I

Introduction

1 The Concept of Strategy

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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**

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INTRODUCTION AND OBJECTIVES

Strategy is about winning. This chapter explains what strategy is and investigates its role in success – both for organizations and individuals. Although our primary concern will be business, we shall also note the critical importance of strategy in other fields of human endeavor, including warfare, entertainment, politics, and sport. We will 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 shall 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:

- Appreciate the contribution that strategy can make to successful performance, both for individuals and for organizations.
- Understand the basic analytical framework that underlies this book where the two fundamental components of strategy analysis are the analysis of the external environment (primarily industry analysis) and the analysis of the internal environment (primarily the analysis of the firm's resources and capabilities).
- Understand the major trends in the development of business strategy over the past 40 years.
- Recognize the multiple roles that strategic management plays within organizations.

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

Strategy Capsules 1.1, 1.2, and 1.3 outline examples of success in three very different arenas: Madonna in popular entertainment, General Giap and the North Vietnamese armed forces in warfare, and the Williams sisters in tennis. Can the success of these diverse individuals and the organizations they led be attributed to any common factors?

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

- Madonna possesses vitality, intelligence, and tremendous energy, 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.
- Masterminding the incredible success of Venus and Serena Williams on the world tennis circuit during 2000–03 was manager, coach and father, Richard Williams. Brought up in an impoverished, single-parent family, Williams had no prior experience of either coaching or playing tennis.

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 a keen awareness of how to maneuver into a position of advantage.

1. Underpinning Madonna's two decades as a superstar has been a strategy built upon dedication, opportunism, periodic reinvention of image and product offerings, and a well-coordinated multimarket presence.
2. 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.

STRATEGY CAPSULE 1.1 Madonna

Summer 2003 saw little sign of any slowdown in the career of 44-year-old Madonna Louise Veronica Ciccone. During May, her tenth album, *American Life*, topped the Billboard charts. A deal with GAP to promote their clothing also involved Gap distributing Madonna's first children's book, *The English Roses.* Meanwhile, at her music and film production company, Maverick, her list of projects and stable of recording artists continued to grow. Twenty years after her first hit album, Madonna was still the world's highest earning female entertainer and one of the best-known women on the planet.

In the summer of 1978, aged 19, Madonna arrived in New York with $35 to her name. After five years of struggle, she landed a recording contract. *Madonna* (1983) ultimately sold 10 million copies worldwide, while *Like a Virgin* (1984) 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 web site proclaims, she is "icon, artist, provocateur, diva, and mogul." She has also made a great deal of money.

What is the basis of Madonna's incredible and lasting success? Certainly not outstanding natural talent. As a vocalist, musician, dancer, songwriter, or actress, Madonna's talents seem modest. Few would regard her as an outstanding beauty.

She possesses relentless drive. 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 incessantly to establish, 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."

She has drawn heavily on the talents of others: writers, musicians, choreographers, and designers. Many of her personal relationships have been stepping stones to career transitions. Her transition from dance to music was assisted by relationships, first, with musician Steve Bray, then with disc jockey John Benitex. Her entry into Hollywood was accompanied by marriage to Sean Penn and an affair with Warren Beatty. Most striking has been her continuous reinvention of her image. From street-kid look of the early 1980s, to hard-core sexuality of the 90s, and spiritual image that accompanied motherhood, Madonna's fans have been treated with multiple reincarnations. As Jeff Katzenberg of Dreamworks 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."

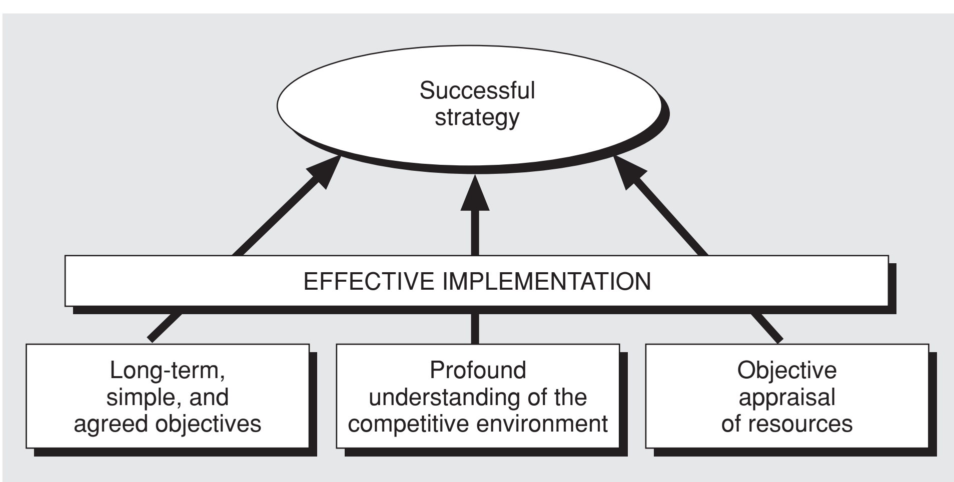
She was quick to learn the ropes both in Tin Pan Alley and in Hollywood. Like Evita Perón, whom Madonna portrayed in *Evita*, Madonna has combined determination, ambition, social astuteness, and mastery of the strategic use of sex. As a self-publicist she is without equal. In using sex as a marketing tool, she has courted controversy through nudity, pornographic imagery, suggestions of sexual deviance, and the juxtaposition of sexual and religious themes. But she is also astute at walking the fine line between the shocking and the unacceptable. In recent years Madonna has devoted increasing time to nurturing the talents of others, mainly through her recording, film production, and management company, Maverick Inc., a joint venture with Time Warner. Her protégés included Mirwais, William Orbit, Donna De Lory, and the Deftones, and the comedian Ali G: "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."

