

A Comparison and Contrast of Strategic Management and Classical Economic Concepts: Definition, Comparison, and Pursuit of Advantages

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Abstract

The field of strategic management contains a diverse set of research interests and paradigms. Also, there is ambiguity of purpose and definition evident within that set of interests and paradigms. By examining that set with the perspective provided by classical economic concepts of absolute and comparative advantage, a goal that points toward increased clarity of purpose and definition may be achieved within strategic management research, the teaching of strategic management concepts, and practitioner efforts to gain competitive advantage.

Introduction

Research in the strategic management field has generally been concerned with assessing the performance outcomes of firms and their antecedents. The overarching goal is generally expressed as a search for the factors that lead to a competitive advantage in the market for a firm. Competitive advantage is examined as resulting from and being associated with a long list of contributing factors. Such factors include operational efficiencies, mergers, acquisitions, levels of diversification, types of diversification, organizational structures, top management team composition and style, human resource management, manipulation of the political and/or social influences intruding upon the market, conformity to various interpretations of socially responsibly behaviors, international or cross-cultural activities of expansion and adaptation, and various other organizational and/or industry level phenomena.

Those phenomena, when viewed using classical economic theory, are organizational efforts designed to gain absolute and/or comparative advantages in the market. Adam Smith in 1776 and David Ricardo in 1817 introduced those two fundamental economic concepts, respectively. By understanding the

Key words and Concepts: Strategic management, Competitive advantage, Competencies, Absolute Advantage, and Comparative Advantage

relationship of the numerous strategic management research efforts to those two classical economic concepts, one may gain new insight and clarity regarding research, practice, and teaching in the area of strategic management.

The Relationship of Strategic Management Practice to Absolute and Comparative Advantages

Very succinctly stated, an absolute advantage is a more efficient transformation of inputs to outputs that results in a greater value derived from a given level of inputs as compared to competitors. A comparative advantage is the state of having a lower opportunity cost of producing a given level of output value as compared to competitors. These are the two fundamental, classical economic concepts that support an understanding of markets and trade. Several areas of strategic management practice that are the subject of intense research illustrate this underlying dependence upon classical economic concepts while not usually acknowledging that fact. Mergers and diversification activities that find and exploit synergistic organizational relationships lower the cost of transforming inputs to outputs, or they increase the value of the transformed outputs to the consumers in the market. This can be viewed as gaining comparative or absolute advantage, respectively.

Management teams that are more adept at analyzing the competitive environment to find and exploit market opportunities are creating absolute advantages for the firm in the market by more efficiently recognizing opportunities and then positioning the firm to fill the opportunity before, or better than, other firms. Teams that motivate their organizational members to transform inputs into outputs with more alacrity, quality or customer responsiveness are also finding absolute and/or comparative advantages in the market. Strategic human resource management is also essentially centered upon a desire to find the most efficient use of and/or the lowest cost for the human capital that a firm possesses, which is, again, a search for absolute and/or comparative advantages.

In other areas of interest within strategic management research, such as the manipulation of political and/or social factors intruding upon and shaping the market environment, expansion to an international / cross-cultural market environment, or conforming to various perspectives of socially responsible behavior, the phenomena observed can also be viewed through the absolute and comparative advantage perspectives of interpretation. In these activities, firms may face more complex tasks in a broader political / social / cultural context than those tasks that are found in the phenomena mentioned above regarding diversification or management team composition. Even if the firm is encountering more complex organizational phenomena by dealing with internal issues, the social environment, or other engaging in strategic relationships with other firms the tasks engaged are, nevertheless, directed toward allowing a more efficient conduct of market activities.

The ultimate aim of the firm is to more efficiently or more cheaply produce and capture value in the market as compared to its competitors. This is true if a firm seeks to lessen regulatory impacts, understand and adapt to a foreign market, or satisfy the concerns of activists or stakeholders who demand the firm engage in some form of socially responsible behavior above and beyond its normal operations. That capture of value is the result of either a wider margin between prices charged for outputs and cost of inputs (comparative advantage found within cost leadership) as compared to its competitors, more perceived quality in the firm's outputs and operations as compared to its competitors (absolute advantage as found within vertical or horizontal differentiation), or a combination of those two factors. This was noted by Porter (1980 and 1985) in his discussion of the cost leadership and differentiation strategies that may be thought of as "generic" strategies because all firms may embrace either of those strategic options to some degree.

