CHAPTER 1

Getting Ready to Do Strategy

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In the early 1990s, the Allegheny Hospital Education and Research Foundation (AHERF) launched a strategy to become a large integrated health care delivery system. AHERF was not the only health care provider pursuing this strategy. In fact, this was the dominant strategic direction proposed by industry analysts and managers alike. Within a few years, AHERF was one of the largest integrated health care providers in the United States and its CEO was hailed as a visionary. By 1998, AHERF was also bankrupt.

In the early 2000s, Samsung Corporation launched a strategy to revitalize its consumer video electronics business. Long regarded as a low-quality brand, it sought a quality leadership position in the fledgling market for digital home entertainment, including high definition television (HDTV). Samsung embraced digital light processing (DLP) technology.[1] Cheaper and fatter than plasma, more expensive and thinner than traditional rear projection televisions (RPTVs), Samsung's DLP televisions offered a picture quality that equaled or beat either alternative.[2]

Samsung's first generation DLP sets garnered rave reviews from specialty magazines and web sites. The technology appealed to critical early HDTV adopters who did their research and ignored the brand reputation. In fact, Samsung's reputation has improved since the launch of DLP. It has successfully entered the market for high-end DVD players and is poised to compete in the high-end plasma market.

It takes little imagination to come up with a strategy. In fact, almost all managers can easily identify any number of strategic options for their

firms. Here are a few popular business strategies, with examples of firms that have pursued them:

- Grow larger (General Electric, AHERF).
- Downsize (Avon, Sara Lee).
- Diversify into new markets (Wal-Mart, PepsiCo).
- Dominate a niche (Starbucks, Jiffy Lube).
- Outsource the production process (Nike, IKEA).
- Integrate the production process (Armani, Tiffany).
- Become the cost leader, even if quality is sacrificed (Kia, Motel 6).
- Become the quality leader, even if costs increase (BMW, Four Seasons Hotels, Samsung).
- Drive rivals from the market (Philip Morris, Microsoft).
- Cooperate with rivals (Philip Morris, Sony).
- Be an innovator (Intel, Philips Electronics).
- Be an imitator (Microsoft, Dell Computer).

While it may be easy to come up with a strategy, it is much more difficult to select the appropriate one. For every Samsung, there is an AHERF. Some consultants may offer compelling arguments in favor of one strategy; others may recommend the diametrically opposite strategy. To make things more confusing, what works for one firm may not work for another firm in the *same* industry. So while it may take little imagination to come up with a strategy, it may take a lot of hard work to come up with the optimal strategy.

In brief, you are describing a strategy when you do both of the following:

1. Describe in what respect your firm's output is truly unique (what is the product market in which your firm has a monopoly, if you will) or the process by which you achieve *inimitable* efficiency.
2. Describe how you plan to defend this unique product or process from competition, entry, and imitation.

This book presents analyses that help you clearly identify your current or intended "monopoly" position.

DOING STRATEGY

This book is about the process of developing and analyzing strategies. It presents the principles, tools, and templates necessary for choosing among strategic alternatives. The goal of this process (often called strategic analysis or strategy evaluation) is to answer the following two principal questions (the PQs):

1. *Does the firm possess advantages that will translate into profits?*

   To answer this question, we need to identify what the firm brings to the market that enables it to outperform its rivals. The firm may have a superior quality product that the market deems worthy of a price premium. Or the firm may have a superior production process that gives it a cost advantage.
2. *Does the firm's business environment permit these advantages to turn into profits?*

   High quality and low costs are no guarantee of profits. It is essential to identify characteristics of the firm's environment that enable it to prosper from its advantages. Through an understanding of the business environment, we can answer questions such as how competition might erode profits, what firms can do about rivalry, and how the firm can sustain its profits over the long haul.

