Strategic Management

Although most can agree that a firm's ability to survive and prosper depends on choosing and implementing a good strategy, there is less agreement about what a strategy is and even agreement about what constitutes a good strategy. Indeed, there are almost as many different definitions of these concepts as there are books written about them.

Defining Strategy

Simply speaking, strategy is the way in which decisions are made. According to Alfred Chandler "strategy is the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals. Kenneth Andrews, however, defined strategy as " the pattern of objectives, purposes or goals, and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or should be in and the kind of company it is or should be". Thus, strategy is a firm's answer to two fundamental questions- 'where' should it compete and 'how' should it compete and it is essentially making the right choices.

In recent years, strategy is linked with the theory of competitive advantages. It is believed that a strategy is good if it helps generate competitive advantages. This theory, like all theories- is based on a set of assumptions and hypotheses about the way competition in an industry is likely to evolve and how that evolution can be exploited to earn profit. The greater the extent to which these assumptions and hypotheses accurately reflect how competition in an industry evolves, the more likely it is that a firm will gain a competitive advantage from implementing its strategies. If these assumptions and hypotheses turn out not to be accurate, then a firm's strategies are not likely to be source of competitive advantage.

But there lies a challenge. It is usually very difficult to predict how competition in an industry will evolve, and so it is rarely possible to know for sure that a firm is choosing the right strategy. Therefore, a firm's strategy is almost always a theory: It's a firm's best bet about how competition is going to evolve and how that evolution can be exploited for competitive advantage.

Strategic Management Process

Although it is usually difficult to know for sure a firm is pursuing the best strategy, it is possible to reduce the likelihood that mistakes are being made. Research suggests that the way to do this is for a firm to choose its strategy carefully and systematically and to follow the strategic management process. The strategic management process is a sequential set of analyses and choices that can increase the likelihood that a firm will choose a good strategy; that is, a strategy that generates competitive advantages. An example of the strategic management process is presented in Figure 1.

A Firm's Mission

The strategic management process begins when a firm defines its mission. A firm's mission is its long-term purpose. Missions define both what a firm aspires to be in the long run and what it wants to avoid in the meantime. Missions are often written down in the form of mission statements.

Most mission statements incorporate common elements. For example, many define the businesses within which a firm will operate- medical products for Johnson and Johnson; adhesives and substrates for 3M- or they can very simply state how a firm will compete in those businesses. Many even define the core values that a firm espouses.

Indeed, mission statements often contain so many common elements that some have questioned whether having a mission statement even creates value for a firm. Moreover, even if a mission statement does say something unique about a company, if that mission statement does not influence behavior throughout an organization, it is unlikely to have much impact on a firm's action. For example, while Enron was engaging in wide ranging acts of fraud, it had a mission statement that emphasized the importance of honesty and integrity. Research suggests that, on average, mission statements do not affect a firm's performance.

Despite these caveats, research has identified some firms whose sense of purpose and mission permeates all that they do.