In summary, the varied research interests pursued by strategic management researchers in a very diverse and scattered field that attempt to explain firm performance can be related back to the concepts of absolute and comparative advantage. Regardless of the exact forms observed and analyzed, firm activities are directed toward either achieving more efficient conversions of inputs to outputs and/or

performing conversions of inputs to outputs with a lower opportunity cost as compared to competitors and has the potential to bring some increased clarity regarding the tactics that firms use to achieve the overarching strategic goal of a competitive advantage. In essence, through their tactics, firms are seeking absolute and/or comparative advantages. Strategic management research is, thus, an attempt to recognize how firms obtain these advantages.

Relating the Classical Concepts to Common Strategic Management Research Paradigms

Since Adam Smith introduced the concept of absolute advantages and David Ricardo popularized the concept of comparative advantages to explain the sources of and gains from trade and commerce, there has been a strong, basic understanding in the economic literature regarding why some firms, individuals, or organizations are more or less successful in their pursuit of value creation and profitability. In short, the combination and interaction of superior efficiency in transforming inputs to outputs and the ability to engage activities with relatively low opportunity costs lead to the creation of value above the cost of production inputs and, consequently, market participants trade upon that value. In essence, an entity (be it an individual, a firm, or another organizational form) strives for absolute advantage in its environment, for comparative advantage in its environment, or for both.

For example, a firm with a comparative advantage in producing footballs has a lower opportunity cost for its production processes than its competitors. In other words, its opportunity cost of production, as reflected in the foregone next best use of its resources and capabilities, is lower than its competitors' respective opportunity costs to produce and deliver a given quantity of footballs. Given the use of resource costs to reflect and approximate value in the market and, hence, foregone opportunities, what one can note in this instance is that the cost of resources used by the firm with the comparative advantage to acquire the inputs to make the footballs is less than the cost of resources that must be used by other firms. Assuming roughly equivalent quality and price positioning in the marketplace, this comparative advantage alone is sufficient to locate a

firm in the marketplace in a superior position as compared to its competitors.

Translating this comparative advantage into Porter's (1980 and 1985) strategic view of competition, this would be a position of cost leadership in the market. In the resource based view of the firm Barney (1991, 1996), this comparative advantage would be a superior resource and/or capability enabling the firm to distinguish itself in the pursuit of above average performance. A transaction cost perspective of the firm Williamson (1979) would additionally focus upon the fact that the firm has organized itself in a means to accomplish its production goals with minimum transaction costs involving vertical and/or horizontal organizational boundaries and operational structures in the conversion of inputs to outputs. Regardless of the theoretical paradigm or model that provides explanatory details about the nature, source and operationalization of a comparative advantage for a firm, the end state of that firm is the result of the comparative advantage.

The example firm that is producing footballs with a comparative advantage might also be the most efficient at converting a given quantity of inputs into outputs and embedding value for consumers in those outputs. In this case, the firm would have an absolute advantage in the market wherein the firm could either produce more outputs from a given level of inputs or better outputs from a given level of inputs, or some combination of higher quantity and quality at a given level of inputs as compared to competitors. Relating this absolute advantage for a firm to models of strategic behavior, this would be a strategic stance of differentiation in Porter's view, or another superior resource capability in a resource based view of the firm. Also, using a transaction cost perspective to examine that firm's absolute advantage would emphasize the firm boundaries, technologies and structures that have permitted the least cost, most efficient transformation of inputs to outputs. Regardless of the theoretical paradigm or model that provides explanatory details about the nature, source and operationalization of an absolute advantage for a firm, the end state of that firm is the result of the absolute advantage.

The presence of an absolute advantage in combination with a comparative advantage for a firm

would translate into an opportunity to create and/or widen the gap between the firm's opportunity cost and its products' value in the market. Turning again to Porter's generic strategies as a means of discussing this combination of comparative and absolute advantages, the firm could pursue both cost leadership and differentiation when it maintains comparative advantage and absolute advantage. The resource based view of the firm would again focus upon the specific resources and/or capabilities that are exploited in order to manifest the comparative and absolute advantages, and the transaction cost perspective would center upon the means by which the firm was organized and structured to accomplish the lower opportunity cost and superior productivity that is enjoyed by the firm.

The Lack of Focus in the Field of Strategic Management

Unfortunately for the teachers, students, and practitioners of business, because of separate paradigms and pedagogical models the field of strategic management research and pedagogy has become filled with a variety of terms, concepts and heuristic devices. That was briefly demonstrated above by noting Porter's work, the resource based view of the firm, and transaction cost perspectives that use different means of diagnosing identical organizational phenomena. There are numerous other perspectives in addition to the three discussed above which would require much space to list and describe.

