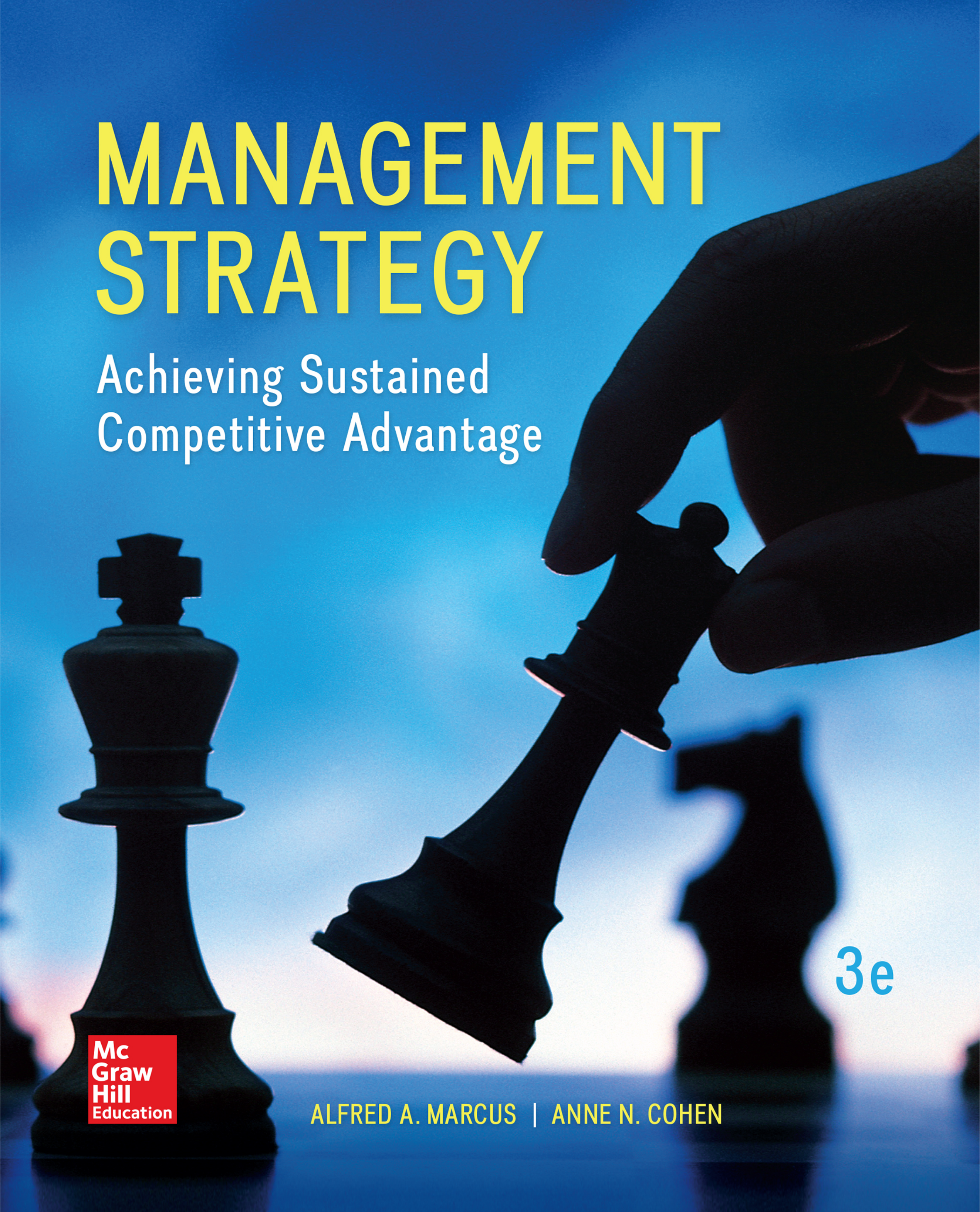

MANAGEMENT STRATEGY

Achieving Sustained Competitive Advantage

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ALFRED A. MARCUS | ANNE N. COHEN

Mc Graw Hill Education

Management Strategy

Achieving Sustained Competitive Advantage

Management Strategy

Achieving Sustained Competitive Advantage *Third Edition*

Alfred A. Marcus
Anne N. Cohen

McGraw Hill Education

MANAGEMENT STRATEGY: ACHIEVING SUSTAINED COMPETITIVE ADVANTAGE, THIRD EDITION

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To my wife, Judy, and to my sons, David Isaac and Ariel Jonathan, philosophically inclined and always questioning everything.

Alfred A. Marcus

To my wonderful husband, Dwayne, and to our charming sons, Brendan and Christopher.

Anne N. Cohen

About the Authors

Alfred A. Marcus

Alfred A. Marcus is currently the Edson Spence Chair of Strategy and Technological Leadership at the University of Minnesota, Carlson School of Management and the Center for Technological Leadership. He has been on the faculty at Minnesota since 1984. His articles have appeared in the *Strategic Management Journal, Academy of Management Journal, Academy of Management Review,* and *Organization Science,* among other places. He is the author or co-author of many other books including *Innovations in Sustainability,* published by Cambridge University Press, *The Future of Technology Management and the Business Environment: Lessons on Innovation, Disruption, and Strategy Execution,* published by Pearson, *Financial Times, Strategic Foresight,* published by Palgrave MacMillan, and *Big Winners and Big Losers,* published by Wharton School Press. His PhD is from Harvard, and he has undergraduate and graduate degrees from the University of Chicago. Prior to joining Minnesota's faculty he taught at the University of Pittsburgh Graduate School of Business and was a research scientist at the Battelle Human Affairs Research Centers in Seattle, Washington. He has consulted or worked with many corporations including 3M, Corning, Excel Energy, Medtronic, General Mills, and IBM and spent a sabbatical year at the Sloan School of Management, MIT. Besides teaching in the Carlson School and the Technological Leadership Institute at the University of Minnesota, he teaches in the Technion MBA program in Israel. He also has taught strategy or management courses in Norway, Hungary, the Czech Republic, Romania, and Costa Rica and was involved in a multinational research project sponsored by the NSF involving companies in the U.S., Finland, Israel, and India.

