A business that realised a profit by running down competitive position would, in this account, appear no different from a firm that realised the same profit while building its competitive position. Yet, when competitive position has been improved, it is very likely to have meant reduced accounting profit because of the cost of gaining on competition. Conversely, increased profit can be a reflection of decay in competitive position as a result of higher prices, decreased quality, reduced advertising or any other reduction in spending that might have decreased the firm's relative competitive appeal in the market.

Because of the failure to incorporate at least some indicators of competitive position in financial accounts, it is not unknown for firms that have performed with adequate accounting profits for many years suddenly succumb to "increased competition" with no prior indication from the revenue accounts that the threat is imminent. Yet the real economic profitability of such a firm may has been declining year by year as the firm's relative cost position decayed. Only when a competitor actually reduced the price, increased quality, or was finally able to surmount tariff protection, was the impact

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realised. But the real loss had been building steadily, the conventional accounts were poor indicators of the true position. Traditional strategy models, such as Michael Porter's Five Forces Model, focus on the company's external competitive environment. Most of them do not attempt to look inside the company.

Core Competence-Based Approach (Hamel & Prahalad's Model)

In contrast, the resource-based perspective highlights the need for a fit between the external market context in which a company operates and its internal capabilities. According to the core competence-based approach, a company's competitive advantage derives from its ability to assemble and exploit an appropriate combination of resources (Hamel and Prahalad, 1994; Hamel, 1996; and Pehrsson, 2000). Sustainable competitive advantage is also achieved through continuously developing existing and creating new resources and capabilities in response to rapidly changing market conditions (Marsden, 1998).

According to Teece et al. (1997), resources, including financial resources, tangible resources (such as plant, equipment, buildings) and intangible resources (such as human capital, structural capital, customers, patents) are firm's specific assets, which are difficult to buy or imitate. The root of competitive advantage is inside the organisation and the adoption of new strategies is constrained by the level of company's resources. The sustainability of these resources depends on the ease with which they can be imitated or substituted. Developing and maintaining critical resources and capabilities requires relationships between all groups involved in the critical processes inside and outside the firm.

The change of external environment will affect on the significance of the resources for the firm. Thus, the abilities of management to consolidate the available resources into competences to adapt quickly to changing environment are the key driver of long-term profitability (Prahalad and Hamel, 1994). Strategic competence reflects both internal and external influences (Perhsson, 2000). It must provide potential to access the wide variety of the markets, make significant contributions to perceive customers' benefits, and difficulties for competitors to imitate. For example, for firms that wish to use alliances to achieve business goals, the important competence is an alliance competence which is the organisational ability for finding, developing, and managing alliances (Lambe et.al., 2002).

In a turbulence environment, creating and sustaining competitive advantage requires maintaining and sustaining dynamic competences in which new resources are continuously created and changed to suit new expectations (SubbaNarasimha, 2001). The competitive advantage derived from development and exploitation of dynamic competence in turbulence environment depends on the appropriate implementation, organisational design and the human resource practice.

The competence-based approach, however, is criticised as being "partial" and "one-sided" approach and thus in danger because it neglects the impact of the environment. The accelerating changes in the environment can increase the possibility of failure in future because the set of competences built at the present time can be unsuitable in the future (Marsden, 1998). Thus, competences should be "contextually based", reflecting the needs of the organisation and the markets in which it operates. In addition, one of the assumptions of competence-based is that managerial skills are natural, they are expected to have the abilities to manage and deploy the resources and competences efficiently. Graeme and Roger (1995) have found that when the business environment changes, the managers do not always perform as well as they did in previous environment.

Strategy Formulation

Mintzberg et al (1998) has identified 10 traditional strategy approaches, which include competitive analysis and core competence-based approach. They have argued that strategy formulation should be a combination of the approaches - judgmental designing, intuitive visioning, and emergent learning; it should be about transformation as well as perpetuation; it has to involve individual cognition and social interaction, co-operative as well as conflictive; it must include analysing before and programming after as well as negotiating during; and all of this must be in response to what can be a demanding environment.

Referring to the blind men and the elephant metaphor, Mintzberg et al (1998) have said that scholars and consultants should certainly continue to probe the important aspects of each approach, for the same reasons that biologists need to know more about the tusks, trunks and tails of elephants. But more importantly, it is a must move beyond the narrowness of each approach. As the authors say, "We shall never find it never really see the whole. But we can certainly see it better". The lesson in all this is that there is a need for a wider systemic perspective and a better practice, not neater, but narrow technique or theory.