The various perspectives are directed toward diagnosing the competitive environments in which firms exist, guiding the formulation of strategic goals, implementing strategic initiatives and predicting the resultant performance of firms. Usually, these perspectives tend not to relate their tools back to the fundamental economic concepts upon which they ultimately stand. Many of the concepts and terms overlap each other, result in similar diagnostic verdicts, and create confusion in the literature and in the classroom regarding which conceptual tools are appropriate in any set of given circumstances. An effort to bring these concepts and terms together in the pursuit of a more focused understanding of strategic management practices and their resultant

performance could benefit researchers, students and practitioners. Based upon the discussion above regarding the fundamental role that the pursuit of absolute and/or comparative advantages has within strategy, an initial effort to focus some of the field's concepts that relate to the creation of value and the pursuit of advantages in the marketplace follows.

Strategic management at its core addresses the fundamental question of how firms are able to create and retain value such that profitability is obtained and threats to that profitability from competitors are countered. While the concept of value is a subjective construct, the realization of the subjective market assessments of value is accomplished via the disbursement and collection of monetary units that are costs of inputs and sales of outputs. The essential nature of value creation in the strategic management process is the foundation upon which all else must rest. Nevertheless, the discussion of value creation and measurement in strategic management articles and texts is diffuse enough to warrant an attempt to bring cohesiveness to the perspectives.

For example, Porter's (1985) value chain discussion that targets value creation within a firm and the pursuit of economic profits (Besanko et al. 2004) based upon value created above opportunity costs are overlapping concepts that may often be discussed separately because they have been developed separately in the literature, often without attempt to relate the concepts to absolute and/or comparative advantages, or to each other. Combining the overlapping concepts into a framework designed to identify sources of value creation and retention within an organization may help to more clearly identify where value is being created along the firm's transformation of inputs to outputs, the chain of value creation. Additionally, the resource based view of the firm Barney (1991, 1996) can be combined with both Porter's value chain concepts and the concept of economic profit to point out where the unique resources and capabilities of a firm are actually engaged and appropriately exploited.

However, in considering these various terms and concepts, one can also note that conflicts among some of them arise, and this is an unfortunate outcome of having different research paradigms competing for journal and classroom space. One of

the more disheartening conflicts occurs in the meaning attached to competitive advantage by a variety of authors.

Appendix A contains a list of university-level texts used in strategic management courses that all use the concept of competitive advantage, though their implicit and explicit definitions of the concept vary markedly. A few texts (e.g., Besanko et al. 2004; Hill & Jones 2004) explicitly define the concept in relationship to achieving above average returns. Other texts (e.g., Hitt et al. 2003; Hoskisson et al. 2004) refer to the inability of competitors to imitate strategies as a competitive advantage. Several texts (e.g., David, 2003) implicitly use the term as if it is clearly understood what a competitive advantage is, though the usage by itself is ambiguous. For example, "Technological advancements can create new competitive advantages that are more powerful than existing advantages" (David, 2003, p. 93). The imprecision in the definition of competitive advantage is confusing to researchers, teachers, students and practitioners.

Using Classical Concepts to Clarify the Search for Competitive Advantage

Returning to the economic concepts provided by Adam Smith and David Ricardo and considering the various expressions of competitive advantage in the strategic management literature as noted herein, the use of the term competitive advantage to denote a superior competitive capability as noted above is redundant upon the concepts of comparative and absolute advantage. In fact, some of the usage of the competitive advantage terminology connotes a desire to find a defining competency within a firm that will allow the firm to achieve absolute and/or comparative advantage within the market. Competencies within firms are a familiar concept in the pedagogical literature related to strategic management (see Appendix A).

Competencies are generally referred to as being either core or distinctive in nature, but in either case, the emphasis in usage is directed toward things that a firm can do well, as compared to the things the firm does less well. Given that competencies are based upon resources and/or capabilities in organizations and allow firms to distinguish their operational characteristics from each other, one can suggest that

absolute and comparative advantages must follow as the consequence from a competency that is truly distinct from the competencies of any other firm with which it competes.

Building upon the brief discussion above and considering the more robust and unambiguous definitions of the terms used in strategic management texts, one could build a brief dictionary of strategic concepts and terms that come from viewing strategic management through the economic perspective created by Smith and Ricardo's works as follows:

Absolute advantage – a state of having the most efficient conversion of inputs to outputs in regard to quantity and/or quality measurements that allows economic profit to be added above opportunity cost via either differentiation or cost leadership.

