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CHAPTER 1

Strategy, Markets, and Competition

WHAT IS STRATEGY?

For at least the last half century, strategy has been a major focus of management concern. The Allied victory in the Second World War highlighted the necessity of grand strategy for success in warfare, and in the subsequent decades, corporate chieftains appropriated the concept for their own battlefields. Today, strategy is a primary business school discipline. Most major companies have in-house strategic planning units, and those that don't often hire teams of outside consultants to come in and guide the process.

Over the decades, definitions of strategy have changed, and the processes for developing it have undergone endless modifications and revolutions. Some companies have even abandoned formal processes altogether. Yet within all of this flux, one feature of strategy has stood out to distinguish it from other management responsibilities.

Strategy is big. Unlike tactical choices, everyone knows strategic decisions mean long-term commitments for the organization. They require large allocations of resources. Top management makes the strategic decisions. And setting strategy entails arduous research and bone-wearying meetings. Changing strategies is like changing the direction of an aircraft carrier—it doesn't happen quickly.

In World War II, the highest-level strategic decision made by the United States was whether to fight the major campaign first in Europe

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TABLE 1.1
Distinctions between strategic and tactical decisions

	Strategic Decisions	Tactical (and Operational or Functional) Decisions
Management level	Top management, board of directors	Midlevel, functional, local
Resources	Corporate	Divisional, departmental
Time frame	Long term	Yearly, monthly, daily
Risk	Success or even survival	Limited
Questions	What business do we want to be in?	How do we improve delivery times?
	What critical competencies must we develop?	How big a promotional discount do we offer?
	How are we going to deal with competitors?	What is the best career path for our sales representatives?

or in the Pacific. Other strategic decisions at somewhat lower levels were the commitment to open a second front and the selection of the Normandy beaches for the invasion of Europe. On the corporate side, AT&T's two separate decisions to enter the information processing business and to spin off local telephone service were strategic choices.* Neither was successful. General Electric's policy, enunciated long before Jack Welch became CEO, that it would leave any business in which it did not have a leading market share, was a strategic principle.

Occasionally, enormous consequences flow from decisions that at the time do not look strategic. When IBM entered the personal computer business, it chose an open standards approach and made two build-or-buy decisions that probably seemed inconsequential and merely tactical. Rather than developing the operating system itself, it licensed one from a tiny company no one had heard of. It made a similar choice for the microprocessor, giving the business to another supplier. These decisions created two of the most successful business franchises of all time, Microsoft and Intel. These companies, rather than IBM, became the beneficiaries of the boom in personal computing. In retrospect, these were clearly strategic decisions with enormous conse-

*The Justice Department had demanded that AT&T restructure in some way, but the company itself was deeply involved in formulating the strategy by which the Regional Bell Operating Companies were spun off.

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quences. If we were to look closely at the history of big outcomes, we would no doubt find that many others were not results of any strategic planning process but were either unintended by-products of some other decision or simply were results on a much larger scale than anticipated.

But big, whether measured by financial commitments or hours spent in planning, or even outcomes, is not the same thing as strategic. Although size and significance are aspects of most strategic business decisions, we propose that they are not the defining criteria. We think the dividing line between strategy and tactics lies elsewhere.

In our view, strategic decisions are those whose results depend on the actions and reactions of other economic entities. Tactical decisions are ones that can be made in isolation and hinge largely on effective implementation. Understanding this distinction is key to developing effective strategy.

Formulating effective strategy is central to business success. It is also extremely challenging. The most valuable resource in any business is management attention, especially the attention of high-level management. This attention should not be squandered on a range of unfocused or inappropriate objectives or consumed by endless discussions about the proper direction for the firm. Our goal in this book is to present a clear step-by-step process for strategic analysis, first to help a firm understand where it fits in the competitive environment and second, to guide it in its strategic choices.