3. The Williams sisters' domination of women's tennis was the fulfillment of a strategy formulated by their father, Richard Williams, even before the two girls were born. The strategy was built upon systematic development of playing skills and physical strength, the fostering of drive and psychological resilience, and establishing a family environment that provided competition, discipline, and support.

We can go further. What do these examples tell us about the characteristics of a strategy that are conducive to success? In all three stories, four common factors stand out (see 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?

FIGURE 1.1 Common elements in successful strategies



STRATEGY CAPSULE 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. In 1954, Giap's brilliant victory over the French at Dien Bien Phu fully vindicated the strategy. Against South Vietnam and its US ally, the approach was similar.

> 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.[2]

The strategy built on the one resource where the communists had overwhelming superiority: their will to fight. 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."[3] 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 who was the enemy and 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 premature in launching his general offensive. Both the 1968 Tet Offensive and 1972 Easter Offensive were beaten back with heavy losses. By 1974, Giap 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.

Sources: [1] Col. Harry G. Summers Jr., *On Strategy* (Novato, CA: Presidio Press, 1982): 1; [2] Vo Nguyen Giap, *Selected Writings* (Hanoi: Foreign Language Publishing House, 1977); [3] J. Cameron, *Here Is Your Enemy* (New York: Holt, Rinehart, Winston, 1966).

   - Richard Williams is a remarkable example of focused parenting – unlike parents who set goals for their children, Williams had children in order to fulfill a specific goal.

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. Most important was appreciation of the political predicament of US presidents in their need for popular support in waging a foreign war.
   - Richard Williams is an astute observer of the world of professional tennis in terms of recognizing both the physical and mental qualities of world-ranked players.

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 grooming Venus and Serena for tennis greatness, Richard Williams has taken careful account of their different physical characteristics as well as their separate vulnerabilities and psychological needs.

4. *Effective implementation.* Without effective implementation, the best-laid strategies are of little use. Critical to the success of Madonna, Giap, and Williams 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

STRATEGY CAPSULE 1.3 Williams & Daughters

Between 2000 and 2003, Venus and Serena Williams dominated women's tennis. The Williams v. Williams Wimbledon final of 2000 inaugurated an era of sibling dominance: in 2002 and 2003, both Wimbledon and the US Open featured all-Williams finals. The sisters were even more remarkable given their race and socio-economic background. Black tennis champions are rare, where the typical breeding grounds of world-class players tend to be suburbs and country clubs rather than the inner city.

The architect of the sisters' success in professional tennis was father, Richard Williams. Born in Shreveport, Louisiana to an impoverished single mother, Williams was determined to better himself. By the mid-1970s, he ran a small security business and lived with his wife and four children in Compton, Los Angeles. His vision is now part of sporting mythology:

> Once upon a time a poor black man (his name is Richard) and his wife (her name is Oracene) got married and settled down in South Central L.A. One day Richard is idly watching tennis on TV when prize money figures are displayed. He turns to Oracene and says, "Honey, let's have two kids. They'll be daughters, and I'll raise them to be tennis superstars and millionaires. Life will be good." Oracene, a little more practical than her husband, says, "Richard, you've never owned a tennis racquet. I know dammed well you've never played tennis." But Richard says, "Not to worry baby. How hard can it be? You hit a little ball into a big green square."

Venus Williams was born on June 17, 1980; Serena followed her 14 months later. Surrounding himself with tennis books and videos, Richard Williams began planning the girls' development. "There was a plan from two years before Venus was actually born as to how I would raise my kids with the help of my wife – their education, their food and most of all their tennis. I'm the master planner, no-one is going to outplan me." At the age of four, Venus began tennis lessons in the public courts coached by Richard. In the following year, Serena joined them. Richard's approach to coaching was both comprehensive and unorthodox:

- He bought used tennis balls for 10 cents each. He reasoned that poorly bouncing balls would require his girls to be faster across court.
- Wondering why men's tennis services were so much stronger than women's, he hypothesized that girls are not so used to throwing things as boys. On this basis, he encouraged Venus and Serena to throw their tennis racquet as far as they could.
- He had the sisters working on a punchbag to develop the girls' strength, hand-eye coordination, and footwork.
- He made the girls use baseball bats to return tennis balls – "it develops accuracy and swing."
- During laborious training sessions the girls would work on improving their accuracy by hitting balls repeatedly at fixed markers.

Above all, Father Williams worked on developing commitment, attitude, and psychological resilience. He was dedicated to developing his daughters as winners – "They are champions in art, in education, in designing their clothes, in helping underprivileged kids – as well as champions in tennis." He would place large signs around the house and garden: "Venus, you must take control of your future!" "Venus, when you fail, you fail alone!" "Serena, you must learn to

STRATEGY CAPSULE 1.3 (*cont'd*)

listen." He was well aware of the dangers of early burnout. While focusing on tennis, he encouraged his girls to participate in track, basketball, ice-skating and, most of all, their schoolwork. In 1991, he pulled both girls out of the national junior circuit – the usual path to stardom for young tennis players – in order to alleviate outside pressure on them.

He trained them too in other aspects of championship tennis. When they were 4 and 5, he bought a video camera and began media training them. As soon as they became professional, they became involved in clothes design, sponsorship, and public service activities. By the time Venus won her first US Open title at the age of 17, the girls were well prepared for the role of tennis champions.

Sources: Douglas S. Looney, "Venus Rising," *Christian Science Monitor*, May 22, 1998; Terry Jervis, *Raising Tennis Aces: The Williams Story* (DVD distributed by Xenon Pictures, 2002).

