

Distinctive Competencies and Competitive Advantage: A Study of Small Independent Retailers

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Abstract

To remain competitive in markets increasingly dominated by large discount chains, “category killers,” and other mass-merchandisers, small independent retailers need to develop distinctive competencies. This study provides insight into the multidimensional character of distinctive competencies by measuring the resources and capabilities possessed by a sample of 255 independent drugstores. Specifically, the relationships between four competency constructs and one performance construct are assessed using multiple regression techniques. Positive relationships between two of the competency constructs and the performance construct helps identify which firm resources and capabilities may lead to a competitive advantage for the small retailer.

Introduction

As we approach the 21st century, small retailers are facing some of the most daunting series of changes and challenges since the introduction of the automobile and the arrival of the suburban mall (Arthur Anderson, 1997). Fierce competition from mass merchandisers, changing demographics, and shifting consumer purchasing patterns are forcing small independent retailers to alter the ways they have traditionally conducted business. However, the velocity of these changes is threatening the very survival of the local merchant in many instances. More than 100,000 retail companies have filed for bankruptcy in the last five years. This is 60 per cent more than the number of bankruptcy filings that occurred in the previous five years (Fine, 1998).

Although the problems facing independent retailers are well documented, many local shopkeepers are actually doing quite well. Surprisingly, no one has attempted to identify systematically what specific organizational resources and capabilities underlie the competitive advantage enjoyed by those local merchants enjoying superior performance. We attempt to fill this void by reporting the results of a study in which we examine the relationship between performance and the possession of distinctive competencies. Although an impressive body of literature addressing a wide variety of issues related to competitive advantage has been published over the last several decades, we base the current study on the premise that some competitive advantages for small, independent retailers are unique to this type of retailing. These influences on competitive advantage for the small, independent retailer may not be readily apparent when addressing similar issues in the context of much larger organizations or in manufacturing firms and other non-retail businesses.

Background

How a business achieves and sustains a competitive advantage has long been the central focus of strategic management research. The dominant paradigm in the field has been the competitive forces approach that posits that the intensity of competition determines the profit potential for individual firms (Porter, 1980). According to this framework, a firm seeks a position in an attractive market that can be defended against both existing and potential competitors. Although the identification and development of the requisite capabilities is important, management's primary focus is on achieving a defensible low-cost or differentiation position, and on keeping rivals off balance through strategic investments, pricing strategies, and competitive signaling.

More recently, there has been growing interest in the role resource-based capabilities have on attaining competitive advantage (Collis and Montgomery, 1995; Long and Vickers-Koch, 1995; McGee and Finney, 1997). Relying on the traditional strategic management construct of distinctive competence (e.g., Selznick, 1957; Hofer and Schendel 1978), the resource-based view suggests that the source of competitive advantage is rooted in a firm's resources and capabilities. Resources include capital equipment, skills of individual employees, reputation, and brand names (Barney 1991). Capabilities, on the other hand, refer to a firm's skill at effectively coordinating its resources. In other words, resources are the source of a firm's capabilities; and capabilities refer to a firm's ability to bring these resources together and to deploy them advantageously (Grant, 1991; Day, 1994). Capabilities also differ from resources in that they cannot be given a monetary value, as can tangible plant and equipment, and are so deeply embedded in the organizational routines and practices that they cannot be easily imitated (Dierkx and Cool, 1989)

Every organization possesses many capabilities that enable it to perform the activities necessary to provide its products or services. Some of these activities may simply be performed adequately, while others may actually be performed rather poorly. However, successful organizations conceivably possess certain capabilities allowing them to perform key activities exceptionally well. These capabilities have been termed "distinctive competencies" and generally refer to the unique skills and activities that a firm can do better than rival firms. (Selznick, 1957; Lado, Boyd and Wright, 1992). Moreover, these are the distinctive capabilities that support a market position that is valuable and difficult to imitate.

The best test of the distinctiveness of a capability is whether it disproportionately facilitates the provision of superior customer value or permits the business to deliver to customers in an appreciably more cost-effective way. In this respect, a distinctive capability functions much like a key success factor (Day, 1994). Wal-Mart's cross-docking system is one well known example of how an inimitable capability led to an impressive distinctive competence (Stalk, Evans, and Shulman, 1992). Wal-Mart has the same resources (e.g., retail space, skilled employees, equipment, etc.) as many other discount chains. However, what distinguishes Wal-Mart is its unique capability to manage its resources in a highly productive way. For example, Wal-Mart's sophisticated cross-docking system provides the mass-merchandise with significant cost advantages by improving its ability to minimize shipping and handling costs.