STRATEGIC VS. TACTICAL ISSUES

Consider this example. Responding to the success of the Jeep in the mid 1980s, many automobile companies chose to produce a sport utility vehicle. The decision to enter the SUV market was strategic for those companies. After that, everything was tactical. Success depended on efficient performance, including the appropriate investments in plants and equipment, marketing campaigns, design and engineering time, and management attention devoted to continuous organizational improvement. That's because, given the competitive nature of this market, and the ease with which all the companies could enter, no firm needed to concern itself with the actions of its competitors. There

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were simply too many to worry about. Success depended on skillful implementation.

Strategic choices, in contrast to tactical ones, are outward looking. They involve two issues that every company must face.

The first issue is selecting the arena of competition, the market in which to engage. All the illustrations we've cited—the United States picking the prime theater of operations in World War II, AT&T's selection of markets to enter and to abandon, General Electric's policy of qualifying business segments in which to compete—involve this kind of choice. So did IBM's decision to outsource the operating system and the microprocessor for its PC; it opted not to compete in those markets. The choice of markets is strategic, according to our definition, because it determines the cast of external characters who will affect a company's economic future.

The second strategic issue involves the management of those external agents. In order to devise and implement effective strategy, a firm has to anticipate and, if possible, control the responses of these external agents. Both theory and experience indicate that this is no easy task. These interactions are complicated and uncertain. There are no exact prescriptions available for the managers who have to make strategic decisions or for the business scholars who have to explain why certain ones work out better than others. All the best-in-class disciplines in the world cannot predict with absolute certainty how some testosterone-crazed CEO will respond to your latest move. Yet devising strategy without taking that response into account can be a glaring mistake.

ONE SINGLE FORCE

Thanks to Michael Porter's groundbreaking work, *Competitive Strategy,* published in 1980, strategic thinking in recent years increasingly has come to recognize the importance of interactions among economic actors. By concentrating on external agents and how they behave, Porter clearly moved strategic planning in the right direction. But, for many people, identifying the many factors in Porter's complex model and figuring out how they will play off one another has proven to be frustratingly difficult. What we are proposing here is a radically simpler approach.

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We agree with Porter's view that five forces—Substitutes, Suppliers, Potential Entrants, Buyers, and Competitors within the Industry—can affect the competitive environment. But, unlike Porter and many of his followers, we do not think that those forces are of equal importance. One of them is clearly much more important than the others. It is so dominant that leaders seeking to develop and pursue winning strategies should begin by ignoring the others and focus only on it. That force is *barriers to entry*—the force that underlies Porter's "Potential Entrants."

If there are barriers, then it is difficult for new firms to enter the market or for existing companies to expand, which is basically the same thing. Essentially there are only two possibilities. Either the existing firms within the market are protected by barriers to entry (or to expansion), or they are not. No other feature of the competitive landscape has as much influence on a company's success as where it stands in regard to these barriers.

If there are no barriers to entry, then many strategic concerns can be ignored. The company does not have to worry about interacting with identifiable competitors or about anticipating and influencing their behavior. There are simply too many of them to deal with.

With a universe of companies seeking profitable opportunities for investment, the returns in an unprotected industry will be driven down to levels where there is no "economic profit," that is, no returns above the costs of the invested capital. If demand conditions enable any single firm to earn unusually high returns, other companies will notice the same opportunity and flood in. Both history and theory support the truth of this proposition. As more firms enter, demand is fragmented among them. Costs per unit rise as fixed costs are spread over fewer units sold, prices fall, and the high profits that attracted the new entrants disappear.

Life in an unprotected market is a game played on a level field in which anyone can join. In these markets, often but mistakenly identified as "commodity" markets,* only the very best players will survive and prosper, and even they have to be continually on their toes. Without the

*Most differentiated products also compete in markets where there are no barriers to entry, so differentiation, as we will illustrate, is not sufficient to protect a firm from the ravages of a highly competitive market.

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protection of barriers to entry, the only option a company has is to run itself as efficiently and effectively as possible.

