The Four Metrics For Competitive Advantage

Richard S. Hawkes, *CEO & Founder, Growth River*

When it comes to aligning priorities, team members will advocate different strategies for how to win in the marketplace. Figuring out which strategies to invest in – *and whose strategies to invest in because they most contribute to competitive advantage* – is a common leadership challenge.

Business systems are married to culture systems. Leading change effectively – and driving towards competitive advantage – requires that you work both sides of the relationship simultaneously.

So when faced with alternative strategies for creating competitive advantage, there are three critical questions.

1. **What definition for competitive advantage will enable all members of your team to see it through the same lens?**
2. **How do you know which investments in your business are most likely to create competitive advantage?**
3. **How do you simultaneously make working in teams and growing businesses easier?**

The *Four Metrics For Competitive Advantage* help you answer these questions.

What conditions make competitive advantage and business growth inevitable?

The key concept behind the *Four Metrics For Competitive Advantage* is this: competitive advantage becomes inevitable when four conditions are met:

I. Market Potential - *through customer value*

II. Operational Scalability – *through business processes and organizational structure*

III. Business Sustainability – *through investing to control risks and create strength*

IV. Financial Performance – *through value focus, complexity reduction, and monetization*

The leadership challenge is to construct and support arguments for how a given change will positively or negatively impact each of these four conditions. Let's walk through a case study and take a look at how to apply each of these conditions.

The Competition For Resources At Amazing Pen, Inc.

We'll tell you the story of Amazing Pen, Inc. You'll chart the senior team's deliberation to determine which of two competing investments will best drive competitive advantage.

Our story begins with a competition for resources among members of the top team. The head of product development wants to acquire a new technology. The head of operations wants to hire a new procurement manager. The CEO has to choose between the two strategies – and wants both team members to fully align with her choice.

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?

The CEO starts her analysis at the beginning. The score is tied:

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

Battle Of The Hockey Sticks

The product development and operations leaders are engaged in the "battle of the hockey sticks." It's a common tactic to resolve resource conflicts in business. 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 these three:

1. 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."*
2. People overemphasize immediate returns instead of assessing impact on competitive advantage:	*"No more coffee machines will definitely save us $300 a month. So tell me, what do all those golf outings do for sales?"*
3. CEOs make unexplained politically motivated compromises:	*"This year sales and marketing will get budget increases – because I think sales and marketing leaders are more engaged in growth than others."*

Choosing The Right Investment Strategy At Amazing Pens

Our CEO sees the inherent failure of the hockey stick approach. It doesn't provide enough structure to force clear strategic thinking. And she needs to ensure an apples-to-apples comparison among alternatives.

So the team sits down in a room and evaluates both strategies, using the Four Metrics.

I. Market Potential

Market Potential is a measure of how often a business is chosen by key stakeholders over the competition – as a result of delivering customer value.

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
- community member-of-choice

Here's how the CEO describes the company's positioning:

> *"Let me tell you about Amazing Pen, Inc.'s amazing pens. They are instilled with the power of the ongo-bongo nuts from the Amazon rainforest. Just holding our pens makes you smarter and live longer. And, of course, they write flawlessly. Every person wants one of our pens – except people with nut allergies. The best companies in the world want to help us bring these pens to market. The best talent wants to work for us. 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.

Based on how the two strategies will contribute to market potential, the team gives these scores:

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

II. Operational Scalability

Operational scalability is a result of creating effective business processes and organizational structures.

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 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 only 10,000 more pens a day.

The score is now:
Product development/new product technology (2)
Operations/new procurement manager (0)

III. Business Sustainability

Business sustainability is the degree to which a business can invest in leadership development and innovation to create strength and 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 technology (2)
Operations/new procurement manager (1)

IV. Financial Performance

Increased returns means that a business returns equal or better value back to investors/benefactors than alternative investments – a result of value focus and complexity reduction.

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 final score is now tied:
Product development/new product technology (2)
Operations/new procurement manager (2)

Breaking The Tie Depends On Priorities

GM

Return / Positioning

(1) increased returns
(2) more scalability
(3) better positioning / market size
(4) more sustainability

Honda

Positioning / Return

(1) better positioning / market size
(2) more scalability
(3) more sustainability
(4) increased returns

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 woke 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.

The Big Conclusion

So who wins at Amazing Pen, Inc.? It depends. The new product 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.

The team will need to talk about their core growth priorities. But how they discuss these priorities may be critical. The *Four Sources* are listed in order for how to create - and sustain - competitive advantage over time. Reversing this order, say emphasizing return over positioning, may be the right short-term answer to solve a specific puzzle. But this choice carries with it the risk of de-emphasizing a winning customer experience, and all that may entail.

The advantages of the *Four Sources Of Competitive Advantage* include:

- ✓ Easy to understand.
- ✓ Surfaces key strategic issues.
- ✓ Encourages transparency.
- ✓ Leads to better strategic thinking and decision-making.
- ✓ Creates buy-in.
- ✓ Facilitates the ability to build coalitions for change.