Role of Strategic Management Accounting (SMA) Information

Regardless of which strategy the management is adopting, SMA should provide accurate information that will be helpful in aligning the implementation process with the strategy. The most popular conception of strategy in SMA is achieving sustainable competitive advantage, through the implementation of techniques that promote the measurement and analysis of information on both markets and internal organisation so as to beat the competition (Nyamori et al, 2001). Activity-based costing (ABC) system and the Balanced Scorecard (BSC), for example, promoted as providing information that can enable a firm to attain competitive advantage.

The role of ABC system, which evaluates the costs of a firm's activities based upon the actual resources and time consumed in performing them, is to provide more accurate analysis of true costs, thus facilitating more accurate future projections of profitability (Liberatore and Miller, 1998). Kaplan and Robin (1989) argued that ABC is intended for long-term application, providing accurate data for measuring the sustainability competitive advantage of a company in creating additional value for shareholders. In this case, ABC will be applied in the measurement by adopting value-based management (VBM). VBM is a powerful strategic tool that can help management to focus on the value drivers, which lead to maximise the shareholder value. This tool includes residual-income approaches, such as economic value added (EVA), shareholder value added (SVA) and market value added (MVA) (Cooper et al., 2000). These tools would be very useful in measuring business performances in the long-term, in which enables the company to utilise resources and perform on going-concern basis as on of the assumptions in financial accounting.

ABC can also be used as a strategic control system in (Ward and Patel, 1990):

- Developing and implementing strategies and providing controls
- Translating the strategy into actions that would be more understood by the stakeholders
- Proposing possible changes and predicting reasonable condition and performance in order to improve the strategy implementation
- Disclosing the company's potencies in terms of its tangible and intangible resources

Another measurement approach recommended by Boston Consulting Group is the cash flow return on investment (CFROI) and discounted cash flow (DCF), which eliminate the distortion from traditional accounting measurement such as return on investment (ROI) and return on equity (ROE). This is because share markets value a company on its ability of generating cash flow stream and to shareholder, only the dividend, one kind of cash, is the crucial indicator. By removing the accounting distortion in normal profit and loss reporting and moving to a cash-based measure of performance, the CFROI and DCF can capture 80% of the determinants of market value. In contrast, ROI or ROE only display 30%~35% correlation with the performance.

On the other hand, BSC has been developed to force management focus on the critical measures that bring together the seemingly disparate elements of a company's competitive agenda (Kaplan and Norton, 1992). BSC acts as a strategy map, which emphasises on the cause-and-effect relationships between the critical elements and the linkages of measurement to strategy. It identifies the importance of non-financial measures in the strategy implementation (Kaplan et al., 2001). In essence, the BSC model provides a cocktail of measures that include the entire value chain of the company i.e. core competencies.

The BSC contains outcome measures (lag indicators) and the performance drivers (lead indicators) of outcome, linked together in cause-and-effect relationships, making the performance measurement system a feed-forward control system (Norreklit, 2000). The four perspectives most likely covered are *customer perspective, financial perspective, innovation and learning perspective and internal perspective,* which enable the company to measure the overall business performance.

BSC approach provides a powerful means for translating a firm's vision and strategy into a tool that effectively communicates strategic intent and motivates performance against established strategic goals (Maiga and Jacobs, 2003). Not only BSC assists in developing a consensus around the firm's vision and strategy, it also enables the strategy to be consistently communicated throughout the organisation and forces the managers to focus on the handful measures that are most critical. BSC also guards against sub-optimisation, where improvement in one area may have been achieved at the expense of another. Nevertheless, it has been proposed that to be relevant, the strategic issues should drive the management accounting systems (MAS), not vice versa (Nyamori et al., 2001). MAS should be able to align the organisation's strategy and its environment in improving the performance (Macintosh, 1994).

Conclusion

Strategy would enable management to make proper and quick decision to maintain the organisation's performance. Two main strategy approaches here, Porter's Five Forces Model and Hamel and Prahalad's Core Competencies Model, are widely used in the organisation, each of which has its strengths and weaknesses. Porter's model emphasises on the primary competitive forces and the relation among those forces within an industry. The model suggests managers to understand and react to the forces that determine the level of competitiveness in developing effective strategy. Whilst on the other model, Core Competencies Model, it views an organisation as a collection of resources and capabilities that are difficult to buy or imitate. The development and maintenance of such things require relationships between all groups involved in the critical processes inside and outside the organisation. Strategy formulation should be viewed from a holistic perspective and not limited to any particular approaches.

The role of SMA will support management with accurate information in the process of choosing the proper strategy approach, applying the strategy into operation and evaluating the strategy performance. SMA should link the different elements of the business strategy, internally and externally, in order to identify and rely on strategically linked measures when evaluating performance. Thus, the focus should not only be on MAS, but more importantly, on the role of the management accountant to be involved in the strategic decision-making process (Banker et al, 2004).

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