

Introduction to Strategy

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Overview of Today's Lecture

- Defining, identifying & evaluating strategy
- Short history of strategy
- Critical concepts in strategy

First a question: What's more important?

- *Strategy or execution?*
 - **On reflection, I have concluded that this is a dumb question:**
 - **Bad choices, executed well?**
 - **Good choices, executed badly?**
 - **Strategy & execution are two sides of the same coin – you need both to win!**

QUIZ

- What is a Strategy?



Strategy is:

- External Positioning
 - **Match internal resources and capabilities to the external environment to achieve a sustainable competitive advantage**



WINNING IN THE MARKETPLACE

- Internal alignment
 - **Match all functional decisions with the chosen competitive advantage**



WINNING THROUGH EXECUTION

Strategy is a goal and set of policies designed to achieve a sustainable competitive advantage

Levels of Strategy

“Competitive” or “Business” Strategy

How do we win in a discrete business

-emphasis is on the competitive advantage in terms of distinctive value proposition and activities

Corporate Strategy

Overall strategy of a diversified firm

-Emphasis is on scope: what businesses the company should be in, and advantage in terms of common resources that add value across strategically distinct business units

A Hierarchy of Company Statements

Vision: How we fit in an evolving world

Mission: Why we exist

Values: What we believe in

Strategy: What will be our competitive game plan

Balanced Scorecard: How we will implement that plan

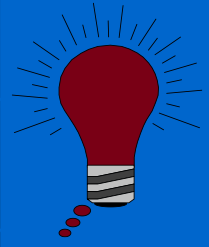
The First Step: Strategy Identification:



Center of the Wheel Defines How the Business Gains Competitive Advantage

Strategy Evaluation

What are appropriate criteria?

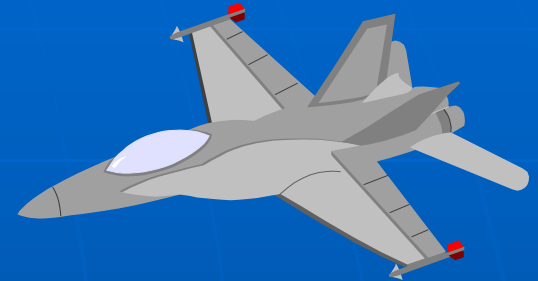


1. **Vision**
2. **Competitive Advantage**
 1. **A difference that “matters”**
3. **Consistency**
 1. **Internal**
 2. **External**
 3. **Dynamic (over time)**
4. **Flexibility**
5. **Sustainability**
6. **Resources**
 1. **Adequacy**
 2. **Commitment**
7. **Risk**
8. **Contributions to society**



Strategy as Art

Early thinking used focused war strategies as the most appropriate metaphor



Von Clausewitz view of strategy:

Strategy was not a formula. Detailed planning always failed due to chance events, imperfections in execution, and the leadership of the opposition.

Strategy was the art of the broken-field runner; strategy was not a lengthy plan, but an idea that evolved through changing circumstances.

Strategy involved the instinctive savvy of the best generals.

Rise of Strategy as a Science

Demand for Strategy

Single business firms



Multi-divisional firm, post WWII

New Managerial Problems:

- what to buy
- what to sell
- how to create "synergy"
- how to allocate resources



Divisions Got The Upper Hand

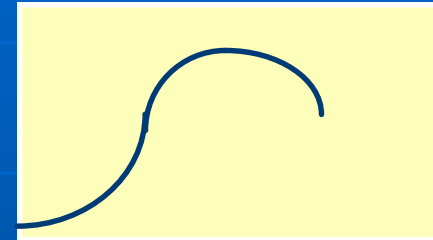
Strategy as an Art is no longer adequate

-Intuition & experience alone cannot manage the multi-divisional firm

Supply of Strategy

GE, Consultants find the answer

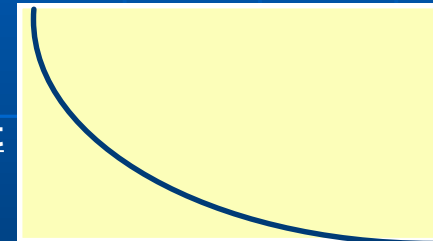
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PLC