There are several reasons why the PQs are the right questions to ask when analyzing strategic alternatives:

1. Answering the PQs gives managers a more thorough understanding of the process by which their firm creates wealth and the conditions upon which that process depends.
2. This deep understanding is necessary to insure that managers do not change strategic direction for the sake of change, rather than in response to genuine problems and challenges.
3. By answering the PQs, managers can better determine whether a chosen strategy directly addresses the problems at hand. Willy-nilly selection of a strategy, whether because it sounds good or because it has become the latest fad, is not likely to bear fruit.

Evaluating and making strategic choices on the basis of how they resolve the PQs will lead to enduring profits.

4. The very process of answering the PQs often generates strategic choices. Strategy may thus be thought of as an organic process, in which choices emerge during the analytic process. We will encounter numerous examples in which the correct strategic responses are revealed through the analysis of the PQs.
5. Correct analysis leads to effective tactical choices, effective because managers are more likely to choose actions that enhance and leverage the firm's true advantage while properly accounting for competitive responses.

A HOMEWORK ASSIGNMENT

Since this book is, in effect, a course in strategy, we think it is helpful to pull from our Kellogg course syllabus, specifically the section describing the homework assignments:

> The evaluation of a firm's strategy will not be satisfied by phrases such as "superior marketing," "superior inventory management," or "superior product variety." The answer to the two key strategy evaluation questions needs to be 7 to 10 single-spaced typewritten pages.

Not to worry; you won't owe us assignments. However, contrast the richness of a 7- to 10-page single-spaced strategic analysis to the platitudes that often follow when managers are asked, "What are this firm's advantages?" or "How competitive is the market?"

This chapter lays out a broad game plan for answering the PQs. The rest of the book fills in the details and offers numerous examples of strategy in action. Chapters 2 to 4 address primarily the first of the two questions; Chapters 5 to 8 turn to the second question. Chapter 9 concludes with two highly detailed strategy evaluations, one for Amazon.com and one for the Chicago hospital market. While these analyses are fairly thorough, we were limited to public information. A manager performing the analysis on his or her own firm could probe more deeply.

We offer a caveat before we proceed. We acknowledge that a one-

size-fits-all framework for strategy evaluation is too much to promise. On the other hand, teaching strategy evaluation exclusively by example may leave the reader inspired but apprehensive about how to initiate his or her own analysis. Hence, we propose a set of *general* tools and frameworks, but remind the reader that they may need to be adapted to his or her own *particular* strategic situations.

One more caveat: The methods that we present can appear daunting in their richness. We offer detailed guidance on how to perform much of the analysis forthcoming, but not all of it. It would be impractical to incorporate all the tools needed to do strategy evaluation in one book. Furthermore, any text suggesting it has enough information to guide one through the entire process is likely to be overreaching. Many good sources exist for topics not fully developed in this book and where appropriate, we point you to them.

