Moving beyond competitive advantage: A rejoinder to Barney et al.

By Marvin B. Lieberman

In their commentary on my *SMR* essay, "Is Competitive Advantage Intellectually Sustainable," Barney, Mackey and Mackey (2022) critique my arguments as "trivially true" and "not at all surprising." They incorrectly claim that "Lieberman's 'solution' to the problem of competitive advantage (is) to develop empirical measures of firm performance." In general, they allege that my essay "provides no real guidance for how the field of strategic management should evolve going forward." These are serious charges, which require a strong rejoinder.

By asserting that my arguments are "trivially true" and "not at all surprising," Barney *et al.* concede that they agree with my key points: competitive advantage can be defined in a variety of ways, and there is no consensus on the best definition. Competitive advantage is therefore problematic as a research concept in the field of strategic management. Barney *et al.* aside, I continue to meet people who are surprised to learn that competitive advantage has no precise meaning. My objective in writing the essay was to make it clear to everyone in strategic management that 'competitive advantage' (absent a specific definition provided by the researcher) is not a viable concept for the field and never has been.

This is not to say that we should simply abandon the term, 'competitive advantage' (although I have made such suggestions in the past). Comparisons of firm performance are central to performing strategic analysis, and 'competitive advantage' provides an easy way to describe them. I suspect that we will never be able to get away from using 'competitive advantage' as a rhetorical phrase and general descriptor. I have therefore come to believe that we should keep ‘competitive advantage’ in the domain of strategic management, but take it "down off the throne," as I maintain at the end of my essay.

Barney *et al.* misunderstand my argument about the benefits of developing new performance measures. Such measures can never "solve" the problem of defining competitive advantage. (Indeed, to claim otherwise would be inconsistent with my main argument.) Innovative performance measures can, however, help to move the field beyond a narrow focus on shareholder returns, the traditional way of assessing competitive advantage. The strategy field has begun to embrace more holistic views about stakeholders and what it means for a firm to be successful. To be quantitative when comparing firms and assessing the flow of value to stakeholders can make our field more precise. I have long subscribed to Lord Kelvin’s dictum:

> "When you can measure what you are speaking about, and express it in numbers, you know something about it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind; it may be the beginning of knowledge, but you have scarcely, in your thoughts, advanced to the stage of science."

Over its six-decade history, strategic management has become more scientific. While the field never will be a pure science, movements in that direction are to be encouraged. Barney *et al.* suggest that our importation of concepts from economics has made it difficult to define competitive advantage. They harken back to early days of the strategic management field, when we often made binary comparisons between more successful and less successful companies: "e.g., Walmart versus Kmart; Crown, Cork, and Seal versus Continental Can;

Southwest Airlines versus United Airlines." I agree that these comparisons often enabled rich discussions about why some firms outperform others.

Barney *et al*. suggest that the problems with competitive advantage intensified when researchers began systematically analyzing larger samples of companies. This in turn led to "ambiguities" around competitive advantage stemming from elusive definitions of industries, firms, and even performance itself. I agree that such ambiguities can make the notion of competitive advantage even more problematic. But I reject the critique that the adoption of ideas and methods from economics is a major source of our problems in the field of strategic management.

It seems evident to me that the selective application of economic tools has made the strategy field more precise, even though any full-blown application of the economics perspective in strategy would be misguided. Michael Porter's early success came from the importation of ideas from economics, and economic concepts have continued to shape the strategy field. Strategic management scholars are fortunate that for many decades, economists left their barn door wide open for us to capture the domain of inquiry on firm heterogeneity, a critical topic area that economists ignored. Today, the behavioral revolution in economics has begun to document how decision makers deviate from optimal behavior, finally extending the field of economics and bringing it closer to strategy (at least at the micro level).

Economic tools and measures can add precision to the binary comparisons that Barney *et al*. find compelling. Economic tools also help us to think more clearly and precisely about how firms create and capture value. For many years I have advocated that in strategic management research the quest to identify competitive advantage should be replaced by assessments of value. This has long been my broad guidance for how the field of strategic management should evolve going forward. Although I did not go into this in detail in my SMR essay, given the challenge raised by Barney *et al*., I will do so here.

To provide a specific illustration, I draw from my SMJ article (Lieberman, Balasubramanian and Garcia-Castro, 2018) that compares two companies over time: Southwest Airlines and American Airlines. Both companies are Texas-based, with Southwest headquartered in Dallas, and American in nearby Fort Worth. While American has long been one of the world's largest airlines, Southwest began its life in 1967 flying within Texas, where it pioneered the "low-cost carrier" business model. When the US airline industry was deregulated in 1979, Southwest started expanding across the United States, becoming a national carrier within three decades. Today, Southwest is recognized as one of the "Big Four" US airlines. Southwest continues to maintain points of differentiation from legacy carriers such as American, United and Delta, but its edge in efficiency has steadily diminished.

