

The Four Arguments Towards Competitive Advantage

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How do you know which changes are most likely to make your business grow? This is an important question for business leaders because it goes to the heart of how to figure out where to focus time, attention and resources.

For example, imagine a competition for resources among members of the top team at Amazing Pen, Inc. The head of product development wants to acquire a new technology, while the head of operations wants to hire a new procurement manager.

The new technology will open markets but make the manufacturing process more complicated. The new procurement manager will ensure access to key resources and reduce costs. How do you determine which of these investments will most likely contribute to competitive advantage and therefore to growth?

This article will demonstrate a way to answer this question by walking through a step-wise analysis. It's called the *Four Arguments Towards Competitive Advantage*.

We'll start our analysis at the beginning. *The score is tied:*

Product development/new product (0)
Operations/new procurement manager (0)

Battle of the hockey sticks

Often times, leadership teams engage in the “battle of the hockey sticks” to resolve resource conflicts in business, and your team probably uses some variation on this strategy. In this approach, team members create plans and forecasts for investment and returns. When graphed, these forecasts look like hockey sticks—a flat line (invest, invest, invest), followed by an upward slope (return, more return, even more return).

When one hockey stick is clearly the winner, this approach can work. But it also often leads to troublesome social dynamics, including:

- People use complexity as a weapon: “My 20-page analysis, which you don't have time to fully understand, shows you that should trust me and my hockey stick most.”
- People overemphasize immediate returns instead of assessing impact on competitive advantage: “No more coffee machines will definitely save us \$300 a month, but what do going on all those golf outings do for sales?”
- CEOs make unexplained politically motivated compromises: “This year sales and marketing will get budget increases, while all other budgets will stay flat (because I believe that my sales and marketing leaders are more engaged in growing the business than my other team members).”

The inherent failure of the hockey stick approach is it doesn't provide enough structure to force clear strategic thinking that ensures an apples-to-apples comparison among alternatives. The *Four Arguments Towards Competitive Advantage* solves this problem.

What conditions make competitive advantage and therefore business growth inevitable?

The key concept behind the *Four Arguments Towards Competitive Advantage* is that competitive advantage becomes inevitable when four conditions are met:

- (1) Better Positioning / Larger Potential Market
- (2) Increased Scalability / Capacity to Meet Demand
- (3) Greater Sustainability / Ability to Manage Risks
- (4) Higher Returns

The idea is to require leaders to construct and support arguments for how a given change will positively or negatively impact these four conditions.

1) Better Positioning / Larger Potential Market

Positioning is a measure of how often a business is chosen by key stakeholders over the competition. As such, it is a measure of potential market share. A business has the ultimate positioning when it is the provider-of-choice, partner-of-choice, employer-of-choice, investment-of-choice and community member-of-choice.

Here's how the CEO at Amazing Pen, Inc. describes the company's positioning:

"Let me tell you about Amazing Pen, Inc.'s amazing pens. Just holding our pens makes you smarter and live longer and, of course, they write flawlessly. Every person, who isn't allergic to nuts, wants one of our pens. The best companies in the world want to help us bring these pens to market. The best talent wants to work for our company. Potential investors are throwing cash at us. And every city wants our facilities in their community. We have almost perfect positioning in our target market (nut allergy-free pen users) and a potential market share of 94% of the people on the planet."

The new technology will make the pens less allergic to people with peanut allergies but not other types of nut allergies. However, the new procurement manager will have no impact on positioning.

The score is now:

- Product development/new product (1)*
- Operations/new procurement manager (0)*

2) Increased Scalability / Capacity To Meet Demand

*Scalability is a measure of the capacity to meet demand. Sometimes people get positioning and scalability confused. Here is the difference: although the potential market share is 94% of the people on the planet, the company can *only* make 5,000 pens a day. It has a strong positioning / potential market, but is not scalable. The new technology would enable Amazing Pen, Inc. to make 15,000 pens more a day. Whereas, the new procurement officer will enable it to make fewer—10,000 more pens a day.*

The score is now:

- Product development/new product (2)
- Operations/new procurement manager (0)

3) Sustainability / Ability To Manage Risks

Sustainability is the degree to which a business can mitigate risks. The secret ingredient in these amazing pens is ink made from rare bongo-bongo nuts.

The new technology would not increase access to bongo-bongo nuts. However, the new procurement officer will enable the company to negotiate contracts to double its bongo-bongo nut supply.

The score is now:

- Product development/new product (2)
- Operations/new procurement manager (1)

4) Increased Returns

Increased returns means that a business returns equal or better value back to investors/benefactors than alternative investments. In for-profit businesses, returns are usually measured in terms of positive cash flow over time or EBITDA. In mission-driven businesses, returns can be measured in other ways.

The new technology will not impact returns because it will not significantly change the margins. However, the new procurement officer will enable the company to lower costs and increase profits.



The score is now tied again:

- Product development/new product (2)
- Operations/new procurement manager (2)

Breaking the tie depends on priorities

To understand how to break this tie, consider the growth of Honda versus General Motors (GM) over the last 20 years. Honda has steadily grown while GM has been in decline. What were the relative priorities of the two companies? If you believe recent press, it appears that only

now, after years of decline and a massive US Government bailout in 2009, GM is waking up to the need to invest to reinvent its product offering—to change its priorities for strategic growth from an historical emphasis on return on investment to establishing its competitive advantage in the marketplace.

	
<p>GM <u>Return / Positioning</u></p>	<p>Honda <u>Positioning / Return</u></p>
<ul style="list-style-type: none"> (1) increased returns (2) more scalability (3) better positioning / market size (4) more sustainability 	<ul style="list-style-type: none"> (1) better positioning / market size (2) more scalability (3) more sustainability (4) increased returns

A few provocative questions:

- What are the implications for long-term growth in publically traded companies if Wall Street's priorities are return/competitive advantage instead of competitive advantage/return?
- For long-term success, which of the Four Arguments is most important, and how should this set the overall priorities of a CEO?
- When building a new business, which of the Four Arguments must be solved first?

The Big Conclusion

So who wins at Amazing Pen, Inc.? It depends. The new technology wins if the priority is to favor positioning over return. And the new procurement function wins if the priority is reversed and return is favored over positioning. I guess the team will need to talk about their core growth priorities.

The advantages of the *Four Arguments Toward Competitive Advantage* include: it is easy to understand, it surfaces key strategic issues, it encourages transparency and it leads to better strategic thinking and decision-making. ♦