Anne N. Cohen

Anne N. Cohen is a Senior Lecturer at the Carlson School of Management, an active consultant to businesses, an executive coach, and a board member for medium to large private enterprises. After receiving an undergraduate degree in mathematics, she began her professional career in the insurance and transportation industries. Her roles focused on the development and managerial oversight of critical information technologies and infrastructures supporting actuarial, purchasing, logistics, and fuel hedging functions. Upon receiving her MBA, Anne launched her own business which served both the residential and commercial market for furnishings and finishes. Her client base included individuals around the globe as well as various hotels, offices, institutions, municipalities, and resellers. The success of this firm permitted both her transition to the classroom, and the launch of her current consulting business.

Anne currently teaches courses at both the undergraduate and MBA levels in strategic management, entrepreneurial management, and strategic leadership. She has also been active on campus as a mentor to a number of startups, as a member of the Carlson School's ethics coursework committee, as a summa cum laude advisor, and as the public and nonprofit program advisor. Off campus, she is highly engaged in the business community, focused on providing strategic guidance to senior leaders, helping build high-performance leadership teams, and serving on the local economic development authority.

Preface

This is a practical book designed to assist those who engage in the art and practice of strategy in organizations large and small in countries throughout the world.

Strategy is probably the most basic and at the same time the most advanced discipline in management. It is a discipline whose principles need to be considered by managers at the most advanced levels of the private sector, understood by individuals pursuing careers in institutions in the public and non-for-profit sectors who regularly come into contact with business, and absorbed by undergraduates just starting out in their business career.

Instruction in strategy takes place in the world's leading business schools in executive, MBA, and undergraduate programs and in in-house corporate programs designed for managers and executives, and this text has been designed to comfortably support the rigors of such programs with copious lessons and examples.

Yet, it is also critical to recognize that employees at all levels, and within all sectors, should be provided with a *common language* of strategy. All must understand the basic principles of strategy so that they can be more fully attuned to the many competitive factors that can be most easily monitored from the organization's front lines. So, this text aims to provide a reference that is accessible to key employees at all levels of the organization, to offer clear frameworks for strategic thinking and action, and to help these employees formulate effective arguments for strategic change when they sense shifts in today's dynamic marketplace.

This book is the third edition of a previously published text. The main change in this edition is that the book now has a co-author, Anne N. Cohen., a full-time instructor in strategy at the Carlson School of Management and a long-time practitioner of strategy as a consultant and employee of major U.S. companies. Anne is an enthusiastic and knowledgeable teacher with real-world savvy. Her contribution has made possible vast improvements in the organization and structure of each of the chapters of this book and the insertion of numerous new examples and other materials. This edition has been vastly improved by Anne's contributions, which are very much appreciated.

The new edition has been thoroughly updated. Material no longer relevant has been discarded and new material introduced. This book remains short and to the point. It is conceptual in nature, although it has numerous examples, and it should be used in conjunction with the many fine cases available in strategic management.

Many books purport to give instruction in the fundamentals of strategy; however, as the academic discipline of strategy has evolved in arcane and specialized ways, these books often miss the most basic ideas in strategy. For example, in his classic and landmark 1980s books on strategy Michael Porter of the Harvard Business School established that sustained competitive advantage is strategy's basic purpose, but even Porter failed to clearly define what sustained competitive advantage actually meant—and as a consequence, his methods were over determined and ultimately too complex for most practicing managers. He never provided a simple analytical method or series of steps the strategist could employ.

The definition of sustained competitive advantage used in this book, therefore, is that of *consistent superior performance in comparison to key competitors over a long period of time*. It is not about winning one championship, but about being a dynasty that always performs substantially better than other companies in an industry. Achieving this goal is never easy, so this book provides its readers with a simple but disciplined approach to engage in the effort to attain sustained competitive advantage.

After establishing in Chapter 1 that the goal of strategy is to achieve *sustained competitive advantage* (SCA), each subsequent chapter takes up in turn the remaining elements of a model or formula for achieving SCA.

- Specifically, Chapter 2 presents three approaches to doing *external analysis* (EA), including classic industry analysis, an assessment of the macro-environment, and the application of stakeholder analysis to managing the external environment.
- Chapter 3 then takes up various methods for doing *internal analysis* (IA) including frameworks like the 7 Ss and the value chain, and a newer method for analyzing strengths and weaknesses that came to prominence in the 1990s, the resource-based view (RBV). RBV will introduce you to ideas about an organization's capabilities and competencies as well as its resources. With these tools in hand for external and internal analysis, you can approach the formidable problem of actually making *moves* (M).

Once you have a clear perspective of the firm's external and internal environments, the book introduces four types of general moves that you might consider. These moves are not discrete and separate choices but can be and often are carried out together or as a sequence of moves depending on the situation. That is, one move may very well hinge on or follow another as in chess or war where a series of moves have to be made to achieve victory.