Operational effectiveness might be thought of as a strategy, indeed, as the only strategy appropriate in markets without barriers to entry. However, operational effectiveness, identified by Michael Porter as doing what rivals do but doing it better, is an internal matter. According to our definition of strategy, it is tactical rather than strategic. That does not make it insignificant. Operational effectiveness can be the single most important factor in the success, or indeed in the survival, of any business. In the last chapter of this book, we describe the extent to which a determined focus on operational effectiveness may carry one firm far ahead of its competitors, even though there is nothing that distinguishes its fundamental economic position from that of its less successful rivals.

Still, the pursuit of operational effectiveness does not require consideration of all the *external* interactions that are the essence of real strategy.

BARRIERS TO ENTRY AND COMPETITIVE ADVANTAGES

The existence of barriers to entry means that incumbent firms are able to do what potential rivals cannot. Being able to do what rivals cannot is the definition of a competitive advantage. Thus, *barriers to entry* and *incumbent competitive advantages* are simply two ways of describing the same thing. *Entrant* competitive advantages, on the other hand, have no value. By definition, a successful entrant becomes the incumbent. It then is vulnerable to the next entrant, who benefits from newer technology, less expensive labor, or some other temporary competitive edge. And because there are no barriers to entry, the cycle doesn't stop. So it is only in the presence of incumbent competitive advantages that strategy, in our sense of the term, comes to the fore.

LOCAL CHAMPIONS

In an increasingly global environment, with lower trade barriers, cheaper transportation, faster flow of information, and relentless competition from both established rivals and newly liberalized economies, it

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might appear that competitive advantages and barriers to entry will diminish. The fate of once powerful American firms in industries like machine tools (Cincinnati), textiles (Burlington Industries, J. P. Stevens), and even automobiles (Chrysler, GM, and Ford) seems to support this position. Either profits have shrunk or companies have disappeared entirely under the onslaught of imports. But this macro view misses one essential feature of competitive advantages—that competitive advantages are almost always grounded in what are essentially "local" circumstances.

Consider the history of Wal-Mart, one of the greatest economic success stories of the late twentieth century. The retail business, especially discount retailing, is not an industry with many trade secrets or rare skills. The practices for which Wal-Mart is known, like "everyday low prices" and efficient distribution, are hardly proprietary technologies, impossible for other firms to duplicate. Yet Wal-Mart has successfully dominated many, although not all, of the markets in which it competes. The way in which it achieved this position is instructive.

Wal-Mart began as a small and regionally focused discounter in a part of the country where it had little competition. It expanded incrementally outward from this geographic base, adding new stores and distribution centers at the periphery of its existing territory. The market that it dominated and in which it first enjoyed competitive advantages was not discount retailing in the United States, but discount retailing within a clearly circumscribed region. As it pushed the boundaries of this region outward, it consolidated its position in the newly entered territory before continuing its expansion. As we shall see, when it moved too far beyond its base, its results deteriorated.

The same process of establishing local dominance and then expanding into related territories accounts for two of the other great corporate achievements of the period, although in these cases the geography in question is product market space, not physical territory.

Microsoft began by dominating one particular segment, the operating system for IBM-type personal computers. It faced some competitors at the start, including for a time IBM itself, but Microsoft was able to establish and secure competitive advantages and marginalize all the other players. It expanded successfully at the edges of this business, adding adjacent software products like word processing, spreadsheets, and other

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productivity tools. Even as a much larger company, with an extensive product line, the core of its profitability remains the operating system and the adjacent software.

Apple's experience stands in stark contrast. From the start, Apple took a more global approach than Microsoft. It was both a computer manufacturer and a software producer. Its Macintosh operating system anticipated the attractive features of Windows by many years—"Windows 95 = Macintosh 87," as the saying goes. Yet its comprehensive product strategy has been at best a limited and occasional success, especially when compared to Microsoft's more focused approach.