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 44 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. Similar points have been made by management guru, Peter Drucker, in his advice on how to be the CEO of our own careers.[1]

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 reached the pinnacles of 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 Joseph Stalin in politics, Marilyn Monroe and Elvis Presley in entertainment, Joe Louis and O. J. Simpson in sport, and Bobby Fischer in chess. Fulfillment in our personal lives is likely to require broad-based lifetime strategies.[2]

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.[3]

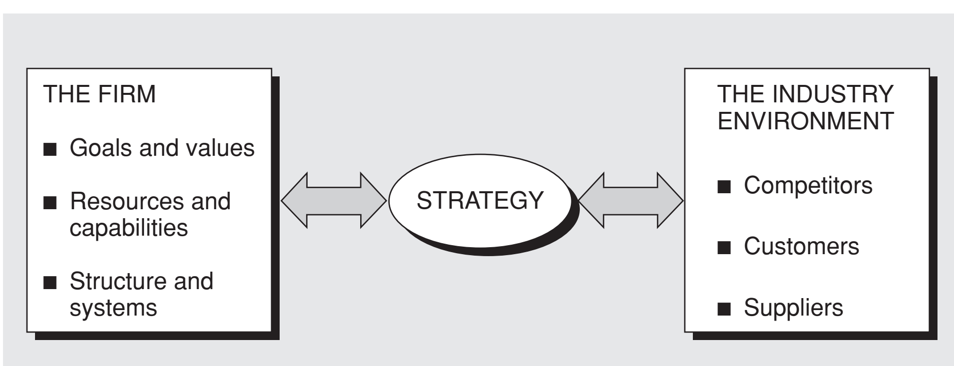
THE BASIC FRAMEWORK FOR STRATEGY ANALYSIS

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

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



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.

What's Wrong With SWOT?

Distinguishing between the external and the internal environment of the firm is common to most approaches to strategy analysis. The best known and most widely used of these approaches is the "SWOT" framework which classifies the various influences on a firm's strategy into four categories: Strengths, Weaknesses, Opportunities, and Threats. The first two – strengths and weaknesses – relate to the internal environment; the last two – opportunities and threats – relate to the external environment.

Which is better, a two-way distinction between internal and external influences or the four-way SWOT taxonomy? The key issue is whether it is sensible and worthwhile to classify internal factors into strengths and weaknesses and external factors into opportunities and threats. In practice, such distinctions are difficult:

- Is BMW's German home base a strength or a weakness for BMW? Its German origins are fundamental for its reputation for engineering excellence and the skills of its German based engineers and technicians are essential to its claim to be the "world's ultimate driving machine." At the same time, Germany is a high cost country with an inflexible labor market and is subject to a plethora of European Union regulations. Hence, BMW's German home base is both a strength and a weakness.
- Is the opening of Iraq's oil sector a threat or an opportunity to American petroleum majors such as Exxon Mobil and ChevronTexaco? Iraq offers opportunities for profitable investment. At the same time, its potential to massively expand its supplies of crude represents a threat to world oil prices.

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. My approach to strategy analysis favors 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 categorization into strengths or weaknesses, and opportunities or threats.

Strategic Fit

Fundamental to this view of strategy as a link between the firm and its external environment is the notion of *strategic fit*. For a strategy to be successful, it must be consistent with the characteristics of the firm's external environment, and with the characteristics of the firm's internal environment – its goals and values, resources and capabilities, and structure and systems. As we shall see, the failure of many companies is caused by lack of consistency with either the internal or external environment. The difficulties experienced by Marks & Spencer, the British retail giant, since 1998 were primarily the result of lack of fit between strategy and the needs of the external environment. Overseas, M&S was applying strategies that had succeeded at home in very different market circumstances. In Britain, M&S had failed to respond to shifting consumer preferences and new approaches to sourcing and supply chain management. In other cases, many companies have failed to align their strategies to their internal resources and capabilities – the downfall of telecom companies such as WorldCom and Global Crossing and multimedia conglomerates such as Vivendi Universal and Kirsch Group was due primarily to strategies that overextended the companies beyond the limits of their financial resources and management capabilities.

A Brief History of Business Strategy

Origins and Military Antecedents

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 decisions made by different individuals. Indeed, the concepts and theories of business strategy have their antecedents in military strategy. The term *strategy* derives from the Greek word *strategia*, meaning "generalship," itself formed from *stratos*, meaning "army," and *-ag*, "to lead."[4] However, the concept of strategy 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.[5]

Military strategy and business strategy share a number of common concepts and principles, the most basic being the distinction between strategy and tactics. *Strategy* 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. Strategic decisions, whether in military or business spheres, share three common characteristics:

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

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.[6] 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 along separate paths indicates 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 six decades, game theory has revolutionized the study of competitive interaction, not just in business but politics, military conflict, and international relations as well.[7] Nevertheless, as we shall see in Chapter 4, despite offering striking insights into competition and bargaining, game theory has yet to fulfill its potential as a practical and broadly applicable approach to formulating business strategies.[8]

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. During the 1950s and 1960s, senior executives were experiencing increasing difficulty in coordinating decisions and maintaining control in companies that were growing in size and complexity. Financial budgeting provided the basic framework for annual financial planning, while discounted cash-flow (DCF) approaches to capital budgeting provided a new approach to appraising individual investment projects. Corporate planning was devised as a framework for co-ordinating individual capital investment decisions and planning the long-term development of the firm. The foundation of the new corporate planning was macroeconomic forecasts of major economic aggregates, which were then disaggregated into forecasts for the firm's individual markets and specific products. The typical format was a 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. The diffusion of corporate planning was accelerated by a flood of articles and books addressing this new science.[9] By 1963, SRI found that the majority of the largest US companies had set up corporate planning departments.[10] Strategy Capsule 1.4 provides an example of such formalized corporate planning.

