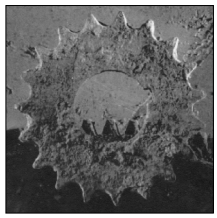
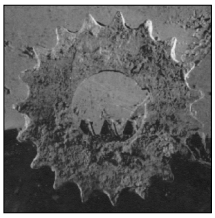


I Introduction

1 The Concept of Strategy



1
The Concept of Strategy

Strategy is the great work of the organization. In situations of life or death, it is the Tao of survival or extinction. Its study cannot be neglected.
—***Sun Tzu*, The Art of War**

Outline

- Introduction and Objectives
- The Role of Strategy in Success
- A Framework for Analyzing Business Strategy
  - Beyond SWOT
  - Strategic Fit
- A Brief History of Business Strategy
  - Origins and Military Antecedents
  - From Corporate Planning to Strategic Management
- The Distinction Between Corporate and Business Strategy
- Different Approaches to Strategy: *Design* versus *Process*
- The Different Roles of Strategy Within the Firm
  - Strategy as Decision Support
  - Strategy as a Process for Coordinating and Communicating
  - Strategy as Target
- The Role of Analysis in Strategy Formulation
- Summary

INTRODUCTION AND OBJECTIVES

Strategy is about winning. This chapter investigates the role of strategy in organizational and personal success – not only in its business context, but also in relation to other fields of human endeavor, including warfare, entertainment, politics, and sport. We examine the nature of strategy and we distinguish strategy from planning. Strategy is not a detailed plan or program of instructions; it is a unifying theme that gives coherence and direction to the actions and decisions of an individual or an organization.

We go on to examine the role of analysis in strategy formulation. If strategy is purely a matter of intuition and experience, then there is little point in studying this book – the only way to learn is to go and do. The key premise that underlies this book is that there are concepts, frameworks, and techniques that are immensely useful in formulating and implementing effective strategies.

By the time you have completed this chapter, you will be able to:

- Identify the contribution that strategy can make to successful performance, both for individuals and for organizations.
- Perceive strategy as a link between the firm and its environment, and recognize external analysis (understanding the industry environment) and internal analysis (understanding the firm's resources and capabilities) as the two primary ingredients into formulating strategy.
- Describe the origins and development of business strategy.
- Recognize the multiple roles of strategy within an organization.

My intention in this chapter is to familiarize you with what strategy is and how strategic analysis and formal processes of strategy making can help organizations achieve superior performance. At the same time, I shall be outlining a framework for strategy analysis that will form the organizing framework for the whole of the book. The basis of this framework is the role of strategy as the essential link between the firm and its business environment.

Since the purpose of strategy is to help us to win, we start by looking at the role of strategy in success.

THE ROLE OF STRATEGY IN SUCCESS

Exhibits 1.1, 1.2, and 1.3 outline examples of success in three very different fields of endeavor: Madonna in popular entertainment, General Giap and the North Vietnamese armed forces in warfare, and Alex Ferguson and Manchester United in soccer. Can the success of these diverse individuals and the organizations they led be attributed to any common factors?

EXHIBIT 1.1 Madonna

Despite a new relationship (with actor Guy Ritchie) a move to London, a second pregnancy, and her 42nd birthday, the new millennium saw little evidence of a slowdown in the career of Madonna Louise Veronica Ciccone. Year 2000 saw the release of her movie *The Next Best Thing*, a major hit with her recording of Don Michelin's "American Pie," a Grammy award for her song "Beautiful Stranger," and a new album, *Music*. Meanwhile, at her production company Maverick, her stable of recording artists continued to grow in size and success. After two and a half decades at the top of her profession, Madonna continues to be the world's highest earning female entertainer and one of the best-known women on the planet.

Born in Bay City, Michigan on August 16, 1958, Madonna studied dance at University of Michigan, but left after a year to pursue a career as a dancer in New York. After a succession of small-time dancing jobs, she turned to music and eventually landed a recording contract. *Madonna*, released in 1983, ultimately sold close to 10 million copies worldwide and her second album, *Like a Virgin*, topped 12 million copies. Between 1985 and 1990, six further albums, three world tours, and five movie roles had established Madonna with an image and persona that transcended any single field of entertainment: she was rock singer, actor, author, and pinup. Yet, she was more than this – as her website proclaims, she is "icon, artist, provocateur, diva, and mogul." She has also made a great deal of money: between 1985 and 1999 she was easily the world's top earning female entertainer and has a net worth estimated at close to $200 million.

So, what is the basis of Madonna's incredible and lasting success? As an entertainer there is little evidence of outstanding natural talent. Although she has evoked comparison with stars of the past – Monroe, Garbo, and Mae West – her endowments seem modest: she lacks the voice of Whitney Houston, the dancing ability of Janet Jackson, and the songwriting talent of Sinead O'Connor. While she is undoubtedly attractive, few would regard her as outstandingly beautiful.

To understand her success, it is first worth noting that she is not the product of any media organization or the protégée of any entertainment entrepreneur. Madonna's success is the result of her own efforts and she has always directed her own career. To launch her music career, she flew to Los Angeles in 1982 to persuade Freddie De Mann, Michael Jackson's manager, to take her on and eventually to drop Jackson. Since then she has forged alliances and drawn on the resources of a wide range of individuals and organizations. Yet, she has never compromised her independence or relinquished control over her career.

Madonna's drive and purposefulness are evident throughout her life. Her wide range of activities – records, concerts, music videos, movies, books, and charity events – belies a remarkable dedication to a single goal: the quest for superstar status. For close to 20 years, Madonna has worked relentlessly to market herself and to maintain and renew her popular appeal. She is widely regarded as a workaholic who survives on little sleep and rarely takes vacations.

> I am a very disciplined person. I sleep a certain number of hours each night, then I like to get up and get on with it. All that means that I am in charge of everything that comes out.

Her career has been largely undeflected by other goals. Many of her personal relationships have been stepping stones to career transitions. Her transition from dancing into music was assisted by relationships, first with a rock musician and later with disc jockey John Benitex. Her move into Hollywood followed her brief marriage to actor Sean Penn and an affair with Warren Beatty. As Jeff Katzenberg of Deamworks observed:

> She has always had a vision of exactly who she is, whether performer or businesswoman, and she has been strong enough to balance it all. Every time she comes up with a new look it is successful. When it happens once, OK, maybe it's luck, but twice is a coincidence, and three times it's got to be a remarkable talent. And Madonna's on her fifth or sixth time.

EXHIBIT 1.1 (*cont'd*)

Like Evita Perón, whom Madonna portrayed in the movie *Evita*, Madonna has shown a determination to climb out of her humble origins, ambition to reach a pinnacle of achievement, astuteness in making the right connections, mastery of the strategic use of sex, and a knack for being in the right place at the right time.

She was quick to learn how to play the game both in Tin Pan Alley and in Hollywood. As a self-publicist she is without equal. In using sex as a marketing tool, she has followed a tradition that extends back thousands of years: her innovation has been to go further in the subtle and not-so-subtle suggestions of sexual deviance, the portrayal of pornographic imagery (often under the banner of "art"), and the juxtaposition of sexual and religious themes. But she is also astute at walking the fine line between the shocking and the unacceptable. She has had concerts banned for indecency, videos pulled from MTV because of their sexual content, and a sponsorship deal with Pepsi canceled once Pepsi discovered that the advertising video featured Madonna making love on an altar (Madonna pocketed $3 million from the deal). Yet, she has carefully nurtured relationships with key producers and promoters, and never risked being exiled from the major channels of distribution that she needs to link her to her audience.

Most striking has been her continuous renewal of her image. From her street kid look of the early 1980s, her fans have been treated to multiple reincarnations. These have included her glam-rock look of the late 1980s, a Marilyn Monroe retro look, her hard-core sexuality of the early 1990s, to her softer and more spiritual image that has accompanied motherhood. Not all her projects have been successful – several of her films have been outright failures, with her performances described as "wooden" and "one-dimensional." Yet, every time her career appears to be in decline, she has shown a remarkable ability to stage publicity coups and renew her image and appeal.

Her approach involves very careful exploitation of her own talents and endowments. Her foremost ability is designing and projecting images that combine music, dance, theater, physical presence, and her sense of style. Her weaknesses as an entertainer are compensated for by her heavy reliance on technology, sexual suggestion, and an array of support personnel, including musicians, dancers, and designers. These are effectively integrated through her own creative vision and design capability.

In all her activities, Madonna shows obsessive attention to detail. Her insistence on control is reflected in the organization of her business interests. Most of her entertainment ventures have been owned and operated by her own companies, including Boy Toy Inc. (publishing), Siren films, and Slutco Inc. (video). In 1992 she formed the recording and management company Maverick Inc., a joint venture with Time Warner. Her Maverick deal guaranteed her a base salary of $8 million a year plus a share of profits. This represented a significant shift in Madonna's business base. Rather than rely on revenues from her music and acting output, she has increasingly become a developer and promoter of younger talent. Maverick provides a vehicle focusing her creative and promotional intuition and experience and the wealth of talented specialists that she has gathered around her to develop new entertainers and enterprises. The company has recording contracts with the Deftones, William Orbit, Cleopatra, and No Authority. Madonna has also been active in launching the international careers of singer Donna De Lory, the French band Mirwais, and comedian Ali G. As Madonna noted:

> I've met these people along the way in my career and I want to take them everywhere I go. I want to incorporate them into my little factory of ideas. I also come into contact with a lot of young talent that I feel entrepreneurial about.

While Madonna's musical career continues to flourish, her business development activities occupy an increasing part of her life and provide a growing share of her income, despite the increasing dominance of the global media sector by a few mega-conglomerates: AOL-Time

EXHIBIT 1.1 (*cont'd*)

Warner, Sony, Disney, Bertelsmann, and Vivendi Universal. Madonna has maintained her independence while expanding her influence. As Harry Scolinos, a Los Angeles attorney, observes: "I would take her street-smart business sense over someone with a Harvard MBA any day."