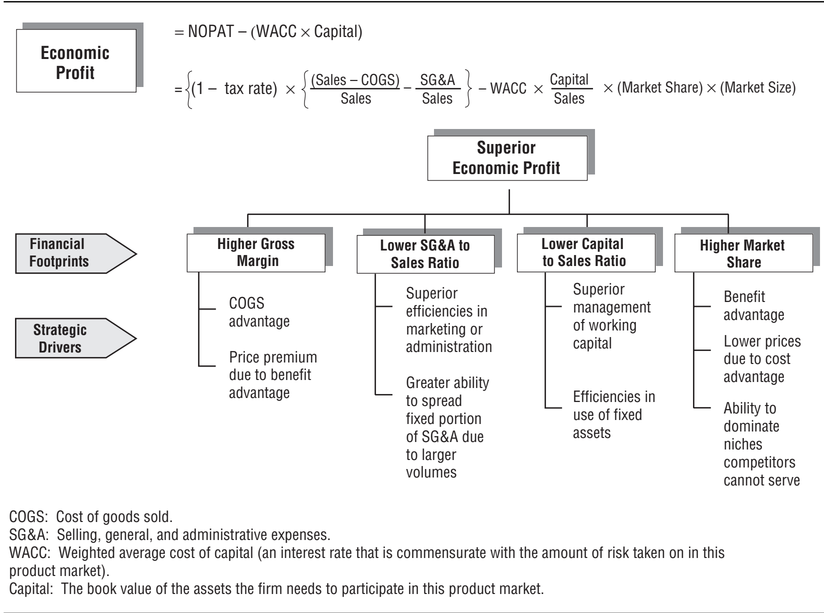
STEP ONE: ORGANIZE THE INFORMATION REQUIRED FOR STRATEGY ANALYSIS

Strategy should be driven by facts: facts about the firm, facts about its rivals, and facts about consumers. No amount of economic theory or consulting templates can substitute for institutional knowledge. But "institutional knowledge" is a broad concept, seemingly without bounds. Moreover, that knowledge is often disorganized and scattered. With a little discipline, it is possible to organize this knowledge to greatly facilitate the process of developing strategy.

In thinking about organizing knowledge, remember that the goal of strategic analysis is to help a particular firm determine how best to generate revenues that exceed its costs, including its capital costs. In our experience, managers often begin their analysis with *qualitative claims* about their firm that cannot be substantiated by *quantitative data* about the firm's actual performance. Hence, a good way to start organizing knowledge is by examining actual financial performance, preferably as close to the business unit level as possible.

We believe that the best measures identify what is commonly known as *economic profit*.[3] Figure 1.1 presents one version of how to measure economic profit, as well as a list of its common sources of economic

Figure 1.1
Economic Profit and Its Sources[a]



COGS: Cost of goods sold.
SG&A: Selling, general, and administrative expenses.
WACC: Weighted average cost of capital (an interest rate that is commensurate with the amount of risk taken on in this product market).
Capital: The book value of the assets the firm needs to participate in this product market.

[a]We are grateful to David Besanko for his permission to use this schematic.

profit. Professor David Besanko, one of the creators of the core strategy course at Kellogg, developed this schematic to introduce students to the topic of strategy. The top equation states that economic profit equals net operating profits after tax (NOPAT) minus a charge for the capital tied up in the weighted average cost of capital (WACC). The equation just below it divides these terms into their components, each of which can be thought of as a metric or financial footprint of superior economic profit.

The schematic shows that a firm cannot generate superior economic profits unless it can map its advantage into some metric or footprint (such as gross margin or SG&A/Sales) in which it outperforms the average of a firm in the same business. By knowing which driver(s) is the basis for the firm's superior performance, the firm is guided in protecting and leveraging its advantage. Begin your strategy process by computing your economic profit and then list the strategic drivers that contribute toward your success.

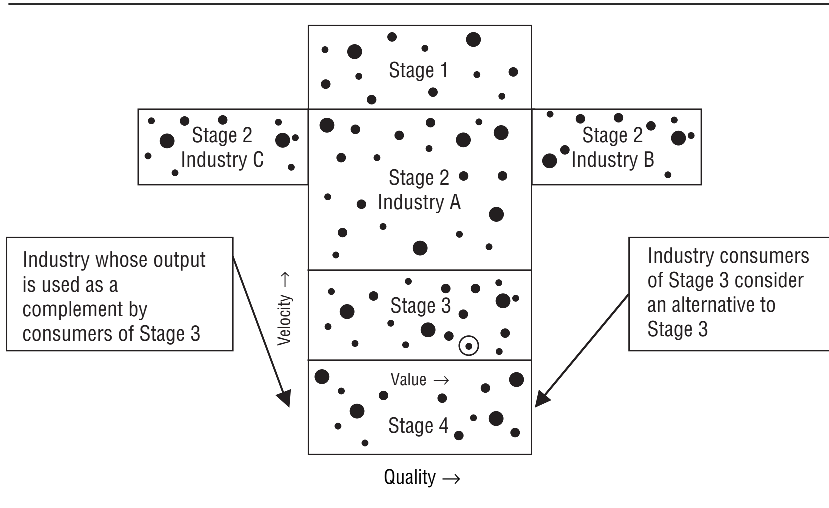
Calculating economic profits and identifying the footprints of economic advantage, by business unit if possible, is certainly not a trivial task. However, this is also essential to any meaningful strategy. We would be highly skeptical if a firm laid claim to a strategic advantage over its rivals but could not back up the claim with financial metrics or economic analysis. Strategy formulation that started with such a questionable premise of superiority would not hold water. Not all firms have the financial and accounting systems that permit convincing analyses along these lines, but the more that a firm relies on using financial measurement as a compass for strategic choices, the better it will become. Starting with poor information and developing the necessary systems over time surely beats ignoring the analysis altogether.