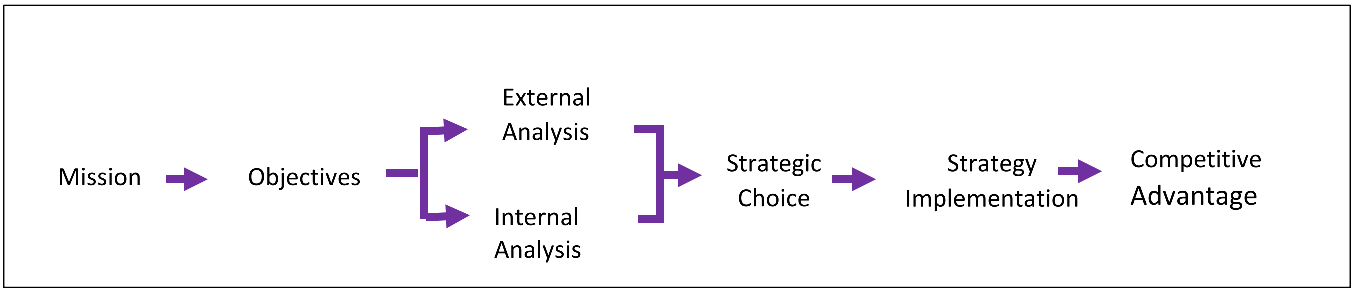

Figure 1 :The Strategic Management Process

These firms have included, for example, 3M, IBM, Hewlett- Packard, and Disney. Some of these visionary firms, or firms whose mission is central to all they do, have enjoyed a long period of high performance. These visionary firms earned substantially higher returns than average firms even though many of their mission statements suggest that profit maximizing, although an important corporate objective, in not their primary reason for existence. Rather, their primary reasons for existence are typically reflected in a widely held set of values and beliefs that inform day-to-day decision making. While, in other firms, managers may be tempted to sacrifice such values and beliefs to gain short-term advantages, in these special firms, the pressure for short tern performance is balanced by widespread commitment to values and beliefs that focus more on a firm's long-term performances.

Of course, that these firms had performed well for many decades does not mean they will do so forever. Some previously identified visionary firm have stumbled more recently, including

American Express, Ford, Hewlett-Packard, Motorola, and Sony. Some of their problems may be attributable to the fact that these formally mission-driven companies have lost focus on their mission.

Although some firms have used their missions to develop strategies that create significant competitive advantages, missions can hurt a firm's performance as well. For example, sometimes a firm's mission will be very inwardly focused and defined only with reference to the personal values and priorities that are consistent with the economic realities facing a firm. Strategies derived from such missions are not likely to be a source of competitive advantages.

Consider, for example, Yahoo. In 2008, Microsoft tried to buy Yahoo for $31 per share, a deal worth, in total, $44.6 billion. This represented a premium over Yahoo's market price at the time. Yahoo declined the offer, citing the strength of their global brand, recent investments in its advertising platform, and their ongoing strategy in concluding that Microsoft's offer undervalued Yahoo. In short, Yahoo remained committed to its mission and strategy, and remained independent.

Over the next several years, Yahoo's market value tumbled, reaching a low of less than $10 per share-well below the $31 per share Microsoft had offered. Finally, in 2013, Yahoo's valuations rose to equal what Microsoft had offered to buy it for in 2008.

But this valuation turned out to be difficult to maintain. While Yahoo continued as an independent company, its value continued to fall. Finally, in July 2016, Verizon purchased Yahoo for $4.8 billion. In other words, by keeping focused on its mission and strategy, Yahoo destroyed almost $40 billion in value for its shareholders over an eight-years period of time.

Obviously, because a firm's mission can help, hurt, or have no impact on its performance, mission by themselves do not necessarily lead a firm to choose and implement strategies that generate competitive advantages. Indeed, as suggested in Figure 1, while defining a firm's mission is an important step in the strategic management process, it is only the first step in that process.

Objectives

Whereas a firm's mission is a broad statement of its purpose and values, its objectives are specific measurable targets a firm can use to evaluate the extent to which it is realizing its mission. High-quality objectives are tightly connected to elements of a firm's mission and are relatively easy to measure and track over time. Low- quality objectives either do not exist or are not connected to elements of a firm's mission, are not quantitative, or are difficult to measure or difficult to track over time. Obviously, low- quality objectives cannot be used by management to evaluate how well a mission is being realized. Indeed, one indication that a firm is not that serious about realizing part of its mission statement is when there are no objectives, or only low- quality objectives, associated with that part of the mission.

External and Internal Analysis

The next two phases of the strategic management process- external analysis and internal analysis- occur more or less simultaneously. By conducting an external analysis, a firm identifies the critical threats and opportunities in its competitive environment. It also examines how competition in this environment is likely to evolve and what implication that evaluation has for the threats and opportunities a firm is facing. A considerable literature on technique for and approaches to conducting external analysis has been developed over the past several years.