Sources: "Madonna Is America's Smartest Business Woman," *Business Age*, June 1992: 66–9; www.madonnafanclub.com; www.maverickrc.com.

EXHIBIT 1.2 General Giap and the Vietnam Wars, 1948–75

> As far as logistics and tactics were concerned, we succeeded in everything we set out to do. At the height of the war the army was able to move almost a million soldiers a year in and out of Vietnam, feed them, clothe them, house them, supply them with arms and ammunition and generally sustain them better than any army had ever been sustained in the field . . . On the battlefield itself, the army was unbeatable. In engagement after engagement the forces of the Vietcong and the North Vietnamese Army were thrown back with terrible losses. Yet, in the end, it was North Vietnam, not the United States that emerged victorious. How could we have succeeded so well yet failed so miserably?[1]

Despite having the largest army in Southeast Asia, North Vietnam was no match for South Vietnam so long as the South was backed by the world's most powerful military and industrial nation. South Vietnam and its United States ally were defeated not by superior resources but by a superior strategy. North Vietnam achieved what Sun Tzu claimed was the highest form of victory: the enemy gave up.

The prime mover in the formulation of North Vietnam's military strategy was General Vo Nguyen Giap. In 1944, Giap became head of the Vietminh guerrilla forces. He was commander-in-chief of the North Vietnamese Army until 1974 and Minister of Defense until 1980. Giap's strategy was based on Mao Tse Tung's three-phase theory of revolutionary war: first, passive resistance during which political support is mobilized; second, guerrilla warfare aimed at weakening the enemy and building military strength; finally, general counteroffensive.[2] In 1954, Giap began the final phase of the war against the French and the brilliant victory at Dien Bien Phu fully vindicated the strategy. Against South Vietnam and its US ally, the approach was similar. Giap explained his strategy as follows:

> Our strategy was . . . to wage a long-lasting battle . . . Only a long-term war could enable us to utilize to the maximum our political trump cards, to overcome our material handicap, and to transform our weakness into strength. To maintain and increase our forces was the principle to which we adhered, contenting ourselves with attacking when success was certain, refusing to give battle likely to incur losses.[3]

The strategy built on the one resource where the communists had overwhelming superiority: their will to fight. As Clausewitz, the nineteenth-century military theorist, observed: war requires

[1] Col Harry G. Summers Jr., *On Strategy* (Novato, CA: Presidio Press, 1982): 1.
[2] G. K. Tanham, *Communist Revolutionary Warfare* (New York: Praeger, 1961): 9–32.
[3] Vo Nguyen Giap, *Selected Writings* (Hanoi: Foreign Language Publishing House, 1977).

EXHIBIT 1.2 (*cont'd*)

unity of purpose between the government, the military, and the people. Such unity was never achieved in the United States. The North Vietnamese, on the other hand, were united in a "people's war." Capitalizing on this strength necessitated "The Long War." As Prime Minister Pham Van Dong explained: "The United States is the most powerful nation on earth. But Americans do not like long, inconclusive wars . . . We can outlast them and we can win in the end."[4] Limited military engagement and the charade of the Paris peace talks helped the North Vietnamese prolong the conflict, while diplomatic efforts to isolate the United States from its Western allies and to sustain the US peace movement accelerated the crumbling of American will to win.

The effectiveness of the US military response was limited by two key uncertainties: what were the objectives and who was the enemy? Was the US role one of supporting the South Vietnamese regime, fighting Vietcong terrorism, inflicting a military defeat on North Vietnam, or combating world communism? Lack of unanimity over goals translated into confusion as to whether America was fighting the Vietcong, the North Vietnamese, or the communists of Southeast Asia, or whether the war was military or political in scope. Diversity of opinion and a shifting balance of political and public opinion were fatal for establishing a consistent long-term strategy.

The consistency and strength of North Vietnam's strategy allowed it to survive errors in implementation. Giap was undoubtedly premature in launching his general offensive. Both the 1968 Tet Offensive and 1972 Easter Offensive were beaten back, inflicting heavy losses on North Vietnamese regulars and Vietcong. Giap was replaced as commander-in-chief by General Van Tien Dung, who recognized that the Watergate scandal had so weakened the US presidency that an effective American response to a new communist offensive was unlikely. On April 29, 1975, Operation Frequent Wind began evacuating all remaining Americans from South Vietnam, and the next morning North Vietnamese troops entered the Presidential Palace in Saigon.

[4] J. Cameron, *Here Is Your Enemy* (New York: Holt, Rinehart, Winston, 1966).

EXHIBIT 1.3 Alex Ferguson and Manchester United

In terms of revenues and audience, soccer is the world's biggest sport. The sport's international governing body, FIFA, presides over the national soccer associations in over 200 countries, and estimates that there are over 200 million registered players of the game and well over a billion fans. Among the thousands of professional soccer clubs worldwide, by the end of 1999 one team was widely acknowledged as the best in the world. After achieving the unprecedented feat of winning the English league championship, the English FA Cup, and the European Cup, Manchester United went on to win the world title by beating the Brazilian champions Palmeiras in Tokyo. The club, which had long been haunted by an aircraft crash in Munich in 1957 that wiped out its brilliant cup-winning side, had exorcized old ghosts and reached a pinnacle of achievement never before realized by a British football team.

Behind this success lay planning, development, and relentless encouragement and pressure by Manchester United's manager Alex Ferguson, the quiet Scotsman who had guided the team's efforts since 1986.

With a determination and dedication to work forged by his childhood in a tenement block in Govan, a tough, shipbuilding community close to Glasgow, Ferguson's life was built around soccer. After a playing career that started in boys' club teams and continued in the Scottish professional league with St. Johnston, Glasgow Rangers, and Aidrie, Ferguson took to coaching and management. He began with bottom-of-the-league East Stirlingshire, then moved to

EXHIBIT 1.3 (*cont'd*)

St. Mirren and later Aberdeen. There, Ferguson succeeded in breaking the duopoly held by the Glasgow teams Rangers and Celtic, and won the Scottish league championship, Scottish Cup, and European Cup Winners' Cup.

It was Ferguson's 14 years at Manchester United, however, where his ambitions were finally realized. After a period of gradual building, the club won the league championship in 1993 – a feat that had eluded it for 26 years. During the following seven seasons, Manchester United dominated English football, coming top of the league in all but two seasons.

Understanding why some managers and coaches achieve outstanding success with particular teams remains a mystery. In American football, for example, how did Tom Landry at the Dallas Cowboys, Vince Lombardi at the Green Bay Packers, and Mike Ditka at the Chicago Bears drive these teams to such heights of performance? In the case of Alex Ferguson, we do have some indications of the key ingredients.

Underlying Ferguson's career has been a remarkable drive for achievement. His life has been built around the exhilaration of winning and the dread of losing. His desire to win is reflected in the determination and aggressiveness that he displayed, as a footballer on the soccer field, and as a manager in the dressing room and the boardroom. His dedication is evident in his modest and sequestered life outside of football and, while devoted to his family, their role appears to mainly lie in offering a support system to help him withstand the rigors of his career.

His approach to management is based on team building:

> The best teams stand out because they are teams, because the individual members have been so truly integrated that the team functions with a single spirit. There is a constant flow of mutual support among the players, enabling them to feed off strengths and compensate for weaknesses. They depend on one another, trust in one another. A manager should engender that sense of unity. He should create a bond among his players and between him and them that raises performance to heights that were unimaginable when they started out as disparate individuals.

Creating unity and integration is at the heart of Ferguson's approach to management. His coaching places huge emphasis on training. His training sessions build individual and team skills through continuous repetition: "refining technique to the point where difficult skills become a matter of habit." Allied to rigorous training is tight discipline. In return for nurturing, developing, and mentoring his players, Ferguson demands total commitment. Some of his biggest showdowns with his players have been over alcohol – long a tradition of British soccer players, but inconsistent, says Ferguson, with professional play at world level.

However, building an outstanding team also requires outstanding players. Here, Ferguson has used a dual approach of identifying and nurturing young players through youth programs and a network of talent scouts, and buying star players from other teams. At both Aberdeen and Manchester United, Ferguson placed significant emphasis on "home-grown" talent. At the same time, he has drawn heavily on his clubs' financial resources to pay top prices for key players. In 1998 alone, Ferguson spent £24 million ($36 million) on just three players: Dwight Yorke from Aston Villa, Jaap Stam from Eindhoven, and Jesper Blomqvist from Parma. At Manchester United, Ferguson has built a team with a depth of talent that is unrivaled in British soccer.

Yet, Ferguson recognizes that individual skills and team capability are not enough. His tactical planning for each game is meticulous. This often includes a visit to watch opponents play as well as the analysis of videoed games to highlight the playing styles and individual strengths and weaknesses. His team composition and tactics are all adjusted to take advantage of the vulnerabilities of different opponents.

Sources: Alex Ferguson, *Managing My Life* (London: Hodder & Stoughton, 1999); www.manutd.com.