The second exercise useful for organizing information is called a "firm map." A useful map depicts the firm's position in its industry, as shown in Figure 1.2. Each stage in the map represents an industry or a set of firms whose outputs are considered reasonably close substitutes by customers. In the vertical chain (from Stage 1 to Stage 4), the industries are ordered from least to most processed (i.e., from furthest to closest to the end customers), and the dots represent particular firms in the industry. Firms in each stage supply the firms in the next, while firms in the final stage sell to consumers. While the firms in any one stage may have multiple suppliers, this analysis should focus on the most critical suppliers. We have arbitrarily determined that our firm of interest is in Stage 3. We have circled one of the dots in Stage 3 to indicate the location of our firm. The firm map shows that our firm (and all others in Stage 3) obtains supplies from three industries (A, B, and C).

Along the vertical and horizontal axis of each box are the characteristics that consumers value most highly and use to distinguish among firms. In this example, we have chosen perceived value on the *X*-axis and product variety on the *Y*-axis of the box for Stage 3. We see that our firm is fairly high in value but low in variety. We could have incorporated a third dimension by varying the size of the dots used to identify each firm. The size of the dots might correlate to market share or annual sales. Quite frankly, the analyst can get as creative and colorful as the availability of data allows.

The remaining boxes depict industries whose outputs substitute for

Figure 1.2
The Firm Map



or are complementary to the output of our industry.[4] When complete, the boxes capture all competitors, substitutes, and complements. For example, Hyatt Hotels and Sheraton Hotels are in the same industry box (hotels), campgrounds are a substitute, and the availability of rental cars is a complement.

Like our financial analysis, firm mapping requires a measure of diligence. It is possible to prepare a qualitative firm map based on institutional knowledge. We offer a number of tools for adding rigor to the mapping exercise: Chapter 4 shows how to quantify a firm's position in the market, and Chapter 5 discusses how to more precisely identify competitors. The marketing literature also offers guidance on a number of mapping issues.[5]

Understanding the facts about your firm's position is an indispensable part of strategic formulation, and you should attempt to make a map even if you know it is imperfect. Like the analysis of economic profits, something is better than nothing. *Do not neglect your obligation to organize essential institutional knowledge as a central component of strategy formulation and analysis. The lack of perfect information is no excuse.*

STEP TWO: DEFINE THE FIRM'S POSITION

To enjoy superior economic profits, a firm must have either a superior position in an industry that generates average returns (e.g., Wal-Mart), or an average position in an industry that generates superior returns (e.g., Eli Lilly). Having a superior position in a superior industry (Microsoft) is rare and especially profitable. The next two steps in the strategy process involve examining the firm's position relative to its industry, and examining the overall industry profitability. We present positioning before industry analysis, but this choice is arbitrary.

The first step in positioning analysis is identifying the firm's customers. The firm mapping should provide this information. The next step is to determine the firm's *value creation proposition*, that is, how the firm creates benefits for consumers (B) above and beyond the cost of production (C). At a minimum, the firm needs to generate a positive B–C. If it cannot do so, it may as well shut down.

Chapter 2 develops the B–C framework thoroughly. In Chapter 2, we argue that it is not sufficient for a firm to produce a positive B–C. If the firm is to outperform its rivals, it must produce more B–C than they do. The chapter then uses B–C to explain a number of concepts that are fundamental to strategy, including generic strategies and disruptive technologies. Increasing B–C is not just a matter of what the firm does, but also about whom the firm chooses to serve. Finding the right customer means segmenting the marketing correctly.[6] After discussing segmentation, the chapter closes by offering a variety of tactics for creating B–C and discussing how firms should set their prices to best exploit their B–C advantage.