Whereas external analysis focuses on the environmental threats and opportunities facing a firm, internal analysis helps a firm identify its organizational strengths and weakness. It also helps a firm understand which of its resources and capabilities are likely to be sources of competitive advantage and which are less likely to be sources of such advantages. Finally, internal analysis can be used by the firm to identify those areas of its organization that require improvement and change. As with external analysis, a considerable literature on techniques for and approaches to conducting internal analysis has evolved over the past several years.

Strategic Choice

Armed with a mission, objectives, and completed external and internal analysis, a firm is ready to make its strategic choice. That is, a firm is ready to choose how to gain competitive advantage.

The Strategic choice available to firms fall into two large categories: business- level strategies and corporate-level strategies. **Business-level Strategies** are actions firms take to gain competitive advantage in a single market or industry. These strategies broadly include cost leadership, products differentiation, and flexibility. In addition, tacit collusion as a business level strategy is widely discussed in strategy literature. **Corporate- level strategies** are actions firms take to gain competitive advantages by operating in multiple markets or industries simultaneously. Common corporate –level strategies include vertical integration strategies, diversification strategies, strategic alliance strategies, and merger and acquisition strategies.

Obviously, choosing specific strategies can be quit complex, and it would depend on a large number of factors. However, the underlying logic of strategic choice is not complex. Based on the strategic management process, the objective when making a strategic choice is to choose a strategy that: (1) supports the firm's mission; (2) is consistent with a firm's objectives; (3) exploits opportunities in a firm's environment with a firm's strengths; and (4) neutralizes threats in a firm's environment while avoiding a firm's weaknesses. If this strategy is implemented- the last step of the strategic management process- a strategy that meets these criteria is very likely to be a source of competitive advantage for a firm.

Strategy Implementation

Of course, simply choosing a strategy means nothing if that strategy is not implemented. Strategy implementation occurs when a firm adopts organizational policies and practices that are consistent with its strategy. Three specific organizational policies and practices are particularly important in implementing a strategy: (1) a firm's formal organizational structure; (2) its formal and informal management control system; and (3) its employee compensation policies. A firm that adopts an organizational structure, management controls, and compensation policy that are consistent with and reinforce its strategies is more likely to be able to implement those strategies than a firm that adopts an organizational structure, management controls, and compensation policy that are inconsistent with its strategies. Normally, the process of choosing a strategy and implementing it are of equal importance and they generally go together.

A Brief History of Strategic Management

Broadly speaking, it seems possible to identify two distinctive phases in the development of the field of strategic management. The year 1980 signifies the crossroad between the two phases. Prior to the year 1980, what characterised strategic management, then called business policy, was inductive reasoning and issue centred organisation of the field. The origin of inductive reasoning in the field goes back to the Harvard Business School's case-study approach, which began in 1920s. The case-studies revealed that firms within the same industry using the same technology differed in terms of their performances. The performance differentials were then attributed to the differences in policies such as different product approaches, organisational forms, marketing, and distributions. From 1960s up to 1980, many tools and techniques of strategic planning, such as product-portfolio analysis and experience curve, were developed. Common to all these endeavours was the idea that strategy theory is essentially a contingency theory**,** i.e. there is no best way to manage a firm or the best way to manage depends on the circumstances under which the firm operate. In this regard, up to 1980, the field was dominated by practical problems or issues, such as diversification, acquisition, innovation, revitalisation. Therefore, the field of strategic management research was organised by topics. Put it in other way, the field lacked a conceptual base.

On the contrary to the prior to 1980, 1980s were the decade of high theory. Michael Porter, in his well-known books *Competitive Strategy: Techniques for Analysing Industries and Competitors* published in 1980 and *Competitive Advantage: Creating and Sustaining Superior Performance* published in 1985, outlined a theory of competitive advantage with a set of tools for analysing industries, competitors and firms. The importance of the Porter's Competitive Strategy Theory lies in its injection of the novel idea of generic strategies into strategy thinking and research, i.e. there are basically three generic strategies (cost leadership, differentiation and focus) that the firm can follow to achieve competitive advantage in any marketplace and time. The idea of generic strategies was deductive in character, and thereby having gone beyond the contingency arguments. It received a wide acceptance and dominated the field of strategy throughout 1980s.