For none of these three examples can success be attributed to overwhelmingly superior resources:

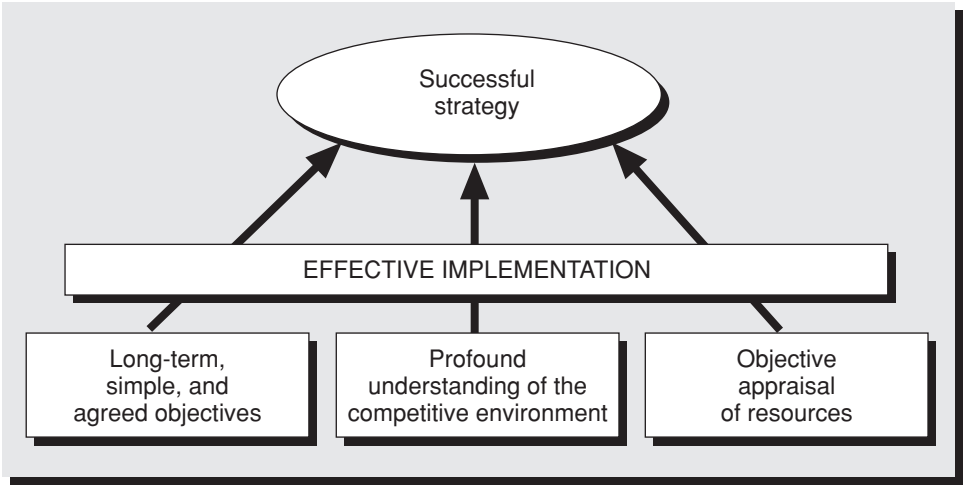
- Madonna possesses vitality, intelligence, and a tremendous capacity for work, but lacks outstanding talents as a vocalist, musician, actress, or any other of the principal vocations within popular entertainment.
- The military, human, and economic resources of the Vietnamese communists were dwarfed by those of the United States and South Vietnam. Yet, with the evacuation of US military and diplomatic personnel from Saigon in 1975, the world's most powerful nation was humiliated by one of the world's poorest.
- Alex Ferguson was a boilermaker's son brought up in the tough shipbuilding community of Scotland's Clydeside. His progress from a child kicking a ball in the street where he lived to becoming the world's leading soccer manager was entirely due to his own efforts.

Nor can their success be attributed either exclusively or primarily to luck. For all three, lucky breaks provided opportunities at critical junctures. None, however, was the beneficiary of a consistent run of good fortune. More important than luck was the ability to recognize opportunities when they appeared and to have the clarity of direction and the flexibility necessary to exploit these opportunities.

My contention is that the key common ingredient in all these success stories was the presence of a soundly formulated and effectively implemented *strategy*. These strategies did not exist as a plan; in several cases the strategy was not even made explicit. Yet, in all three, we can observe a consistency of direction based on a clear understanding of the "game" being played and an acute awareness of how to maneuver into a position of advantage.

- Madonna's phenomenal decade and a half as a superstar has been based on a multimarket strategy, where she has positioned herself as style leader and sex goddess, while continually keeping in the public eye through continual image renewal.
- The victory of the Vietnamese communist forces over the French and then the Americans is a classic example of how a sound strategy pursued with total commitment over a long period can succeed against vastly superior resources. The key was Giap's strategy of a protracted war of limited engagement. With American forces constrained by domestic and international opinion from using their full military might, the strategy was unbeatable once it began to sap the willingness of the US government to persevere with a costly, unpopular foreign war.
- Manchester United's success between 1992 and 2000 was based on Alex Ferguson's strategy of building depth of talent through investing in youth and procuring the best available players worldwide, undertaking meticulous competitor analysis, developing team coordination, and instilling determination and discipline within his players.

FIGURE 1.1 Common elements in successful strategies



We can go further. What do these examples tell us about the characteristics of a strategy that are conducive to success? Four common factors stand out, which are illustrated in Figure 1.1.

1. *Goals that are simple, consistent, and long term.* All three individuals displayed a single-minded commitment to a clearly recognized goal that was pursued steadfastly over a substantial part of their lifetime.
   - Madonna's career featured a relentless drive for stardom in which other dimensions of her life were either subordinated to or absorbed within her career goals.
   - North Vietnamese efforts were unified and focused on the ultimate goal of reuniting Vietnam under communist rule and expelling a foreign army from Vietnamese soil. By contrast, US efforts in Vietnam were bedeviled by confused objectives. Was the United States supporting an ally, stabilizing Southeast Asia, engaging in a proxy war against the Soviet Union, or pursuing an ideological struggle against world communism?
   - Alex Ferguson's dedication to success on the football field is legendary. A steadfast husband and committed father, outside of soccer his only significant interest is his family.
2. *Profound understanding of the competitive environment.* All three individuals designed their strategies around a deep and insightful appreciation of the arena in which they were competing.
   - Fundamental to Madonna's continuing success has been a shrewd understanding of the ingredients of stardom and the basis of popular appeal. This extends from the basic marketing principle that "sex sells" to recognition of the need to manage gatekeepers of the critical media distribution channels.

Her periodic reincarnations reflect an acute awareness of changing attitudes, styles, and social norms.

- Giap understood his enemy and the battlefield conditions where he would engage them. Supporting the military effort was an acute awareness of the political predicament of US presidents in their efforts to conduct a foreign war. This was key to the core element of North Vietnamese strategy: undermining the will of the American people to support the war effort.
- Alex Ferguson's commitment to competitive intelligence is legendary. He regularly makes visits to upcoming opponents to understand their pattern and style of play and diagnose their strengths and weaknesses.

3. *Objective appraisal of resources.* All three strategies were effective in exploiting internal strengths, while protecting areas of weakness.
   - By positioning herself as a "star," Madonna exploited her abilities to develop and project her image, to self-promote, and to exploit emerging trends, while avoiding being judged simply as a rock singer or an actress. Her live performances rely heavily on a large team of highly qualified dancers, musicians, vocalists, choreographers, and technicians, thus compensating for any weaknesses in her own performing capabilities.
   - Giap's strategy was carefully designed to protect against his army's deficiencies in arms and equipment, while exploiting the commitment and loyalty of his troops.
   - In creating a world-class soccer team, Ferguson has shown an acute understanding of the need for depth of talent and versatility. As new players are acquired and existing players build new skills, so Ferguson has been able to adapt Manchester United's style of play to exploit these resources.
4. *Effective implementation.* Without effective implementation, the best-laid strategies are of little use. Critical to the success of Madonna, Giap, and Ferguson was their effectiveness as leaders in terms of capacity to reach decisions, energy in implementing them, and effectiveness in instilling loyalty and commitment among subordinates. All three built organizations that allowed effective marshaling of resources and capabilities, and quick responses to changes in the competitive environment.

These observations about the role of strategy in success can be made in relation to most fields of human endeavor. Whether we look at warfare, chess, politics, sport, or business, the success of individuals and organizations is seldom the outcome of a purely random process. Nor is superiority in initial endowments of skills and resources typically the determining factor. Strategies that build on the basic four elements almost always play an influential role.

Look at the "high achievers" in any competitive area. Whether we review the 43 American presidents, the CEOs of the Fortune 500, or our own circles of friends and acquaintances, it is apparent that those who have achieved outstanding success in their careers are seldom those who possessed the greatest innate abilities. Success has gone to those who managed their careers most effectively – typically by combining the four strategic factors. They are goal focused; their career goals have taken

primacy over the multitude of life's other goals – friendship, love, leisure, knowledge, spiritual fulfillment – which the majority of us spend most of our lives juggling and reconciling. They know the environments within which they play and tend to be fast learners in terms of understanding the keys to advancement. They know themselves in terms of both strengths and weaknesses. And they implement their career strategies with commitment, consistency, and determination.

While focusing on a few, clearly delineated career goals is conducive to outstanding career success, such success may be matched by dismal failure in other areas of life. Many people who have achieved remarkable success in their careers have led lives scarred by poor relationships with friends and families and stunted personal development. These include Howard Hughes and John Paul Getty in business, Richard Nixon and Charles de Gaulle in politics, Marilyn Monroe and Elvis Presley in entertainment, Joe Louis and O. J. Simpson in sport, and Bobby Fischer in chess. Peter Drucker has pointed to the role of effective strategizing in career management (see Exhibit 1.4).

These same ingredients of successful strategies – clear goals, understanding the competitive environment, resource appraisal, and effective implementation – form the key components of our analysis of business strategy. These principles are not new. Over 2,000 years ago, Sun Tzu wrote:

> Know the other and know yourself:
> Triumph without peril.
> Know Nature and know the Situation:
> Triumph completely.[1]

A Framework for Analyzing Business Strategy

The same four principles that are critical to the design of successful strategies form the analytical foundations on which this book is based. Our framework views strategy as forming a link between the firm and its external environment (see Figure 1.2). The firm embodies three sets of key characteristics:

- Its goals and values.
- Its resources and capabilities.
- Its organizational structure and systems.

The external environment of the firm comprises the whole range of economic, social, political, and technological factors that influence a firm's decisions and its performance. However, for most strategy decisions, the core of the firm's external environment is its *industry*, which is defined by its relationships with customers, competitors, and suppliers.

The task of business strategy, then, is to determine how the firm will deploy its resources within its environment and so satisfy its long-term goals, and how to organize itself to implement that strategy.

[1] Sun Tzu, in *The Art of Strategy: A New Translation of Sun Tzu's Classic "The Art of War,"* trans. R. L. Wing (New York: Doubleday, 1988).

EXHIBIT 1.4 Peter Drucker on Managing Oneself

If we are to be successful in life, we must learn how to manage ourselves: how to develop ourselves, where to place ourselves to make the biggest contribution, and how and when to change the work we do. To manage ourselves effectively we need to ask some probing questions about ourselves:

What are my strengths? We need to assess our strengths and weaknesses through *feedback analysis* – when taking a key decision or action, write down the expected results and, nine or 12 months later, compare outcomes with expectations. Practiced consistently, this will show, over two or three years, where your strengths lie, and where you are not particularly competent. Use this understanding, first, to put yourself where your strengths can produce results, second, work on improving your strengths and addressing those weaknesses that deprive you of deriving full benefit from your strengths.

How do I perform? Understanding the processes through which one achieves results is essential to performing at one's best. Some people absorb information through reading rather than through listening (Dwight Eisenhower for example), others are better listeners than readers (Lyndon Johnson for example). By what means do I learn best: by formal instruction, by writing, by talking, or by practicing? Do I perform better individually or as part of a team? What degree of stress is ideal for me?