Under the right circumstances, firms can convert B–C into profits for their owners or shareholders. Chapter 3 identifies these circumstances through the lens of a powerful theory known as the "resource-based view of the firm." The resource-based view holds that the translation from B–C to profits depends on whether the firm's value creation process is proprietary. For a firm to profit from B–C, it must possess resources and capabilities that are scarce, immobile, and scopable. Chapter 3 clarifies these concepts and offers a "resources and capabilities audit" that the analyst should use to fully

gauge a firm's strengths. A detailed example of Disney's animated motion picture division illustrates how to use the audit. As we have already mentioned, there is no substitute for institutional knowledge, and it cannot be emphasized enough that the results of this type of analysis must be consistent with the facts. Otherwise, a firm can delude itself into overestimating its strengths and fail to take appropriate actions.

This analysis is often largely qualitative, consisting of lists of resources and capabilities and subjective assessments of the resulting value creation proposition. Chapter 4 presents tools from economics, accounting, and marketing research that the analyst may use to quantify value creation. With this final step, the analyst can identify the firm's strategic position with some degree of certainty. Such an analysis will be a vast improvement over the type of cursory positioning statement that often underlies strategic thinking.

STEP THREE: INDUSTRY ANALYSIS

Each firm belongs to a particular stage in its overall market. Industry analysis is a tool for assessing the profitability of that stage by considering the environment in which the firms in that stage compete. This analysis should provide a very clear sense of what is positive and negative about the environment. (All too often, industry analysis devolves into a litany of negatives; this is a temptation that must be avoided.) By far the most popular tool for industry analysis is Michael Porter's five forces framework.

The five forces framework begins with market definition, a tool that we develop in Chapter 5. Porter's framework then posits a simple hypothetical: Suppose that an industry creates positive B–C. Given this hypothetical, the framework identifies five environmental forces that could cause this industry to earn zero economic profits, despite creating positive value. The five forces are:

1. *Internal Rivalry:* Competition among firms in the industry can drive prices down toward costs. Consumers end up enjoying all the value created by the industry.

2. *Entry:* Industry profits act as a siren call to new firms. Their entry erodes the profits of incumbents by stealing market share and intensifying price competition.
3. *Substitutes:* These also steal market share, and the distinction between substitutes and competitors/entrants is often a matter of degree.
4. *Supplier Power:* This refers to the power of suppliers to command high prices for their inputs. A powerful supplier can extract all the profits from its trading partners, who may have no alternative but to accede to the demanded price or go out of business altogether.
5. *Buyer Power:* Buyer power is symmetric to supplier power. A powerful buyer can demand steep discounts and if its suppliers have nowhere else to turn, they will be forced to accept them.

Chapters 5 to 7 detail the factors that contribute to internal rivalry and entry, drawing heavily on economic theories of competition. We view internal rivalry as a kind of industry cancer. Chapter 5 offers a variety of ways to diagnose the disease and Chapter 6 offers suggested cures. In Chapter 7, we describe how to assess the threat of entry and steps that firms may take to prevent it. These chapters contain checklists that will assist in assessing how these forces may affect industry profits.

Here are some checklists for assessing the remaining forces. The distinction between substitutes and internal rivalry/entry is often a matter of degree and often requires little further elaboration. The analyst who wishes to give due consideration to the topic of substitutes should be sure to complete the checklist shown in Table 1.1.

Tables 1.2 and 1.3 offer checklists for the analysis of supplier and buyer power. A thorough analysis of supplier and buyer power requires a range of subtle analytic tools that are beyond the scope of this book. These topics are treated in great detail in *The Economics of Strategy*, however. (This is the textbook that we use in our core strategy class.) You may wish to refer to the textbook for the analytic details.