Time

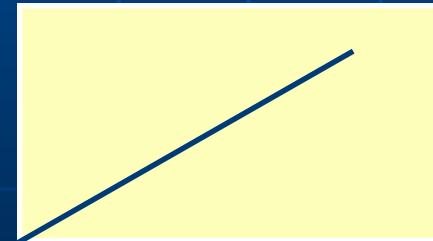
Unit Cost



Learning Curve

Volume

ROI



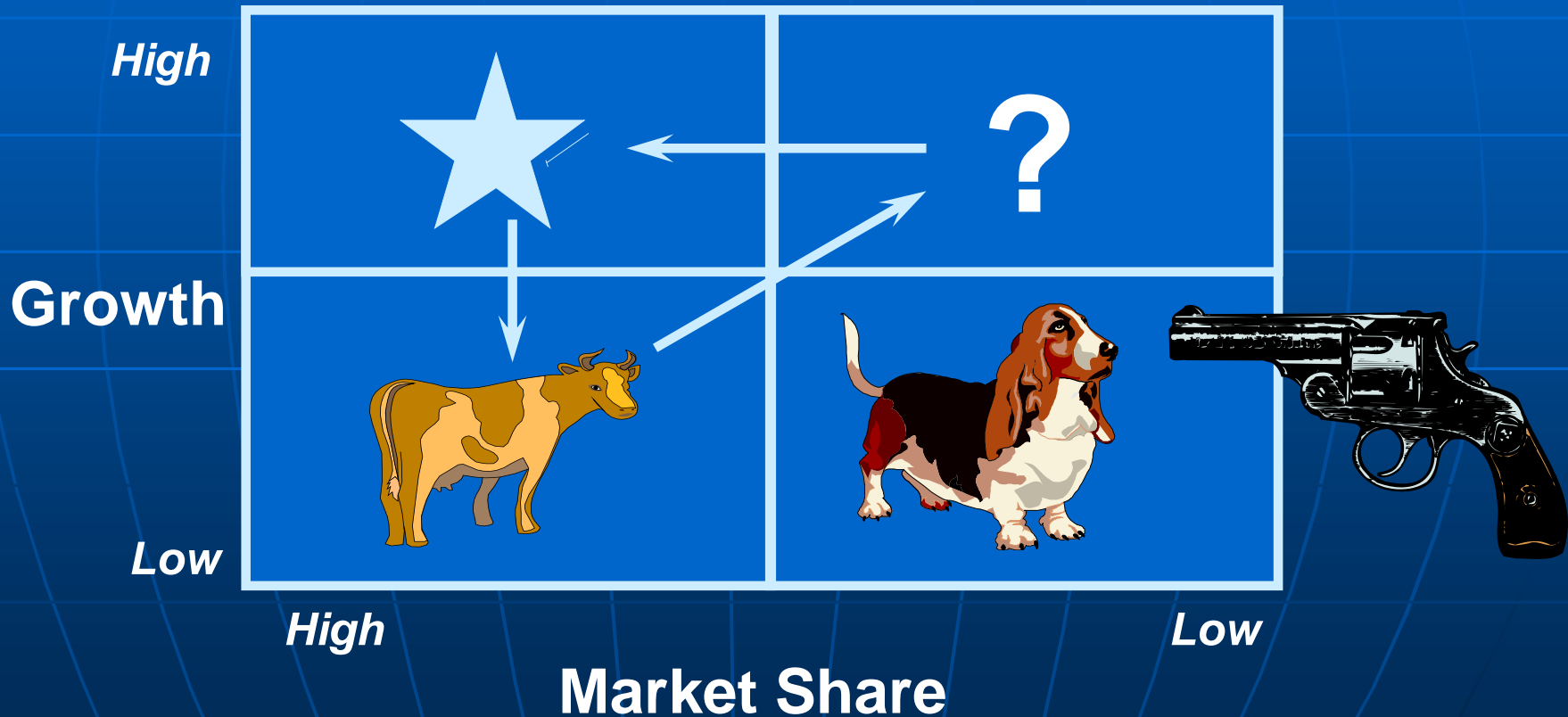
ROI
Mkt Share

Market Share



Peak of Scientific Strategy

PLC plus learning curve plus mkt share = **The BCG Matrix**



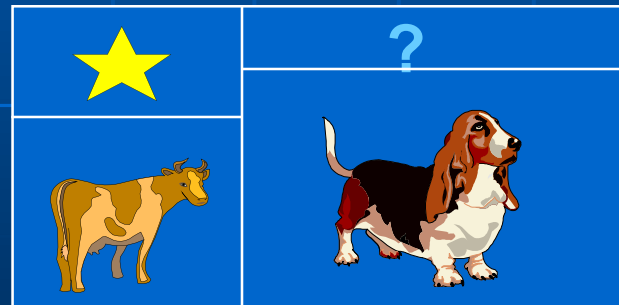
The Decline of Strategy as a Science

Exceptions:

- low share winners
- low growth winners

Damaging Studies: Mktg. Science Inst. on PLC

Slow growth and new competitors:



- The Result:

"The Relationship Between Relative Market Share and Profitability Doesn't Hold As Much Significance Any More"

Alan Zakon, BCG, 1981

Strategy Fads

Fleeting (But Important) Tools for Competitive Advantage

- **1960s: (heavy external focus)**
 - Learning curves, market share, product cycles
- **1970s: (strategy as 2x2)**
 - Distinctive Competencies, BCG growth/share matrix, SWOT analysis
- **1980s: (heavy Japanese mgt focus)**
 - Shareholder value, time-based competition, total quality management, & core competencies
- **1990s: (heavy internal focus)**
 - Re-engineering, Learning organizations, disruptive technologies, profit zones, chaos theory, ecosystems...
- **2000s: Blue & Red Oceans**
 - ???????????????

Is the logic rt? Is there empirical evidence? Distinguish operational improvement vs. competitive advantage? Old wine in new bottles?

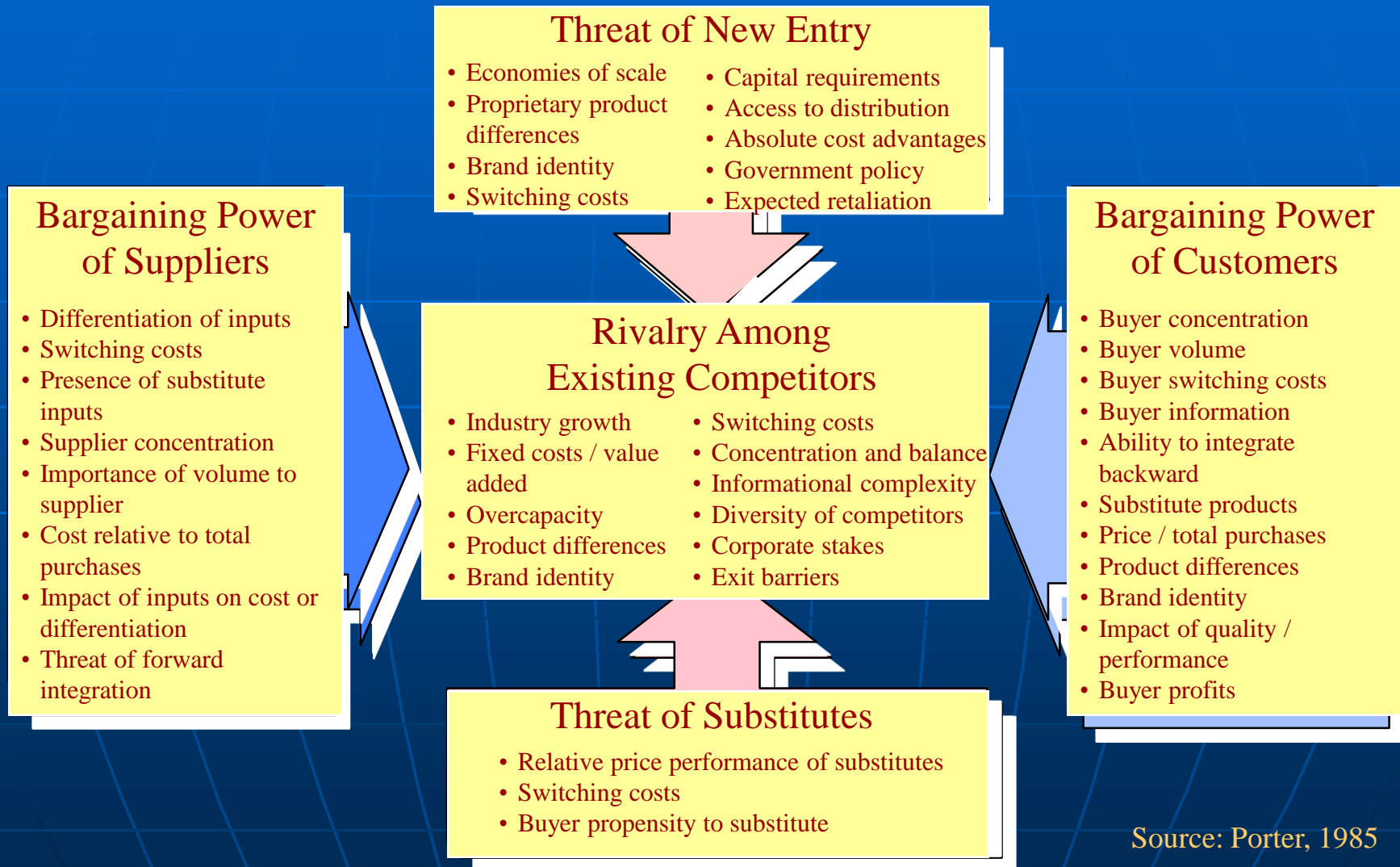
Theory of Strategy

Frameworks vs. Fads

- Strategy balances the internal & external
 - not just ‘re-engineering’ nor ‘blue oceans’
- Strategy is neither “war” nor “peace”
 - cooperation is essential for creating the “pie”
 - competition is fundamental for dividing the “pie”
 - strategy is about creating as well as capturing value
- Strategy is about the search for competitive advantage
 - strategy frameworks require *analysis* for firm-specific *insights*
 - strategy fads seek *the answer*