What are my values? Our values are a critical test of who we are and what we believe in. Organizations have values too and an individual's values must be compatible with those of the organization within which he or she works.

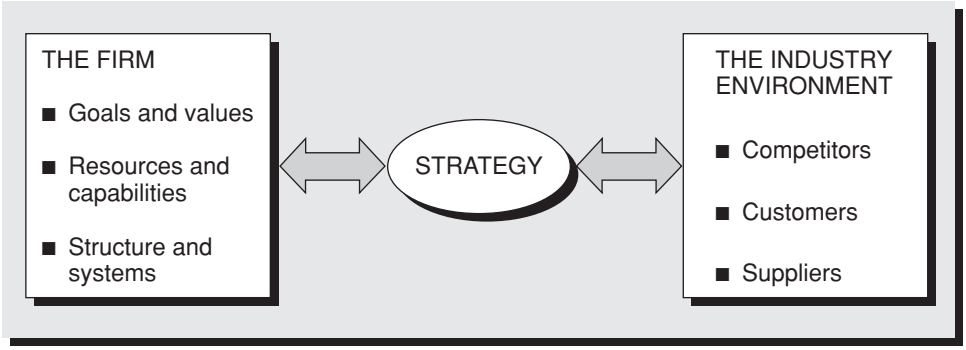
The answers to these three questions can help guide the key choices that we make in managing our careers and our lives.

- *Where do I belong?* Although some people have a mission to become a mathematician or a musician, most of us do not. We must progress first by identifying where we do not belong, and then by recognizing the types of opportunity that are fitted to our strengths, method of work, and values.
- *What should I contribute?* The degree of control we can exert over our own jobs has increased greatly over the years. How can I make a difference and what sort of difference do I want to make? How can I translate this into specific targets?
- *What kinds of relationships do I need?* Few of us work on our own, and the kinds of people we work with and how we relate to them have a huge impact on our own performance. Choosing the people we want to work with and managing our relationship with them requires that we need to know about our co-workers' strengths, values, and how they perform.

In the new knowledge economy, each of us becomes our own chief executive officer. As with any chief executive, doing the analysis is not enough. Knowing our strengths, our method of work, and our values is the starting point, but the key is to act on this knowledge.

Source: Peter F. Drucker, "Managing Oneself," *Harvard Business Review*, March–April 1999: 65–74.

FIGURE 1.2 The basic framework: strategy as a link between the firm and its environment



Beyond SWOT

Distinguishing between the external and the internal environment of the firm is common to most approaches to the design and evaluation of business strategies. One well-known approach is the SWOT framework: Strengths, Weaknesses, Opportunities, and Threats. This framework distinguishes between two features of the internal environment, strengths and weaknesses, and two features of the external environment, opportunities and threats. However, the SWOT framework is handicapped by difficulties in distinguishing strengths from weaknesses and opportunities from threats. For instance:

- Is Michael Eisner a strength or a weakness for Walt Disney Company? To the extent that he has masterminded Disney's revival over the past 17 years, he is an outstanding strength. Yet, his quadruple heart-bypass surgery and inability to implement a management succession plan suggest that he is also a weakness.
- Was the emergence of networked computing during the late 1990s a threat or an opportunity to Dell Computer? To the extent that computer networks shift computing power from PCs to servers, their expansion represented a threat to Dell's core business. However, while PCs have fallen in price and their margins have narrowed, so Dell moved strongly into servers (by mid-2000 it was US market leader), and it has simultaneously expanded into computer servers. It would seem, therefore, that computer networking represented both a threat and an opportunity for Dell.

The lesson here is that an arbitrary classification of external factors into opportunities and threats, and internal factors into strengths and weaknesses, is less important than a careful identification of these external and internal factors followed by an appraisal of their implications. Our approach to strategy analysis is therefore based on a simple two-way classification of *internal* and *external* factors. What will characterize our strategic appraisal will be the rigor and depth of our analysis of these

factors, rather than a superficial classification of whether they are strengths or weaknesses, and opportunities or threats.

Strategic Fit

At the same time, strategy analysis is not just about identifying and understanding the various characteristics of the firm's internal and external environment. Developing strategies and appraising strategy are all about seeing "the big picture" – looking at the firm as a whole within the context of its industry environment. Thus, central to our view of strategy as forming an interface between the firm and its environment is the concept of *strategic fit*. For a strategy to be successful, it must be consistent with the firm's goals and values, with its external environment, with its resources and capabilities, and with its organization and systems. Lack of consistency between the strategy pursued by a firm and its external and internal environments is a common source of failure. The difficulties faced by many companies when they expand into a foreign market – Laura Ashley in the US, Disney with EuroDisney, General Motors in Japan – typically result when a strategy that worked well in the home market is applied to the different circumstances of an overseas market. Failure to match a strategy to the resources and capabilities of the organization can be equally disastrous. What did the fast-growing Korean auto makers Daewoo and Kia have in common with the high-profile e-commerce startups eToys and WebVan? Both sets of companies were forced into bankruptcy by strategies that overstretched their limited resources.

A BRIEF HISTORY OF BUSINESS STRATEGY

Enterprises need business strategies for much the same reasons that armies need military strategies – to give direction and purpose, to deploy resources in the most effective manner, and to coordinate the stream of decisions being made by different members of the organization.

Origins and Military Antecedents

The concepts and theories of business strategy have their antecedents in military strategy. Indeed, the term *strategy* derives from the Greek word *strategia*, meaning "generalship," itself formed from *stratos*, meaning "army," and *-ag*, "to lead."[2] However, the concept did not originate with the Greeks: Sun Tzu's classic *The Art of War*, written about 500 BC, is regarded as the first treatise on strategy. The military associations with strategy are apparent from dictionary definitions (see Table 1.1).

Military strategy and business strategy share a number of common concepts and principles, the most basic being the distinction between strategy and tactics. *Strategy*

[2] Roger Evered, "So What Is Strategy?," *Long Range Planning* 16 no. 3 (June 1983): 57–72.

TABLE 1.1 Some Definitions of Strategy

- Strategy. The art of war, especially the planning of movements of troops and ships etc., into favorable positions; plan of action or policy in business or politics etc.
  —*Oxford Pocket Dictionary*
- The determination of the long-run goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.
  —Alfred Chandler, *Strategy and Structure* (Cambridge, MA: MIT Press, 1962)
- A strategy is the pattern or plan that integrates an organization's major goals, policies and action sequences into a cohesive whole. A well-formulated strategy helps marshal and allocate an organization's resources into a unique and viable posture based upon its relative internal competencies and shortcomings, anticipated changes in the environment, and contingent moves by intelligent opponents.
  —James Brian Quinn, *Strategies for Change: Logical Incrementalism* (Homewood, IL: Irwin, 1980)
- Strategy is the pattern of objectives, purposes, or goals and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be.
  —Kenneth Andrews, *The Concept of Corporate Strategy* (Homewood, IL: Irwin, 1971)
- What business strategy is all about is, in a word, *competitive advantage* . . . The sole purpose of strategic planning is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy thus implies an attempt to alter a company's strength relative to that of its competitors in the most efficient way.
  —Kenichi Ohmae, *The Mind of the Strategist* (Harmondsworth: Penguin Books, 1983)
- Lost Boy: "Injuns! Let's go get 'em!"
  John Darling: "Hold on a minute. First we must have a strategy."
  Lost Boy: "Uhh? What's a *strategy*?"
  John Darling: "It's, er . . . It's a plan of attack."
  —Walt Disney's *Peter Pan*

is the overall plan for deploying resources to establish a favorable position; a *tactic* is a scheme for a specific action. Whereas tactics are concerned with the maneuvers necessary to win battles, strategy is concerned with winning the war.[3] Strategic decisions, whether in the military or the business sphere, share three common characteristics:

- They are important.
- They involve a significant commitment of resources.
- They are not easily reversible.

[3] For a review of the concepts and principles of military strategy, see B. H. Liddell Hart, *Strategy* (New York: Praeger, 1968).

Many of the principles of military strategy have been applied to business situations. These include the relative strengths of offensive and defensive strategies; the merits of outflanking over frontal assault; the roles of graduated responses to aggressive initiatives; the benefits of surprise; and the potential for deception, envelopment, escalation, and attrition.[4] At the same time, the differences between business competition and military conflict must be recognized. The objective of war is (usually) to defeat the enemy. The purpose of business rivalry is seldom so aggressive: most business enterprises limit their competitive ambitions, seeking coexistence rather than the destruction of competitors.

The tendency for the principles of military and business strategy to develop as separate bodies of knowledge reflects the absence of a general theory of strategy. The publication of Von Neumann and Morgenstern's *Theory of Games* in 1944 gave rise to the hope that a general theory of competitive behavior would emerge. During the subsequent half-century, game theory revolutionized the study of competition and collaboration both between firms and within firms, and has been applied widely in military and political analysis.[5] Nevertheless, as we shall see in Chapters 3 and 4, despite offering striking conceptual insights into competition and bargaining, game theory has yet to fulfill its potential as a widely applicable and practical basis for strategy formulation by firms.[6]

From Corporate Planning to Strategic Management

The evolution of business strategy has been driven more by the practical needs of business than by the development of theory. The emergence of corporate planning was associated with the problems faced by managers during the 1950s and 1960s in coordinating decisions and maintaining control in increasingly large and complex enterprises. The development of financial budgeting procedures provided a basic control mechanism, but coordinating capital investment decisions required a longer planning horizon than the standard annual budgeting process. The emphasis on longer-term planning during the 1960s reflected concern with achieving coordination and consistency in investment planning during a period of stability and expansion. As companies sought to exploit the efficiencies of large size while controlling risks, so long-term planning based on economic and market forecasts became a central task of top management. The typical format was a

[4] On the links between military and business strategy, see Roger Evered, op. cit. For a survey, see Nigel Campbell, "Lanchester Market Structures: A Japanese Approach to the Analysis of Business Competition," *Strategic Management Journal* 7 (1986): 189–200.