Intel's history is closer to Microsoft's. It began life as a manufacturer of memory chips in the 1970s and was profitable for a time in that market. It also designed and produced microprocessors, one of which was selected by IBM as the heart of its new PC in 1980. Intel continued in both businesses for several years, but it began to lose out on the memory chip side to companies with lower costs and fewer defects. It made the decision in 1985 to abandon that business, even though memory chips were part of its corporate DNA. By concentrating on microprocessors, Intel restored and increased its profitability and has maintained its dominance in that large market ever since.

Competitive advantages that lead to market dominance, either by a single company or by a small number of essentially equivalent firms, are much more likely to be found when the arena is local—bounded either geographically or in product space—than when it is large and scattered. That is because the sources of competitive advantage, as we will see, tend to be local and specific, not general or diffuse.

Paradoxically, in an increasingly global world, the key strategic imperative in market selection is to *think locally.* Dominance at the local level may be easier to accomplish than one might initially think. If the global economy follows the path of the more developed national economies, service industries will become increasingly important and manufacturing less significant. The distinguishing feature of most services is that they are produced and consumed locally. As a consequence, opportunities for sustained competitive advantages, properly understood, are likely to increase, not diminish. The chances of becoming the next Wal-Mart

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or Microsoft are infinitesimal, but the focused company that understands its markets and its particular strengths can still flourish.

WHICH COMPETITIVE ADVANTAGES?

Strategic analysis should begin with two key questions: In the market in which the firm currently competes or plans to enter, do any competitive advantages actually exist? And if they do, what kind of advantages are they?

The analysis is made easier because there are only three kinds of genuine competitive advantage:

- **Supply.** These are strictly cost advantages that allow a company to produce and deliver its products or services more cheaply than its competitors. Sometimes the lower costs stem from privileged access to crucial inputs, like aluminum ore or easily recoverable oil deposits. More frequently, cost advantages are due to proprietary technology that is protected by patents or by experience—know-how—or some combination of both.
- **Demand.** Some companies have access to market demand that their competitors cannot match. This access is not simply a matter of product differentiation or branding, since competitors may be equally able to differentiate or brand their products. These demand advantages arise because of customer captivity that is based on habit, on the costs of switching, or on the difficulties and expenses of searching for a substitute provider.
- **Economies of scale.** If costs per unit decline as volume increases, because fixed costs make up a large share of total costs, then even with the same basic technology, an incumbent firm operating at large scale will enjoy lower costs than its competitors.

Beyond these three basic sources of competitive advantage, government protection or, in financial markets, superior access to information may also be competitive advantages, but these tend to apply to relatively few and specific situations. The economic forces behind all three primary

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sources of competitive advantage are most likely to be present in markets that are local either geographically or in product space. Pepsi loyalists have no particular attachment to Frito-Lay salty snacks, any more than Coke drinkers prefer movies from Columbia Studios when that was owned by Coca-Cola. Nebraska Furniture Mart, the store Warren Buffett bought for Berkshire Hathaway one afternoon, is a dominant player in Omaha and its hinterland, more powerful there than Ethan Allen or other large national furniture retailers.

As we examine the workings of the different sources of competitive advantages through detailed examples, the benefits of operating in markets with limited boundaries will become apparent, as will the difficulties of establishing or sustaining dominance where the boundaries are vast. Most companies that manage to grow and still achieve a high level of profitability do it in one of three ways. They replicate their local advantages in multiple markets, like Coca-Cola. They continue to focus within their product space as that space itself becomes larger, like Intel. Or, like Wal-Mart and Microsoft, they gradually expand their activities outward from the edges of their dominant market positions.

THE PROCESS OF STRATEGIC ANALYSIS

The natural starting point for any strategic analysis is a market-by-market assessment of the existence and sources of competitive advantages.

When there are no competitive advantages present, then genuine strategic issues are of little concern. Therefore, in markets along the "Competitive Advantage: No" branch in figure 1.1, operational effectiveness—efficiency, efficiency, efficiency—is both the first priority and the last.