It may be instructive to raise the question of competitive advantage in this context. Did Southwest have a competitive advantage over American in the 1980's, when Southwest operated at much lower cost but was less than ten percent of American's size? Did it have a competitive advantage in the 1990's, the 2000's, or today? Unless we adopt a specific definition of competitive advantage, the answers are not clear. And if we award the crown of competitive advantage to Southwest, what does that accomplish? While much can be learned by comparing these two airlines, to do so effectively we need a framework that is richer and more detailed than the one provided by the simple notion of competitive advantage.

In my 2018 SMJ article with Balasubramanian and Garcia-Castro, we use the VCA model as a comparative framework. This model, adapted from economics, uses accounting data to provide an estimate of the total value created by a firm and the distribution of that value among the firm's primary stakeholders (shareholders, employees, suppliers, and customers). The model works well in the context of a relatively simple industry like the airline industry, where the product (passenger seat miles) does not change much over time and is comparable across companies.

Our analysis reveals that even though Southwest's advantages in cost and efficiency were diminishing over the period of expansion, Southwest was for many years able to increase total profit through growth – a process where Southwest created economic value by displacing less efficient rivals. (For a visual representation and specific details, see Figure 2 and related discussion in Lieberman, *et al*., 2018.) Thus, as one key measure of Southwest's competitive advantage was diminishing, another was increasing. Early on, a major source of Southwest's cost advantage came from its low wages, which were, on average, 23% below those paid by American in 1980. By 2010, however, Southwest had the highest wages in the industry, 21% above American's. For whatever reasons, Southwest promoted a large shift of value to employees, who benefited as stakeholders more than employees at any other US airline.

Oil price fluctuations had a major impact on the distribution of value by Southwest and other airlines. During years of rising oil prices, airlines attempted to buffer this impact by increasing operational efficiency, and Southwest was successful for a time in using hedges in the financial market. When oil prices fell, airlines often succumbed to price wars, shifting the benefits to customers rather than shareholders. Not surprisingly, over the long term about 80% of the value created by Southwest (and other airlines) flowed to customers.

By documenting this creation and distribution of value, our VCA analysis raises a host of questions for strategic management research. For example, to what extent does value creation come from improvements made within a firm, as opposed to the firm's displacement of less efficient (or effective) rivals, as reflected by changes in market share? Under what conditions is it desirable for a firm to compensate stakeholders above their outside market value? (In the case of Southwest, management may have chosen to reward employees for various reasons: because they viewed employees as stakeholders on a par with investors, because higher wages can have motivational effects, and because such wages helped the company avoid labor strife during its period of rapid growth.) How quickly and to what extent can rivals learn from a pioneering firm's innovations, and thereby catch up? Under what conditions do firms succumb to price wars with their rivals? Such questions have a dynamic element that is absent from any simple analysis of competitive advantage. Finding answers to such questions within a specific industry context can be critical to understanding the relative success of companies (and providing guidance to managers) in the airline industry or elsewhere.

The perspective of the VCA model goes beyond returns to shareholders. Even so, it is limited to the stakeholders in the firm's immediate value chain. A broader framework is needed to support a more holistic perspective. Consider Figure 1, which lists all the major actors in a value distribution framework:

[Figure 1 goes here]

The left-hand side of the figure shows the stakeholders who are positioned within the firm's value chain. These stakeholders include shareholders, employees, suppliers, and customers. Employees can be broken down into subcategories, such as the CEO, managers, and salaried and hourly workers. Similarly, suppliers can be subdivided and extended to include ecosystem and alliance partners.

The right-hand side of the figure shows the 'outside the value chain' stakeholders. These include local and national governments, local communities, and broader society. The net flow of value from the focal firm to local and national governments depends on the balance between taxes and subsidies. Much of the flow of value between the firm and local communities and/or broader society is indirect, taking the form of what economists call positive and negative externalities. On the positive side, the firm can contribute (financially or otherwise) to strengthen the community and society by providing jobs, infrastructure, charitable contributions, etc. On the negative side, the firm may extract value from these stakeholders, e.g., by polluting the environment, otherwise detracting from human health, raising the cost of local resources, etc. A firm that enjoys a 'competitive advantage' based on purely financial criteria ultimately fails to serve society if it creates large negative externalities.

