

# MODERN COMPETITIVE STRATEGY

*Gordon*

# Modern Competitive Strategy

**Gordon Walker**

*Southern Methodist University*



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# Modern Competitive Strategy

To Nancy

# About the Author

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Gordon Walker is Professor and Chairman of the Strategy and Entrepreneurship Department at the Edwin L. Cox School of Business at Southern Methodist University. He received his BA from Yale University and an MBA and PhD from the Wharton School, University of Pennsylvania. Dr. Walker has previously taught at the Sloan School, MIT; the Wharton School, University of Pennsylvania; and Yale University. The author of numerous articles, he is on the editorial boards of *Administrative Science Quarterly* and *Strategic Organization*. He has received several grants from the National Science Foundation.

Dr. Walker has consulted and performed contract research for a number of organizations including Chaparral Steel, Sprint, Xerox, General Motors, Johnson & Johnson, Carlson Restaurants, Texas Instruments, The Associates, Halliburton, UICI, and EDS, as well as numerous smaller firms. His executive training programs include senior management seminars at Southern Methodist University, the Wharton School, Yale University, and INSEAD. He was named among the best Business Policy teachers in the United States in 1994 and 1998 by *Business Week* magazine and received the President's University Teaching Award in 1999 at SMU. He is listed in *Who's Who in America* and *Who's Who in the World*. Professor Walker was an infantry officer in the Marine Corps from 1967 to 1970 and was awarded the Bronze Star.

# Preface

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The genesis of this book lies in my experience as a strategy professor. Over the past 19 years, I have taught the core strategic management course in some very good MBA programs. When I began as an assistant professor, Michael Porter's book, *Competitive Strategy*, had recently been published, and I adopted it. The book brought the concepts and observations of industrial economists into the realm of business policy in a way that students and practitioners could comprehend and appreciate. At the time Porter's book was introduced, there was little research in strategic management, and his book presented the most rigorously developed set of frameworks available to academics teaching and doing research in strategy.

Over the past two decades, however, the strategy field has developed into a robust discipline with its own interests and research topics. Many of these topics build on the original synthesis of industrial economics in early strategy texts. However, many current ideas, concepts, and theories are only loosely related to traditional industry analysis. Practitioners, moreover, have continuously innovated to solve strategic problems in ways that the frameworks of industry analysis do not address. Its major points remain essential, but these points do not cover as much of the territory of strategy as they once did.

As the field developed, I moved more to teaching with readings, a shift that I believe has been fairly common for strategy courses in many business schools. But because many effective readings were (and are) written in practitioner journals, they were often oriented primarily toward application. This emphasis was beneficial for particular topics, but the course was often perceived as lacking sufficient theoretical content or coherence.

What was needed then was a book founded on disciplinary research which at the same time included the concepts and topics of strategy that have been developed over the past 20 years. Moreover, since I teach at all levels—undergraduate, MBA, and EMBA—the book had to be understandable by students who had never been in business and yet offer immediate practical benefits to line managers and executives. And it had to be readable and fit within the confines of a module or quarter (7 to 10 weeks) or a semester-long course.

This is the book I have tried to write. It is organized in five parts:

- Introduction.
- Building Competitive Advantage.
- Managing the Boundaries of the Firm.
- Expanding the Scope of the Firm.
- Governing the Firm.

Each part deals with a separate set of strategic issues as the firm grows from one to multiple lines of business.

Part I lays out the concept of strategy and argues that strategy is about achieving superior performance over time. Companies can accomplish this goal in ways that look very different across industries. But a single theme underlies these differences: The superior firm produces more value for the customer at a lower cost than competitors and defends the sources of this advantage—the firm’s resources and capabilities—from imitation. This traditional but robust approach to defining competitive advantage pervades the book. The first chapter then outlines the origins of strategy as a discipline of inquiry drawing from a variety of fields, including industrial economics, evolutionary economics, and organizational sociology. And the distinction is made between strategy in a firm with a single business and one with multiple businesses, a central organizing theme in the book. The end of this chapter briefly describes the content that will follow in later chapters.

The chapters in Part II describe how successful firms build competitive advantage within the constraints of industry forces as they evolve over time, with a separate discussion of strategy execution within the organization. Part III focuses on how the firm executes its strategy by managing its boundaries through vertical integration and outsourcing and takes a separate look at partnerships. Part IV expands the scope of the firm to global markets and multiple businesses. Last, Part V outlines in detail the major issues of corporate governance, including its legal and institutional frameworks, and of strategic planning, the practical tool that brings the logic of strategy systematically to the whole organization.

I believe this approach has three main advantages:

1. It provides a relevant, discipline-based underpinning to the discussion of important strategy topics and allows the student to make connections among these topics as the course proceeds. By the end of the course, the student should see that many strategic problems can be understood as elaborations of a small number of theoretical frameworks. Thus, the course is an integrated experience.
2. It provides a clear way to understand the similarities and differences between single and multibusiness strategic issues. Identifying how a business can be improved as part of a larger multibusiness enterprise is a central management task. However, without linking single and multibusiness firms through common strategic frameworks, the task can be obscured.
3. The text covers a wide range of current strategy topics and links current theory to management practice. My experience with the frameworks in the book is that they are especially well suited for teaching cases, from any era currently in the case archives—Head Ski to Microsoft 2002. Also, when students read the business press, they will be able to see the applicability of what they’re being taught.