But for markets along the "Competitive Advantage: Yes" branch, where companies do benefit from competitive advantages, the next step is to identify the nature of the competitive advantages and then to figure out how to manage them. The alternatives are not pleasant. If the advantages dissipate, whether through poor strategy, bad execution, or simply because of the unavoidable grindings of a competitive economy, these firms will find themselves on a level economic playing field—the no-

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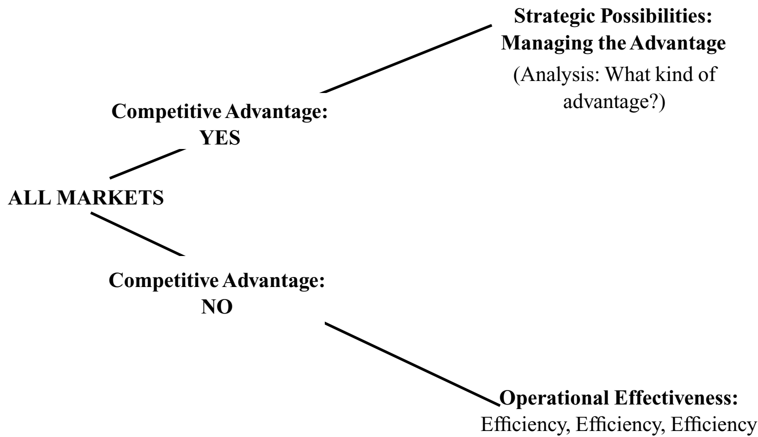

FIGURE 1.1
Strategic analysis, step one

competitive-advantage branch—where life is all work and where profits, except for the exceptionally managed companies, are average at best.

THE COMPETITIVE LANDSCAPE

MANAGING COMPETITIVE ADVANTAGES

By definition, in any market in which companies enjoy a competitive advantage, there will be a short list of legitimate competitors. At the extreme, companies such as Microsoft in the world of PC operating systems or IBM in its golden days will find themselves alone or surrounded by dwarfs. From their perspective, their competitors constitute an army of ants who can't enjoy the picnic because they are outside the barriers to entry. These firms are free to make their decisions without regard to what the ants might do in response to their initiatives. They need not spend much time anticipating specific competitive interactions.

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In this situation—generally one large firm and many smaller ones—a company is either an ant or an elephant. The ants, outside the walls and looking in, operate at a competitive disadvantage. The strategy for a firm that finds itself in the ant's position is clear-cut. If it is already in the industry, it should consider getting out as painlessly as possible and returning to its owners as much of its economic resources as are salvageable. Admittedly, the list of CEOs who have followed this prescription is short. If it is considering getting into the business, the company ought to stop and look elsewhere because whatever slim chance it has for success depends entirely on the elephant competitor messing up.

And then, even if the incumbent's advantage shrinks and the barriers to entry disappear, the new firm will be just one of many entrants pursuing profit on an essentially level playing field. It should remind itself of Groucho Marx's rule not to join any club that would have him as a member. At best, economic life will be average, with normal profits; more likely, the elephant trods on it and the ant gets crushed.

For an elephant operating within the barriers, life is sweet and returns are high. But competitive advantages still have to be managed. Complacency can be fatal, as can ignoring or misunderstanding the sources of one's strength. An elephant's first priority is to sustain what it has, which requires that it recognize the sources and the limits of its competitive advantages.

A thorough understanding makes all the difference:

- It allows the firm to reinforce and protect existing advantages and to make those incremental investments that can extend them.
- It distinguishes those potential areas of growth—both geographically and in product lines—that are likely to yield high returns from tempting areas that would undermine the advantages.
- It highlights policies that extract maximum profitability from the firm's situation.
- It spots the threats that are likely to develop and identifies those competitive inroads that require strong countermeasures.

