MICHAEL PORTER: WHAT IS STRATEGY?

Thinker 028

» INTRODUCTION

Porter has generally been viewed as being at the leading edge of strategic thinking since his first major publication, Competitive Strategy (1980), which was a great success and became a corporate bible for many in the early 1980s. A second major publication Competitive Advantage (1985) introduced the now familiar concepts of competitive advantage and the value chain. His five forces model has been widely taught and his ideas have been hugely influential for organisations and governments on a global scale.

Although he has always had his critics, Porter's reputation has taken a particularly serious dent in recent years with the bankruptcy of his strategy consulting firm Monitor and its subsequent acquisition by Deloitte; as well as robust challenges being made to some of his key ideas.

» LIFE AND CAREER

Born in 1947, Porter completed a degree in aeronautical engineering at Princeton in 1969 and took an economics doctorate at Harvard, joining the faculty there as a tenured professor at the age of 26. He has acted as consultant to companies and to governments and, like many academics, set up a consulting company, Monitor, in 1983. Porter is currently the Bishop William Lawrence University Professor at The Institute for Strategy and Competitiveness, Harvard Business School.

» KEY THEORIES

Porter's Thinking

Porter's thinking on strategy has been supported by precision research into industries and companies, and has remained consistent as well as developmental. He has concentrated on different aspects at different times, spinning the threads together with a logic that seemed irrefutable.

Before *Competitive Strategy*, most strategic thinking focused either on the organisation of a company's internal resources and their adaptation to meet particular circumstances in the marketplace, or on increasing an organisation's competitiveness by lowering prices to increase market share. These approaches, derived from the work of Igor Ansoff, were bundled into systems or processes which provided strategy with its place in the organisation.

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In *Competitive Strategy*, Porter managed to reconcile these approaches, providing management with a fresh way of looking at strategy - from the point of view of industry itself rather than just from the point of view of markets, or of organisational capabilities. In *Competitive Advantage*, he introduced the concept of the value chain which enabled organisations to look in detail at each stage of their operations. Each unit could then be costed and measured for competitiveness.

The Value Chain

Porter describes two different types of business activity - primary and secondary. Primary activities are principally concerned with transforming inputs (raw materials) into outputs (products), and delivery and after-sales support. These usual line management activities include **Inbound Logistics** (materials handling, warehousing), **Operations** (turning raw materials into finished products), **Outbound Logistics** (order processing, and distribution), **Marketing and Sales** (communication and pricing), and **Service** (installation and after-sales service).

Secondary activities support the primary and include **Procurement** (purchasing and supply), **Technology Development** (know-how, procedures and skills), **Human Resource Management** (recruitment, promotion, appraisal, reward and development), and **Firm Infrastructure** (general and quality management, finance, planning).

To be able to survive competition and supply what customers want to buy, the firm has to ensure that all these value-chain activities link together and fit, as a weakness in any one of them will impact on the chain as a whole and affect competitiveness.

The Five Forces

In 1979, Porter argued that in order to examine its competitive capability in the marketplace, an organisation must choose between three generic strategies: **cost leadership** - becoming the lowest-cost producer in the market; **differentiation** - offering something different, extra or special; and focus - achieving dominance in a niche market. The question is to choose the right one at the right time. These generic strategies are driven by five competitive forces which the organisation has to take into account:

- the threat of new market entrants to intensify competition and further impact on pricing and profitability.
- the threat of similar products to limit market freedom and reduce prices and thus profits
- the power of customers to affect pricing and reduce margins
- the power of suppliers to influence the organisation's pricing
- the level of existing competition which impacts on investment in marketing and research and thus erode profits

Porter revisits his earlier work with On Competition in 1998. Here he emphasises the acceleration of market change that means companies now have to compete not just on a choice of strategic front, but on all fronts at once. Porter has also said that a company that tries to position itself in relation to the five competitive forces misunderstands his approach, since positioning is not enough. What companies have to do is ask how the five forces can help to re-write industry rules in the organisation's favour. (See Related model, Porter's Five Forces).