There is a rich body of literature pertaining to the interplay between competitive advantage and distinctive competencies that suggests that those firms which develop and exploit

their distinctive competencies outperform firms that do not do so (Conant, Mokwa, and Varadarajan, 1990; Hambrick, 1983; McDaniels & Kolari, 1987). Yet, little empirical research has focused on the role distinctive competencies play in providing a competitive advantage for the small, independent retailer. The majority of prior studies have been conducted in the context of much larger organizations (e.g., Snow and Hrebiniak, 1980) or in non-retail industries such as manufacturing (e.g., Acar, 1993).

A notable exception is the research stream produced by Conant and his colleagues. In a study of 599 small apparel retailers, for example, Conant, Smart, and Solano-Mendez (1993) hypothesized that merchants with clearly defined strategies enjoy a competitive advantage, in part, because they possess relatively more distinctive marketing competencies. The results of their inquiry were supportive, but the investigators were only able to conclude that those organizations that chose to compete in clearly defined ways enjoyed relatively better performance and possessed relatively more individual distinctive competencies than those organizations whose strategies were characterized by a lack of emphasis or clarity. In other words, they were unable to identify which specific capabilities and activities were explicitly related to performance because their study did not address any potential direct relationships between distinctive competencies and competitive advantage.

In a similar study, Smart and Conant (1994) compared the “entrepreneurial orientation (EO),” of the same sample of 599 small apparel stores along a series of distinctive competency and performance measures. A firm’s entrepreneurial orientation included such dimensions as propensity to take risks, level of innovation, and the ability to recognize opportunities. The results of their study indicate that respondents with higher EO levels reported that their businesses possessed a wider variety of distinctive competencies and enjoyed higher performance. Once again, however, direct relationships between performance and the possession of distinctive competencies were not explicitly addressed.

Most recently, McGee and Finney (1997) examined the role distinctive competencies play in attaining competitive advantage among a cross-section of 189 small retailers located in several rural, Midwestern communities. Two features of this study are worth noting. First, the authors successfully used a modified version of the distinctive competency measurement instrument developed by Conant et al (1993) suggesting that this particular instrument may boost future efforts to investigate empirically the distinctive capabilities possessed by small retailers. More importantly, McGee and Finney’s (1997) study explicitly addressed the direct relationship between distinctive competencies and competitive advantage. Here, factor analysis of 23 individual distinctive competency items found an underlying structure of five discrete factors or areas of distinctive competence. These five factors were 1) quality image, 2) effective differentiation, 3) effectiveness of key merchandising practices, 4) civic involvement, and 5) control of retail program. McGee and Finney (1997) also gauged the influence of these factors on a number of performance variables using regression analysis. Importantly, the factor representing the ability to control and evaluate retail programs was positively associated with all three performance measures used. The study’s results suggested that certain areas of distinctive competence do, in fact, serve as viable sources of competitive advantage for small retailers. Stated differently, the authors identified a positive correlation between better performance and the possession of specific

distinctive capabilities or competencies, namely effective merchandising practices and a superior ability to control overall retail program activities.

Although the results of McGee and Finney's (1997) study provide useful insight into the possible direct relationships between distinct capabilities and performance among small retail merchants, this issue was not the primary thrust of this research. Rather, the authors were most concerned with how independent merchants compete against mass-merchandisers. To effectively address this issue, the participating retailers were drawn from rural communities in which Wal-Mart had recently opened a store. Regrettably, Wal-Mart's impact on local retailing limits the generalizability of McGee and Finney's (1997) findings concerning how distinctive competencies influence performance. For example, Wal-Mart's entry into a local retail market often has a very negative economic effect on the established retail community (Stone, 1994; Steinhaurer, 1995; McGee, 1996). Consequently, the ability to achieve competitive advantage is largely out of the local merchant's control and any performance measures would be more reflective of the impact of Wal-Mart's arrival instead of the distinct capabilities of individual merchants. In addition, Wal-Mart's arrival may cause the existing small retailers to respond to the retailing giant's merchandising prowess by temporarily refocusing their capabilities on areas not normally emphasized by the local merchant. Thus, McGee and Finney's (1997) findings may very well depict temporary events instead of the actual capabilities the small merchants were using as a source of sustainable competitive advantage.

