

Different views of strategy

Strategy is about organizational *change*.¹ An action is strategic when it allows a firm to become better than its competitors, and when this ‘competitive advantage’ can be *sustained*. This means that not all decisions are strategic: some decisions are, for example, simply dedicated to maintaining the status quo. Others might increase a firm’s competitiveness but in a way that is not sustainable in the future. In answering the question ‘What is strategy?’, some focus more on the role of strategy in allowing a firm to ‘position’ itself in an industry, hence to make choices regarding ‘what game to play’. Others focus more on the role of strategy in determining how well a given game is played. Strategy is about both: choosing new games to play and playing existing games better.

One of the biggest disagreements amongst strategy researchers concerns the *process* by which strategies emerge (see readings in Section 1). Some describe strategy as a rational and deliberate process (the Design school), while others describe it as an evolutionary process which emerges from experimentation and trial and error (the Evolutionary and Processual schools). Some place more emphasis on external factors, like the structure of the industry to which the firm belongs (e.g. the Industrial Organization approach), while others place more emphasis on factors internal to the organization, like the way production is organized (e.g. the Resource-Based approach). Furthermore, some describe a relatively *static* relationship between strategy and the environment where firms respond to external conditions (the Structure-Conduct-Performance approach), while others describe a *dynamic* picture of competition, where firms not only are influenced by the environment, but also actively seek to change it (e.g. the Schumpeterian approach). This feedback relationship between firm strategy and the environment is the focus of industry ‘lifecycle’ studies which look at the sources and effects of changes in industry structure.

Internal versus external factors

Today the study of strategic management pays much more attention to intra-organizational dynamics than it did in the past 20 or so years. Strategy is seen as primarily determined no longer by market conditions external to the firm but by organization-specific factors, for example the way that information flows inside an organization and how new knowledge is created.

The competitive forces approach to strategy, developed by Michael Porter in the 1980s (see readings in Section 2), is an example of the view of strategy that places primary importance on external conditions faced by the firm. In this view, strategy is about the firm creating for itself a ‘market position’ whereby it can defend itself from competitive forces and/or influence them in a way that places it at an advantage *visà-vis* its competitors and suppliers. Porter focuses on the effect of five industry-level forces impacting on strategy and performance: entry barriers, threat of substitution, bargaining power of buyers, bargaining power of suppliers and rivalry among industry incumbents. This framework is connected to the ‘structure–conduct–performance’ approach to industrial organization, where the structure of an industry (e.g. how easy it is for new firms to enter) determines firm conduct/strategy (e.g. innovation strategies) and hence firm performance (e.g. profits).

A different way of thinking about strategy is to give primary role to intra-organizational factors. This view is best exemplified by the ‘resource-based theory of the firm’, which has its roots in the work of Edith Penrose. Penrose suggested viewing the firm as a ‘pool of resources’. Resources include not just tangible resources (like buildings, machinery and research labs) but also intangible ones embodied in skills and in the interactions between people and systems. Intangible resources are *unique* to each firm and, when a firm finds itself with different uses for its excess resources, it will often choose those combinations that are tied most closely with its previous activities. The fact that the firm’s prior experience and history matter means that firm growth is often path-dependent: where the firm goes tomorrow depends on *how* it got to where it is today (its future path depends on its previous path). The main point is that value is created not only by the quantity of physical capital, land and labour that the firm owns but also, and especially, how it combines its different resources (i.e. how the different resources interact). Modern strategy theorists, inspired by Penrose, have called this ability to combine resources in an innovative and efficient way the firm’s ‘capabilities’ or ‘competencies’. Unique capabilities refer to the productive activities that the firm is very good at. Core competencies refer to those broad capabilities that are essential to the firm’s performance and that allow it to enter different product markets. Competencies are unique, and hence hard to imitate, because they are the results of particular combinations and interactions between different resources. Since different firms have different capabilities, their implementation of strategies will differ.

The focus on intra-organizational dynamics is supported by empirical studies which have shown that inter-firm differences in rates of return are primarily due to firmspecific factors. For example, Rumelt (1991) found that 46.4 per cent of a business unit’s profitability can be accounted for by business-specific factors (i.e. choice of strategy) and only 8.3 per cent by general factors related to the industry to which it belongs. The reading by Baden-Fuller and Stopford in Chapter 6 will also support this by providing case study evidence of firms succeeding in industries which are considered no longer profitable (or ‘attractive’). *However, the fact that intra-organizational factors are very important does not mean that industry-specific factors,*

like industry structure, do not matter! In fact one of the most innovative areas of strategy analysis has to do with how firm strategy changes over the industry life-cycle and how strategy and structure co-evolve (Klepper, 1997). These studies have focused especially on the changing role of firm-led technological change: the structure of an industry will constrain the amount and type of firm innovation at any one moment in time, yet industry structure will itself evolve depending on the characteristics of the innovation activity. One of the biggest challenges in strategy analysis is to find an innovative framework through which firm-level and industry-level factors can both be analysed.