- Chapter 4 is a pivotal chapter inasmuch as it treats both the timing of moves that your organization can make by going over the elementary principles of game theory and the actual content of moves at the business level—generic positioning or Porter's ideas about "low cost" and "differentiation" and the space in-between, which Porter maintains is to be avoided, but which this book considers essential territory to occupy and labels "best value." Chapter 4 is about *business strategy* (BS).
- Chapter 5 is also pivotal in that it treats not competition within an established business as Chapter 4 does, but introduces you to competition at the corporate level where the main questions are: what are the businesses in which an organization should participate, and what should be the scope of its activities? The main tools for determining the outcome of these decisions are mergers, acquisitions, and divestitures. Chapter 5 is about *corporate strategy* (CS).
- Chapter 6 builds on and deepens central concepts of business and corporate-level strategy by considering another type of move, that is, globalization, or how to best align a firm's resources, capabilities, and competencies to meet competition in a hotly contested global marketplace. Chapter 6 is about *global strategy* (GS).

- The final type of general move that the strategist can make is to be entrepreneurial and to innovate. The perils and pitfalls of being entrepreneurial and innovating are the subject of Chapter 7. Chapter 7 is about *innovation strategy* (IS). The last two chapters cover implementation (I) and reinvention (R).

The final chapters of this text are focused on the implementation of strategy and the necessity of continual reinvention. Good moves must be well implemented, and Chapter 8 provides solid and practical advice on how to best implement a strategy. Chapter 9 emphasizes that the strategic management process is an iterative one. It has to be repeated again and again. A firm does not simply once have its employees scan the external and internal environment and take a series of moves, but it has to be constantly engaged in these activities, refining, refocusing, and repositioning itself over time. There is nothing more common in business than a stale strategy whose basic assumptions have not been criticized based on performance feedback, and that has not been thoroughly reexamined and reset so that the firm is repositioned and better equipped to withstand ongoing competitive challenges. This final chapter also provides a summary of the strategic management process in its entirety.

In short, the strategic model that is central to this book is the following:

$$\mathbf{SCA} = \underbrace{[EA + IA]}_{\textit{Analysis}} + \underbrace{[BS + CS + GS + IS]}_{\textit{Moves}} + \underbrace{I + R}_{\textit{Implementation \& Reinvention}}$$

Thus, this book has nine basic chapters very tightly and logically linked with a goal in mind, SCA, and a series of steps laid out to help the strategist reach that goal. For those teaching strategy at any level, this is an ideal book as these relatively short but deep chapters can be assigned with one or two cases that can come from any number of sources. As indicated, the use of cases to supplement the chapters is critical, for it is essential that those who wish to gain mastery of the art and craft of strategy practice it.

Each chapter begins with a profile of an executive or academic who has made a significant contribution to strategy (Andy Grove, Michael Porter, Michael Dell, Michael Eisner, Gary Hamel, and Bill Gates), or a short vignette of a situation that illustrates the main chapter theme (KFC goes to Japan). Each chapter also portrays the main concepts with which it deals with discussion of businesses that have been competitors (e.g., Intel versus AMD, Amazon.com versus Barnes & Noble, Dell versus Gateway, Best Buy versus Circuit City, Disney versus AOL Time Warner, Coke versus Pepsi, and Walmart versus Spartan Foods.). This book is rich in examples and practical applications.

To sum it up, the rationale for the book is the following:

- Most strategy books have lost sight of the basic purpose of strategy—making a series of moves, which are designed to achieve sustained competitive advantage.
- Most books fail to relate moves back to their outcomes—the extent to which these moves actually affect business performance.
- This book is focused on the moves corporations can make and the types of analyses required to make these moves effective.
- It shows managers how to undertake an analysis of the industry environment and an analysis of a company's internal resources before making moves.
- It provides solid advice on how to implement a strategy, once it is formulated.

The main moves that flow from the analysis are positioning of the firm in relation to its competitors in terms of the cost and quality of its products, positioning it in terms of the scope of businesses in which it is involved, positioning it in terms of its global versus domestic reach, and positioning it with respect to the extent to which it will strive to be an innovator as opposed to a follower.

The exhibit below indicates in detail how the third edition compares with the book's prior edition.

EXHIBIT Main Changes from Edition Two to Edition Three

Chapter 1 WINNING MOVES	New examples. Added a step to making winning moves called ongoing evaluation and implementation; removed sections on balanced scorecard and industry boundaries which are covered elsewhere.
Chapter 2 EXTERNAL ANALSYSIS	New examples. Started with broader picture of external analysis (macro-analysis) and then discussed the specifics of industrial organization analysis, the five forces, with emphasis on the five-force dynamism. Updated discussion of pharmaceutical and airline industries, added entirely new section on strategic group analysis with mobile phone and restaurant examples. Extended discussion of scenario analysis and system analysis.
Chapter 3 INTERNAL ANALSYSIS	New examples. Reversed the order of discussion with the resource-based view coming first. Emphasized examples like *Moneyball* more. Showed systematically how resources, capabilities, and competencies are linked and emphasized the need for their replenishment. Integrated financial analysis with value chain analysis. Reorganized section called management theory under title of assuring accounting and ended the chapter with a summary of how to do a SWOT (strengths, weakness, opportunities, threats) analysis.
Chapter 4 POSITIONING, TACTICS, AND TIMING	New examples. Reversed the order of discussion with positioning coming before timing and a new section on tactics coming between positioning and timing. Section on tactics, offensive and defensive is quite unique and special. Discuss life-cycles in section on timing. Game theory comes at end and not beginning of chapter. Updated early/late mover discussion.
Chapter 5 CORPORATE-LEVEL STRATEGY AND DIVERSIFICATION	New examples. Retitled chapter Corporate-Level Strategy and Diversification as opposed to Mergers, Acquisitions, and Divestitures. Introduced new section on tactics short of full-scale merger and acquisition. Put greater emphasis on examples of good deal making and effective management. Further developed section on why mergers and acquisitions fail. Maintained discussion of portfolio models and more explicitly featured transaction cost reasoning in section on vertical integration.
Chapter 6 GLOBALIZATION	New examples. More managerial with section on options for global expansion and global success factors. Landscape of future discussion is more succinct and up to date.
Chapter 7 INNOVATION AND ENTREPRENEURSHIP	New examples. Reorganized to make more managerially relevant. Introduced distinction between incremental and radical (seismic) innovation and provided extended examples from smartphone and other industries. Explicated uniqueness of Apple and its accomplishments. New section on process of innovation with four factors discussed: the innovator, the organization, finance, and government. New section on the business model with managerially relevant process laid out of how to determine opportunities to pursue, external and internal consideration, vetting ideas, creating prototypes and pilots, and scaling up. Extended discussion of barriers to innovation to diffusion curves, time, flawed processes as well as risk and uncertainty. Moved leading edge industries and environment as business opportunity to last chapter.
Chapter 8 IMPLEMENTATION	New examples. Changed order with this chapter coming before last chapter and not being last chapter. Chapter remains very managerial with bad examples followed by a 10-step process for effective implementation.
Chapter 9 CONTINUOUS REINVENTION	New examples. New sections develop idea that strategy is about preparing for inevitable turmoil and uncertainty; it involves a portfolio of initiatives that must be managed, and requires a regular reinvention of the business model. Open sources, minimally viable models, and eco-system are introduced as part of what can be used to reinvent the business models. Discussion of leading-edge industries is now found here. Continued to wrap up book with recapitulation of model strategy as external, internal analysis, moves, implementation, and reassessment. Incorporated judo strategy discussion in final examples of Microsoft and retail food industry.