A major emphasis of corporate planning during the 1960s and early 1970s was planning diversification – expansion into new business sectors, often through acquisition. Igor Ansoff, 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.[11]

STRATEGY CAPSULE 1.4 Business Models and Business Strategies

Few business buzzwords survived the internet bust of 2000. One term that did earn a permanent place in the strategy lexicon is *business model*. The central question that venture capitalists posed every would-be "netpreneur" was: "What is your business model?"

Is *business model* simply an alternative term for *business strategy*? If so, what is the distinction and in what ways can the concept of a business model assist us in our strategy analysis?

At its root, a business model is the concept behind a business in terms of its underlying economic logic: What is the basis on which profit is made in this business? This is dependent upon the ability of the business to create value for customers that exceeds the costs entailed in providing the good or service.

Business models are particularly relevant in relation to new business concepts – new products, new services, or fundamentally new approaches to producing or delivering existing products or services. The key question facing every would-be entrepreneur is: "Is this an undiscovered opportunity, or is this simply a bad idea that others have already rejected?"

American Express's invention of the traveler's check is a classic example of the development of an attractive and robust business model. The traveler's check offered multiple streams of profit:

- It offered convenience for travelers – for which they would be willing to pay a charge.
- It offered increased business to merchants accepting travelers' checks – for which they would be willing to pay a commission.
- It offered interest returns to American Express, on the basis that the checks are paid for by the traveler some time before American Express needs to reimburse the merchant who takes the checks as payment.
- Some checks are never cashed.

Evaluating a business model involves two tests. First, the narrative test: Does the story make sense? Second, the numbers test: Can the business cover its costs and yield a viable return on capital? Many internet startups failed because they didn't provide services that anyone was willing to pay for. Others failed because the numbers didn't add up. Webvan's costs in setting up warehouses and distribution meant that it was very difficult to earn a profit in distributing low-margin products like groceries.

A business model is not the same as a strategy. Business models are concerned only with the underlying business concept – they don't take account of competition. When a number of firms adopt a similar business model, the critical determinant of success is which firm will be most successful in deploying its unique attributes in order to create a competitive advantage. Few of the world's most successful companies have achieved their success on the basis of new business models – most have utilized established business models but with superior strategies. Sam Walton imitated the discount store model established by Kmart and others – however, he did so with a customer focus, a passion for cost efficiency, and a recognition of the potential of small-town America that soon put Wal-Mart at the head of the pack.

Source: Joan Magretta, Why Business Models Matter, *Harvard Business Review* (May 2002): 86–92.

The rush to establish departments of corporate planning was part of a wider enthusiasm among both companies and governments for "scientific" techniques of decision making, including cost–benefit analysis, discounted cash flow (DCF) 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.[12]

During the 1970s, circumstances changed. Not only did diversification fail to deliver the anticipated synergies, but also 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 could no longer plan their investments, new product introductions, 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 than 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.[13]

This shift of attention toward strategy as a quest for performance focused attention on the sources of profitability. During the late 1970s and into the 1980s, the emphasis was upon sources of profit within firms' external environments. Michael Porter of Harvard Business School pioneered the application of industrial organization economics to analyzing the determinants of firm profitability.[14] Other researchers focused upon how profits were distributed between the different firms in an industry. The Boston Consulting Group pioneered a series of studies into the impact of market share and learning upon costs and profits.[15] These two lines of inquiry – the determinants of industry profitability and determinants of profitability differences within industries – provided the basis of the empirical analysis undertaken by the Strategic Planning Institute's PIMS (Profit Impact of Market Strategy) project.[16]

By the 1990s, the focal point for strategy analysis shifted from the sources of profit in the external environment to the sources of profit within the firm. Increasingly the resources and capabilities of the firm became regarded as the main source of competitive advantage and the primary basis for formulating strategy.[17] This emphasis on what has been called the *resource-based view of the firm* has represented a substantial shift in thinking about strategy. Industry analysis encourages firms to seek out attractive markets and favorable strategy positions. The result was substantial imitation of strategies between firms. The primacy now given to internal resources and capabilities has done the reverse: firms increasingly look to what differentiates them from their competitors and design strategies that exploit these differences in order to establish unique positions of competitive advantage. Michael Porter, answering the question, "What is strategy?" 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."[18]

The emphasis on exploiting distinctive resources and capabilities resulted in firm strategies moving in the opposite direction to the 1970s and early 1980s. Instead of expanding through diversification and vertical integration, firms moved towards increasing specialization – divesting non-core businesses and outsourcing those activities where they did not possess superior competence. Such narrowing of firm scope encouraged a move towards greater inter-firm collaboration through alliances and joint ventures. The term *co-opetition* has been used to describe the recent recognition that strategy is as much about cooperation as it is competition.[19]

The technology boom of the late 1990s encouraged a major flourishing of new thinking about business strategy – even though much of it did not survive the technology bust of 2000–2002. Rapidly declining costs of communication and information processing fostered new thinking about the networked economy and dynamics of standards wars,[20] the impact of "disruptive technologies,"[21] the central role of knowledge,[22] and the phenomenon of winner-take-all markets.[23] The rapid pace of change in technology-based markets stimulated interest in applying option theory and complexity science to strategy making.[24] Most important has been interest in strategic innovation. When industries were changing rapidly and unpredictably, what novel approaches to making money and establishing competitive advantage could be invented?[25] A key aspect of this quest has been interest in new business models – fundamentally new approaches to accessing sources of value (see Strategy Capsule 1.5). Table 1.1 summarizes the development of strategic management over time.