Consonance analysis is another framework that may be used to get a sense of the overarching features of an industry.[7] Like the five forces, consonance analysis begins with market definition. The analyst then describes how firms in the market create value for their consumers, that is,

Table 1.1
Factors Affecting Pressure from Substitutes

Factor	*Comment*
Are close substitutes available?	If yes, industry price is tempered by substitute's price.
Do substitutes offer high value for the price?	If yes, industry price is tempered.
Does the industry face a high price elasticity of demand?	If yes, this would indicate that consumers are willing to purchase substitute.

Table 1.2
Factors Affecting Power of Input Suppliers

Factor	*Comment*
Is supplier industry more concentrated than industry it sells to?	If yes, then competition among suppliers may be limited, and their power enhanced.
Do firms in industry purchase small volumes relative to other customers of the supply industry?	If yes, then industry may have to pay premium prices and obtain inferior trade terms relative to other customers.
Are there few substitutes for the supplier's input?	If yes, then supplier can hold out for higher price.
Do firms in industry make investments that are specific to their relationship with suppliers?	If yes, then industry may be tied to its suppliers and unable to turn elsewhere if supply prices increase.
Do suppliers pose a credible threat of forward integration into the industry?	If yes, then industry may have to accede to price increases or invite forward integration.
Are suppliers able to price discriminate on the basis of ability/willingness to pay?	If yes, suppliers can extract profits from the firms that most highly value the inputs.

Table 1.3
Factors Affecting Power of Buyers

Factor	*Comment*
Is buyer industry more concentrated than industry it sells to?	If yes, then competition among buyers may be limited, and their power enhanced.
Do buyers purchase in large volumes?	If yes, then buyers may be able to negotiate favorable prices and trade terms.
Can buyers find substitutes?	If yes, then industry pricing is tempered by availability of substitutes.
Do firms in industry make investments that are specific to their relationship with buyers?	If yes, then industry may be tied to its buyers and unable to turn elsewhere if prices decrease.
Do buyers pose a credible threat of backward integration into the industry?	If yes, then industry may have to accede to price decreases or invite backward integration.
Are suppliers able to price discriminate on the basis of ability/willingness to pay?	If yes, suppliers can extract profits from the firms that most highly value the inputs.
Does the industry's product represent a significant fraction of the buyer's cost?	If yes, buyer will be aggressive in seeking discounts.
Are buyers able to negotiate prices on a transaction by transaction basis?	If yes, buyers may be able to extract price concessions from the most vulnerable sellers.

how they create B. Similarly, the analyst describes the factors that affect costs. Next, the analyst identifies emerging trends that will affect the creation of B and C.

"Consonance" means agreement or harmony. The goal of consonance analysis is to determine whether the activities that firms in the industry use to create B and C are aligned with the conditions in which

the industry operates. If value creating activities are consonant with industry conditions, then the industry has greater potential to create value (create B–C). Likewise, if a firm's value creating activities are consonant with industry conditions, that firm is well-positioned to create value. In this way, consonance analysis is more oriented toward firm-level analysis than is the five forces framework, because the latter considers the conditions facing a typical firm, not necessarily one particular firm.

Consider the pharmaceutical industry, which until the 1980s created B largely by a system of "informed trial and error" that screened hundreds of thousands of compounds for their medical effects and moved a few dozen of the most promising through a lengthy and costly process of clinical trials. For some time, this was not consonant with ongoing changes in clinical science that enabled researchers to better predict the effects of compounds on the basis of theoretical models. The result was the emergence of small companies that specialized in early stage research. Many of today's most successful drugs were first discovered by these small companies, and much of the industry's wealth has migrated in that direction as well. Even so, many pharmaceutical companies developed new value creation tools in response to the change in scientific regimes. A good example is Merck, which borrowed tools from financial economics to align its drug development budgeting methods with the new realities of how scientific knowledge was emerging.[8] These methods became the paradigm for the industry.