For functional departments within the firm, understanding the nature of the competitive advantages is essential for capital budgeting,

for marketing, for evaluating mergers and acquisitions, and for new ventures.

In these markets of one dominant firm and an army of ants, strategic analysis for the dominant firm consists almost exclusively of understanding and managing competitive advantages. It doesn't need to confront the complexities of explicit mutual interactions among competitors. We illustrate this state in figure 1.2, which extends figure 1.1.

CONFLICTS AS GAMES: INTERACTING WITH COMPETITORS

In the remaining strategic situations, several companies enjoy roughly equivalent competitive advantages within a single market setting. The soft drink market in the United States is a prime example. Nationally, Coke and Pepsi are two elephants, with the other players considerably smaller, although in particular geographic markets, regional favorites like Dr Pepper may be legitimate competitors. Commercial aircraft manufacturing has a similar structure. Boeing and Airbus control the

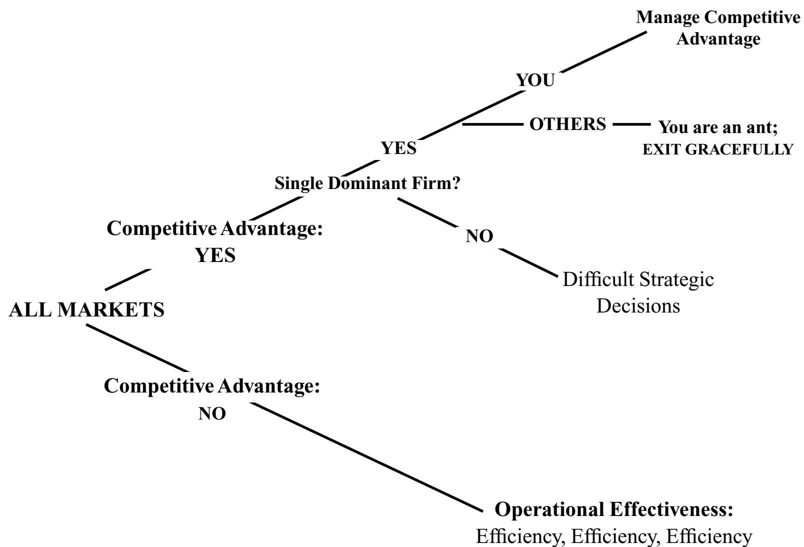

FIGURE 1.2
A single dominant firm

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market for larger jets, with the smaller manufacturers like Embraer and Bombardier competing in the regional jet market. In the personal computer business, Intel and Microsoft dominate their specific niches, but they compete indirectly against one another for a share of the overall value created in the industry.

It is for companies in these markets, those that enjoy the benefits of competitive advantages but with potent competitors of similar capabilities, that strategy formulation is most intense and demanding. They face the big challenge of figuring out how to manage their competitors.

To develop an effective strategy, a company not only needs to know what its competitors are doing, but to also be able to anticipate these competitors' reactions to any move the company makes. This is the true essence of strategic planning. It embraces all of the things a company does in which a competitor's direct reactions are critical to its performance—pricing policies, new product lines, geographical expansions, capacity additions.

There are several distinct approaches that are particularly valuable in developing competitive strategies: game theory, simulation, and cooperative analysis.

Classical game theory is primarily useful because it imposes a systematic approach to collecting and organizing the mass of information about how competitors may behave. Game theory, as the *Stanford Encyclopedia of Philosophy* describes it, is "the study of the ways in which *strategic interactions* among *rational players* produce *outcomes* with respect to the *preferences* (or *utilities*) of those players, none of which might have been intended by any of them."

The salient features of a competitive situation are:

- *The players*—a restricted number of identifiable actors, generally competitors; if the list is not short and manageable, there are probably no genuine barriers to entry
- *The actions* each player can pursue—the choices that are available to them
- *The motives* that drive them—profitability is the most common in business, but other goals, like winning against competitors regardless

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of the costs to oneself, may take hold and therefore need to be considered

- *The rules* that govern the game—who goes when, who knows what and when, and what penalties there are for breaking the rules

Fortunately, the fundamental dynamics of the great majority of competitive situations can be captured by two relatively simple games.