To summarize, there is clearly a growing interest in the resource-based view of competitive advantage among business scholars. However, research has yet to explicitly address the empirical issue of what unique capabilities allow certain small retailers to achieve competitive advantage. Accordingly, the following paragraphs describe a study in which we identify areas of distinctive competencies common to local merchants, and assess the degree to which these competencies can lead to a competitive advantage.

Research Design and Methodology

Industry Setting

The traditional independent retail pharmacy industry was selected as this study's domain. Members of this industry grouping can best be characterized as a community drugstore that delivers traditional pharmacy services and whose nonprescription inventory goes beyond health care items to include other merchandise lines traditionally associated with pharmacy sales, such as cosmetics and other beauty aids, stationery, tobacco, candy, greeting cards, photographic supplies, and other items (Lipowski, 1992). Pharmacies whose principle activity involved dispensing prescription medication and who carried a minimal nonprescription inventory are excluded from this industry domain.

This industry was selected because communities across America have long depended upon their local drugstore for medication, over-the-counter (OTC) products, sundry items, and medical advice. In many small towns and rural areas, the local pharmacist is not only a respected small businessperson, but also the primary allied health-care professional. Most such local pharmacists

owned the small, retail pharmacy in which they work. Until the last several decades when their importance began a precipitous decline, these independently-owned retail establishments ruled the pharmacy marketplace.

Today, the neighborhood drugstore struggles to compete with a variety of retailing outlets. Large discount chains, along with supermarkets and mass-merchandising outlets with in-store pharmacies dominate the pharmacy marketplace. While total sales have increased for all pharmacies, the market share served by independent pharmacies has declined from nearly 100 percent in 1935 to less than 25 percent now. The number of independent operators has decreased by nearly 25 percent, from over 50,000 to fewer than 40,000, during the last decade alone (Maline, 1997).

Survey Procedures

A modified version of Dillman's (1978) "total design method" was used in this study to enhance response rate and response quality. An initial survey-booklet including a cover letter and a postage-paid return envelope were sent to 700 randomly selected independent pharmacies located across Texas. The cover letter explained the overall goals and objectives of the research project and how the data would be used. A reminder postcard was subsequently mailed to all potential respondents approximately one week after the initial mailing. In addition, a second booklet with another cover letter and postage paid return envelope was sent to all nonrespondents approximately three weeks later.

Prior to distributing the questionnaires, the survey instrument was pretested on eight independent pharmacists not included in the study sample to determine if there were any interpretation difficulties. No problems were discovered and the pretest respondents were not troubled by any of the questions or by their ability to rate their pharmacies.

Measuring Distinctive Competencies

Distinctive competencies, the primary focus of the study, were measured using an adaptation of the instrument developed by Conant et al (1993) and subsequently used by McGee and Finney (1997). Some of the Likert-type scale items focused on planning process variables while others focused on marketing effectiveness. This dual focus is consistent with distinctive competency scales employed by other researchers (e.g., Hitt and Ireland, 1985). Our multiple-item, perceptual scale required respondents to comparatively rate their organization against competitors on twenty-seven items of distinctive competencies. Twenty-one of the items (e.g., handling customer complaints, effectiveness of pricing strategies, employee training) were evaluated on seven-point scales with values ranging from 'Much worse' to 'Much better'. Six of the items (e.g., quality of customer service, awareness of store strengths) were evaluated on similar seven-point scales with values ranging from "Much higher" to "Much lower."

Measuring Organizational Performance

Pharmacy performance was also operationalized and measured using subjective self-report data. Respondents were asked to compare their financial performance to other pharmacies on the following four dimensions: 1) gross profit, 2) net income after taxes, 3) total sales growth over the past three years, and 4) overall pharmacy performance/success, using the same seven-point Likert-type scales previously described. Although the merits and potential shortcomings of this measurement approach have been debated in the literature, previous empirical research has demonstrated that subjective assessments of organizational performance are highly consistent with objective performance data both internal (Dess and Robinson, 1984) and external (Venkatraman and Ramanujam, 1987) to the organization.

Results

Survey Response

The three-step survey mailing resulted in the return of 271 surveys. Adjustments to the original sample size of 700 caused by questionnaires that were undeliverable (e.g., business had closed, no forwarding address provided), reduced the number of independent pharmacies who might have participated to 658. In addition, 16 surveys were excluded from the study because of omitted items. Thus, a total of 255 questionnaires were available for analysis, representing a response rate of roughly 39 percent.