Acknowledgments

So much of what I know about strategy I have learned from my colleagues in the Strategic Management and Organization Department at the Carlson School of Management. They let me serve as department chair from 1994 to 2000 (I kept urging them to have a coup d'etat), and in that capacity, I read their papers and came to especially value and appreciate their work. Fundamental to my thinking about strategy are ideas about the external environment and how to analyze it. At Minnesota, we always have been strong in this area, and I would like to especially thank my colleagues Aks Zaheer, Andrew Van de Ven, Shaker Zahra, Joel Waldfogel, Myles Shaver, Mary Benner, Paul Vaaler, Sri Zaheer, Dan Forbes, Stu Albert, Jiao Luo, Russell Funk, Aseem Kaul, Harry Sapienza, Gurneeta Vasudevia, Ian Maitland, and Sunasair Dutta. Past colleagues such as Margie Peteraf (Dartmouth), Bala Chakravarthy (IMD), Phil Bromiley (University of California, Irvine), P. K. Toh (University of Texas), Richard Wang (Babson), and Stefanie Lenway (University of St. Thomas) also have influenced me. I have learned an enormous amount from Ari Ginberg at NYU. I owe debts of gratitude to former PhD students such as Adam Fremeth at Western Ontario, Bill McEvily at the University of Toronto, Sumit Majumdar at University of Texas–Dallas, Marc Anderson, who is at Iowa State, Tim Hargrave, who is at Simon Fraser University, Mazhar Islam, who teaches at Tulane, and especially to Joel Malen at Hitotsubashi University in Tokyo.

In addition to teaching at the Carlson School, I have taught strategy in the Management of Technology program at the University of Minnesota. This program is sponsored by the engineering school of the University of Minnesota and is mainly composed of mid-career engineers from local companies. From my students in this program I have learned and continue to learn a great deal. The head of this program, Massoud Amin, is a true gem and a great colleague. Other faculties there are in the same category. The students have to write capstone papers, and they must present them to faculty committees. The capstones involve real-world company problems, and I have learned a great deal from how the students have approached these problems and tried to solve them. The staff at the Carlson School and at the Management of Technology program are superb and have assisted me a great deal in all the work that I have done there.

I teach part of the year at the Technion in Israel. Eitan Naveh of the Technion in Israel, who was a post-doc at Minnesota who worked with me for a number of years, is an excellent colleague. I also want to acknowledge Mia Erez and Dovev Lavie as excellent Technion colleagues from whom I have learned a great deal as well as PhD student Ella Glickson and the many superb Technion students who have been in my classes.

And of course, there is my wife who has not complained (or has not complained a lot) about my constantly working. My older son David has become a writer and editor of note himself. He co-edits *Dissent Magazine.* My younger son, Ariel, works for Spotify, which brings us sweet music by which to live. Ariel has a keen sense for the strategies of startups, and I have learned a great deal from him as well.

Alfred A. Marcus

Nanos gigantum humeris insidentes . . . It is at times like these that I realize I am but a dwarf standing on the shoulders of giants, and that I'm extremely fortunate to have so many "giants" in my life—those that have contributed to my formation and have helped me along the way:

- I'm indebted to those that have shaped my journey to the front of the classroom, from my initial inspiration, David Stenson, who could hold the rapt attention of math students with his graphs of 3D rotations (all done in chalk pastels in those days), to Tim Robertson, my first teaching mentor, to Phil Anderson, my first department chair who first informed me that I had caught "the teaching bug," to Myles Shaver, Harry Sapienza, Steve Spruth and Svetlana Madzar, who served on my hiring committee at Carlson School.
- I'm humbled by the talents of my co-author, Alfred Marcus, who invited me to participate in the writing of this edition. It has been a joy to engage and collaborate with such a gifted and prolific strategist as we developed this edition's topics. He has been a wonderful colleague.
- I am also thankful to all those that helped us cross the finish line with this edition's manuscript. Thank you Merav Levkowitz, Arpana Kumari, Ann Cutaia, Jenilynn Mcatee, Laura Spell and the many dedicated professionals on this book's production team.
- I'm grateful for my clients, students and wonderful team of assistants. They energize me and teach me just as much as I teach them by sharing their perspectives, their goals, their challenges and their talents.
- I'm also greatly blessed with a loving family that provides unwavering support: Dwayne, my husband, and Brendan and Christopher, my two sons. Dwayne, who started his career as an aircraft engineer, now serves as regional manager for Eaton. Brendan works on multi-billion-dollar energy infrastructure projects at Xcel. Christopher, our car nut, works for Audi in sales. My extended family—as anchored by my Aunt Pat in Ohio (Sr. Patricia Conway), Aunt Jane in California (Mrs. David Volz), and cousin Lynn Conway in Florida—has also been a source of great love and strength. Life is good.
- Lastly, I will always remember my very first giants, two great parents, Jordan and Agnes Ussai, who throughout their lives so selflessly gave our family countless and enduring gifts of knowledge, courage and faithfulness.