Strategic economics fit within an environment

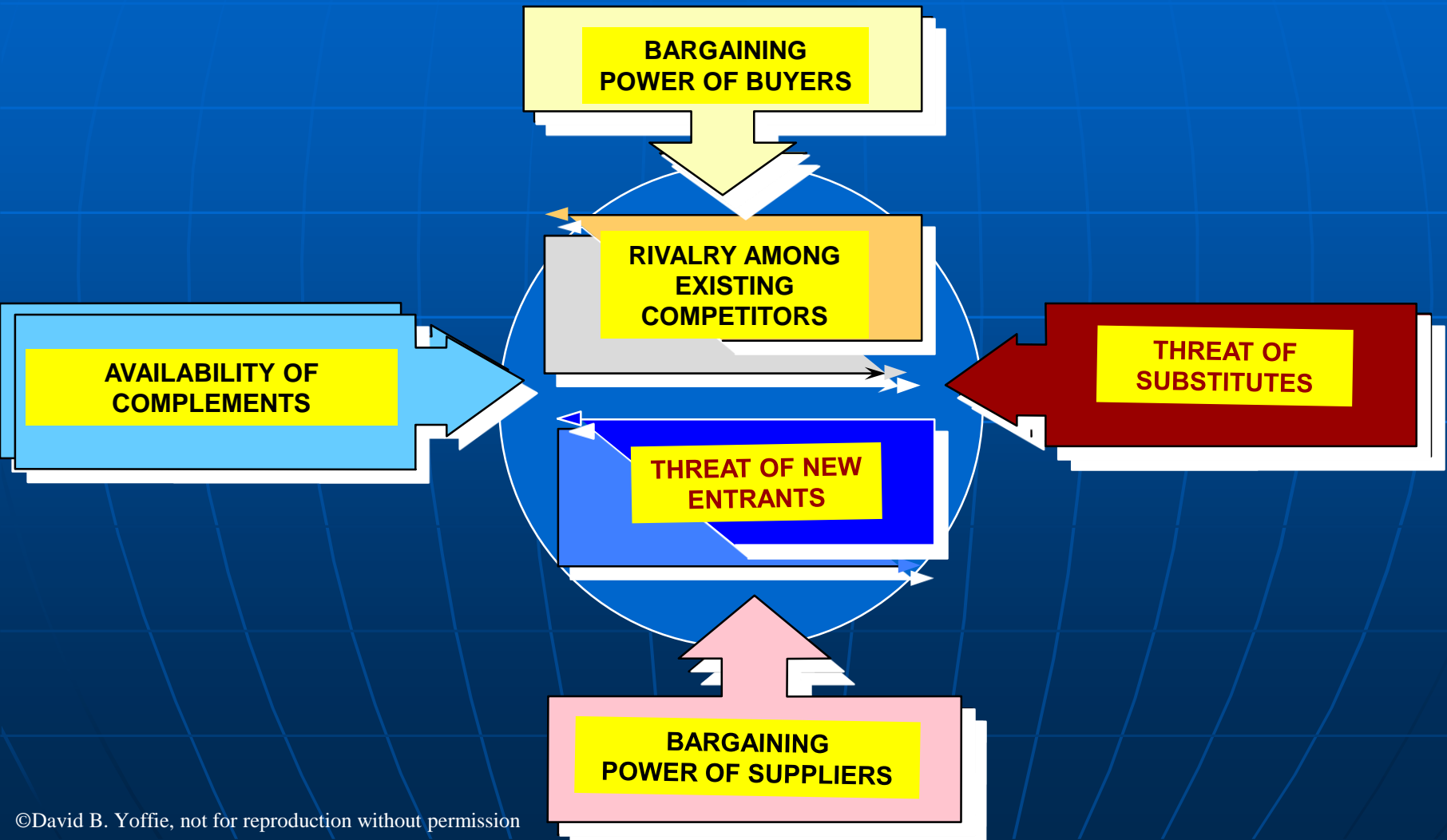
Traditional Model: Porter's Five Forces



Source: Porter, 1985

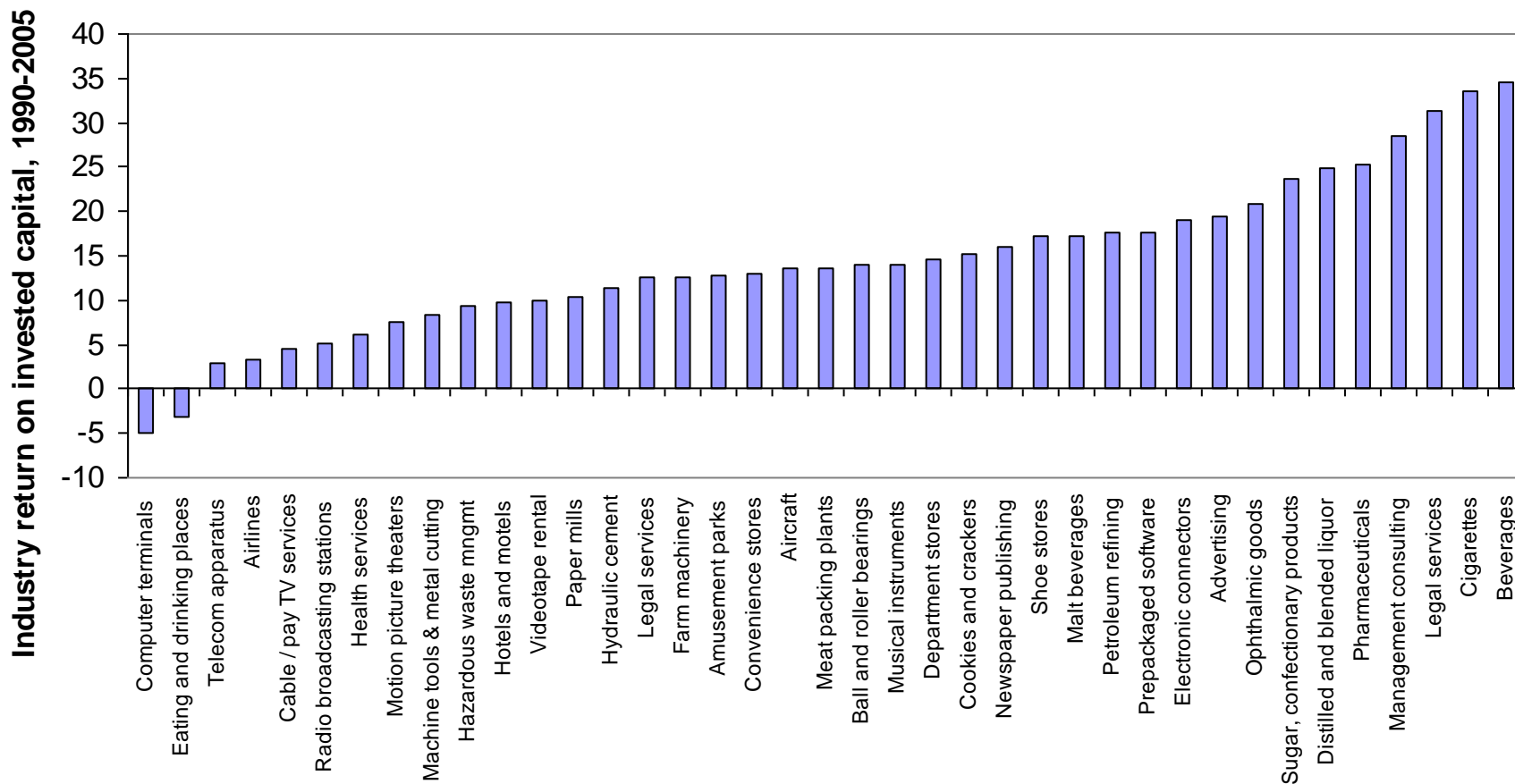
Revised Model:

The Six Sources of Industry Profits



Start with industries because some industries are inherently more profitable than others

Differences in Profitability Across Selected Industries, 1990-2005



Economics of Industry Analysis

Two Key Questions

- To What Extent Does the Industry Deviate from “Perfect Competition”?