Comparative advantage – a state of having the lowest opportunity cost (e.g., cost of capital and other resources used) that allows a cost leadership tactic to be engaged by an organization.

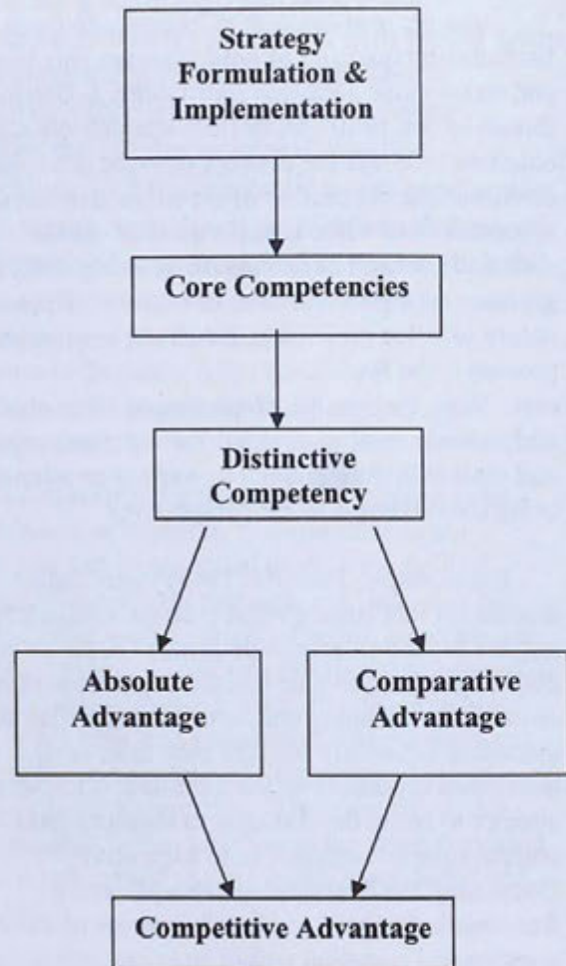
Core Competency – a resource or capability that is utilized in a superior manner within an organization as compared to its full set of resources and capabilities. This is measured in terms of relative absolute and/or comparative advantages within the organization.

Distinctive competency – a resource or capability that allows for the creation of comparative and/or absolute advantages for an organization in comparison to its competitors, which may result from a large selection of organizational and/or industry characteristics. These may include, but are not limited to, asset specificity, exploitable economies of scale / scope, exploitable network externalities, control of unique assets, organizational structure and culture that facilitates superior use of inputs and/or the reduction of transaction costs, social complexity, exploitation of luck, intangible assets, or the exploitation of non-market environmental factors (political, social, cultural) that affect the conduct of business.

Competitive advantage – the end state of having above average returns, as returns are measured among a firm and its competitors in a defined period

A very simple model showing the hierarchical relationships among these concepts follows in Exhibit 1.

Exhibit 1



The definition of concepts and their relationships provided by this model is not redefining or inventing a new strategic management paradigm. Instead, the model provides a means by which one can clearly communicate what the purposes of strategy formulation and implementation actually are. Through strategy formulation and implementation, firms seek to develop competencies that create absolute and/or comparative advantages as compared to their competitors so that they may achieve levels of performance that are above average, a competitive advantage.

Implications

Based upon the thinking outlined above, the essence of strategic management falls into the search for the distinctive competencies that allow absolute and comparative advantages to manifest themselves. The search for distinctive competencies is conducted and examined through a variety of theoretical and heuristic paradigms advanced by academic researchers and practitioners who tend to focus upon particular means of viewing organizations without necessarily attempting to integrate those paradigms toward the overarching goals of achieving absolute and/or comparative advantages. Without achieving one or both of those advantages in the market, the end state of competitive advantage in the market is unobtainable unless fortuitous luck is involved in some way. Without attempting to integrate and relate the research paradigms into the overarching goals of achieving absolute and/or comparative advantages, researchers tend to confuse students and practitioners with a variety of terms and concepts that can become disconnected from the necessary and fundamental goals of business.

Looking at the model from a more goal oriented and process oriented perspective, the most elusive goal addressed in the strategic management literature is focused upon sustaining competitive advantage in the market. That goal can now be more accurately defined as the attempt to find distinctive competencies that will sustain existing, or create anew in a repetitive manner, absolute and/or comparative advantages in the market. The means for sustaining or creating absolute and/or comparative advantages in the market thus becomes the search for distinctive competencies that distinguish a firm from its competitors via lower opportunity costs or a more efficient transformation of inputs to outputs. The integration of differing theoretical perspectives on how to achieve absolute and comparative advantages arising from distinctive competencies in organizations would be a welcome addition to strategic management literature and the strategic management classroom.