A final framework we mention here (although there are several more) is SWOT analysis. SWOT stands for "Strengths, Weaknesses, Opportunities, and Threats." This framework is very commonly used by companies at off-site strategy retreats. At the breakout sessions, participants are given four flip charts, one for *S*, and so on, and asked to identify the firm's SWOT. Everyone brainstorms for five minutes and then makes their list. Like any other framework for industry analysis, rigor and deep analysis have a payoff. If ideas are off the cuff and unsubstantial, the output of the analysis will not be valuable. Fortunately, there are sound theoretical underpinnings to SWOT analysis. You might consider the *SW* to be akin to positioning analysis and the *OT* to be much like the industry analysis. The tools and frame-

works we present in this book should help any manager produce a stellar SWOT analysis.

STEP FOUR: EVALUATE SUSTAINABILITY

It is one thing for a firm to outperform its rivals in the short run. It is quite another to secure an advantage that lasts for many years. Entry is one of the major threats to sustaining an advantage. Chapter 8 describes many other challenges to sustaining advantage. Some of the factors that we discuss in Chapter 8 are:

- Is there a learning curve that confers an advantage on the firms with the most experience?
- Are there switching costs that make it difficult for newcomers to steal the customers of incumbent firms?
- Does reputation affect demand and supply relationships?
- Does the market display "network effects," whereby consumers lock onto a single product design or technology standard?

Some of these factors are associated with the topic of "early mover advantages"—those advantages enabling firms to continue to outperform the competition well after achieving early success. But firms need not be first to the market to enjoy sustained advantages. Look no further than Microsoft, Wal-Mart, and Southwest Airlines for famous examples of successful second (or later) movers.

No assessment of a firm's strategy is complete without careful attention to sustainability. Chapters 7 and 8 discuss how firms can create sustainable advantages. But advantaged firms are vulnerable due to the myriad factors that tend to reduce excess returns over time. The five forces must be kept at bay, and the factors that permit a sustained advantage (e.g., reputation effects) can deteriorate over time. There can be shocks, or changes, in the general environment. While all firms in an industry are affected by shocks, they are not all affected the same. Firm level choices with respect to particular trading partners, location, product/service features, and so on affect how one firm is affected relative to the industry as a whole. At the same time,

deterioration (or improvement) can be the result of purely firm level factors. Chapter 8 discusses many of these effects.

WRAP-UP: THE STRATEGY TOP 10

Several times during the course we like to remind students of the main course concepts—the Strategy Top 10.[9] See how these 10 concepts resonate with your understanding of your own firm's strategy:

1. Firms exist to turn shareholders' resources into profits. While other imperatives frequently emerge, the best leaders resist getting sidetracked. If the initiative is not about creating shareholder wealth, it is ill-advised. This is absolutely not the same as saying the firm's environmental impact or reputation vis à vis labor or other such concerns are unimportant. This is to say that any initiative must be understood in the context of converting shareholder resources into profits over the long run.
2. The firm must have a *unique and defensible value creation proposition.* One can conceive of ways to create value but not profits. If a network creates a hit TV show only to lose all of its profits to the show's stars and writers, that network might have done well to consider how it was going to retain, as profits, the value it created.
   - Does the firm create value from the perspective of some consumers?
   - Can the firm's activities be imitated?
   - If the firm does not own the productive resource, can the owner expropriate the value away from the firm?
3. If the firm's uniquely valuable role is that it is better at something, it should leverage this advantage in as many markets as possible. Be sure to identify all the markets in which you can leverage your advantage. Some firms appear to be operating in disparate businesses and thereby defying the hackneyed strategist's advice to stay focused. However, disparate businesses may, in fact, rely on similar competencies or assets. The best opportunities are not necessarily in the same market, but do

leverage the source of the firm's current success. Using the analyses suggested here will help your firm identify what it might leverage.