Market imperfections create the potential for profits?

- Who Creates & Captures the Value?

Do buyers or suppliers appropriate the returns?

Do substitutes or prospective entrants limit demand and/or profits?

Does intense competition among incumbents kill the margins?

Are complements available to increase value and raise demand?

Strategic Analysis:

START WITH THE BASICS

- Analyze all of the competitive force in the environment
- Assess possible changes as a result of government policy, changes in technology, demographics, etc.
- Ask yourself -- can competitors alter the environment?

QUESTION: BETTER OFF WITH DUMB OR SMART COMPETITOR(S)?

Dumb competitors destroy profits for everyone

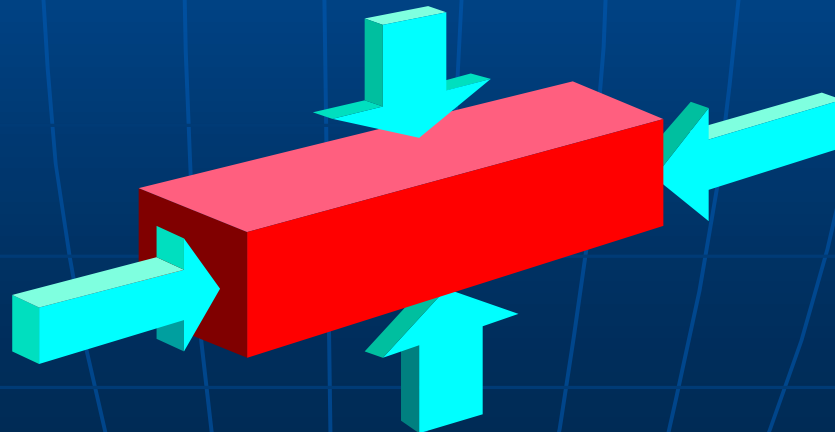
My Answer:

Smart, but not too smart!

DEGREE OF RIVALRY

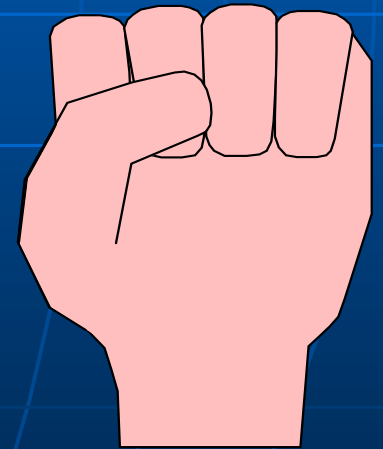
Why are some industries more or less “competitive?”

- Industry Growth
- Size of Capacity Increments
- Product Differentiation
- Switching Costs
- Concentration & Balance of Competitors
 - 1 65/25/10
 - 2 25/25/25/25
 - 3 100x1
- Exit Barriers



EXIT BARRIERS

- **Specialized Assets**
- **One-time Costs of Exit**
- **Strategic Barriers**
- **Emotional Barriers**
- **Government & Social Barriers**



ENTRY BARRIERS

- **Economies of Scale & Experience**

(e.g., commercial aircraft -- MES = 25% of the world)

- **Product Differences**

- **Switching Costs**

- **Capital Requirements**

(relative to opportunity & resources available)

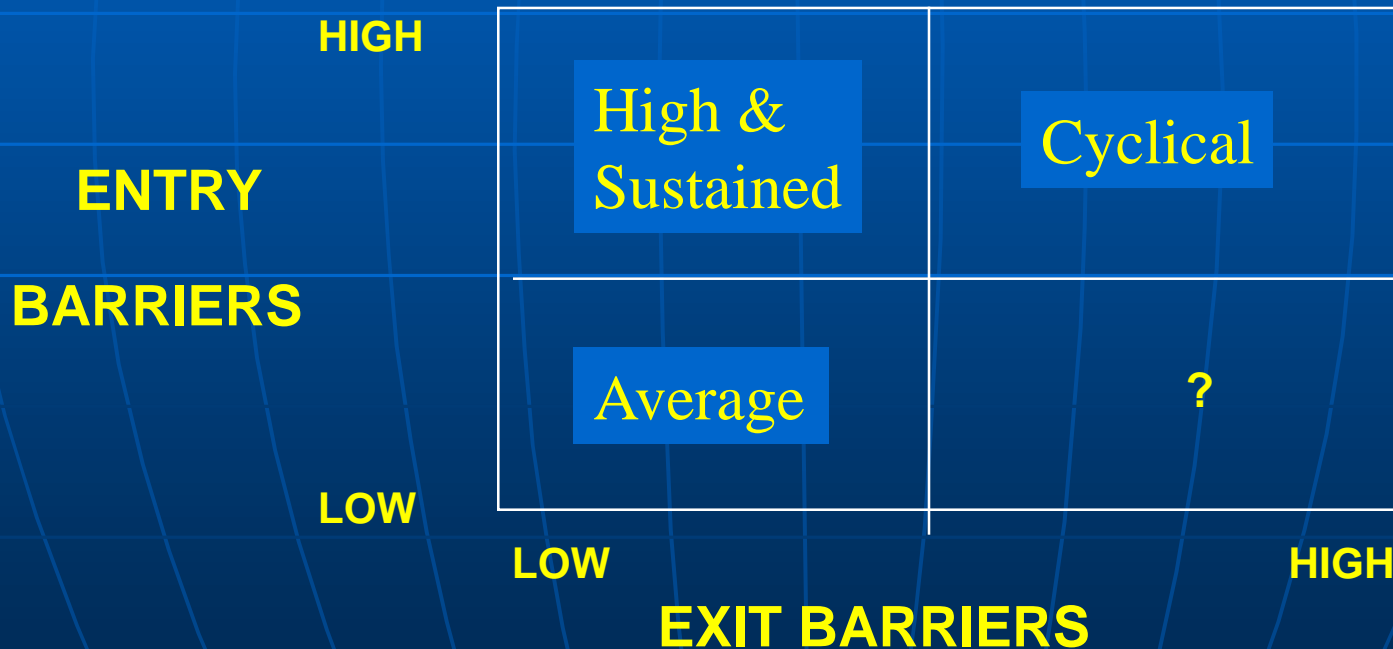
- **Government Policy**

- **Expected Retaliation**



IMPACT OF ENTRY AND EXIT BARRIERS

Which is most desirable? Least desirable?