Anne N. Cohen

Brief Contents

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CHAPTER ONE

Winning Moves

"A key warning sign [of] a strategic inflection point is when … all of a sudden, the company … you worry about has shifted. You … dealt with one … competitor all your life, and all of [a] sudden you do not care about them, you care about … somebody else. A mental silver bullet test [is] if you had one bullet, whom would you shoot with it? If you change the direction of the gun, that … signals … you may be dealing with … more than an ordinary shift in the competitive landscape."[1]

Andy Grove, former CEO of Intel Corporation

Chapter Learning Objectives

- Understanding **strategy** as a set of both planned and reactive moves taken in the pursuit of competitive advantage.
- Identifying **inflection points**—extraordinary shifts in the competitive landscape that change the basis for sustained competitive advantage (SCA).
- Comprehending that SCA is the result of making *winning moves* over the long term, not just producing a few years of good performance.
- Using analogies from chess, war, and sports to help understand the many facets of making winning moves, including knowing the enemy and yourself, attending to the rules, concentrating forces, relying on teamwork, staying agile, and keeping score.
- Being aware that firms are simultaneously located in the past, striving to achieve their current *mission*, while, at the same time, trying to move toward a **vision** of the future where they desire to excel.
- Understanding the *strategic management process*—an approach designed to help an organization better understand the strategic context within which it operates, select the best moves in light of its situation, and successfully execute these moves.

Introduction

A **strategic inflection point** occurs when a company faces major changes in its competitive environment. These changes may arise from new technologies, different regulatory conditions, or transformations in customer values and preferences. In the

21st century, such inflection points occur at a more rapid pace and come from many directions. Here are but a few examples:

- Digital mobile media have changed how consumers access information and how they shop. They have revolutionized every industry from publishing to dating. Gartner Group forecasts that there will be 7.3 billion smartphones, tablets and PCs, and 26 billion other Internet-connected products by 2020.[2] This growing base of devices is having multiple impacts on just about every business.
- Regulatory changes in the U.S. health care system have quickly shifted the tides for medical practices, hospital systems, medical device manufacturers, developers of information technologies, and employers. Health care and health care–related industry players have to react to these extraordinary and dramatic shifts in the competitive environment.
- An increased desire for healthier living is providing opportunity for producers of organic foods, suppliers of alternative fuels/transport, and pioneers in customized genomic medicine.

Companies that fail to react appropriately to strategic inflection points will struggle, while savvy and agile firms will recognize these points, modify their strategies, and gain market share.

It is incumbent on everyone in an organization to be alert to these strategic inflection points as top management teams often are isolated and do not see them coming.[3] Lower-level employees on a company's front lines frequently are the ones that detect the inflections first. Their job is to bring the inflection point to the organization's attention and mobilize support for changes in a company's strategy. Gaining recognition for spotting inflection points and introducing strategic change in a company is a method for career advancement. Those who notice and help make the needed changes can be rewarded for their efforts.

This book, therefore, is meant for everyone in a company, not just top management. It is meant to sensitize everyone in an organization to the need to identify inflection points. It provides its readers with the tools for strategic analysis and emphasizes that the goal of strategy is to achieve long-term or sustained competitive advantage (SCA). These tools permit readers to make sound arguments for changes that put their companies in a better position to meet these challenges, and move them from the realm of threats to the organization to that of opportunities.

This first chapter is meant to acquaint readers with the basics of strategic management. It establishes the **framework** for strategic assessment and analysis that is used in the book. The framework provides a means to better understand and evaluate a firm's external environment and its inner strengths, to weigh its strategic options, and to make and carry out recommendations for strategic adjustment. This chapter compares strategy to three analogous activities—chess, war, and sports—where the goal is also long-term strategic advantage.

Sustained Competitive Advantage

The goal of strategy is **sustained competitive advantage (SCA)** or above-average performance in an industry for a period of ten years or more.[4] Though many firms perform better than their main competitors for a short time, very few companies have consistently outperformed their industry for more than 10 years.[5] Dominant winners are rare, and the companies that achieve SCA in most industries are outliers.

Natural parity is the condition found in most industries. Over a long period, the performance in most industries converges toward a mean. Many top management teams have no better aspiration than to keep up with industry norms. They benchmark what others are doing, rather than trying to be industry leaders. The inability of companies to maintain competitive advantage for long periods suggests that firms have not typically recognized inflections and change within their industries. They must adjust existing models to novel circumstances.

According to one study, only about 5 percent of firms achieve sustained competitive advantage with respect to an indicator of profitability (return on assets), and only about 2 percent do so with respect to an indicator of stock market performance.[6] Surprisingly, these high performers are not regularly cited in the business press as exemplars. They often operate under the radar, and their stories are not told. How do these companies achieve SCA?

Choosing a route to sustained competitive advantage depends on being in a strong industry or having the resources and capabilities to compete effectively in industries that are waning. A company must scan the external environment to find good industries in which to compete, and it must build internal resources and capabilities to be a strong competitor within the industries it chooses.