A further significant development within the strategy field was of the resource-based view of strategy by Wernerfelt in 1984. The approach is presented as a complementary explanation to the Porter's approach, drawing attention to the inside the firm, i.e. resources and capabilities, as much as outside the firm, i.e. competitive market or industry. The central thesis of this approach was that firms must establish strong *resource* positions, since strong *market* positions alone do not ensure persistent competitive advantage.

In the 1980s, there have been numerous notable contributions. However, the turning point for the resource approach was with the publication of Prahalad and Hamel's article 'The Core Competence of the Corporation' in Harvard Business review in 1990. It was this article that drew practising managers' attention to the importance of the resources and capabilities, i.e. core competences in Prahalad and Hamel's term, within the firm. The resource-based approach has gained significant momentum in 1990s, and it seems that it has been gaining dominance over the Porter's competitive strategy, so far as some scholars of strategy have made the announcement of the arrival of a new paradigm. In short, as Montgomery and Porter observe, 'the 1980s were the decade during which strategy became a full-fledged management discipline.' Although Montgomery and Porter do not elucidate in what sense strategy is a discipline (ontologically or methodologically?), from their presentation it is understood that it has arrived a disciplinary standing in an ontological sense. In clearer terms, they imply that strategy theory now has an identifiable problem area. It concerns with the nature of firm differentials in terms of their profit performance. In doing so, it does not follow a certain method. Furthermore, it has arrived a disciplinary standing in the sense that it now has a conceptual base to investigate the nature of firm differentials. In 1980s the introduction of the Porter's competitive strategy and the resource-based view of strategy have brought about a disciplinary base, which has facilitated accumulation of knowledge, rendered a groundwork on which strategic thinking and research could be based.

Different Approaches of Strategic Management

The production of knowledge within strategic management discipline, from the 1980s onwards, has been astounding. Yet, the field does not show a disciplinary purity. There are many schools of thought or approaches to strategy in the field. For example, Chaffee identifies three distinguishable models of strategy-making present in strategy literature: linear, adaptive, and interpretive. Linear model of strategy assumes that top managers follow a rational decision-making process. In this respect strategy making is a sequential planning process. Adaptive model of strategy assumes that top managers assess external and internal conditions and align environmental opportunities and firm resources and capabilities in a simultaneous and continuous manner. Interpretive model takes a social contract view and portray the firm as a collection of cooperative agreements entered into by individuals with free will. It assumes that reality is not something objective and external to the perceiver, but rather socially constructed, thereby defined through a process of social interchange in which perceptions are affirmed, modified, and replaced. In a similar way, Whittington classifies approaches to strategy into four categories alongside two dimensions, namely, outcomes (the degree to which strategy either produces profit-maximising outcomes or deviates to allow other possibilities to intrude) and process (whether strategies are made through deliberate planning or emergent adapting); classical, evolutionary, processual, and systemic. Classical approach assumes that strategy is a rational process of deliberate calculation and analysis, designed to maximise long-term advantage; evolutionary approach assumes that strategies emerge in response to permanent environmental turbulence in order to maximise the chances of survival by aligning the firm with the environment; processual approach assumes that strategy emerges from a process of learning and compromise between divergent interest groups within the firm and the strategy needs not to be optimal; systemic approach assumes that strategies are always contingent on the social system such as Europe, Asia and Middle East in which strategy-making take place, and often deviate from the profit-maximising norm.

Mintzberg makes a more detailed classification of approaches to strategy according to the degree of rationality assumed in the process of strategy-making (formulation/formation). He identifies ten schools in strategy literature: design school (strategy-making as a conceptual process), planning school (strategy-making as a formal process), positioning school (strategy-making as an analytical process), entrepreneurial school (strategy-making as a visionary process), cognitive school (strategy-making as a mental process), learning school (strategy-making as an emergent process), political school (strategy-making as a power process), cultural school (strategy-making as an ideological process), environmental school (strategy making as a passive process), and configurational school (strategy-making as an episodic process).