Power of Buyers

Differentiate Two Types

1) Intrinsic Power

- Buyer Concentration
- Volume of Purchases
- Number of Alternative Products
- Backward Integration
- Cost of Switching

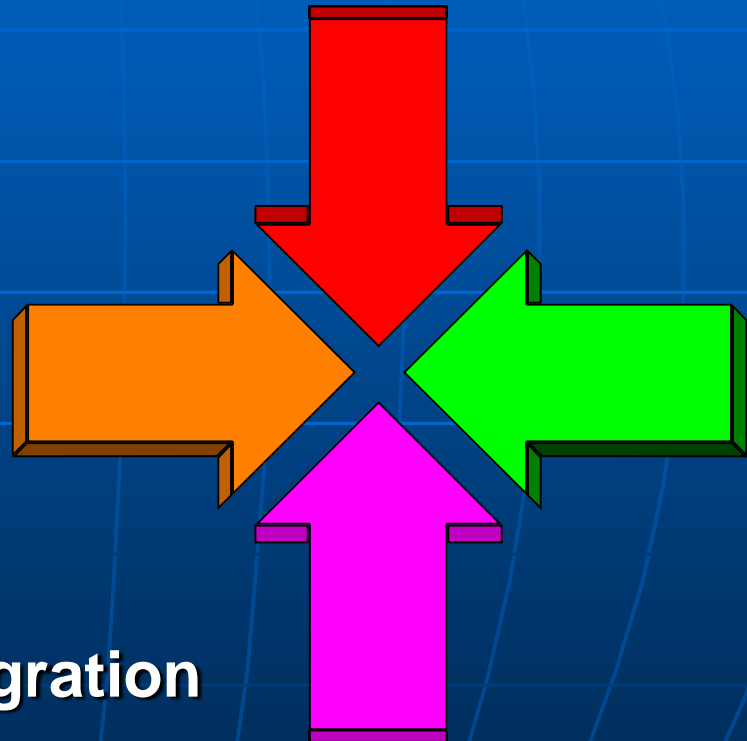
2) Price Sensitivity

- Product Cost vs. Total Purchases
- Product Differentiation
- Buyer Information
- Cost of Failure
- Buyer Profitability

POWER OF SUPPLIERS

Same Principles as Buyer Power

- Supplier Concentration
- Supplier Volume
- Product Differences
- Brand Identity
- Switching Costs
- Buyer Information
- Threat of Forward Integration



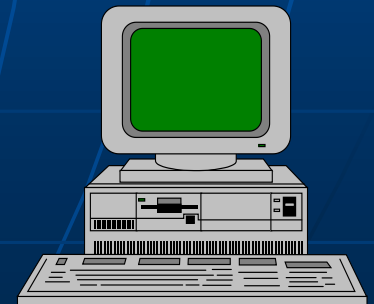
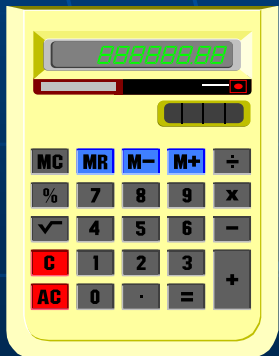
THREAT OF SUBSTITUTION

What are they?

- Direct Substitution
- Doing Without
- Backward\Forward Integration

Why are they important?

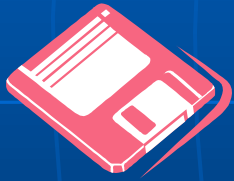
- Impact on Demand -- limit demand
- Impact on Price -- ceiling on price



Availability of Complements

What are they?

- Anything a customer buys that raises a customer's willingness to pay or increases demand for your product or service:



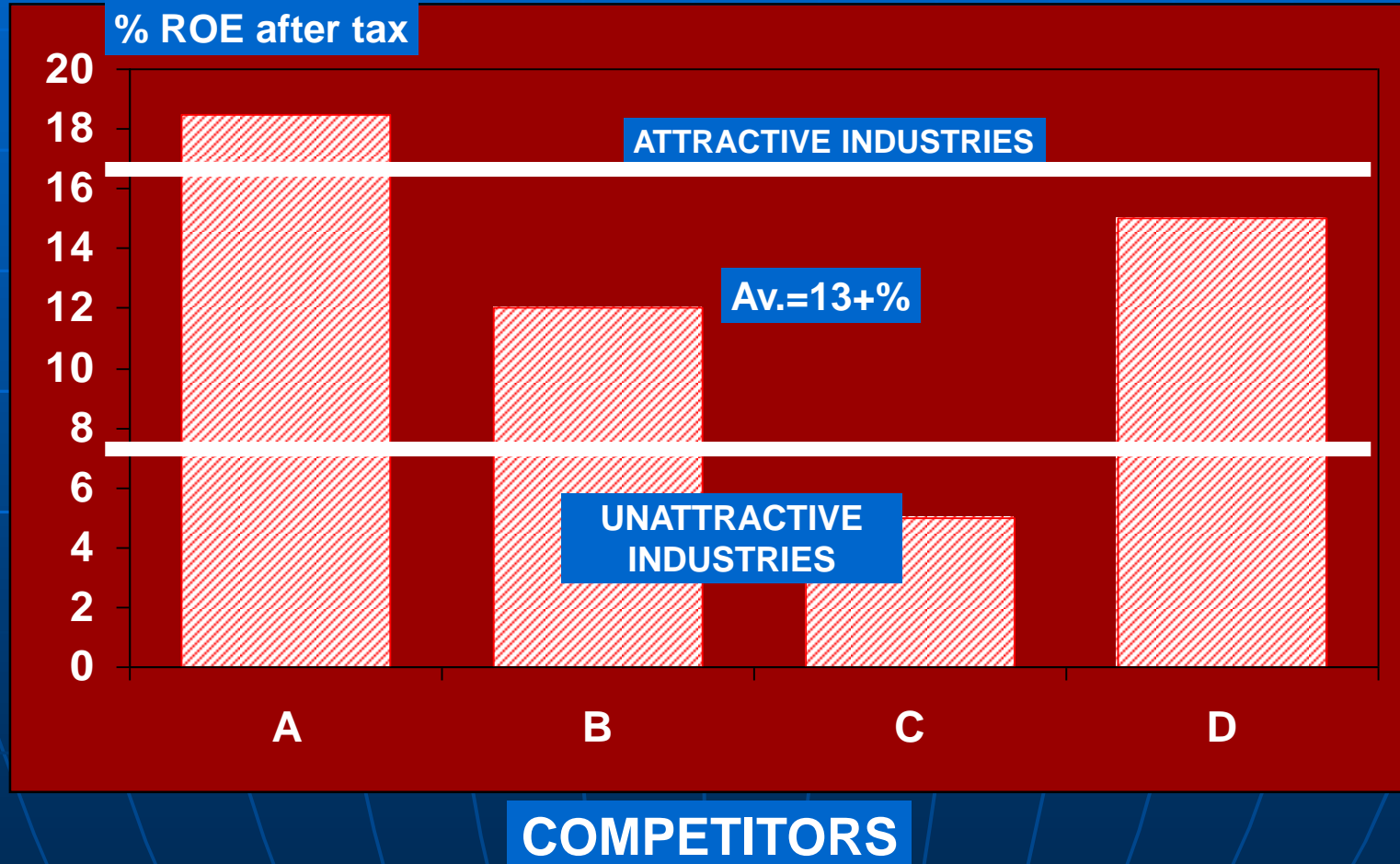
- hardware --- software
- car -- car insurance, car loans
- oil – kerosene lamps
- bagels -- cream cheese