The Meaning of Strategy

In the light of this review, what can we conclude about the meaning of the term *strategy*? At its most general level, strategy is concerned with planning how an organization or an individual will achieve its goals. As soon as we move beyond general notions of strategy to more precise definition, then these depend upon the type of arena within which strategy is being deployed. In warfare, strategy is about achieving military victory over the enemy, in politics it is about managing power and electoral support to attain and hold on to office; in business it is about ensuring the survival and prosperity of the firm.

TABLE 1.1 The Evolution of Strategic Management

PERIOD	1950s	1960s–EARLY 1970s	LATE 1970s–MID 1980s	LATE 1980s–1990s	2000s
Dominant Theme	Budgetary planning and control	Corporate planning	Positioning	Competitive advantage	Strategic and organizational innovation
Main Issues	Financial control	Planning growth, especially diversification and portfolio planning	Selecting industries and markets Positioning for market leadership	Focusing strategy around sources of competitive advantage New business development	Reconciling size with flexibility and responsiveness
Principal Concepts and Techniques	Financial budgeting Investment planning Project appraisal	Medium- and long-term forecasting Corporate planning techniques Synergy	Industry analysis Segmentation Experience curves PIMS analysis SBUs Portfolio planning	Resources and capabilities Shareholder value Knowledge management Information technology	Cooperative strategies Competing for standards Complexity and self-organization Corporate social responsibility
Organizational Implications	Systems of operational and capital budgeting become key mechanisms of coordination and control	Creation of corporate planning departments and long-term planning processes Mergers and acquisitions	Multidivisional and multinational structures Greater industry and market selectivity	Restructuring and reengineering Refocusing Outsourcing E-business	Alliances and networks New models of leadership Informal structures Less reliance on *direction*, more on *emergence*

STRATEGY CAPSULE 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.

The nature of strategy also depends upon the stability and predictability of the environment in which strategies are applied. As we have noted, in the stable business environment of the 1960s, strategy was associated with detailed plans. In the turbulent business conditions of the recent decades, strategy became much more about the overall direction of the enterprise. As a result, in their strategic planning, companies have put greater emphasis on mission, vision, business principles, and performance targets and less upon specific actions. This shift in emphasis from plans to overall direction of the enterprise does not imply any downgrading of the role of strategy. Certainly, greater volatility puts a premium on flexibility, responsiveness, and opportunism. Yet, in these circumstances, strategy becomes more rather than less important. To cope with turbulence – in particular, to screen the huge array of opportunities that appear and to ensure a coherent approach to the various forces buffeting the firm – a sense of identity and direction is critical. Bain & Company has pointed to the importance of *strategic principles* – "a memorable and actionable phrase that distills the essence of a company's corporate strategy."[26] This notion of strategy as direction and principles takes us back to our three introductory examples. Madonna, General Giap, and Richard Williams did not possess plans in any formal sense; however, we can discern principles and guidelines that give consistency to the stream of decisions that each made over a period of decades.

As a result, there is little consensus as to the definition of strategy, either in its generic sense or applied to business. Table 1.2 offers a selection of definitions. Typically, business strategy is defined in terms of its content – in particular, the kinds of choices that are seen as paramount. Some writers define strategy primarily in relation to external market positioning. Thus, Costas Markides defines strategy in terms of choice of market position, which is determined by the answers to three questions:

TABLE 1.2 Some Definitions of Strategy

- Strategy: a plan, method, or series of actions designed to achieve a specific goal or effect.
—*Wordsmyth Dictionary*

- 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*

- 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)

> "Who should I target as customers?
> What products or services do I offer them?
> How should I do this?"[27]

Jay Barney defines strategy in terms of a firm's deployment of its internal resources:

> "Strategy is a pattern of resource allocation that enables firms to maintain or improve their performance."[28]

Among all the different definitions of strategy, there is one basic commonality – strategy is about *choice*. These key strategic choices revolve around two fundamental choices:

- *Where* to compete?
- *How* to compete?

As we shall see below, the answers to these questions also define the two principal levels of firm strategy – *corporate strategy* and *business strategy*.

CORPORATE AND BUSINESS STRATEGY

The goal of strategy is to ensure the survival and prosperity of the firm. This requires that the firm earns a return on its capital that exceeds the cost of its 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* defines 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 different terminology, Jay Bourgeois has referred to corporate strategy as the task of *domain selection* and business strategy as the task of *domain navigation*.[29]