4. Clarifying the preceding, the goal of strategy is to maximize economic profits through time, not to grow! Firms should grow into new markets or new activities only if there are synergies with their existing activities. If the firm's unique role is that it is different, the firm should optimize its activities to that difference and be careful not to overgrow. Consider the effect of growing in a particular way on the equation given previously for economic profits. Are the sales being added actually reducing profits? This is more than entirely possible!
5. Firms should be diligent to understand and, whenever possible, document the sources of their advantage. Nearly all managers claim that their firms are positioned to outperform their rivals. This is a statistical impossibility. Does the analysis suggested enable you to articulate your monopoly? Is the market you monopolize as valuable as you want to believe?
6. From a firm's point of view, the key question of *industry analysis* is: Can the firm define a uniquely valuable role in its industry?
   - If yes, rivalry and entry threats are lowered, as the firm has a unique position relative to current and potential competitors.
   - If yes, buyer and supplier power are lowered, as the firm fills a unique role for them.
   - Consonance analysis considers whether this unique role is consistent with long-term trends in consumer tastes, technology, and so on.
   - A uniquely valuable role requires a firm to be different from or better than the competition.
7. This is clear from the central position of rivalry in the industry analysis framework already presented, and certainly merits repeating: Firms must avoid destructive price competition, which is always a lose-lose proposition. If each firm has a uniquely valuable position, price competition is minimized, and each firm profits by serving its role. If not, you must find ways to soften price competition.

8. As indicated previously, a positioning statement is a statement of relatives. A firm's position can be expressed only relative to other firms. In developing strategy, never take competitors' positions as given or fixed. While it can be tough to anticipate the actions and reactions of rivals, it is important to make intelligent conjectures by stepping into their shoes.
9. In situations of high risk, evaluate strategies more on the extent to which they create or destroy *options* and less on a single prediction of their expected value. That is, take the economic profit equation given earlier and project the effect of your initiative over time. Does taking a hit in the near term give you a good vantage point in the future?
10. There are situations in which building market share is strategically important for future profits. These are first-mover advantages: learning curves, reputation effects, switching costs, and network effects (the power of all of these is discussed throughout this book). Firms must recognize when these situations do and *do not exist*, to avoid choosing the wrong tactics.

Does your firm follow these guidelines? If so, then you are likely on the right strategic course. This book can reinforce what you already know about strategy and help you refine your strategic choices when appropriate. If not, do not despair. We provide the details necessary to work through the Strategy Top 10, offer frameworks for assessing strategic choices, and help put your firm on course for strategic success.

NOTES

1. Texas Instruments holds the patent on the DLP processing chip and supplies several other brands, including Panasonic, Mitsubishi, and Gateway.
2. A 61-inch Samsung DLP set retails for about $3,000, versus $10,000 for a typical 60-inch plasma and $2,000 for a typical 60-inch RPTV.
3. Many consulting firms have their own proprietary measures. The most well known is Stern Stewart's Economic Value Added (EVA). However, there are many alternative ways to measure firm performance that take into account the opportunity cost of the firm's capital. Essentially, the difference between accounting profits and economic

profits is that the latter subtracts these operating costs (the book value of the firm's assets multiplied by an appropriate weighted average cost of capital (WACC). There is a large literature on this subject. The web site for the consulting firm Marakon (www.marakon.com) offers some good background reading on this subject.

4. A substitute industry sells something consumers consider an alternative to our firm's output but not as close an alternative as what our rivals or competitors sell. Complements enhance demand for the output of our industry.
5. For example, Professor George Day of the Wharton School Department of Marketing has a chapter on this in the book *Wharton on Dynamic Competitive Strategy* (Wiley).
6. There are many sources outside this text to learn about market segmentation, including *Kellogg on Marketing*.
7. The term "consonance" is usually attributed to Rumelt; however, the consonance analysis we describe here is a compilation of a variety of frameworks including Rumelt's framework and a framework developed by Kellogg faculty members.
8. Merck adapted the economics of real options to the budgeting process. It understood that investing in drug development was analogous to investing in options. Merck could "call" the option (i.e., increase the investment) at any time. Optimal investments depended on how scientific knowledge evolved. Some investments were necessary in order to obtain valuable information, and as new evidence altered assessments of the drug's potential, development budgets were altered according to complex formulae.
9. Thanks to David Besanko for coining this expression and developing the list.