Why are they important? – Opposite of substitutes

- Impact on Demand -- Expand the market
- Impact on Price – Increase willingness to pay



Once you understand the industry, and the prospects for dynamic change, move to “positioning” analysis: Strategy is all about how do you become the “A” player



Competitive Positioning

Successful strategies must:

-Minimize buyer power
(e.g., build customer loyalty)

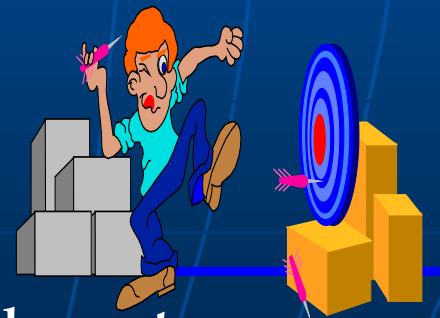
-Offset supplier power
(e.g., multiple sources)

-Reduce the intensity of rivalry
(e.g., attack emerging vs. entrenched segments)

-Raise barriers to entry
(e.g., pre-emptive investment)

-Reduce threat of substitution
(e.g., incorporate the benefits)

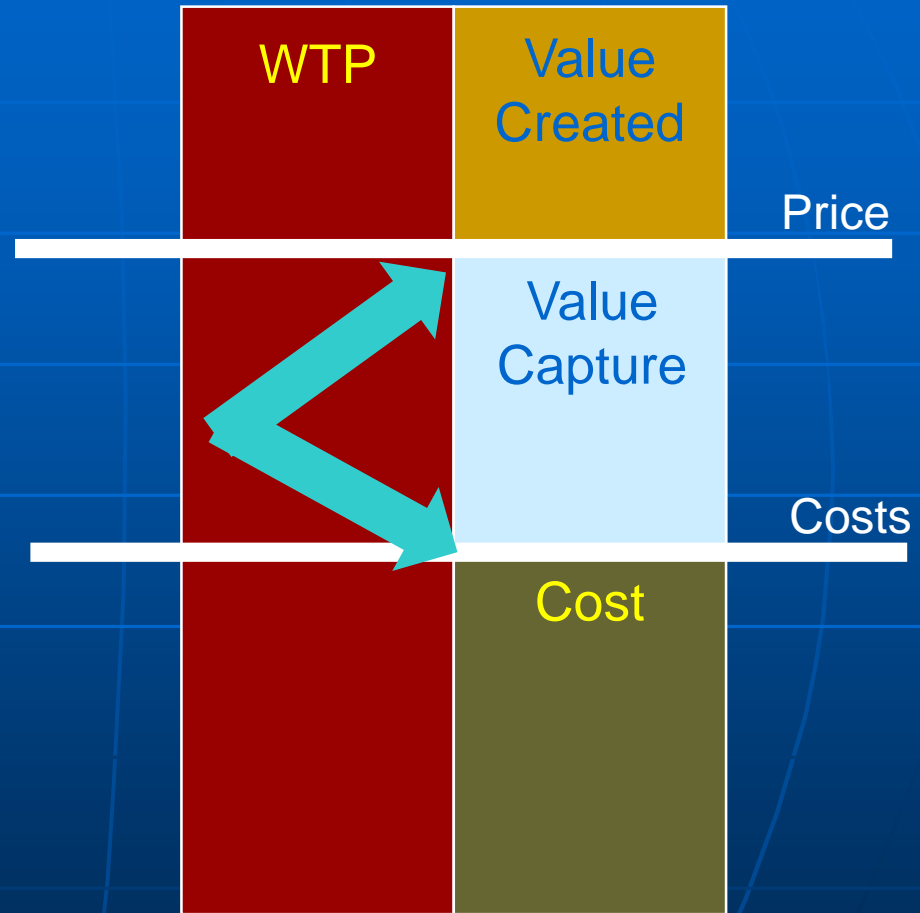
-Expand the availability of complements
(e.g., subsidize entry)



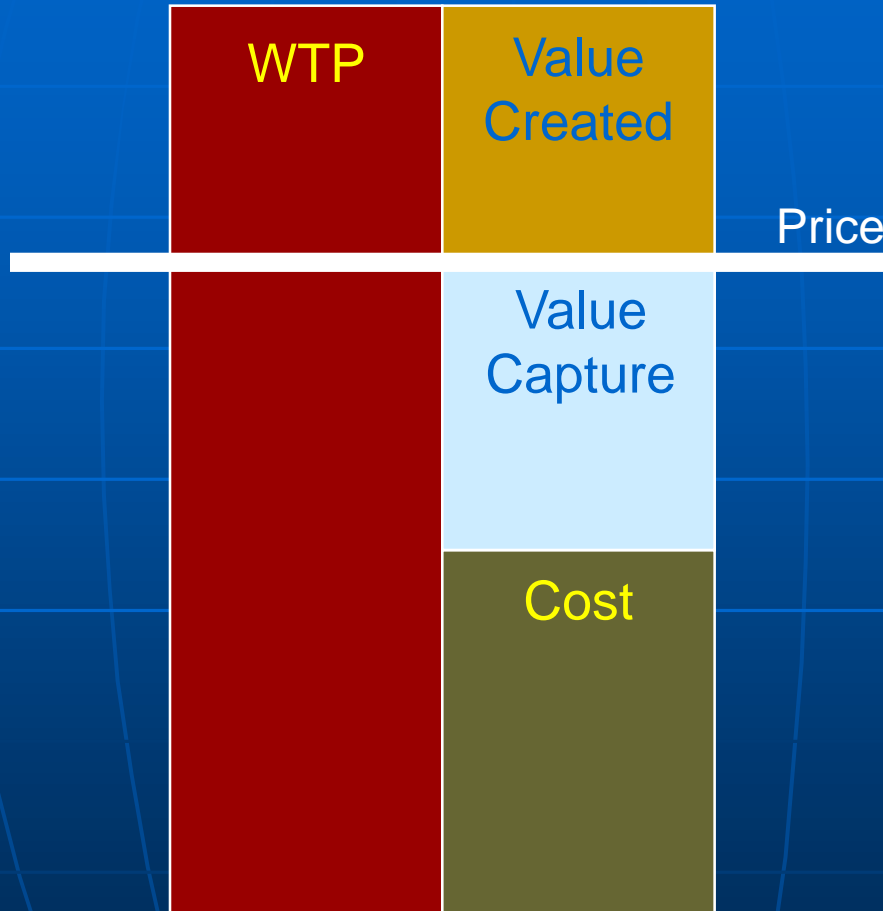
Positioning & the Value Wedge

Drive a wedge between WTP & Costs

- Value Created
 - willingness to pay
 - costs of providing good or service
- Value Captured