FIGURE 1.3 The sources of superior profitability

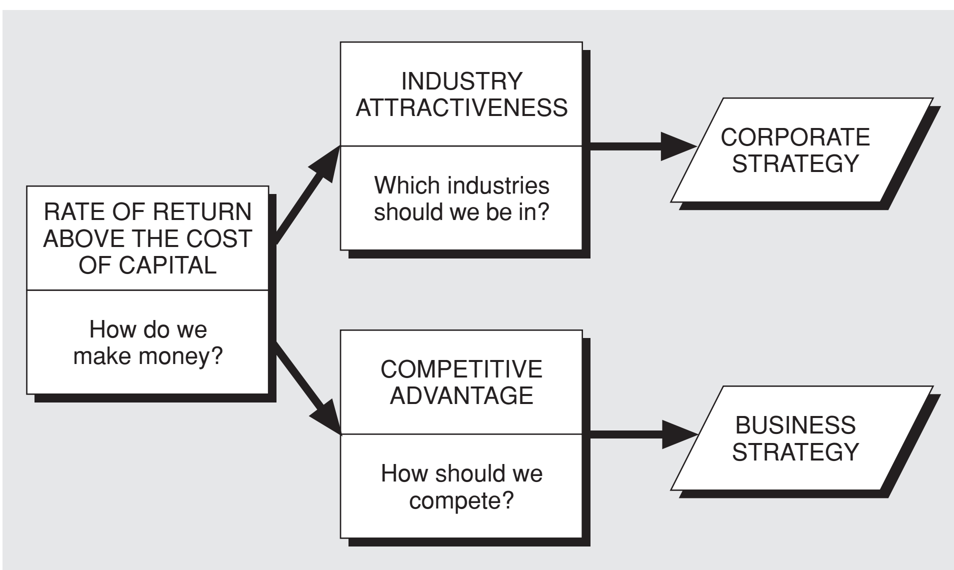
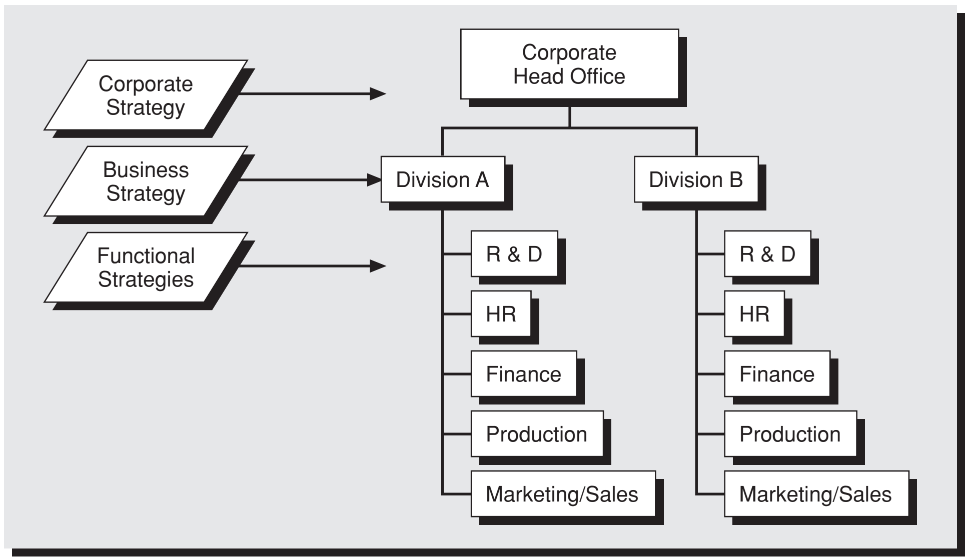


FIGURE 1.4 Levels of strategy and organizational structure



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 most large companies. Corporate strategy is the responsibility of the top management team and the corporate strategy staff. Business strategy is the responsibility of divisional management (see Figure 1.4).

In practice, the picture is a little more complicated. Most large, multibusiness companies are organized not only into major divisions, but these divisions are sub-divided into individual business units. In addition, companies are organized by functions as well as by business sector. Business strategies are elaborated and implemented through *functional strategies* in terms of production, R&D, marketing, human resources, and finance.

As an integrated approach to firm strategy, this book deals with both business and corporate strategy. However, my primary emphasis will be business strategy. This is because the critical requirement for a company's success is its ability to establish competitive advantage. Hence, issues of business strategy precede those of corporate strategy. At the same time, these two dimensions of strategy are closely linked: the scope of a firm's business has implications for the sources of competitive advantage, and the nature of a firm's competitive advantage determines the range of businesses it can be successful in.

HOW STRATEGY IS MADE: *DESIGN* VERSUS *EMERGENCE*

As indicated by its title, the purpose of this book is to develop an analytical approach to strategic management. Implementing this approach requires that senior managers objectively appraise the enterprise and its environment, formulate a strategy that maximizes the chances for success, and implement that strategy. Among large organizations, this deliberate, analytical approach to strategy making typically occurs through formal systems of strategic planning.

But is this how strategies are really made? When we examined Madonna's career, we discerned a consistency and pattern to her career decisions that we described as a strategy, yet there is no evidence that she engaged in any systematic strategic planning or articulated her strategy. Similarly with many successful companies, Wal-Mart's incredibly successful strategy based upon large store formats, hub-and-spoke distribution system, small-town locations, and unique approach to employee motivation was not the result of grand design – it was the result of Sam Walton's hunches and intuition plus a series of historical accidents.

How organizations make strategy has emerged as an area of intense debate within the strategy field. Henry Mintzberg and his colleagues at McGill University distinguish *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, *realized strategy* – the actual strategy that is implemented – is only partly related to that which was intended (Mintzberg suggests only 10–30 percent of intended strategy is realized). The primary determinant of realized strategy is what Mintzberg terms *emergent strategy* – the decisions that emerge from the complex processes in which individual managers interpret the intended strategy and adapt to changing external circumstances.[30]

Analysis of Honda's successful entry into the US motorcycle market has provided a battleground for the debate between those who view strategy making as primarily a rational, analytical process of deliberate planning (the *design school*) and those that envisage strategy as emerging from a complex process of organizational decision making (the *emergence* or *learning school*) of strategy.[31] According to the Boston Consulting Group, Honda pursued a rational, analytic approach to designing a strategy based upon exploiting economies of experience and scale to establish unassailable cost leadership in the world motorcycle industry.[32] However, subsequent interviews with the Honda managers in charge of US market entry revealed a different story: a haphazard approach to entry, with little analysis and no clear plan.[33] The massive success of the 50cc Supercub was as great a surprise to the Honda managers as to anyone. 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."[34]

Henry Mintzberg's critique over analytical approaches to strategy design 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."[35] At the basis of this fallacy is that it fails to allow for learning though a continuous interaction between strategy formulation and strategy implementation in which strategy is constantly being adjusted and revised in light of experience.