Inter-firm differences

Theories of strategy embody specific explanations for why firms within and between industries differ in their performance. For example, the market positioning framework views differences between firms as resulting from the different characteristics of the markets they operate in. ‘Imperfect competition’ is often blamed for not allowing all firms to achieve the same level of efficiency and hence performance. Examples of market imperfections are barriers to entry which prevent new firms from competing with incumbents, or information asymmetries that allow only some firms access to special information/knowledge. It is assumed that such differences will disappear in the ‘long run’ when ‘perfect competition’ is restored. Instead, in the ‘resource based approach’ firm differences arise not from imperfect markets but from firms actively seeking to differentiate themselves via their unique competencies and capabilities. These differences will persist even in the long run since by definition competencies and capabilities are difficult to imitate and strategy is about renewing core competencies.

Since capabilities are developed over time in a cumulative and complex manner, firm differences are accentuated by the dynamics of increasing returns and path dependency: those firms able to develop unique capabilities today are more likely to develop them tomorrow. In fact empirical studies on technological change have found firm innovation to often (not always) be characterized by persistence: successful innovators today are likely to innovate in the future. This is because the ability to innovate depends on prior innovation, prior related knowledge and diversity of background – what Cohen and Levinthal in Chapter 14 call ‘absorptive capacity’. This ‘rich gets richer’ dynamic can lead to concentrated markets until the industry undergoes a fundamental product change (or ‘architectural innovation’ as studied in Chapter 11). And yet, sometimes, it is new players who are not burdened by tradition and existing rules that are the best innovators. They are more prone to ‘think differently’ and to thus challenge the status quo. The readings in Sections 4 and 5 will examine under which conditions it is the incumbents or new comers that are more likely to lead the innovation process. The readings in Section 6 explore how the path-dependent nature of the development of capabilities is even stronger in knowledge-based sectors, such as information technology.

Competition

The fact that, in the resource-based perspective, differences between firms are due not to ‘market imperfections’ but to the competitive process by which firms actively try to differentiate themselves, means that what is also at stake in strategy theory is the underlying view of competition. The resource-based perspective is more compatible with a Schumpeterian view of competition where firms are viewed as actively competing against each other for technological superiority. Schumpeter (1934) called this process ‘creative destruction’, i.e. the process by which firms *create* new products, processes and markets *destroys* the advantage of firms that built their success with previous, now obsolete, technologies. Technological change thus often leads to turbulence in market shares of firms, especially when new firms enter an industry through the introduction of a radical innovation. The readings in Section 4 study different reasons why large incumbent firms are often not the best innovators.

A relatively new branch of economics called ‘evolutionary economics’ has concentrated its efforts in using Schumpeter’s work on technological change to develop a new theory of competition where the focus is on the co-evolution of mechanisms that create differences between firms and mechanisms of competitive selection that winnow firms via those differences (Nelson and Winter, 1982). Competition is described here as a disequilibrium process whereby firm-specific technological change and processes of increasing returns shape both the internal organization of the firm and market outcomes. Nelson (1991) connects the point about inter-firm differences to competition in this way:

I want to put forth the argument that it is organizational differences, especially differences in abilities to generate and gain from innovation, rather than differences in command over particular technologies, that are the source of durable, not easily imitable, differences among firms. Particular technologies are much easier to understand, and imitate, than broader firm dynamic capabilities . . . Competition can be seen as not merely about incentives and pressures to keep prices in line with minimal feasible costs . . . but, much more important, about exploring new potentially better ways of doing things.

Content of volume

The readings in this volume were chosen for their ability to together tell a ‘dynamic’ story about strategy: a story which explores the feedback relationship between firm strategy and the environment. The older pieces are classics in the field of strategy and continue to provide the theoretical background for more recent innovative pieces. The issues addressed by these newer pieces lie at the centre of strategy analysis today.

Section 1 introduces the study of strategic management by diving into a particular definition of strategy and then stepping back and looking at various

theoretical perspectives on the processes that determine strategy, each of which embodies specific assumptions on human nature and on the interaction between individual action and the environment. Section 2 introduces a fundamental distinction in strategy analysis: the focus on external industry characteristics versus the focus on the internal organizational dynamics. As reviewed briefly earlier in this introduction, the former looks at the role of industry structure in determining firm strategy and performance, while the latter looks at the role of resources and capabilities developed *inside* the firm. Section 3 focuses on how the *internal* organization of the firm affects strategy and performance. It builds on Penrose's notion of the firm as a 'pool of resources' to study the origin of firm-specific capabilities and competencies. Section 4 focuses on a particular type of organizational capability: the capability to innovate. The readings illustrate how technological innovation depends on firm-specific characteristics like firm size (are small firms or large firms better innovators?) and the internal organization of the firm. Section 5 continues the discussion by considering the ways in which organizations can be structured to stimulate individual and organizational learning and the management of new knowledge. Section 6 considers the implication of recent changes in the world economy for strategic behaviour. The changes considered are the rise of information technology and the increasingly global nature of competition, both of which are considered to be part of the 'new economy'.

Notes

- 1 Although the word 'firm' (or business) is used here and in most of the readings, the unit of analysis in strategy theory is the organization. We use the two words interchangeably.

References

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