[5] On the contribution of game theory to business strategy analysis, see Franklin M. Fisher, "Games Economists Play: A Noncooperative View," *RAND Journal of Economics* 20 (Spring 1989): 113–24; and Colin F. Camerer, "Does Strategy Research Need Game Theory?," *Strategic Management Journal* 12, Special Issue (Winter 1991): 137–52.

[6] For practical and accessible introductions to the application of game theory, see Thomas C. Schelling, *The Strategy of Conflict*, 2nd edn (Cambridge, MA: Harvard University Press, 1980); A. K. Dixit and B. J. Nalebuff, *Thinking Strategically: The Competitive Edge in Business, Politics, and Everyday Life* (New York: W. W. Norton, 1991); and A. Brandenburger and B. J. Nalebuff, *Co–opetition* (New York: Doubleday, 1996).

EXHIBIT 1.5 Corporate Planning in a Large US Steel Company, 1965

The first step in developing long-range plans was to forecast the product demand for future years. After calculating the tonnage needed in each sales district to provide the "target" fraction of the total forecast demand, the optimal production level for each area was determined. A computer program that incorporated the projected demand, existing production capacity, freight costs etc., was used for this purpose.

When the optimum production rate in each area was found, the additional facilities needed to produce the desired tonnage were specified. Then the capital costs for the necessary equipment, buildings, and layout were estimated by the Chief Engineer of the corporation and various district engineers. Alternative plans for achieving company goals were also developed for some areas, and investment proposals were formulated after considering the amount of available capital and the company debt policy. The Vice President who was responsible for long-range planning recommended certain plans to the President, and after the top executives and the Board of Directors reviewed alternative plans, they made the necessary decisions about future activities.

Source: Harold W. Henry, *Long Range Planning Processes in 45 Industrial Companies* (Englewood Cliffs, NJ: Prentice-Hall, 1967): 65.

five-year corporate planning document that set goals and objectives, forecast key economic trends (including market demand, the company's market share, revenue, costs, and margins), established priorities for different products and business areas of the firm, and allocated capital expenditures. In 1963, SRI found that the majority of the largest US companies had set up corporate planning departments.[7] Exhibit 1.5 provides an example of such formalized corporate planning. The diffusion of corporate planning was accelerated by a flood of articles and books addressing this new science.[8]

The primary emphasis of corporate planning during the 1960s and early 1970s was on the diversification strategies through which large corporations pursued growth and security. Igor Ansoff, widely recognized as one of the founding figures of the new discipline of corporate strategy, went as far as to define strategy in terms of diversification decisions:

> Strategic decisions are primarily concerned with external rather than internal problems of the firm and specifically with the selection of the product-mix that the firm will produce and the markets to which it will sell.[9]

[7] Frank F. Gilmore, *Formulation and Advocacy of Business Policy*, rev. edn (Ithaca, NY: Cornell University Press, 1970): 16.

[8] For example, during the late 1950s, a number of articles on corporate planning appeared in *Harvard Business Review*: D. W. Ewing, "Looking Around: Long-range Business Planning" (*Harvard Business Review*, July–August 1956): 135–46; B. Payne, "Steps in Long-range Planning," *Harvard Business Review* (March–April 1957): 95–101; W. J. Platt and N. R. Maines, "Pretest Your Long-range Plans," *Harvard Business Review* (January–February 1959): 119–27; H. E. Wrap, "Organization for Long-range Planning," *Harvard Business Review* (January–February 1957): 37–47.

[9] Igor Ansoff, *Corporate Strategy* (London: Penguin, 1985): 18.

The creation of corporate planning departments by the vast majority of large companies was part of a wider enthusiasm among both companies and governments for "scientific" techniques of decision making, including cost–benefit analysis, discounted cash flow appraisal, linear programming, econometric forecasting, and macroeconomic demand management. Many economists and social commentators argued that scientific decision making and rational planning by corporations and governments were superior to the haphazard workings of the market economy.[10]

During the 1970s, circumstances changed. Not only did diversification fail to deliver the anticipated synergies, but the oil shocks of 1974 and 1979 ushered in a new era of macroeconomic instability, combined with increased international competition from resurgent Japanese, European, and Southeast Asian firms. Faced with a more turbulent business environment, firms no longer had the ability to plan their investments, product introductions, market initiatives, and personnel requirements three to five years ahead, simply because they couldn't forecast that far into the future.

The result was a shift in emphasis from *planning* to *strategy making*, where the focus was less on the detailed management of companies' growth paths as on positioning the company in markets and in relation to competitors in order to maximize the potential for profit. This transition from *corporate planning* to what became termed *strategic management* was associated with increasing focus on competition as the central characteristic of the business environment and competitive advantage as the primary goal of strategy. As Bruce Henderson, founder of the Boston Consulting Group, observed:

> Strategy is a deliberate search for a plan of action that will develop a business's competitive advantage and compound it. For any company, the search is an iterative process that begins with a recognition of where you are now and what you have now. Your most dangerous competitors are those that are most like you. The differences between you and your competitors are the basis of your advantage. If you are in business and are self-supporting, you already have some kind of advantage, no matter how small or subtle . . . The objective is to enlarge the scope of your advantage, which can only happen at someone else's expense.[11]

This shift of attention toward strategy as a quest for performance focused attention on the sources of profitability. Initially (during the late 1970s and into the 1980s), the focus was on firms' external environments through the analysis of industry structure and competition. Michael Porter of Harvard Business School pioneered the application of industrial organization economics to analyzing the determinants of firm profitability.[12] Meanwhile, at the Boston Consulting Group, the determinants of profitability differences within industries were under investigation – their studies pointed to the critical role of market share and economies of experience.[13] These two lines of inquiry – industry themes and the cost advantages of market share –

[10] J. K. Galbraith was a leading advocate of the view that planning by large corporations closely linked with governments would supersede markets in allocating resources, see his *New Industrial State* (London: Penguin, 1968).

[11] Bruce D. Henderson, "The Origin of Strategy," *Harvard Business Review* (November–December 1989): 139–43.

[12] Michael E. Porter, *Competitive Strategy* (New York: Free Press, 1980).

[13] Boston Consulting Group, *Perspectives on Experience* (Boston: Boston Consulting Group, 1978).

were developed and empirically refined in the Strategic Planning Institute's PIMS (Profit Impact of Market Strategy) project.[14]

During the late 1980s and early 1990s, interest in the role of strategy in building competitive advantage resulted in a shift of interest toward the internal aspects of the firm. Developments in the resource-based view of the firm and organizational competencies and capabilities pointed to the firm's resources and capabilities as the primary source of its profitability and the basis for formulating its longer-term strategy.[15] This emphasis on the internal resources and capabilities of the firm represented a substantial shift in thinking about strategy. Prior to the 1990s, the emphasis of strategy was a quest for optimal positioning: companies needed to locate within the most attractive markets where they should seek to become market leaders. However, if all companies attempted to achieve market share leadership in the same sectors, the result would be a competitive bloodbath. The focus on internal resources and capabilities has emphasized the *differences* between companies and their need to exploit these differences in order to establish unique positions of competitive advantage. Michael Porter makes the point: "Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value."[16]

At the beginning of a new decade, the field continues its rapid evolution. Key theoretical developments include interest in the dynamics of competition through applying game theory and complexity theory to business,[17] probing the disruptive effects of technology,[18] diagnosis of the "new economy",[19] the strategic use of knowledge within the firm,[20] and the application of real options thinking to strategic choice.[21] At the practical level, companies continue to battle with the core dilemma of strategy formulation: how can companies take long-term decisions concerning new products, new technologies, and investments in physical and human capital when their business environments are changing at an ever accelerating pace? Resolving this dilemma calls for new approaches to strategy formulation and new tools of decision making.[22] As managers seek new strategies to exploit new sources of profitability, new approaches to strategy formulation that can generate strategic innovation, and new

[14] R. D. Buzzell and B. T. Gale, *The PIMS Principles* (New York: Free Press, 1987).

[15] R. M. Grant, "The Resource-based Theory of Competitive Advantage: Implications for Strategy Formulation," *California Management Review* 33 (Spring 1991): 114–35; D. J. Collis and C. Montgomery, "Competing on Resources: Strategy in the 1990s," *Harvard Business Review* (July–August 1995): 119–28.

[16] Michael E. Porter, "What is Strategy?," *Harvard Business Review* (November–December 1996): 64.

[17] On game theory, see A. K. Dixit and S. Skeat, *Games of Strategy* (New York: W. W. Norton, 1999); on chaos and complexity see S. Brown and K. Eisenhardt, *Competing on the Edge: Strategy as Structured Chaos* (Boston: Harvard Business School Press, 1998) and P. Anderson "Complexity Theory and Organization Science," *Organization Science* 10 (May–June 1999): 243–57.

[18] Clayton Christensen, *The Innovator's Dilemma* (Boston: Harvard Business School Press, 1997).

[19] Carl Shapiro and Hal R. Varian, *Information Rules* (Boston: Harvard Business School Press, 1998); Philip Evans and Thomas S. Wurster, *Blown to Bits: How the New Economics of Information Transformed Strategy* (Boston: Harvard Business School, 1999).

[20] G. Von Krogh, K. Ichijo and I. Nonaka, *Enabling Knowledge Creation* (New York: Oxford University Press, 2000).

[21] T. Copeland and V. Antikarov, *Real Options: A Practitioner's Guide* (Texere, 2001); E. S. Schwartz and L. Trigeorgis, *Real Options and Investment under Uncertainty: Classical Readings and Recent Contributions* (Cambridge: MIT Press, 2001).