Ninety-three per cent of the respondents described themselves as pharmacist/owner, 4 per cent pharmacy manager, 3 percent miscellaneous other titles. Respondents also indicated that on average their pharmacies generated slightly more than 1 million in annual sales, employed six people, and occupied roughly 17,000 square feet. These size characteristics compare quite favorably with industry-wide statistics (NARD, 1997).

Nonresponse Check

To detect any potential nonresponse bias, a telephone survey was conducted with 40 randomly selected nonrespondents. Six descriptive questions that had been included in the original survey instrument were asked of the pharmacist or pharmacy manager. The questions focused on the pharmacy size, the size of the prescription department, the number of years the pharmacy had been in operation, the total number of employees, and percentage of total pharmacy revenue derived from the sale of prescription drugs. Comparisons between respondents and nonrespondents based on a series of independent t-tests revealed no statistically significant differences. These findings suggest that nonresponse bias was negligible.

Analysis

Multiple regression techniques were used to identify the areas of distinctive competencies that are related to small retail store performance. Before the data was submitted to the analysis,

however, the twenty-one individual distinctive competency variables and the four performance measures were factor analyzed to produce a more parsimonious set of variables. Principle components factor analysis was used since it detects the existing latent structure in data and serves as a useful data reduction technique (Pedhazur & Schmelkin, 1991). As shown in Table 1, the principle components factor analysis with an orthogonal rotation produced a five-factor solution.

Twenty-three of the variables exhibited factor loadings greater than .40. A factor loading of .40 was utilized because factor loadings greater than or equal to .40 can be considered more important than those below this level (Hair, Anderson and Tatham, 1991). Each of the internally consistent patterns of distinctive competencies has been labeled based on an assessment of the competencies that load on each factor. Factor 1 -- "control of retailing" -- represents independent pharmacies who believe their source of competitive is primarily rooted in their ability to contain costs, control and evaluate overall retail programs, and to establish effective pricing policies. Factor 2 -- "service image" -- represents a commonly cited source of distinctive competence for small retailers. In particular, local drugstores emphasizing this factor believe their level of

Table 1
Principal-Components Factor Analysis of Distinctive Competencies

	Factor Loadings*					Communities
	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5	
	Control of Retailing	Service Image	Promotion & Presentation	Performance	Market Segmentation	
Control and Evaluation of Retail Program	.71					.67
Accuracy of Sales and Profit Forecasts	.61					.50
Effectiveness of Cost Containment	.61					.48
Effectiveness of Pricing Strategies	.60		.41			.57
Cash Flow Management	.57	.46				.65
Ability to Differentiate Store Offerings	.44					.34
Knowledge of Industry Trends	.41					.32
Quality of Customer Service		.77				.61
Handling of Customer Complaints		.70				.53
Quality of Products		.60				.41
Store Image		.58	.41			.66
Knowledge of Current Customers		.54				.46
Allocation of Financial Resources	.47	.48				.58

Advertising Effectiveness				.59				.37
Public Relations Effectiveness				.51				.46
Selection of New Products				.48				.40
Store Layout and Merchandise Presentation				.48				.35
Net Income						.92		.80
Gross Profit						.90		.74
Overall Performance and Store Success						.77		.66
Total Sales Growth						.61		.47
Knowledge of Prospective Customers							.55	.48
Ability to Segment and Target Markets							.42	.46
Eigenvalues	9.3	2.8	2.0	1.6	1.3			

*These five factors accounted for 64.0% of the total variance

customer service, ability to effectively handle customer complaints, and the quality of their products are the primary sources of competitive advantage. These pharmacies also believe their knowledge of current customers and their store's overall image are important.

Advertising effectiveness is the predominant feature of third area of distinctive competence -- "promotion and presentation." However, independent pharmacists emphasizing this factor would also appear to possess superior public relations skills and to be keen merchandisers. These businesses place a relatively greater emphasis on store layout. The fourth factor represents the performance construct. As expected, all four performance variables loaded quite heavily on this factor. Local drugstores emphasizing the fifth factor -- "segmentation" -- perceive their knowledge of potential customers and their ability to effectively segment and target customers as the primary sources of competitive advantage.