The above-mentioned categorisations concern the ‘how’ of strategy, rather than the ‘what’ of strategy. In other words, they represent the ‘process’ of strategy-making, rather than the ‘content’ of strategy. Approaches to strategy content are concerned with the sources of sustainable performance differences. De Wit and Meyer classify approaches to strategy content into two categories: positioning approach and resource-based approach.' While the former takes an ‘outside-in’ perspective and places most emphasis on various market structures and firms’ positions within those structures as the decisive variables of firms’ profitability, the latter takes an ‘inside-out’ perspective and places most emphasis on firms’ specific resources and capabilities as the major factors of persistent firms’ competitive advantages.

Scientific State of Strategy Research

The above account should also have implied that there is yet no accepted ‘mainstream’ approach directing strategic studies or a ‘dominant’ framework to pull together all aspects or components of strategic studies and within which particular themes can be understood as specific applications. That is to say, the discipline of strategic management demonstrates a state of disciplinary fragmentation, rather than purity. As such, what is the scientific status of strategic management discipline? To use the Kuhnian terminology, is it a pre-paradigm or post-paradigm or, to use the Lakatosian’s, is it an immature or a mature science? In a Kuhnian model of science, the scientific status of strategic management should be considered as pre-paradigm, the period during which "... there is a multiplicity of competing schools (but)... evidence of progress, except within schools, is very hard to find. This is the period ... during which individuals practice science, but in which the results of their enterprise do not add up to science as we know it".

In other words, according to Kuhn, the scientific status of strategic management corresponds to the ‘early’ rather than ‘advanced’ stage of scientific activity since no one paradigm or theoretical framework has yet established monopoly over the field. In the same respect, from the Lakatosian point of view, strategic management should not be considered as a ‘mature’ science since within a mature scientific research programme scientists consistently ignore both anomalous problems and outside criticism (intellectual and social), and focus, instead, primarily on the mathematical articulation of the research programme.' In short, to both philosophers of science, strategic management should not be seen as a genuinely scientific paradigm or research programme.

However, do these highly tight categorisations about the scientific status of a discipline have any correspondence in the history of science? Or, more simply, what are the examples of the other radically different type (post-paradigm or mature activity) of science? Laudan, another philosopher of science, observes that we cannot square which Kuhn and Lakatos describe with what we know about the evolution of science: Kuhn can point no major science in which paradigm monopoly has been the rule, nor in which foundational debate has been questioned. Lakatos for his part, has identified no (physical) science in which the disdain for anomaly and the indifference to extra-programmatic conceptual problems have been the prevailing features. As a result, it is extremely unclear whether the notion of a ‘mature’ science finds any exemplification whatsoever in the history of science.'

That is to say, disciplinary fragmentation is the case for many, if not all disciplines. Therefore, it is rather difficult to label disciplines in this respect less genuinely scientific than then mature/post-paradigm counterparts. Nevertheless, disciplinary fragmentation has certainly presented a serious obstacle to scientific growth of the field of strategic management. Enormous effort has been wasted in interfamily disputes rather than put in search of a firm disciplinary base for the field.

There are some other obstacles to scientific growth of the field. As Camerer argues, the following three deficiencies originating in the *way* that strategic thinking and research is typically done also cause the slow accumulation of scientific knowledge in the field: (i) the field is plagued by confusion about its basic concepts which are often ambiguous and their definitions are not agreed upon, (ii) theories and models in the field are rarely tested, and (iii) theories in the field do not cumulate upon previous theories as they should.