[22] Gary Hamel, *Leading the Revolution* (Boston: Harvard Business School Press, 2000).

TABLE 1.2 The Evolution of Strategic Management

PERIOD	1950s	1960s	EARLY-MID 1970s	LATE 1970s AND EARLY 1980s	LATE 1980s AND EARLY 1990s	LATE 1990s AND EARLY 2000s
Dominant Theme	Budgetary planning and control	Corporate planning	Corporate strategy	Analysis of industry and competition	The quest for competitive advantage	Strategic innovation and the new economy
Main Issues	Financial control through operational and capital budgeting	Planning growth	Diversification and portfolio planning	Choice of industries, markets, and segments, and positioning within them	Sources of competitive advantage within the firm	Competitive advantage through strategic innovation Competing on knowledge Adapting to the new, digital, networked economy
Principal Concepts and Techniques	Financial budgeting Investment planning Project appraisal	Business forecasting Investment planning models	Synergy Strategic business units Portfolio planning matrices	Experience curve and returns to market share Analysis of industry structure Competitor analysis PIMS analysis	Resource analysis Analysis of core competencies	Organizational flexibility and speed of response Knowledge management and organizational learning Competing for standards Early-mover advantage
Organizational Implications	Financial management the key	Rise of corporate planning departments and medium-term formal planning	Diversification Multidivisional structures Quest for global market share	Greater industry and market selectivity Industry restructuring Active asset management	Corporate restructuring and business process reengineering Refocusing and outsourcing	The virtual organization The knowledge-based firm Alliances and networks The quest for critical mass

organizational forms capable of implementing these strategies, so we business school academics search for concepts and theories that can offer insight into these complex issues. Applications of evolutionary biology, cognitive psychology, complexity theory, options theory and fractal mathematics to the practical issues of strategy have resulted in this being one of the most intellectually exciting and fast-developing fields of business management.

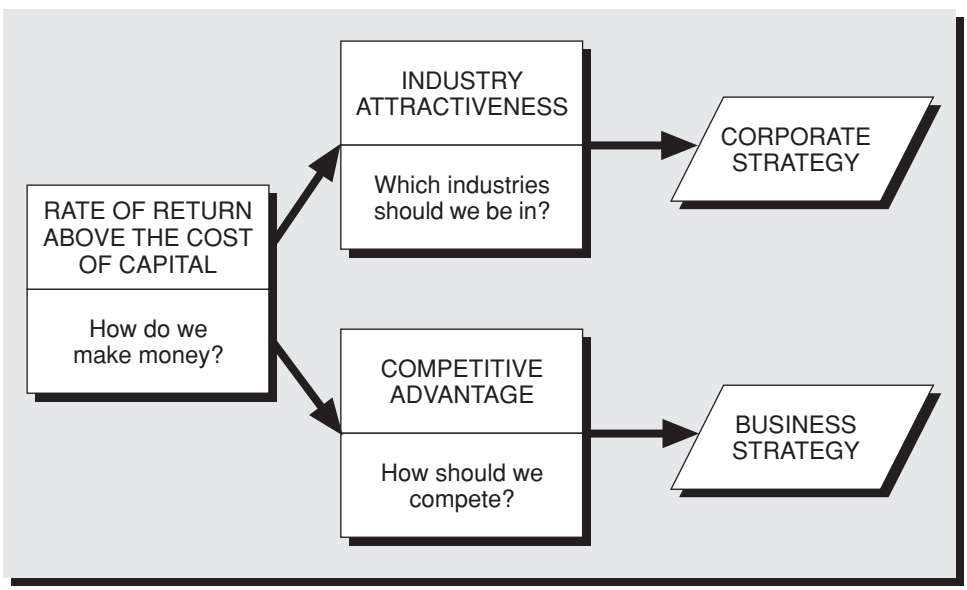
Table 1.2 summarizes the development of strategic management over time.

THE DISTINCTION BETWEEN CORPORATE AND BUSINESS STRATEGY

As the focus of strategic management has shifted from planning processes to the quest for profit, so the theoretical foundations of the field have been driven by analysis of the sources of profit and the factors that result in differences in profitability between firms. If we accept that the fundamental goal of the firm is to earn a return on its capital that exceeds the cost of that capital, what determines the ability of the firm to earn such a rate of return? There are two routes. First, the firm may locate in an industry where favorable conditions result in the industry earning a rate of return above the competitive level. Second, the firm may attain a position of advantage *vis-à-vis* its competitors within an industry, allowing it to earn a return in excess of the industry average (see Figure 1.3).

These two sources of superior performance define the two basic levels of strategy within an enterprise: corporate strategy and business strategy. *Corporate strategy* defines

FIGURE 1.3 The sources of superior profitability



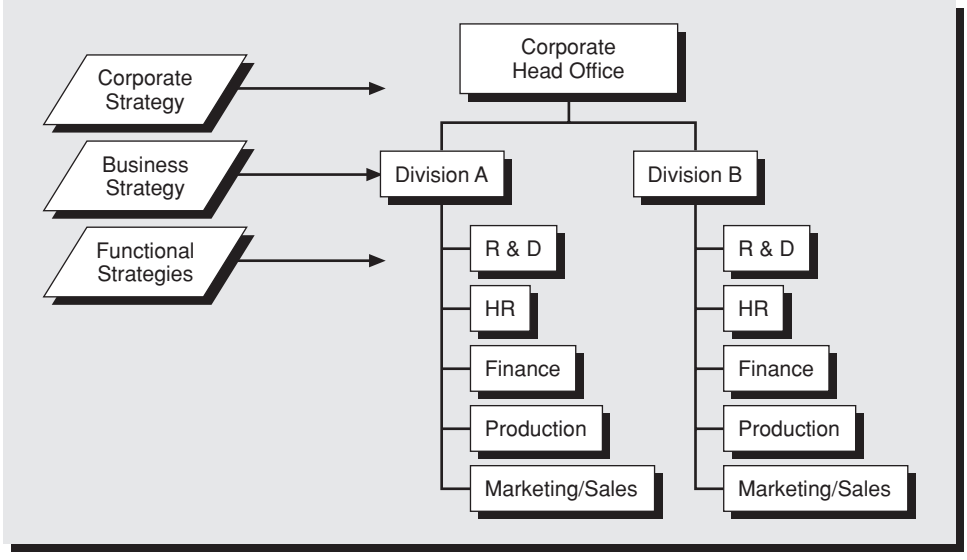
the scope of the firm in terms of the industries and markets in which it competes. Corporate strategy decisions include investment in diversification, vertical integration, acquisitions, and new ventures; the allocation of resources between the different businesses of the firm; and divestments.

Business strategy is concerned with how the firm competes within a particular industry or market. If the firm is to prosper within an industry, it must establish a competitive advantage over its rivals. Hence, this area of strategy is also referred to as *competitive strategy*. Using slightly different terminology, Jay Bourgeois has referred to corporate strategy as the task of *domain selection* and business strategy as the task of *domain navigation*.[23]

The distinction between corporate and business strategy and their connection to the two basic sources of profitability may be expressed in even simpler terms. The purpose and the content of a firm's strategy are defined by the answer to a single question: "How can the firm make money?" This question can be elaborated into two further questions: "What business or businesses should we be in?" And, within each business: "How should we compete?" The answer to the first question describes the corporate strategy of the company, the answer to the second describes the primary themes of business (or competitive) strategy.

The distinction between corporate strategy and business strategy corresponds to the organization structure of the typical multibusiness corporation. Corporate strategy is the responsibility of the top management team, supported by corporate strategy staff. Business strategy is formulated and implemented primarily by the individual businesses (typically organized as divisions or business units). Figure 1.4 also shows

FIGURE 1.4 Levels of strategy and organizational structure



[23] L. J. Bourgeois, "Strategy and the Environment: A Conceptual Integration," *Academy of Management Review* 5 (1980): 25–39.

a third level of strategy: functional strategy. *Functional strategies* are the elaboration and implementation of business strategies through individual functions such as production, R&D, marketing, human resources, and finance. They are primarily the responsibility of the functional departments. In single-business firms there is no distinction between corporate and business strategy.

The primary emphasis of this book is business rather than corporate strategy. This is justified by the conviction that the key to the success of an enterprise is establishing competitive advantage. Hence, from an analytical standpoint, issues of business strategy precede those of corporate strategy. Yet, these two dimensions of strategy are closely linked: the scope of a firm's business has implications for the sources of competitive advantage, whereas the nature of a firm's competitive advantage is relevant to the range of businesses and markets within which a firm can be successful.

DIFFERENT APPROACHES TO STRATEGY: *DESIGN* VERSUS *PROCESS*

As indicated by its title, the concern of this book is developing an analytical approach to strategic management. The implicit belief is that the senior managers of an organization are able objectively to appraise the enterprise and its environment, to formulate a strategy that maximizes the chances for success in an uncertain future, and to implement that strategy. The emphasis is the formulation of strategy, although, as we shall see, formulation and implementation cannot be separated: a well-formulated strategy must take account of the means by which it will be implemented, and it is through its implementation that a strategy is refined and reformulated.

How organizations formulate strategy has emerged as one of the main areas of debate within strategic management. What has become termed the "design school" of strategy views strategic decision making as a logical process, in which strategy is formulated through rational analysis of the firm, its performance, and the external environment. The strategy is then communicated to the organization and implemented down through successive organizational layers.

Such a picture is mostly a fiction: the real process is less structured, more diffused, and the dichotomization of formulation and implementation is less apparent. Consider the case of Madonna that we discussed earlier. It is doubtful whether Madonna ever formulated any explicit career strategy, even less likely that she wrote it down. She made up her strategy as she went along. What we are saying is that, as we look back on Madonna's career, we can see a consistency and direction in her decisions and actions that we can label "strategy." It is similar with most successful companies: Wal-Mart's brilliantly successful chain of discount stores based on its unique distribution system and small-town locations was not the result of grand design. It was the result of Sam Walton's hunch that discount stores could do well in small, rural towns, then finding that he needed to do his own distribution because manufacturers and wholesalers would not.

