PREFACE

Anyone running a business knows that competition matters and that strategy is important. But although most experienced businesspeople recognize that these two critical elements of business are associated, few understand their essential natures or the direct relationship between them.

This book cuts through the fog that pervades many discussions of competition and strategy. Our goal is to clarify readers' understanding of strategy and to reframe their approach to it. We want executives to know how their markets work, where their competitive opportunities lie, and how to develop and protect them. To this end, we include both broad discussions of general principles and detailed case studies of actual competitive interactions. Taken together, we think they present a useful guide for people who need to make strategic decisions.

Executives often confuse strategy with planning. They think that any plan for attracting customers or increasing margins is a strategy. Any large-scale plan that requires a lot of resources or takes a long time to execute is considered strategic. Essentially, any plan that answers the question "How can we make money?" qualifies as a business strategy. As a result, too many leaders end up fighting wars they cannot win while failing to protect and exploit the advantages that are the real bases for their success.

Strategies are indeed plans for achieving and sustaining success. But they are not just any ideas for how to make a product or service and sell it profitably to customers. Rather, strategies are those plans that specifically focus on the actions and responses of competitors.

At its core, strategic thinking is about creating, protecting, and exploiting competitive advantages. On a level playing field, in a market open to all competitors on equal terms, competition will erode the returns of all players to a uniform minimum. Therefore, to earn profits above this minimum, a company must be able to do something that its competitors cannot. It must, in other words, benefit from competitive advantages. The appropriate starting point of any strategic analysis is a careful assessment of those economically advantageous aspects of a firm's market situation that cannot be replicated by its competitors or, at most, can be reproduced by only a handful of them.

The existence or absence of competitive advantages forms a kind of continental divide when it comes to strategy. On one side are the markets in which no firms benefit from significant competitive advantages. In these markets, strategy is not much of an issue. Lots of competitors have essentially equal access to customers, to technologies, and to other cost advantages. Each firm is in more or less the same competitive position. Anything that one does to improve its position can and will be immediately copied. Without any firm enjoying a competitive advantage, this process of innovation and immitation repeats itself continually. In these markets, the sensible course is not to try to outmaneuver the competitors, but rather to simply outrun them by operating as efficiently as possible.

Constant pursuit of operational efficiency is essential for companies in markets without competitive advantages. However, operational efficiency is a tactical matter, not a strategic one. It focuses internally on a company's systems, structures, people, and practices. Strategy, by definition, looks outward to the marketplace and to the actions of competitors.

On the other side of the divide are the markets where strategy is critically important. In these markets, incumbents have competitive advantages, and the race for profitability is shaped by how well companies manage the competition among their peers and how effectively they are able to fend off potential entrants. A focus on outsiders lies at the heart of business strategy. This book is a handbook on how to identify, understand, anticipate, and influence those important outsiders.

Many people have helped in the creation of our book. They include most importantly Paul Johnson, Nancy Cardwell, Barry Nalebuff, John Wright, Stephanie Land, Adrian Zackheim, Artie Williams, Paul Sonkin, Erin Bellissimo, and colleagues at Columbia Business School and The Hummingbird Value Funds. The help and support of our families, especially Ava Seave, Anne Rogin, and Gabriel Kahn, was indispensable.

We owe a major debt to the many fearsomely intelligent and energetic students who have contributed to the development of this material through their participation in the courses from which it arose. The origins of this book lie in a second-year MBA course taught at Columbia University. The "Economics of Strategic Behavior" was first offered in 1995 with an intended enrollment of sixty students. Almost ten years later, it is now taken as an elective by over 80 percent of the students in each class. In the Executive MBA program, with more experienced students who are sponsored by their employers, upwards of two hundred out of a class of three hundred fill the single available section. The goal of this course at inception was to bring clarity of vision to the complicated field of business strategy. The course's reception suggests that this goal has been substantially achieved. Our book is an attempt to convey that clarity of vision to a wider audience for whom business strategy is a significant issue.