Camerer goes further and argues that the failure of knowledge to cumulate swiftly identifies strategy research as more an art than a science 'since most arts do not *need* to progress' (emphasis in origin).'" But, the slow accumulation of scientific knowledge in the field should not be taken as a sign of the discipline being an art, but, rather of not being progressed towards the advance stage of scientific activity. Arguably, what makes it an art more than a science is its strong normative, practical/pragmatical orientation. The focus of strategy scholars is yet on 'what ought to be' rather than 'what is'. Their major interest is in explaining persistent performance differentials between firms but the way they approach performance phenomena leads them into, primarily, discussion of implications for top management. They approach questions and problems relating performance phenomena in the practical/pragmatical way that they are asked and formulated by managers (for example, where to compete and how to compete to get competitive advantage?) rather than asked, formulated and answered by scientists.

Admittedly, all disciplines have a normative orientation. Yet, on the contrary to studies in other disciplines, studies in the discipline of strategic management often overlooks to make linkages from 'what is' to 'what ought to be'. This certainly relates its strong practical/pragmatical inclinations, i.e. to produce as much advises as and as much quickly as it can to sell, in the market of ideas (consultations, business schools, publications, etc.), people in or to be in the business world to overcome their (practical/pragmatical) problems.

Obviously, in order for strategic management to progress towards an 'advanced' stage of scientific status, it needs to ground its 'what ought to be' explanations onto 'what is' explanations. As we have implied in the previous chapter, one way of doing so is to connect practical/pragmatical strategic explanations to economics ones, such as connecting 'how markets are organised' to 'how the organisation of markets can influence the strategic behaviour and performance of firms' or connecting 'why firms are organised as they are' to 'how the organisations of firms can effect their competitive behaviour for advantage', etc. Thus, strategic thinking and research may proceed from 'what is' explanations to 'what ought to be' advises in a scientific manner. It is one of the purpose of this study is to find out whether such a connection is possible.

After this brief history of the emergence, development of strategic management discipline and its scientific status, it is time to deal with the question what constitutes its problem area and hard core assumptions or, to put it differently, what constitutes its disciplinary base?

The Problem Area of Strategic Management Theory

Kuhn argues that what basically differentiates one paradigm from another or what constitutes a paradigm's distinctive character is its problem area, that is, which problems it attempts to solve. Which problems are more significant to solve or the choice of problem area constitutes a paradigm base within which research take place. In this context, what is the problem area that strategy research attach importance and endeavour to tackle?

In his attempt to define the field of strategic management, Teece observes that 'the field... is defined not by methodology, discipline-based theories, or paradigms, but a set of questions, the answers to which have tremendous implications for management practice.''' He gives such examples: (i) what is the source of economic profits and performance differentials in profits between individual firms?, (ii) how can the sources of these differential profits be protected from competitive equalisation? (iii) can a firm's knowledge assets be managed strategically?, (iv) how do the boundaries of the firm-lateral and vertical-affect performance?, (v) how much difference in performance does good strategic management really make?, etc.

He maintains that the strategy research focus on these issues separates the field from the related fields since no other field or discipline treat them as mainstream issues. However, a careful analysis of the all questions or issues makes it clear that all of them refer, in one way or another, to the identification of 'the sources and mechanism of *persistent firm differentials* in terms of profit performance'. In fact, Teece himself goes a bit further arguing that strategic management requires a dominant paradigm or research programme, and then suggests the 'study of rent-seeding by the enterprise' as discipline-base focus for strategy research:

... a key, if not *the* key, issue is one of how to position and manage the firm so as to generate, augment, and protect "economic rents". Economic rents are the returns above those necessary to keep the underlying assets available to the firm in the long run. ... It is ... what economists refer to as the "study of rent-seeking by the enterprise" (emphasis in origin).

From the Teece's viewpoint, if the strategy research deserves a name, it should be the rent-seeking paradigm/research programme'. In this respect the strategy field is a distinctive paradigm or research programme, not an extension of economic paradigm. As we see later, the mainstream economics, i.e. neoclassical theory, does not lack a *definition* of rent-seeking but it lacks a *theory* of rent-seeking.