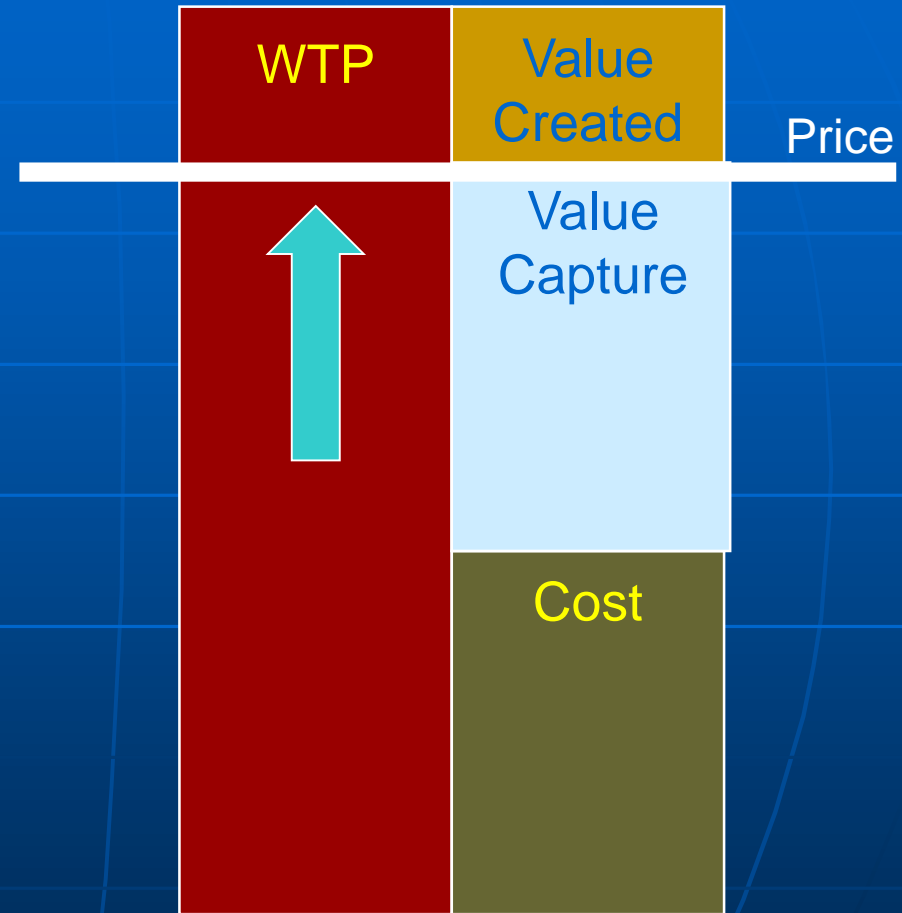


What are the options for capturing more value?



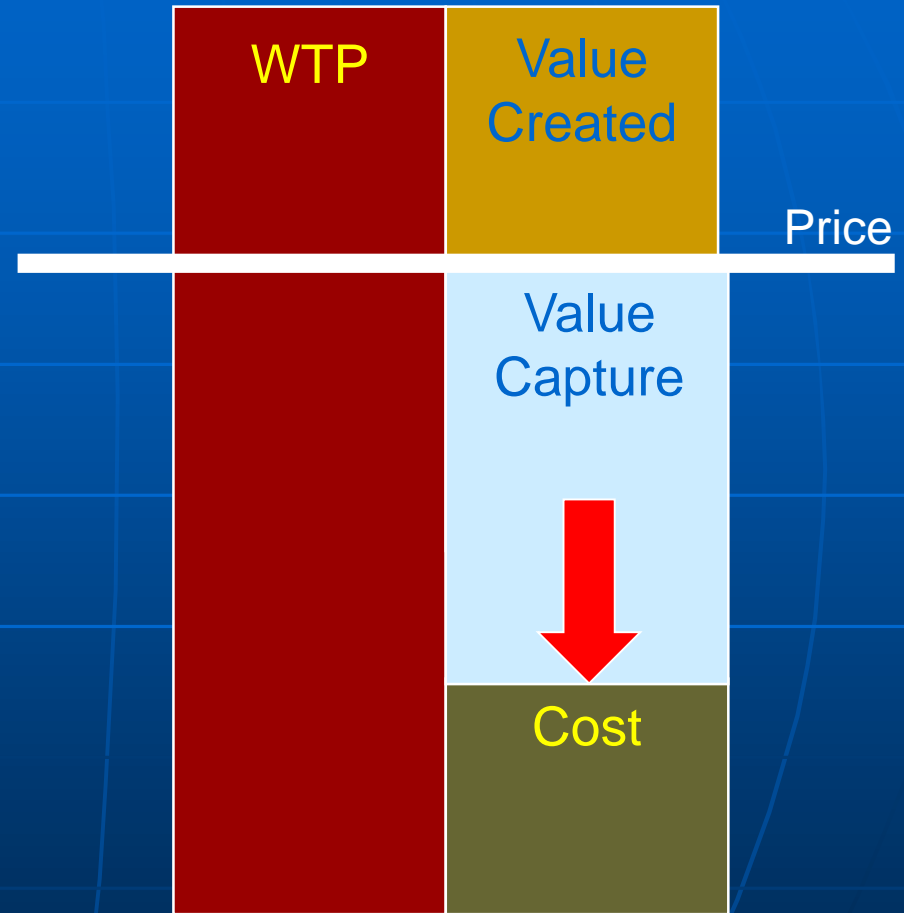
What are the options for capturing more value?

1. Raise WTP



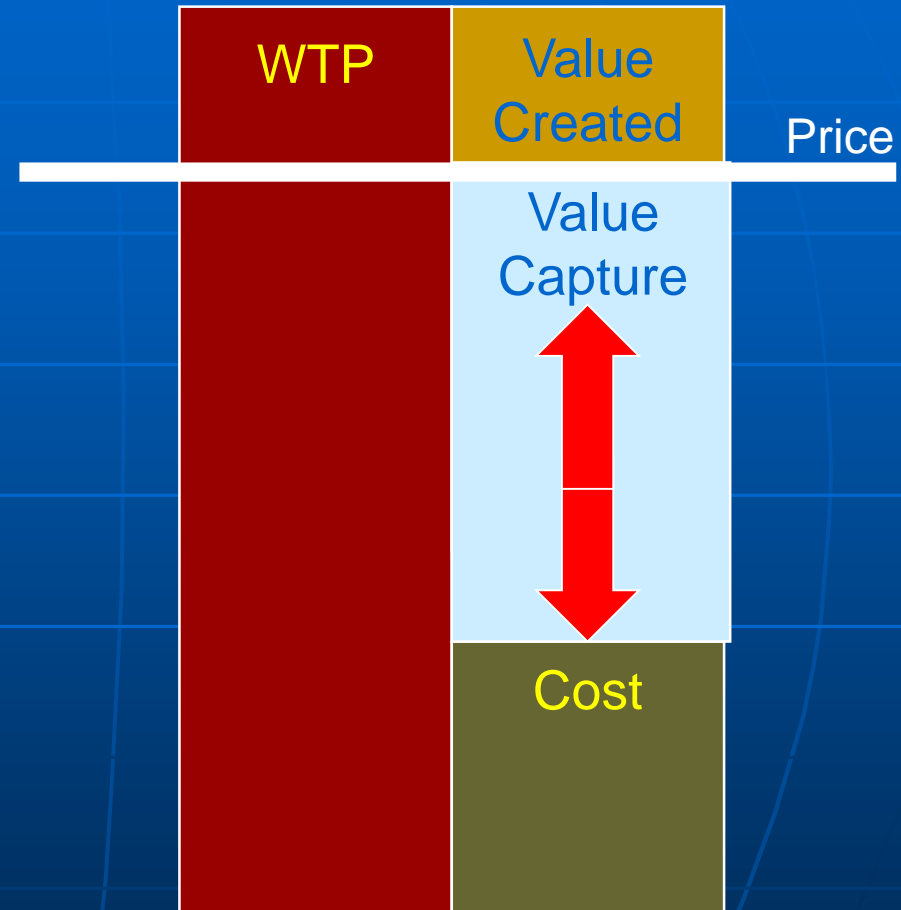
What are the options for capturing more value?