The prisoner's dilemma (PD) game has been thoroughly studied theoretically, historically, and experimentally. It describes competition that concerns price and quality. A great deal is known about how a PD game is likely to play out, and this knowledge can be brought to bear on any situation in which price/quality competition is a key to competitive interactions. We describe the PD game in chapter 7 and use it to analyze competitive interactions in chapters 9 and 10.

Another game focuses on entry/preemption behavior, by capturing the dynamics of quantity and capacity competition (unfortunately this game lacks a catchy name). Whenever a company decides to build a new plant or open a new store in a market served by a competitor, entry/preemption is the game being played. There is also a wealth of established knowledge about how this game works out. We will discuss entry/preemption in chapter 11 and illustrate its principles at play in chapters 12 and 13.

Given these available insights, a valuable approach to strategic analysis is to start by putting this received wisdom to use. First you must identify the competitive situations to which one or another of these two games can appropriately be applied. For example, if an industry's history has been dominated by a long-lived and debilitating price war, then the natural place to look for a solution is the accumulated knowledge about how to play the prisoner's dilemma game. If the industry is one in which any expansion by one firm has habitually induced its rivals to counter with their own expansions, then the entry/preemption game provides the template for strategic analysis.

In simple, straightforward interactions, it may be possible to anticipate how the game will evolve merely by listing the various courses of action and comparing the results. In practice, however, alternative possi-

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bilities multiply rapidly, and the analysis becomes intractable. In many cases, a better way to proceed is by simulation. One can assign individuals or teams to represent each competitor, provide them with appropriate choices for actions and with motives, and then play the game several times. The simulation should provide a rough sense of the dynamics of the situation, even though the outcomes are only rarely definitive.

A Cooperative Alternative

In addition to classic games and simulations, another approach to analyzing competition among the elephants is to assume that instead of battling, companies can learn how to cooperate for mutual gain and to fairly share the benefits of their jointly held competitive advantage. This type of interaction among competitors—which could also be called "bargaining"—makes all the players better off, but it requires an outlook and a disposition rarely found in this environment.

Players, nonetheless, need to think about what this ideal state of affairs would look like, even if it is not immediately practical. They need to identify joint gains and envision the best configuration of market activity. This would be the one in which costs are minimized, products and services most efficiently produced and delivered, and prices set to maximize income. In this ideal configuration, everyone in the market, including their competitors, must benefit. In other words, if this market were organized as a cartel or a monopoly, what would it look like? The players also have to decide upon a fair division of the spoils, because cooperative arrangements do not last if any participant believes it is being unfairly treated.

This analysis of the theoretically ideal market configuration has two distinct benefits. First, it identifies the possibilities that a cooperative posture might produce. Second, it helps a firm on the margin of a protected market, or a potential entrant, to set reasonable strategic goals.

For example, the relatively high-cost supplier with no captive customers should see that it cannot expect to gain any advantage through strategic alliances, competitive threats, or other means. That's because, if the market is configured efficiently, such a supplier has really no role to play. Why should other, more powerful competitors support it at the

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price of a reduction in overall industry performance, especially when it is they who will inevitably pay the costs? In other words, if you don't bring anything to the dance, don't expect to take anything home.

When these conditions apply, the high-cost firm's continued existence will usually hinge on irrational and noncooperative behavior from the other companies. Identifying and exploiting that behavior—making sure they don't get together—thus becomes the core of its strategy.

In practice, a high level of cooperation among firms in any market is rare. Still, contemplating cooperative possibilities reveals aspects of the strategic situation that can guide company decision making even in the absence of full-fledged cooperation. It adds a bargaining perspective as a complement to the more traditional noncooperative assumptions embodied in classical game theory and other treatments of competitive interaction.