Some companies achieve SCA by choosing industries with high mean returns and trying to dominate them. All the firms in such an industry thrive, and thus the industry is an attractive one in which to compete. The implication of this route to success is to choose a successful industry or industry niche and ride its overall success. Take advantage of the good economic conditions in such a segment to grow revenues and profits. The path to success is to select the right industry or industry niche in which to operate. If the segment does not exist, play a leading role in its creation.

Not all companies have the freedom to move from industry to industry, however, they too can achieve SCA by being the dominant player in a consolidating or declining industry. Such an industry has low mean returns, and the deviation in these returns is high. If the deviation is high, there is still room for some companies to excel. Companies that achieve SCA in this type of setting stand out by means of their superior resources and capabilities. They dominate industries in decline. Being a dominant player in a weak industry means possessing the unique resources or capabilities that permit a company to win in a demanding setting of market shrinkage. The moves companies make to achieve SCA then must be backed up by moves to protect their leadership position once it has been achieved. The path to SCA consists of choosing the market segments in which to compete which fit well with a company's strengths and weaknesses.

In order to help companies realize SCA, Chapter 2 introduces **external analysis** (EA) and Chapter 3 discusses **internal analysis** (IA). EA permits you to identify the opportunities and threats a company confronts in its industry, and IA allows you to analyze the strengths an organization can utilize to take advantage of the opportunities and to defend itself from the threats.

Industry structure is the main focus of Chapter 2. If an industry is very concentrated, some firms have high market share, and there are strong barriers to entry, then the industry's prospects are promising and long-term above-average returns are more likely.

A company's strengths and weaknesses are the main focus of Chapter 3. Peculiar configurations of resources, capabilities, and competencies make the positions of leading firms especially hard to copy and highly valuable. These firms maintain an advantage because of their rare, nonsubstitutable internal assets. However, even these assets can be challenged. Organizations must be perpetually vigilant against competitors that devise better business models. Thus, it is incumbent on all firms to continuously adjust their business and corporate strategies.

Smart strategic moves can help a business compete by positioning it with respect to the cost and quality of the goods and services it offers. That is the domain of **business strategy** (BS). Continuous positioning and repositioning via moves a company makes is the main focus of Chapter 4. An understanding of external and internal environments also helps with the decision about which types of businesses in which to compete. That is the domain of **corporate strategy** (CS). Changing businesses via mergers, acquisitions, divestitures, and alliances is the main focus of Chapter 5.

Company moves also entail choices about globalization and innovation. **Global strategy** (GS) is essential for any business today. What will be the scope of its activities? Where will a company sell its products? Where will it source its raw materials, design and make its products, and do research and development? Chapter 6 focuses on the opportunities and threats offered by globalization.

Companies also must be ready to abandon existing products and business models, find new opportunities, and make the leap into fresh fields of endeavor. Having a vigorous **innovation strategy** (IS) that rests on the understanding that today's markets are not permanent is also essential. Chapter 7 is about entrepreneurship and the striving for innovation.

Implementation (I) is the alignment of a strategy with the management systems and tools to carry it out successfully. Management may have a bold and exciting vision about where to go next, but if it lacks the means to carry out its vision, its creativity and imagination in establishing that vision are likely to be in vain. Chapter 8 emphasizes the tools managers need to successfully implement strategy.

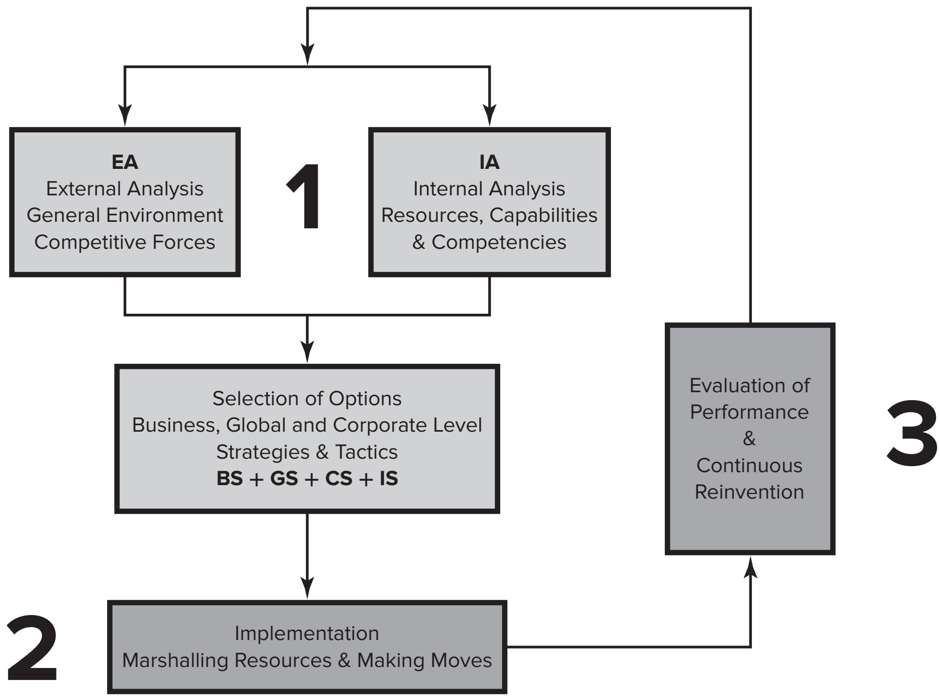
Firms must constantly position and reposition themselves in relation to their competitors. This process is not a one-time event. **Repositioning** (R) is the constant adjustment and revisiting of strategy that are essential for every firm. In repositioning, a firm can engage in tactics borrowed from judo to keep its opponents off balance. Chapter 9 focuses on the role that judo strategy plays in repositioning.