Although the debate between the two schools continues,[36] it is increasingly apparent that the central issue is not "Which school is right?" but, "How can the two views complement one another to give us a richer understanding of strategy making?" Let us explore these complementarities in relation to the factual question of how strategies are made and the normative question of how strategies should be made.

- *How is strategy made?* For most organizations, strategy making is a combination of design and emergence. The deliberate design of strategy (through formal processes such as board meetings and strategic planning) has been characterized as a primarily top-down process. Emergence has been viewed as the result of multiple decisions at many levels, particularly within middle management, and has been viewed as a bottom-up process. These processes may interact in interesting ways. At Intel the key historic decision to abandon memory chips and concentrate upon microprocessors was the result of a host of decentralized decisions taken at divisional and plant level that were subsequently acknowledged by top management and promulgated into strategy.[37] In practice, both design and emergence occur at all levels of the organization. The strategic planning systems of large companies involve top management passing directives and guidelines down the organization and the businesses passing their draft plans up to corporate. Similarly, emergence occurs throughout the organization – opportunism by CEOs is probably the single most important reason why realized strategies deviate from intended strategies. What we can say for sure is that the role of emergence relative to design increases as the business environment becomes increasingly volatile and unpredictable. Organizations that inhabit relatively stable environments – the Roman Catholic Church and national postal services – can plan their strategies in some detail. Organizations whose environments cannot be forecast with any degree of certainty – a gang of car thieves or a construction company located in the Gaza Strip – can only establish a few strategic principles and guidelines, the rest must emerge as circumstances unfold.

- *What's the best way to make strategy?* Mintzberg's advocacy of strategy making as an iterative process involving experimentation and feedback is not necessarily an argument against the rational, systematic design of strategy. The critical issues are, first, determining the balance of design and emergence and, second, how to guide the process of emergence. The strategic planning systems of most companies involve a combination of design and emergence. Thus, corporate headquarters sets guidelines in the form of mission statements, business principles, performance targets, and capital expenditure budgets.

> However, within the strategic plans that are decided, divisional and business unit managers have considerable freedom to adjust, adapt, and experiment. I have described this type of strategic planning process as one of "planned emergence."[38] The view that strategic management in a turbulent environment is to be achieved through a combination of rational, top-down planning and decentralized emergence is supported by the findings of complexity theory. Rapid adaptation to changing environmental conditions is typically achieved through seemingly chaotic processes of decentralized responses where the overall effectiveness of this adaptation is maintained through moderate levels of adaptive tension and simple rules that foster coordination. Bill McKelvey argues that Jack Welch's management of General Electric embodied simple directives ("Be number 1 or number 2 in your sector," "Simplicity . . . Self-confidence," "Achieve six-sigma quality") together with strong performance incentives, which corresponds closely to the implications of complexity thinking.[39] We shall explore the implications of complexity theory more fully in Chapter 17.

My approach in this book is to emphasize and outline analytic approaches to strategy formulation. This is not because I wish to downplay the role of skill, intuition, emotion, and creativity – these qualities are essential ingredients of successful strategies. 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 power battles, to the whims and preferences of individual managers, to contemporary fads, and to wishful thinking. Concepts, theories, and analytic frameworks are not substitutes for experience, commitment, and creativity; their key role is to provide frameworks for organizing discussion, processing information and opinions, and assisting communication and consensus. They may even 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 key lesson to be drawn from the attacks by Mintzberg and others on strategic planning, is not that strategic planning should be abandoned, but that the processes and tools of strategy making need to be improved. If we downplay the role of systematic analysis and emphasize intuition and emotion, there is a danger that we enter 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 and understanding.

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, the practicalities of implementation, and the potential for emergence and self-organization – then it is poor analysis. Strategy formulation must involve intuition, reflection, and the interaction between thought and action. However, the deployment of sound analysis can support the development of intuition and promote creativity. Analysis can also facilitate the organizational processes through which strategy is formulated through providing a common conceptual language and frameworks that can clarify points of similarity and difference between alternative ideas.

THE DIFFERENT ROLES OF STRATEGIC MANAGEMENT WITHIN THE FIRM

Once we begin to consider the *process* of strategy making within organizations, it becomes apparent that strategic management fulfills multiple roles. Among these, three key managerial purposes stand out.

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, I have argued, 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. To the extent that decision makers are limited by *bounded rationality* – though rational by intent, humans are limited in their search and information-processing capacity – strategy in the form of guidelines and decision criteria can enhance the quality and consistency of strategic decision-making.[40]

When we move from individuals to organizations, the problem of optimizing decisions becomes much greater and it becomes impossible to consider the implications of every permutation of decision choices. In these circumstances, strategic principles such as Wal-Mart's "Low prices, every day," or Southwest Airlines' "Meet customers' short-haul travel needs at fares competitive with the cost of automobile travel," can 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.

Strategy not only simplifies decision making, the creation of a strategy process also results in better decision making, first, by allowing the knowledge of different individuals to be pooled, second, by facilitating the application of analytic tools. The tools and frameworks of industry analysis, resource analysis and performance appraisal that you will become familiar with in the next few chapters of this book will result in your designing better strategies that will result in better decisions, and improved performance.