Diversification

Instead of going it alone, an organisation can spread risk and attain growth by diversification and acquisition. While the blue-chip consulting companies such as Boston Consulting Group (Market growth/market share matrix) and McKinsey (7-S framework) have developed analytical models for discovering which companies will rise and fall, Porter prefers three critical tests for success:

1. The attractiveness test. Industries chosen for diversification must be structurally attractive. An attractive industry will yield a high return on investment but entry barriers will be high, customers and suppliers will have only moderate bargaining power and there will be only a few substitute products. An unattractive industry will be swamped by a range of alternative products, high rivalry and high fixed costs.
2. The cost-of-entry test. If the cost of entry is so high that it prejudices the potential return on investment, profitability is eroded before the game has started.
3. The better-off test. How will the acquisition provide advantage to either the acquirer or the acquired? One must offer significant advantage to the other.

Porter devised seven steps to tackle these questions:

1. As competition takes place at the business unit level, identify the interrelationships among the existing business units.
2. Identify the core business which is to be the foundation of the strategy. Core businesses are those in attractive industries and where competitive advantage can be sustained.
3. Create horizontal organisational mechanisms to facilitate interrelationships among core businesses.
4. Pursue diversification opportunities that allow shared activities and pass all three critical tests.
5. Pursue diversification through transfer of skills if opportunities for sharing activities are limited or exhausted.
6. Pursue a strategy of restructuring if this fits the skills of management or if no good opportunities exist for forging corporate partnerships.
7. Pay dividends so that shareholders can become portfolio managers.

National Competitiveness

Why do some companies achieve consistent capability in innovation, seeking an ever more sophisticated source of competitive advantage? For Porter the answer lies in four attributes which affect industries: These attributes which form four points of a diamond are: **Factor Conditions** (the nation's skills and infrastructure to enable a competitive position), **Demand Conditions** (the nature of home-market demand), **Related and Supporting Industries** (presence or absence of supplier/feeder industries), and **Firm Strategy, Structure and Rivalry** (the national conditions under which companies are created, grow, organise and manage).

These are the chief determinants which create the environment in which firms flourish and compete. The points on the diamond constitute a self-reinforcing system, where the effect of one point often depends on the state of the others and any weaknesses at one point will impact adversely on an industry's capability to compete.

The ‘New’ Strategic Wave

Somewhere between 1980 and 1990 strategic planning came unstuck. Old theories no longer worked as customers became more demanding and changeable, and markets and technologies rose and fell ever more rapidly. Even industries that were once distinct with definable products and services now converged and became blurred. A new wave of more subversive strategic thinking - with Gary Hamel and Strategy as Revolution, and Mintzberg with *The Fall and Rise of Strategic Planning* - emerged to replace the old rule-book. Porter's article *What is strategy?* argued that strategic planning lost its way because managers failed to distinguish between strategic and operational effectiveness and confused the two. The old strategic model - which still held up in the 1980s - was based on productivity, increasing market share and lowering costs. Hence total quality management, benchmarking, outsourcing and re-engineering were all at the forefront of change in the 1980s as the key drivers of operational improvements. But continuing incremental improvements to the way things are done tend, over time, to bring different players up to the same level, not differentiate them. To achieve differentiation means that:

› Strategy rests on unique activities based on customers' needs, customers' accessibility or the variety of a company's products or services.

- The company's activities must fit and link together. In terms of the value chain, one link is prone to imitation but with a chain, imitation is very difficult.
- Making trade-offs: excelling at some things means making a conscious choice not to do others - a question of being a `master of one trade' to stand out from the crowd as opposed to being a `jack of all trades' and lost in the crowd. Trade-offs purposefully limit what a company offers. The essence of strategy lies in what not to do.