Altogether, this book brings you the formula for making winning moves diagrammed in the following section. First, do EA and IA; then choose from a repertoire of moves that include BS, CS, GS, and IS; and finally engage in continuous I and R. Thus, SCA = EA + IA followed by some combination of BS + CS + GS + IS, which is to be followed by I + R.

Making Winning Moves

The main message of the book is that in response to changing external circumstances, an organization constantly must endeavor to find new sources of competitive advantage. This requires that the organization make a sequence of short-term maneuvers and long-term

EXHIBIT 1.1 **Three-Step Model for Sustained Competitive Advantage (SCA)**



$$\mathbf{SCA} = \underbrace{[EA + IA]}_{\textit{Analysis}} + \underbrace{[BS + CS + GS + IS]}_{\textit{Moves}} + \underbrace{[I + R]}_{\textit{Implementation \& Reinvention}}$$

changes in directions that add up to a unique position against which competitors cannot make serious inroads. Critical to an organization's long-term advantage is positioning its products and markets in a space free from competitors. In strategizing, a three-step process is needed, which involves analysis, moves, ongoing evaluation, and implementation (see Exhibit 1.1).

Step 1: Analysis

Before exploring the various moves a company can make to achieve SCA, it is important to do the types of analyses that will increase the chances that the moves a company makes will yield success. The two types of analysis needed are (1) an analysis of the company's external environment, EA (see Chapter 2), and (2) an analysis of its internal environment, IA (see Chapter 3). Assessing a company's external opportunities and threats and matching them with its internal strengths and weaknesses provide it with the ability to make better moves. How to estimate and match these factors is covered in detail in the book's next two chapters.

Step 2: Moves

The moves that flow from such analyses better position a company to prevail in the ongoing competitive challenges it confronts. This book explores moves that position the firm in relation to its competitors with respect to the cost and quality of the products and services the firm provides in Chapter 4 (BS); the scope of its activities in Chapter 5 (CS); its global, as opposed to domestic, reach in Chapter 6 (GS); and the extent to which it innovates and searches for new business opportunities as opposed to exploiting existing ones in Chapter 7 (IS).

Step 3: Implementation and Ongoing Reinvention

The need to implement a strategy well once it is chosen is the lesson of Chapter 8, while repeated repositioning of a company vis-à-vis its competitors is emphasized in Chapter 9. The whole process of deliberating how to achieve SCA as a function of EA, IA, moves, and sound implementation must be continuous. The analytical process cannot come to a halt. Distinct stages of formulation and implementation should not be separated out, but rather ongoing evaluations, adjustment of strategies, and continuous reinvention should be the norm.

Understanding Management Strategy: Three Analogies

The tools of strategic management are best understood through analogies with other areas in life in which competition is fierce, such as chess, war, and sports. Each of these bears important resemblances to strategy.

A Chess Analogy

Strategy is like chess in that the goal may be seen as checkmate, or thwarting an opponent so that escape is nearly impossible (see Exhibit 1.2). In driving Borders and Circuit City to bankruptcy, Barnes and Noble and Best Buy came close to this goal, but in business, the results are rarely so definitive. Rather, the best companies can hope for is sustained dominance, similar to that achieved by Microsoft and Intel in their markets during the 1990s. In disabling their competitors, Microsoft and Intel each captured more than 90 percent of the market in operating systems and microprocessors, respectively.

EXHIBIT 1.2
Strategy and Chess

Operating by the Rules

In both business and chess, dominance has to be achieved according to rules. Following the rules and playing fairly guarantee that the results are a consequence of skill rather than of illegal or unfair practices. In the world of commerce, skill means being better able than one's opponents to meet customer needs.

The rules of chess are very well defined and have remained the same for centuries, so few questions arise about the legality or ethics of the moves. In strategy, by contrast, companies operate with a legal framework that is less precise and static, so it is sometimes difficult to ascertain what is permissible. As a result, firms may believe that their job is to test the laws' limits. Managers may have the view that innovative theories promoted by consulting firms and management theorists give them the license to stretch what the law allows. However, when gains are achieved by questionable moves, the extent to which these gains endure depends on how the legal system judges them. The courts may reverse apparent victories. The stories of Enron, Arthur Andersen, WorldCom, Adelphia, and other companies that came to light after 2000 provide stunning examples and warnings against engaging in illegal activities. They show that society will not tolerate some moves. Blatant cheating, when detected, does not go unpunished. Therefore, the moves firms make must be above board and in accord with prevailing legal doctrine and ethics.

Milton Friedman, who maintained that it was the purpose of managers to maximize shareholder returns, held that doing so must occur within the confines of law and ethics.[7] However, the law is not always clear regarding some strategic issues. The judgments of legal authorities clarify what the law says and establish precedents for how the game is played. Regulations dealing with competition, for instance, have shifted over time, depending on who the legal authorities were and how they interpreted the law. The Kennedy administration's view of antitrust law was much stricter than today's understanding of this phenomenon. The European Union (EU) struck a major blow against Intel in 2009 when it imposed a huge fine on the company for violating its antitrust laws. Microsoft has been treated similarly by the EU, and the EU has been preparing action against Google for quite some time, while U.S. antitrust laws have moderated. Companies must take into account not only the rules in their countries of origin, but the rules globally in every nation in which they operate.