Multiple regression techniques were used to examine the relationships between the four distinctive competency constructs and performance. In order to control for the effects of exogenous demographic variables, however, the potential relationships between performance and a set of four control variables were first examined. Two of these variables addressed store size -- number of employees and retailing footage. The remaining two control variables are somewhat idiosyncratic to the retail pharmacy industry -- pharmacy location and pharmacy type (NARD, 1997). After entering the set of control variables, the four distinctive competency constructs were added to the regression equation as a block. Results of the analysis are shown in table 2.

Table 2
Results of Regression Analysis

R^2	R^2	F	Variables		t
.04		3.10**	Store Location	0.14	1.09
			Store Type	-0.02	-0.17
			Square footage	-0.00	-1.60
			Number of Employees	-0.00	3.51***
.19	.15	7.17***	Control of Retailing	0.14	2.01*
			Service Image	0.25	3.31***
			Promotion & Presentation	0.11	1.37
			Market Segmentation	-0.16	-2.18*

*p<.05 **p<.01 ***p<.001

Only one of the control variables (i.e., number of employees) was related to performance. More importantly, three of the four distinctive competency constructs were associated with performance. The coefficients for the “control of retailing” and “service image” constructs were both positive and statistically significant. The coefficient for the “market segmentation” construct, on the other hand, was statistically significant but in the negative direction. The “promotion and public relations” construct was not associated with performance.

Discussion

The results of this study clearly indicate that nurturing a customer-focused strategy remains a key source of competitive for small retailers. The business press has featured recent reports of a “backlash against huge, impersonal discount stores in which low prices usually come at the expense of good service” (Kroll, 1998). In fact, many forms of retailing from bookstores, to women’s apparel, and even to warehouse clubs are integrating the personalization which consumers are demanding and for which they are willing to pay. Reports of a swing in the retailing pendulum back to high quality service for the purpose of building customer loyalty (and winning repeat business) appear to reflect important findings from this study and also McGee and Finney’s (1997). In both of these studies, the service quality construct was positively related to performance. The words of one shopper from Garden City, New York explained the reason for his willingness to pay a forty per-cent premium for vitamins from a GNC Live Well store (with customized packs of vitamins, and with massage chairs for use while waiting for consultations) rather than buying vitamins from his pharmacy. “It’s a nice feeling when you go in there and the people are so helpful” (Kroll, 1998).

The study’s results should also serve as a reminder that the cost of adopting such a customer focus requires careful monitoring. Control and evaluation of retail programs along with considerable attention to pricing and cost containment policies were considered primary sources of competitive advantage among the sampled merchants. Budgeting, in particular, seems to be important for small merchants since it can be used as the benchmark against which retailers of any size can accurately forecast cash flow; track performance; and measure sales, expenses, and profits. Arguably, many local merchants fail to control and evaluate their retail operations through budgeting activities because they either do not know how or fail to see the benefits. However, the merchants who fail to engage in such activities may be severely misjudging the financial control they have over their stores. This finding is of particular interest to independent pharmacies since cost containment pressures are growing due to the increased usage of third-party reimbursement programs.

Interestingly, the “market segmentation” construct was negatively associated with small store performance. This finding may very well be due to measurement error since small retailers are generally encouraged to target specific markets or customer groups with a unique mix of merchandise or services that compel customers to shop at the store. Consequently, this particular finding must be interpreted with caution.

Finally, one relationship not discovered in the analysis is of interest. Management authorities generally agree that greater public relations activities and civic involvement are key sources of competitive advantage for the small retailer. Although this study’s results failed to support this prescription, greater community involvement is arguably one of the most unique advantages many small retailers enjoy. The failure to achieve statistically significant results is

most likely attributable to the fact that nearly all local merchants generally tend to place considerable emphasis on civic activities.

Limitations

The current study is cross-sectional and was conducted in a single industry using self-reported, subjective measures of distinctive competencies and organizational performance. Although the generalizability of findings of single-industry studies has some limits, a highly desirable feature of such studies is that they provide a much greater degree of control over market and environmental peculiarities. The advantages and disadvantages of self-reported, subjective measures have been discussed for research involving managerial respondents (e.g., Dess and Robinson, 1984) and will not be elaborated here.

Conclusion

In sum, these results support the proposed substantive linkage between the resource-based capabilities of a firm and competitive advantage. In this study, the performance of small independent retailers appear to be positively correlated with high-quality service image and control of retailing programs. In other words, more highly performing local retailers are likely to be keenly aware of the ingredients of customer value and are likely to emphasize a quality image for their store through customer service. Moreover, these merchants appreciate the need to monitor the costs associated with such activities.

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