Competition and society

In 2006, Porter (with Kramer, a fellow Harvard academic) applied his principles of competitive strategy to the relationship a company has with society, introducing the concept of shared value. In this strategic approach to corporate social responsibility Porter and Kramer develop a framework for companies to identify their effects on society and to address them in the most effective way. They developed this further in 2011 introducing Creating Shared Value (CSV) to supercede Corporate Social Responsibility (CSR) saying CSV creates economic value by creating societal value. Porter's interests in competition and society have also been directed at healthcare, philanthropy and the environment.

» IN PERSPECTIVE

It is a mark of Porter's achievement that much of his work on *Competitive Strategy*, researched in the 1970s, has shaped mainstream thinking on competition and strategy. While his work is academically rigorous, his ability to abstract his thinking into digestible chunks for the business world has given him wide appeal to both the academic and business worlds. It has been standard practice for organisations to think and talk Value Chains, and the Five Forces have entered the curriculum of every management programme. Whether this is set to change, time will tell.

Porter's Five Forces framework has been criticised before. Consultants have said it is too static and isn't useful in predicting how competitive environments change. Porter has also been criticised as sometimes neglecting the human factor in his work on strategy and the effect people can have on how the strategy is implemented. Porter would say that it is important to understand the economic logic first and that although how people implement and commit to the chosen strategy is extremely important, this is complimentary to his own work.

In 2013, research by Raynor and Ahmed challenged Porter's ideas that cost leadership is one of three important competitive strategies. The practical implications of these findings were analysed and developed by Goddard (see further reading). Goddard identified a fatal managerial bias towards cost competitiveness which he says can be harmful to corporate performance.

» KEY WORKS BY PORTER

BOOKS

Competitive strategy: techniques for analyzing industries and competitors
New York: Free Press, 1980

Competitive advantage: creating and sustaining superior performance
London: Collier Macmillan, 1985

Competitive advantage of nations
London: Macmillan, 1990

On competition
Boston Mass: Harvard Business School Press, 1998

Strategy seeking and securing competitive advantage, with Cynthia A Montgomery (eds)
Boston Mass: Harvard Business School Press, 1991

Can Japan compete?, with Hirotaka Takeuchi and Mariko Sakakibara
London: Macmillan, 2000

UK competitiveness: moving to the next stage, with Christian H M Ketels
London: Department of Trade and Industry ; Economic and Social Research Council, 2003

Redefining healthcare: creating value-based competition on results, with Elizabeth Olmsted Teisberg
Boston Mass: Harvard Business Press, 2006

JOURNAL ARTICLES

How competitive forces shape strategy
Harvard Business Review, vol 57 no 2, Mar 1979, pp 137-145

What is strategy?
Harvard Business Review, vol 74 no 6, Nov/Dec 1996, pp 61-78

Strategy and the internet
Harvard Business Review, vol 79 no 3, March 2001, pp 63-79

Strategy and society the link between competitive advantage and corporate social responsibility, with Mark R Kramer
Harvard Business Review, vol 84 no 12, Dec 2006, pp 78,80-92

The five competitive forces that shape strategy
Harvard Business Review, vol 86 no 1, Jan 2008, pp 79-93

Creating shared value, with Mark R Kramer
Harvard Business Review, vol 89 nos 1/2, Jan/Feb 2011, pp 62-77

FURTHER READING

BOOKS

The fatal bias: the prevailing managerial bias towards cost efficiency is seriously harmful to corporate performance, Jules Goddard. In: Winning ideas: the Management Articles of the Year
London: Chartered Management Institute, 2014, pp 7-13

Three rules for making a company truly great, Michael E Raynor and Mumtaz Ahmed
Harvard Business Review, vol 91 no 4, 2013, pp 108-117

Understanding Michael Porter: the essential guide to competition and strategy, Joan Magretta
Boston Mass: Harvard Business Review Press, 2012

The lords of strategy: the street intellectual history of the new corporate world, Walter Kiechel
Boston Mass: Harvard Business Press, 2010

RELATED MODELS

Porter's five forces

RELATED THINKERS

Igor Ansoff: the Father of corporate strategy (52)
Gary Hamel: the search for a new strategic platform (49)
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Revised April 2014