According to legal doctrine in the United States in the early 1960s, simply having very high market share was proof of possible illegality. Today, high market share does not have this connotation in the United States, but it may in other countries. The United States requires proof of actual anticompetitive behavior. For example, when Microsoft was sued by antitrust authorities it was not because it had more than 90 percent of the market in operating software, but because it was alleged to have taken specific actions to exclude a competitor, Netscape, from installing a browser on newly manufactured personal computers. The legal challenges Microsoft faced threatened to reverse the gains the company had made in the 1990s. To continue as the world's leading software company, it had to defend itself in the courts. In the face of this challenge, Microsoft almost was broken up into several firms.

Intel, too, has been embroiled in frequent legal controversies in the United States with major competitors such as AMD. It tried, for example, to use the legal system to block

Via Technologies, a Taiwanese company and AMD's primary chipset partner, from making chipsets that would be compatible with Intel's Pentium 4 chips. Via turned around and sued Intel for trying to abridge its rights to operate.

Changing the Rules

Legal suits and countersuits affect the strategic battles in which companies are engaged. Microsoft's opponents, including Sun and Oracle, pressured federal officials to be tough on the software giant. This pressure was a primary reason antitrust authorities acted against Microsoft.

Thus, companies must be aware that the rules of the "game" of strategy tend to shift over time. These shifts occur not only because of variations in the legal and ethical climate, but also because of changes in technology and economics. These shifts in the environment in which firms operate are the types of inflection points to which reference was previously made. To some extent, the forces that change the rules of the game are outside the control of a company, but often companies have influence over the rules under which they operate. Nonetheless, the forces of external changes are not entirely within the control of companies. Some of the changes are hard to direct or block entirely. Once they gain momentum, they can have overwhelming power to change an industry, and a company and its employees have no choice but to adjust.

At the start of the 21st century, executives of Microsoft, Intel, and other leading high-tech companies discovered how strong these forces were when the bubble burst in their industry, terror struck, global security became an overriding issue, and extremely tough economic conditions set in. Plus, as these events occurred, users were starting to install Linux, a virtually free operating system that could replace Windows.

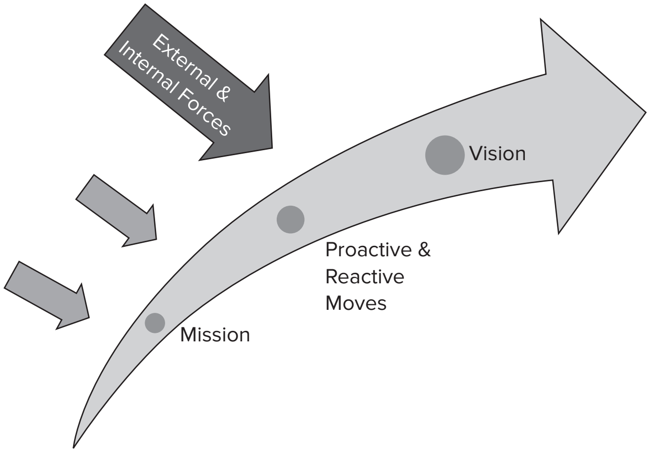
Fundamental new forces in the external environment such as these require an alteration in firm strategy. All of the employees in a company must analyze these changes and consider the moves a company can make to better position itself in the face of challenges. For example, employees can promote the idea that a company should shift all or some of its resources to areas in which it can compete better. Companies can be *prospectors,* aggressively pursuing new growth opportunities, or *defenders,* clinging to their existing niche and trying to protect their turf. They also can be *analyzers,* both searching for new market opportunities and protecting an existing position. In the worst case, they can be *reactors,* incoherently responding to the changed circumstances.

The success of the moves a company makes ultimately depends on how much flexibility it has to maneuver. Companies always find themselves between two poles—the past and the future. Their *mission* typically represents the company's current purpose and what it has been good at in the past, while their *vision,* on the other hand, normally is based on their future—what they would like to be good at next (see Exhibit 1.3).

Envisioning Where to Go Next

In chess, it's critical to think several moves ahead, but even if the employees in a company have a vision of where they would like the company to go, it may not be possible to achieve this vision quickly. Because of fixed physical or human assets, bureaucracy, or the inflexible worldviews of top managers, the company might not easily make the transition from where it is now to where it would like to be next.

EXHIBIT 1.3
A Company's Mission and Vision



Andy Grove recommends that companies be "**agile giants**."[8] They need agility to move quickly to new competitive ground (this is their vision), but once they occupy that ground, they must be giants, capable of defending it (this is when their vision becomes a mission). In the mid-1980s, Intel's main product was computer memory. When Intel could no longer compete with large and better-capitalized Japanese firms in this business, its employees realized the company had to concentrate on the one thing it did best: focus on an area in which it had *comparative advantage*. So, Intel shifted to microprocessors based on the reasoning that it was better to be positioned as the top player in microprocessors than to be a mediocre player in both microprocessors and memory. Comparative advantage means that a company pursues what it does best. This is the foundation for sustained competitive advantage. Doing what a firm does best, doing what no other firm can do as well in meeting customer needs and expectations, is the key to sustained competitive advantage.

A company incorporates these strengths into its mission but, while pursuing its mission, it must also have a vision for where it wants to go next, as conditions do change. Companies such as Intel and Microsoft constantly balance between what they have proven good at in the past and what they would like to be good at in the future. They are trying to develop new options they might use to achieve advantage when their current businesses slacken. Another firm that has been grappling with how to adjust its strategies to react to changing conditions is Medtronic. Its recent moves are summarized in Exhibit 1.4.

In business, it is also possible to create new games. A company can redefine the game that is in process, play a different game, or walk away from a game and refuse to compete. Usually, change is gradual and incremental, but it can also be massive and sudden, like Andy Grove's inflection points. Because change cannot be predicted with great certainty, employees must be alert to a variety of different contingencies. They need to develop and propose options that will give their firms the flexibility to move in a number of directions regardless of how external conditions evolve.