These benefits can be palpable no matter what level the course. It can be gratifying to see undergraduates respond appropriately and enthusiastically to almost the same material that executive MBAs like for somewhat different reasons. The undergrads like the clarity, coherence, and consistency of the approach to strategy, while EMBA students can take much of the material and apply it di-



rectly to their work. Needless to say, regular MBAs can experience the material in both ways.

Several teaching supplements are available to adopters of this text: an instructor's manual including lecture notes, multiple-choice questions, and suggested cases for each chapter; a computerized test bank; and PowerPoint slides with key figures from the book and other lecture materials. Select supplements and additional resources are also available from the book website at [www.mhhe.com/walker1e](http://www.mhhe.com/walker1e).

Many people have helped in preparing this book. Without their assistance, it could not have been written. Steve Postrel and Tammy Madsen have been remarkably helpful in commenting on the material. Their input has been critical for choosing and organizing content throughout the book. Bente Lowendahl and Andy Spicer gave me excellent comments on parts of the text. Dave Mauer was highly instrumental in ensuring that the nuance in the text was consistent with current thinking in finance. Roger Kerin and Ed Fox served in the same role for marketing. David Hoopes and Gary Moskowitz provided key feedback on separate sections. Glenn Carroll, Stanislav Dobrev, and Ken Simons were generous in sharing their data, and all of my understanding of the money market fund industry I owe to my collaboration with Richard Makadok. Bruce Kogut has been a constant source of interesting and helpful commentary on various problems throughout the book's gestation. Chuck Armstrong of IBM, Raymond Herpers of Strategian, Greg Mutz of UICI, Barry Mike of Pizza Hut, Tommy Valenta of Chapparral Steel, and Heidi Ryback provided important feedback on the practical side of various chapters. Their encouraging and insightful comments were very important in shoring up my confidence in the book's applicability to management problems.

The following reviewers of the book over several years were enormously helpful in keeping my language and concepts straight:

Jaideep Anand <i>University of Michigan</i>	Jackson Nickerson <i>Washington University in St. Louis</i>
Heather Elms <i>University of Florida</i>	Steve E. Phelan <i>University of Texas at Dallas</i>
Michelle Gittelman <i>New York University</i>	Anju Seth <i>University of Illinois Champaign-Urbana</i>
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Anuradha Nagarajan <i>University of Michigan</i>	

I don't think I have done justice to their excellent comments. But without them the task of steering this material through the shoals of the strategy field would have been impossible.

I am indebted to my students who allowed me to experiment with the book's concepts as they applied to a wide range of teaching cases. This experience was essential for helping me appreciate how the book's ideas worked in the classroom. In many cases, the linkages between the ideas and their range of applicability were not clear until the ideas were taught.

My publisher has provided invaluable assistance in putting this book together. My editors at McGraw-Hill/Irwin—John Biernat, Ryan Blankenship, and especially Laura Spell—have been constantly supportive of this project and remarkably patient about its development. Susanne Riedell, my project manager, has been consistently helpful as the book has progressed.

Finally, my family deserves the greatest thanks. They were very patient with me during the book's gestation and have forgiven the many times I have pulled away to write instead of play or participate in normal family life. It will take me some time to repay their kindness and generosity.

*Gordon Walker*

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Part

1

# Introduction

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## 1 What Is Strategy?





# Chapter 1

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## What Is Strategy?

The question at the heart of strategy is: Why do some firms outperform others over time? No two firms are the same, even in the same industry. They vary in size, products, people, location, organization, and history. In almost all industries this underlying variability among companies leads to significant differences in their performance. How can this be explained and the explanation used by managers to make better strategic decisions?

The road to success is by no means the same for all firms. Some, like Microsoft, rise to dominance because they develop an industry-wide standard (Windows, Microsoft Office) and partner with firms selling complementary products (Intel). Others, like Walmart and Nucor, become number one due to efficient practices that enable low prices. In turn, Dannon yogurt has neither the highest value nor the lowest cost but offers the best value-price combination. How should strategy be conceived to capture these differences?

An effective strategy gives a firm three benefits. First, it is a source of *economic gain*. Second, it provides a framework for *resource allocation*. And third, it guides the firm's decisions regarding *management and organization*.

1. Strategy matches the market position of the firm to its resources and capabilities. Market position entails both the amount and type of value offered to customers and the cost the firm incurs to produce that value. The more value customers receive at a lower cost to the firm, compared to its rivals, the more productive the firm. But the firm must also prevent the imitation of its value and cost drivers by competitors. Otherwise, it loses its advantage as rivals copy the sources of its strength. Since market dominance correlates with higher economic returns, strategy is a determinant of economic gain.