Strategy as a Coordinating Device

Strategy making, we have observed, is an emergent process involving decision making by all members of the organization. The greatest challenge facing any organization with multiple members is how to achieve coordination of individual actions. Strategy can promote coordination in several ways. First, it is a communication device. Statements of strategy are a powerful means through which the CEO can communicate the identity, goals, and competitive stance of the company to all organizational members. However, communication alone is not enough to achieve coordination. For cooperation to be effective, buy-in is essential from the different functions, levels and interest groups within an organization. One role of the strategic planning process is to provide a forum in which views are exchanged and consensus developed. Once a strategy has been agreed, the strategic planning process typically involves a set of goals and commitments that are then monitored over the strategic planning period. The growing role of the strategic planning processes of large companies as mechanisms for coordination is evident in the shift of strategic planning responsibilities from corporate planning professionals to line managers, and from corporate to business levels.[41]

Strategy as Target

Strategy is forward looking. It is concerned not only with how the firm will compete now, but also what the firm will become in the future. Many organizations articulate this idea of becoming in a *vision statement*. The purpose of a forward looking view of what the company will become is not just to establish a direction to guide the formulation of strategy, but also to set aspirations for the company that can motive the members of the organization. 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.[42] Examples of 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," and Coca-Cola's "Project Infinity" (see Strategy Capsule 1.6). Jim Collins and Jerry Porras make a similar point: US companies that have been sector leaders for 50 years or more – Merck, Walt Disney, 3M, IBM, and Ford – have all generated commitment and drive through setting "Big, Hairy, Ambitious Goals."[43] 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.[44]

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

STRATEGY CAPSULE 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.

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. Strategy, according to Hamel and Prahalad, should be less about fit and resource allocation, and more about *stretch* and *resource leverage*.[45] 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

This discussion, first, of strategy as an emergent process and, second, of the role of strategy in coordination, communication, and motivation raises some important issues about the types of analysis that are relevant to strategic management. Ever since two leading Harvard management professors identified "modern management techniques" as instrumental in American firms' declining international competitiveness,[46] 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.

Strategic management is still a young field. It lacks an agreed, internally consistent, empirically validated body of theory and draws widely from economics, psychology, sociology and biology on an *ad hoc* basis. Unlike the more technically oriented managerial disciplines – finance, operations research, and production management – strategy analysis does not generate solutions to problems. It does not yield scheduling algorithms or identify which investment proposal had the highest net present value. The strategic questions that companies face – like those that individuals face (Shall I marry? Shall I go into investment banking or consumer goods marketing?) – are simply too complex to be programmed.

The purpose of strategy analysis is not to provide answers but to help us understand the issues. Most of the analytic techniques introduced in this book are frameworks that allow us to identify, classify, and understand the principal factors relevant to strategic decisions. Such frameworks are invaluable in allowing us to come to terms with the complexities of strategy decisions. 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 – I hope that you are not suffering from indigestion. If you are feeling a little overwhelmed, not to worry: we shall be returning to most of the themes and issues raised in this chapter in the subsequent chapters of the book.

The next stage is to delve further into the basic strategy framework shown in Figure 1.2. Each element of this framework – goals and values, the industry environment, resources and capabilities, and structure and systems – comprise the basic components of strategy analysis. Part II of the book will devote a separate chapter to each. (In the case of industry analysis – two chapters.) 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 structure of the book

I INTRODUCTION
Ch. 1 The Concept of Strategy

II THE TOOLS OF STRATEGY ANALYSIS

Analysis of Industry and Competition
Ch. 3 Industry Analysis: The Fundamentals
Ch. 4 Further Topics in Industry and Competitive Analysis

Analysis of the Firm
Ch. 2 Goals, Values, and Performance
Ch. 5 Analyzing Resources and Capabilities
Ch. 6 Organization Structure and Management Systems

III THE ANALYSIS OF COMPETITIVE ADVANTAGE
Ch. 7 The Nature and Sources of Competitive Advantage
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NOTES

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

2 Stephen Covey (*The Seven Habits of Highly Effective People*, Simon & Schuster, 1989) advises us to start at the end – to visualize our own funerals and imagine what we would like the funeral speakers to say about us and our lives. He then recommends that we go on to develop lifetime mission statements based upon the multiple roles that each of us occupies in life.

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

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

5 Sun Tzu, op. cit.

6 On the links between military and business strategy, see Roger Evered, op. cit.; Nigel Campbell, "Lanchester Market Structures: A Japanese Approach to the Analysis of Business Competition," *Strategic Management Journal* 7 (1986): 189–200; Eric Clemons and Jason Santamaria, "Maneuver Warfare," *Harvard Business Review* (April 2002): 46–53. For a review of the concepts and principles of military strategy, see B. H. Liddell Hart, *Strategy* (New York: Praeger, 1968).

[7] On the contribution of game theory to business strategy analysis, see Franklin M. Fisher, "Games Economists Play: A Non-cooperative 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.

[8] 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).

[9] During the late 1950s, *Harvard Business Review* featured a number of articles on corporate planning: 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.

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

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

[12] J. K. Galbraith (*New Industrial State*, London: Penguin, 1968) predicted that planning by large corporations and governments would supersede markets in allocating resources.

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

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

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

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

[17] 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.

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

[19] A. Brandenburger and B. J. Nalebuff, *Co-opetition* (New York: Doubleday, 1996).

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

[22] Nick Bontis and Chun Wei Choo (eds.), *The Strategic Management of Intellectual Capital and Organizational Knowledge: A Collection of Readings* (New York: Oxford University Press, 2002).

[23] Robert H. Frank and Philip J. Cook, *The Winner-Take-All Society* (New York: Penguin, 1997).

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

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[37] R. A. Burgelman and A. Grove, "Strategic Dissonance," *California Management Review* 38 (Winter 1996): 8–28.

[38] "Strategic Planning in a Turbulent Environment: Evidence from the Oil and Gas Majors," *Strategic Management Journal* 14 (June 2003): 491–517.

[39] Bill McKelvey, "Energising Order-Creating Networks of Distributed Intelligence: Improving the Corporate Brain," *International Journal of Innovation Management* 5(2) (June 2001).

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