Studies by Henry Mintzberg and his colleagues at McGill University into the process of strategy making distinguish between intended, realized, and emergent

strategies. *Intended strategy* is strategy as conceived of by the top management team. Even here, rationality is limited and the intended strategy is the result of a process of negotiation, bargaining, and compromise, involving many individuals and groups within the organization. However, the *realized strategy* that we observe tends to be only about 10–30 percent of the intended strategy. The primary determinant of a firm's realized strategy is what Mintzberg terms *emergent strategy* – the patterns of decisions that emerge from individual managers adapting to changing external circumstances and the ways in which the intended strategy was interpreted.[24]

The case of Honda's successful entry into the US motorcycle market has provided a well-defined battleground for the two schools to debate.[25] According to the Boston Consulting Group, Honda exemplified the rational, analytic approach to strategy formation. US entry was part of Honda's strategy aimed at exploiting volume-based economies to attain an unassailable position of cost leadership in the world motorcycle industry.[26] However, Richard Pascale's interviews with the Honda managers in charge of US market entry revealed a different story.[27] The initial decision to enter the US market was based on little analysis and included no clear plan of how the company would build a market position. The outstanding success of the Honda 50cc Supercub was a surprise to the company; Honda had believed that its main opportunities lay with its larger bikes. As Mintzberg observes: "Brilliant as its strategy may have looked after the fact, Honda's managers made almost every conceivable mistake until the market finally hit them over the head with the right formula."[28]

The debate over the Honda story and its implications continues.[29] The key point, however, is not whether it is the "design school" or the "process school" that is right, but recognizing that different approaches are suited to answering different questions. The "process school" of strategy research focuses on the realities of how strategies emerge. The central issues are the means by which strategic decisions are made in practice. The "design school" is normative: its goal is to uncover the factors that determine success to provide managers with the analytic tools needed to develop performance-enhancing strategies.

However, Henry Mintzberg goes further: not only is rational design an inaccurate account of how strategies are actually formulated, it is a poor way of making strategy. "The notion that strategy is something that should happen way up there, far removed from the details of running an organization on a daily basis, is one of the great fallacies of conventional strategic management." The problem is that a

[24] See Henry Mintzberg, "Patterns of Strategy Formulation," *Management Science* 24 (1978): 934–48; "Of Strategies: Deliberate and Emergent," *Strategic Management Journal* 6 (1985): 257–72; and *Mintzberg on Management: Inside Our Strange World of Organizations* (New York: Free Press, 1988).

[25] The two views of Honda are captured in two Harvard cases: *Honda [A]* (Boston: Harvard Business School, Case 384049, 1989) and *Honda [B]* (Boston: Harvard Business School, Case 384050, 1989).

[26] Boston Consulting Group, *Strategy Alternatives for the British Motorcycle Industry* (London: Her Majesty's Stationery Office, 1975).

[27] Richard T. Pascale, "Perspective on Strategy: The Real Story Behind Honda's Success," *California Management Review* 26, no. 3 (Spring 1984): 47–72.

[28] Henry Mintzberg, "Crafting Strategy," *Harvard Business Review* 65 (July–August 1987): 70.

[29] Henry Mintzberg, Richard T. Pascale, M. Goold, and Richard P. Rumelt, "The Honda Effect Revisited," *California Management Review* 38 (Summer 1996): 78–117.

divide between formulation and implementation precludes learning. In practice, the two must go hand in hand, with strategy constantly being adjusted and revised in light of experience. Mintzberg argues that strategy development is more about *crafting* than *planning*:

> *Crafting* strategy . . . is not so much [about] thinking and reason as involvement, a feeling of intimacy and harmony with the materials at hand, developed through long experience and commitment. Formulation and implementation merge into a fluid process of learning through which creative strategies emerge.[30]

The approach of this book is to follow a rationalist, analytic approach to strategy formulation in preference to the crafting approach advocated by Mintzberg. This is not because planning is necessarily superior to crafting – we have already noted that strategy is about identity and direction rather than planning. Nor is it because we wish to downplay the role of skill, dedication, involvement, harmony, or creativity. These qualities are essential ingredients of successful strategies and successful enterprises. Strategy development is a multidimensional process that must involve both rational analysis and intuition, experience, and emotion. Nevertheless, whether strategy formulation is formal or informal, whether strategies are deliberate or emergent, there can be little doubt as to the importance of systematic analysis as a vital input into the strategy process. Without analysis, the process of strategy formulation, particularly at the senior management level, is likely to be chaotic, with no basis for comparing and evaluating alternatives. Moreover, critical decisions become susceptible to the whims and preferences of individual managers, to contemporary fads, and to wishful thinking. Concepts, theories, and analytic frameworks are not alternatives or substitutes for experience, commitment, and creativity. But they do provide useful frames for organizing and assessing the vast amount of information available on the firm and its environment and for guiding decisions, and may even act to stimulate rather than repress creativity and innovation.

Central to the rational approach to strategy analysis is the idea that we can systematically analyze the reasons for business success and failure and apply this learning to formulating business strategies. The problem of the rationalist approach, as emphasized in Mintzberg's attacks on strategic planning, is that the analysis is too narrow – it has tended to be overformalized and has emphasized quantitative over qualitative data.[31] The danger of the Mintzberg approach is that by downplaying the role of systematic analysis and emphasizing the role of intuition and vision, we move into a world of new-age mysticism in which there is no clear basis for reasoned choices and in which disorder threatens the progressive accumulation of knowledge.

The goal of this book is to promote analysis that is sound, relevant, and applicable. If strategy analysis does not take account of experiential learning and the practicalities of implementation, it is poor analysis. Similarly, the process of strategy formulation must involve intuition, reflection, and the interaction between thought

[30] Henry Mintzberg, "Crafting Strategy," *Harvard Business Review* 65 (July–August 1987): 66.

[31] Henry Mintzberg, "The Rise and Fall of Strategic Planning," *Harvard Business Review* (January–February 1994): 107–14.

and action. Good analysis should encourage the development of intuition and promote creativity. Analysis can also greatly facilitate the process of strategy formulation. It provides a conceptual framework for rational discussion of alternative ideas and a vocabulary for communicating the strategy throughout the organization.

THE DIFFERENT ROLES OF STRATEGY WITHIN THE FIRM

An important realization that emerges from this discussion of strategy making as a decision-making process is a recognition that strategic management fulfills multiple roles within the organization. We can view strategy as a vehicle for achieving three key managerial purposes.

Strategy as Decision Support

At the outset of this chapter, we identified strategy as a key element in success. But why is this so? Strategy is a pattern or theme that gives coherence to the decisions of an individual or organization. But why can't individuals or organizations make optimal decisions in the absence of such a unifying theme? Consider the 1997 "man-versus-computer" chess epic in which Gary Kasparov was defeated by IBM's "Deep Blue." Deep Blue did not need strategy. Because of its phenomenal memory capacity and computing power, it could identify its optimal moves based on a huge decision tree that computed the implications of every possible move. Kasparov, in contrast, was subject to the cognitive limitations that constrain all human beings. *Bounded rationality* – decision making that is intentionally rational, but is constrained by human beings' limited search and information-processing capacity – creates the need for a strategy to establish a set of guidelines and criteria for how individual decisions will be made.[32]

Even in the smallest enterprise, many hundreds of decisions are likely to be made every day. Decisions range from whether to give a discount to a particular customer, to the choice of sending mail by express or regular delivery. It is not possible or desirable to optimize every single decision by considering the full implications of every permutation of decision choices. In these circumstances, strategies such as "We will seek technological leadership in military applications of wireless communication," or "We shall provide the lowest-priced gasoline in Ohio" simplify decision making by *constraining* the range of decision alternatives considered, and by acting as a *heuristic* – a rule of thumb that reduces the search required to find an acceptable solution to a decision problem.

The benefit of strategy is not just offering simplification and consistency to decision making; the identification of strategy as the commonality and unity of all the

[32] The concept of bounded rationality was developed by Herbert Simon and James March: J. G. March and H. A. Simon, *Organizations* (New York: Wiley, 1956); J. G. March, "Bounded Rationality, Ambiguity and the Engineering of Choice," *Bell Journal of Economics* 9 (1978): 587–608.

enterprise's decisions also permits the application of powerful analytic tools to help companies create and redirect their strategies. The tools of performance appraisal, industry analysis, and resource analysis with which you will become familiar as you work through the first few chapters of this book will result in your designing better strategies that will result in better decisions, and improved performance.

Strategy as a Process for Coordinating and Communicating

So, strategy helps achieve consistency in decisions. One aspect of this is consistency over time – strategy can help the firm establish long-term direction in its development and behavior. Equally important, a strategy serves as a vehicle for achieving consistent decision making across different departments and individuals. Organizations are composed of many individuals – 388,000 in the case of General Motors – all of whom are engaged in making decisions that must be coordinated.

For strategy to provide such coordination requires that the strategy process acts as a communication mechanism within the firm. Such a role is increasingly recognized in the strategic planning processes of large companies. The shift of responsibility of strategic planning from corporate planning departments to line managers, and the increased emphasis on discussion between the businesses and the corporate headquarters (as opposed to the formal approval of written plans), are part of this increased emphasis on strategic planning as a process for achieving coordination and consensus within companies.[33] Increasingly, strategic planning processes are becoming part of companies' *knowledge management* systems: as management becomes more and more concerned with how companies create, store, transfer, and deploy knowledge assets, so strategic planning becomes an integral part of how deeply embedded understanding of businesses and their environments is transferred between business units, divisional, and corporate levels, and how the knowledge of many different managers and functional experts becomes integrated within strategy.