Briefly, let us return to the example firm introduced earlier in this discussion that is engaged in producing footballs. Using the framework and concepts discussed herein, an observer of the firm would be seeking to understand where the functional

level operations and business level decisions of the firm are achieving absolute and comparative advantages. To do so, the observer would first note what the firm is doing particularly well within its internal environment. Those areas of exceptional efficiency and productivity in the organization would be noted as core competencies of the firm. For example, suppose the marketing functions in the firm are organized and implemented in a way that is clearly more efficient and productive as compared to the actual production line functions. Suppose also that the supply chain functions are very well executed and managed. These two core competencies would then be compared to external competitors' operations to determine if our example firm's core competencies are actually distinctive competencies that result in absolute and/or comparative advantages as compared to the competitors.

Continuing with the example, suppose the observer determines that both the supply chain and marketing functions of the firm are indeed superior to the competitors' operations. Because of the supply chain's distinctive competency, the example firm has a comparative advantage in the marketplace, achieving a lower cost of inputs for a given quantity/quality level of football production. Also, the marketing team in the example firm has been able to achieve a much higher level of market penetration with superior relationships with retail outlets for the firm's footballs. Those superior relationships have resulted in an absolute advantage for the example firm as compared to its competitors. Our example firm has superior access to channels of distribution.

The final question is whether or not these two distinctive competencies of the example firm has or will result in above average returns as compared to the firm's competitors. If there are not areas within our example firm that negatively counterbalance its distinctive competencies (a.k.a. incompetencies), then the prediction would be that the combination of the observed absolute and comparative advantages should produce a competitive advantage.

In regard to possible further research that builds upon the framework and concepts discussed in this work, several avenues might be explored. First, further work could be done to demonstrate that the various strategic management paradigms are essentially identifying ways in which firms pursue,

develop and sustain core and distinctive competencies to gain absolute and comparative advantages. Fitting the variety of terms and concepts from strategic management paradigms into this framework's skeleton could help to bring coherency to the field of strategic management research.

Second, empirically demonstrating that competitive advantages as defined by above average returns are a consequence of the absolute and/or comparative advantages employed by firms would serve to clarify the confusing and competing definitions of competitive advantage presently used in the pedagogical and research literature. Linking above average returns to absolute and/or comparative advantages and then denoting that state as a defined and demonstrable competitive advantage might result in a common and useful definition of competition advantage that is not redundant upon the absolute and comparative advantage definitions.

Third, empirically demonstrating that the pursuit of competencies within firms that do not result in absolute and/or comparative advantages inhibit a firm's potential for achieving a competitive advantage and negatively impact returns would serve to confirm that absolute and comparative advantages are necessary for superior performance and not simply a tautological means of restating superior returns.

Conclusions

Thus, through this classical economic perspective that focuses strategic management as a search for absolute and comparative advantages resulting from the creation of core and distinctive competencies within firms, one has an opportunity to create an overarching framework in which to fit the various strategic concepts, terms, and heuristic paradigms that have been developed in the quest for creating and explaining competitive advantages. Regardless of the means of or differing explanations for strategic tactics, the necessity of creating core and distinctive competencies that result in absolute and/or comparative advantages for a firm as compared to its competitors can become the goal upon which students and practitioners of management can focus and employ their various conceptual and theoretical tools.

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Appendix A: Strategic Management Texts and Use of Key Terminology

Text	Use of Term Competitive Advantage	Explicit Definition of Competitive Advantage	Use / Explanation of a Variant of Competency
Besanko et al.	Yes	Yes	No
David	Yes	No	Yes
Dess et al.	Yes	No	Yes
Digman	Yes	Yes	Yes
Gupta & Govindarajan	Yes	Yes	No
Harrison & St. John	Yes	No	Yes
Hill & Jones	Yes	Yes	Yes
Hitt, et al.	Yes	Yes	Yes
Hoskisson et al.	Yes	Yes	Yes
Parnell	Yes	Yes	Yes
Pitts & Lei	Yes	Yes	Yes
Sanchez & Heene	Yes	No	Yes
Spulber	Yes	Yes	Yes
Thompson et al.	Yes	No	Yes

Text References

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