Such flows of value between the firm and these stakeholders located 'outside the value chain' have begun to attract much greater attention. Efforts have been accelerating to quantify these flows within a formal ESG (environmental, social, governance) framework. Some strategic management scholars have been involved in these efforts, and I believe it is an important area for our field in the future. Unfortunately, the current efforts remain in a primitive state, with enormous inconsistencies among the measures that have been proposed. At a minimum, I believe it is important to separate the three ESG components, rather than combine them into a single index. Focusing on the dimensions separately can help to refine the measures. If consensus can be reached, a single index may eventually be justified.

I include “competitors” at the bottom of the value distribution framework in Figure 1. Competitors are not stakeholders of the focal firm. Nevertheless, competitors (and, in turn, their system of stakeholders) can capture value that would otherwise go to a focal firm, particularly a firm that has been innovative or successful. Strategy scholars have identified numerous mechanisms that can hold competitive imitation at bay. Indeed, the ability of a firm to prevent imitative leakage is part of what is meant by the sustainability of competitive advantage.

This brings us back to the basic question of what might be defined as competitive advantage. Consider a firm that introduces an innovation that proves to be more valuable than the inventions of competitors. Assume that this firm can keep its innovation proprietary (e.g., the innovation is organizationally embodied in a way that makes imitation very difficult), which allows the firm to earn shareholder returns above those of competitors. Most observers would claim that such a firm has a competitive advantage. Conversely, most would agree that if such a firm quickly succumbs to competitive imitation, which pushes the firm’s financial returns below those of rivals, it fails to have a competitive advantage. These cases seem relatively clear cut.

Adding more stakeholders to the mix adds complexity. What if the innovative firm successfully fends off imitation but chooses voluntarily to give its excess returns to some combination of the stakeholders in Figure 1? And what if this contribution is involuntary - say, it arises as the result of managerial or union power or differential government taxation? Does such a firm have a competitive advantage, even though its returns to shareholders are inferior? In essence, when we add up the returns to multiple stakeholders, a very different picture may emerge, compared to one that focuses exclusively on shareholders. The standard notion of competitive advantage keeps us glued to the one-dimensional shareholder-centric perspectives of the past.

In providing the structure for Figure 1, I have drawn from concepts of the value chain and the firm. These concepts are clear in most cases, and Figure 1 is appropriate. Sometimes, though, a more fluid framework is needed. As Barney, *et al.* point out, defining a firm or an industry can be difficult in certain situations. This is increasingly the case as the economy becomes more digital, with multi-sided platforms and ecosystems playing a larger role. Barney, *et al.* argue that “the field of strategic management should be searching for a theory of cooperative economic value creation… (in which) networks among actors can facilitate the kinds of co-specialization that can create economic value.” One way to push in this direction within the value distribution framework I have outlined would be to add complementors to the set of stakeholders in Figure 1.

Looking to the future, I hope that strategic management scholars can flesh out this value distribution framework and develop better measures, particularly in the domain of ESG. Although Figure 1 should not surprise anyone, I have never seen a listing of economic and strategic actors organized in quite this way. Still, Figure 1 is just a list, without an overarching theoretical construct. Providing one, or at least connecting existing strategic constructs within this framework, strikes me as a useful objective going forward. Economists would view the interaction of actors in Figure 1 under the broad construct of social welfare maximization. How is our view in strategic management different? What distinctive conceptual assessments do we have to contribute? At the very least, our perspective on firm heterogeneity is important and distinct from that of most economists. I invite others to move in this direction, and I hope that our field can respond effectively to these challenges. But we will never get there if we remain stuck in the mud with 'competitive advantage.'

References

Barney JB, Mackey TB, Mackey A. 2022. Why has it been so hard to define competitive advantage? Forthcoming, *Strategic Management Review*.

Lieberman M. 2021. Is Competitive Advantage Intellectually Sustainable? *Strategic Management Review* 2(1): 29-46.

Lieberman MB, Balasubramanian N, Garcia-Castro R. 2018. Toward a dynamic notion of value creation and appropriation in firms: The concept and measurement of economic gain. *Strategic Management Journal* 39(6): 1546-1572.

Figure 1. Actors in Value Distribution Framework

*Stakeholders **inside** the value chain*

Shareholders

Employees

- CEO
- other management
- salaried and hourly workers

Suppliers (and ecosystem/alliance partners)

Customers

*Stakeholders **outside** the value chain*

Government (taxes minus subsidies)

Local Communities

Broader Society

Competitors (non-stakeholders that can capture value from the focal firm, along with their set of customers, shareholders, etc.)