Taken together, these three approaches—application of knowledge about specific games (prisoner's dilemma, entry/preemption), simulation, and cooperative analysis—produce a balanced and comprehensive treatment of the problems of formulating strategy in markets with a few genuine competitors, all mutually capable and conscious of one another.

This last step in the analysis is depicted in figure 1.3, which extends the previous figures to incorporate those situations in which several firms with competitive advantages share a market.

THE ROAD AHEAD

In this chapter and the two that follow, we discuss competitive advantage in general (position 1 in figure 1.3). There are only a few types of competitive advantage (demand, supply, and economies of scale) and two straightforward tests (market-share stability and high return on capital) to confirm their existence. Next, we will cover those situations in which a single firm dominates a market, using historical examples to illustrate how the different companies have identified and managed their competitive advantages, some successfully, others less so (position 2). We will then discuss competitive interactions among firms that

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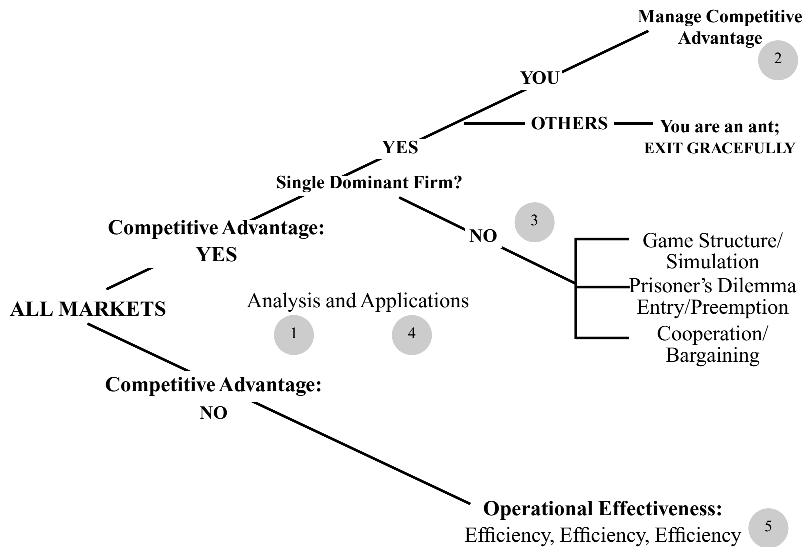

FIGURE 1.3
Architecture of the book

share a single market (position 3). For these companies, strategy can lead to continual war punctuated by the occasional cease-fire, or to long-term cooperation for mutual benefit.

In the later chapters of the book we apply the competitive advantage concepts to functional areas like valuation, mergers and acquisitions, and brand extensions (position 4). Finally, we will turn to those markets in which there are no barriers to entry or competitive advantages (position 5), to explain why some firms do much better than others even though there is no fundamental economic distinction between them. Good management matters enormously. The key to operational effectiveness is relentless focus, which requires that the enveloping fog of visionary strategic possibilities first be dissipated. This book is designed to do just that.

Like most other recent authors on strategy, we owe a debt to Michael Porter. As we mentioned earlier, Porter highlighted the importance of interactions among economic actors and identified the five forces that he feels explain the competitive world in which a company operates. He

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thus gave us an invaluable approach, but the complexity of his model makes it difficult to apply. It sacrifices clarity for completeness. Attending to five forces at one time is not easy, especially if none of them has any claim to priority.

We have simplified Porter's approach by concentrating first on the one force that dominates all the others: barriers to entry. Then we turn to the other forces, starting with industry competitors and direct competitive interactions where these apply and next including suppliers and customers in a bargaining context. Our purpose here is not to ignore Porter's forces but to prioritize and clarify them. Simplicity and clarity are important virtues of strategic analysis, provided we keep in mind Einstein's admonition that "Everything should be made as simple as possible, but not simpler."