Strategy as Target

Strategy is forward looking. A fundamental concern is what the firm (or the individual or the organization more generally) wants to be in the future. Such a view is often made explicit in a statement of company *vision*. The purpose of such goal setting is not just to establish a direction to guide the formulation of strategy, but also to set aspirations for the company that can create the motivation for outstanding

[33] Studies of strategic planning that identify these trends include: R. M. Grant, "Strategic Planning Among Large Corporations: Evidence from the Oil Sector," working paper (McDonough School of Business, Georgetown University, 1999); I. Wilson, "Strategic Planning Isn't Dead – It Changed", *Long Range Planning* 27, no. 4 (1994): 12–24. See also the changes in General Electric's strategic planning system: R. Slater, *Jack Welch and the GE Way* (New York: McGraw Hill, 1999), "General Electric: The Jack Welch Era, 1981–1998," in R. M. Grant and K. E. Neupert, *Cases in Contemporary Strategy Analysis* (Oxford: Blackwell, 1999).

EXHIBIT 1.6 Coca-Cola's Project Infinity

Coca-Cola has 43 percent of the US market for carbonated soft drinks. In the United States Coca-Cola products are sold through 2 million stores, 450,000 restaurants, and 1.4 million vending machines. A dominant player with limited growth prospects? Not according to Chairman Roberto Goizueta, who calculated Coca-Cola's market share as 3 percent. Why the discrepancy? Goizueta identifies the relevant market as the human race's total consumption of fluids. The purpose of Project Infinity is to galvanize the company into exploiting its infinite opportunities for market growth.

How will this ambitious goal be translated into sales? Rather than looking at Coke's overall share of the US and world market, the company will break down its market share data to identify discrepancies in market share between countries, localities, and specific outlets. In Bismarck, North Dakota, consumption per person averages 566 eight-ounce servings each year; in nearby Jamestown, consumption is only 314. In Memphis, Tennessee, consumption per head is 50 percent higher than in nearby Hot Springs, Arkansas.

Standing in a shopping center in Atlanta, Jack Stahl, head of Coke's US operations, can see a grocery store, three restaurants, and three vending machines, all of which sell Coke. Saturated market? No, a "microcosm of opportunity," says Stahl. "Nearby apartment buildings and office complexes could support more vending machines. I bet 150 people come into that hair salon each day – why shouldn't it sell Coke?"

Source: "A Coke and a Perm?," *Wall Street Journal*, May 8, 1997: A1.

performance. Hamel and Prahalad argue that a critical ingredient in the strategies of outstandingly successful companies is what they term "strategic intent" – an obsession with achieving leadership within the field of endeavor.[34] Examples of organizational strategic intent include the goal of the Apollo program "To put a man on the moon by the end of the decade," McDonald's pronouncement that "Our vision is to dominate the global food service industry," Komatsu's intent to "Encircle Caterpillar," and Coca-Cola's "Project Infinity" (see Exhibit 1.6). A similar point was made by James Collins and Jerry Porras in their book *Built to Last*.[35] A common feature of US companies that were preeminent in their sectors for 50 years or more, such as Merck, Walt Disney, 3M, IBM, and Ford, was the presence of "Big, Hairy, Ambitious Goals" that generated long-term commitment and drive at all levels of the companies. Sir Brian Pitman, chairman of Lloyds TSB, Britain's most profitable retail bank, argues:

> A big benefit to be derived from setting ambitious goals is that the status quo is never enough. The challenge itself brings forth new ideas and new excitement. It encourages out-of-the-box thinking.[36]

[34] Gary Hamel and C. K. Prahalad, "Strategic Intent," *Harvard Business Review* (May–June 1989): 63–77.

[35] J. C. Collins and J. I. Porras, *Built to Last: Successful Habits of Visionary Companies* (New York: HarperCollins, 1995).

[36] Sir Brian Pitman, "In My Opinion," *Management Today* (June 2000): 14.

Hamel and Prahalad extend their argument further. In a dynamic environment, the conventional approach to strategy formulation, which emphasizes the fit between internal resources and external opportunities, may be insufficient to drive long-run competitiveness. Critical to the success of upstart companies such as CNN in television, Apple in computers, Yamaha in pianos, and Southwest Airlines and Virgin Atlantic in air travel was a mismatch between resources and aspirations, in which unreasonable ambition became the driving force for innovation, risk taking, and continuous improvement. In place of *strategic fit* and *resource allocation*, Hamel and Prahalad emphasize *stretch* and *resource leverage*.[37] What we seem to be observing here is conflict between a firm's resource strength and the commitment and the intensity with which it implements its strategy. Resource scarcity may engender ambition, innovation, and a "success-against-the-odds" culture, while resource abundance may engender complacency and sloth.

THE ROLE OF ANALYSIS IN STRATEGY FORMULATION

Recognition of the multiplicity of purposes that a company's strategy fulfills – and, in particular, strategy's role in communicating purpose and setting aspirations – raises further questions about the analytical approach to strategy. Ever since Abernathy and Hayes identified "modern management techniques" as instrumental in American firms' declining international competitiveness in many sectors,[38] analytical approaches to management have been castigated for being static, conservative, risk averse, inflexible, short term, and detrimental to innovation.

The purpose of this book is not to defend conventional approaches to business strategy analysis, but to do better. Management's approach to strategy must be dynamic, flexible, and innovative. It must recognize the powerful role that values and goals play in organizations, and the importance of the strategy process in facilitating communication and coordination. It must recognize the importance of intuition, tacit knowledge, and learning-by-doing in complementing more "scientific" analysis.

It is vital that we recognize the limitations of analysis in guiding strategic management. Unlike mathematics, chemistry, or even economics, strategic management lacks an agreed, internally consistent, empirically validated body of theory. Though it employs theory and theoretical concepts, these are drawn mainly from economics, psychology, ecology and sociology, principally on an *ad hoc* basis. Even as applied science, strategic management differs substantially from more technically oriented managerial disciplines such as finance and production management. Strategy analysis does not generate solutions in the same way that scheduling algorithms or discounted cash flow analysis or the sampling frameworks of market research provide. A major feature of the techniques introduced in this book is that they do not provide solutions. Just as strategic decisions in our personal lives are not amenable to

[37] Gary Hamel and C. K. Prahalad, "Strategy as Stretch and Leverage," *Harvard Business Review* (March–April 1993): 75–84.

[38] W. J. Abernathy and R. H. Hayes, "Managing Our Way to Economic Decline," *Harvard Business Review* (July–August 1980): 67–77.

quantitative decision techniques (Should I get married? Have children? Change my career from bond trading to brain surgery? Move to a new location?), the same is true in business. There are simply too many variables to reduce strategy analysis to programmed algorithms.

The purpose of strategy analysis is not to provide answers but to help us understand the issues. Many of the analytic techniques introduced in this book are simply frameworks to identify, classify, and understand the principal factors that influence strategic decisions. Such frameworks are invaluable in understanding the complexities of strategy decisions: the infinite richness of the firm's environment and the tangle of people, resources, structures, and traditions that make up the business enterprise. In some instances, the most useful contribution may be in assisting us to make a start on the problem: by guiding us to the questions we need to answer, and by providing a framework for organizing the information gathered, we are in a superior position to a manager who relies exclusively on experience and intuition. Finally, analytic frameworks and techniques can improve our flexibility as managers. The analysis in this book is general in its applicability; it is not specific to particular industries, companies, or situations. Hence, it can help increase our confidence and effectiveness in understanding and responding to new situations and new circumstances. By encouraging depth of understanding in fundamental issues concerning competitive advantage, customer needs, organizational capabilities, and the basis of competition, the concepts, frameworks, and techniques in this book will encourage rather than constrain innovation, flexibility, and opportunism.

SUMMARY

This chapter has covered a great deal of ground. We have introduced the concept of strategy, explained its role in success, traced its development over time, and examined its purposes and limitations.

The fundamental premise of this chapter is that strategy is an important determinant of success in most areas of human activity. In identifying some common features of successful strategies, we have presented a framework for studying strategic choices that views strategy as a link between an organization and its environment.

In Part II, we examine each of the separate components of this framework: goals, values, and performance; the industry environment; the resources and capabilities of the firm; organization structure; and management systems. These chapters comprise the basic tools of strategy analysis. We then deploy these tools in the analysis of competitive advantage (Part III), in the formulation and implementation of business strategies in different industry contexts (Part IV), and then in the development of corporate strategy (Part V). Figure 1.5 shows the framework for the book.

FIGURE 1.5 The framework for the book

I INTRODUCTION

Chapter 1 The Concept of Strategy

II TOOLS OF STRATEGY ANALYSIS

Analysis of Industry and Competition Chapter 3 Analyzing the Industry Environment Chapter 4 Intra-Industry Analysis	*Analysis of the Firm* Chapter 2 Goals, Values, and Performance Chapter 5 Analyzing Resources and Capabilities Chapter 6 Organization Structure and Management Systems

III THE ANALYSIS OF COMPETITIVE ADVANTAGE

Chapter 7 The Nature and Sources of Competitive Advantage	
Chapter 8 Cost Advantage	Chapter 9 Differentiation Advantage

IV BUSINESS STRATEGIES IN DIFFERENT INDUSTRY CONTEXTS

Chapter 10 Industry Evolution	Chapter 11 Technology-based Industries and the Management of Innovation	Chapter 12 Competitive Advantage in Mature Industries

V CORPORATE STRATEGY

Chapter 13 Vertical Integration and the Scope of the Firm	Chapter 14 Global Strategies and the Multinational Corporation	Chapter 15 Diversification Strategy
Chapter 16 Managing the Multibusiness Corporation	Chapter 17 Current Trends in Strategic Management	