- 2. Lower costs

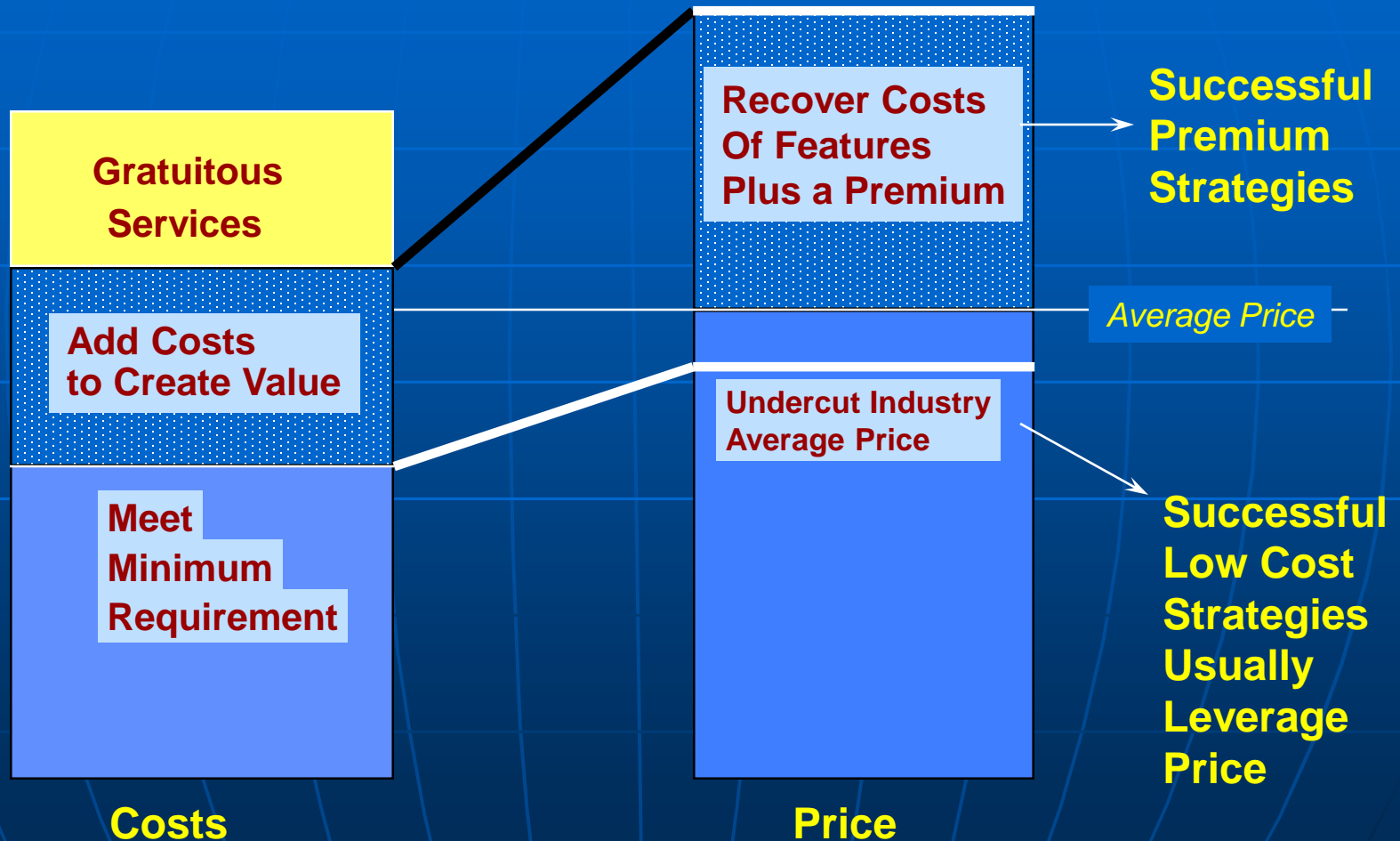


What are the options for capturing more value?

3. both



The Key to Creating Value



Choice & Competitive Advantage

- Strategy is about making choices
 - **Choosing and creating attractive industries**
 - **Building superior and sustainable competitive positions**
- Strategic analysis focuses on *doing the right thing*
 - » **Key choices can be the life or death of the corporation, e.g.:**
 - **Apple -- launch of the iPod, make it work on Windows**
- Great choices always have to be combined with *doing things right*
 - » **Execution**
 - » **Operational efficiency**
 - » **Continuous improvement**

Final Thoughts:

Warren Buffet

- “When an **industry** with a reputation for difficult economics meets a **manager** with a reputation for excellence...,
- it is usually the **industry** that keeps its reputation intact.”
- **IMPLICATION:**
 - **START BY UNDERSTANDING YOUR INDUSTRY**

The Purpose of Strategy:

“ Philosophers have only interpreted the world. The point, however, is to change it. ”

Karl Marx

A few practical tips:

- **Start with your performance?**
 - Good/Bad? Trends? Why?
 - What makes money? Loses money? Why?
- **Is it due to the industry?**
 - Overall attractiveness? Improving/worsening?
 - Where are changes occurring in industry structure? What's driving the change? What's the impact of change?
 - **Focus on the relevant players, not on product or industry boundaries alone**
- **What is our competitive advantage?**
 - Why do customers buy? Not buy it?
 - What do customers value? Why?
 - What are the key drivers of cost in the business?
 - What activities do we do differently than competitors? What do they do differently than us?
- **What are competitors doing?**
 - How do they win customers, etc...?
 - What changes have they made recently? Why?
 - What are they likely to do next?
 - Can they imitate or offset our advantage?

Appendix:

Some Public Sources of Industry Information

- **Industry studies**
 - **Book-length reports**
 - **Investment analyst reports**
 - **Conferences and tradeshow**
 - **Market research specialists**
- **Industry trade associations**
- **Business press**
 - **General publications (e.g., *Wall Street Journal*, *Fortune*)**
 - **Specialized industry trade journals**
- **Government sources**
 - **Bodies responsible for industry oversight**
 - **Antitrust, legal, or tax documents**
 - **Census or IRS data**
- **Industry and company directories (e.g., *Thomas' Register*, *Dun & Bradstreet directories*)**
- **Company sources**
 - **Annual reports**
 - **SEC filings, especially Form 10-K, proxies, and prospectuses**
 - **Company web sites**
 - **Public relations offices**
 - **Investment analyst reports**
 - **Online services (e.g., Bloomberg, OneSource, Compustat)**
 - **Company histories**

WTP – Questions to Ask

- **What do my customers value?**
 - **No customer, No business!**
- **What do final customers value?**
- **What do customers not value?**
- **How do customers use existing products to satisfy their needs?**
- **Can we use complementors to create more value for the customer?**