Porter, the most celebrated theorist in the field, expresses the central problem of strategic thinking and research as follows: 'The reason why firms succeed or fail is perhaps the central question in strategy. It has preoccupied the strategy field since its inception The Porterian idea of 'firms success and failure' as central question is another way of expressing the idea of 'rent-seeking by enterprise', and to him it has been the unifying research question from the very outset up to now. For Porter the problem of firms success and failure constitutes the base of strategy discipline in the sense that 'the causes of firm success or failure encompass all the other questions that have been raised ... [in strategy work]. It is inextricably bound up in questions such as why firms differ, how they behave, how they choose strategies, and how they are managed.

That is to say, according to Porter, the identification of the causes of firm success and failure is the problem area of strategic management, and all other questions must be considered the elaboration of this central problem. Lippman and Rumelt, accepting the rent-seeking behaviour of individual firms or firms success and failure as the research focus of strategic management, give a more precise and operational delineation of the problem area of any strategy-related endeavours. In their view, a theory explaining profit differentials (rent-seeking behaviour or success and failure) of individual firms must address 'both the origins of interfirm differences and the mechanism that impede their elimination through competition and entry.

In other words, strategy theory does not deal with short-lived or temporary differentials, but 'persistent' profit differentials between firms. Therefore, alongside an explanation of the *sources* of firm differentials, there must also be an explanation of the *mechanism* of how the differentials persist over time. That is, business strategy deals with enduring competitive advantages in a competitive setting, and necessarily attempts to explain the sources of competitive advantage (success, etc.) as well as how they are sustained over time despite of competitive pressure, imitation or equilibrating market forces. If competition would erode profits, firms would find no incentive for 'strategic' investments and behaviours. Therefore, short-term advantages are not considered as a subject matter of strategic investigation.

Within the strategy discipline, there is, however, little agreement regarding the sources and mechanism of persistent firm differential. The answers given are quite diverse: the positioning of the firm relative to its market forces, the embodiment of the firm's visions, the firm's unique competencies, the firm's efficiency, the firm's critical success factors, the firm's learning ability, the firm's ability to innovate; barriers to entry and mobility, barriers to imitation and so forth. "When reduced to the bare essentials, however, the diversity of views can be categorised into two fundamentally different approaches ... - the *positioning approach* and the *resources based approach* In order to give a more concrete idea of the strategic management's problem area, it seems of necessity to introduce, at least briefly, the two approaches. They are first to be introduced in terms of their view about the sources of firm differentials, and then about the mechanism how the differentials are sustained.

The Sources of Profit Differentials Between Firms

In any market there exist competitively advantageous and disadvantageous firms competing side by side. Some of them have competitive advantages in the sense that they outperform their rivals, and others have less advantages, earning lower rates of profit as compared with their market average. What are the sources of competitive advantages and disadvantages (success or failure)? The positioning approach, a name popularised by Mintzberg, attempts to explain interfirm differences with regard to market phenomena, whereas the resource-based approach explains with internal organisational phenomena.

Positioning Approach

According to the positioning approach, firm differences are the result of 'first ... the attractiveness of industries for long-term profitability and the factors that determine it ... second ... the determinants of relative competitive position within an industry. To start with market attractiveness, the basic idea is that not all markets offer equal profit opportunities. Therefore, the average level of long-term profitability of firms varies according to markets in which they operate. Markets in which firms compete have characteristics which make them intrinsically more (or less) profitable. According to Porter, there are basically five competitive forces determine the ability of firms in a market to earn above-normal profits: 'the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among existing competitors.'"" Markets with large barriers to entry, with a small number of firms, with a large degree of product differentiation, or low demand elasticity, are more profitable than markets with that of opposite features. In other words, in markets where the five forces are favourable, such as pharmaceuticals, printing and publishing, and chemicals, many competitors earn attractive returns. But in markets where from one or more of the forces is intense, such as iron and steel or textile mill products, few firms earn attractive returns despite the best efforts of management. In short, the weaker the forces' collective power, the greater the potential of high profits, or *vice versa.*

Having explained five forces at the level of the market, the Porter's positioning approach switches to competitors analysis to explain intra-market differences. According to the positioning approach, interfirm differences can be explained by firms' unique *positions* in their markets *vis-à-vis* the five competitive forces. The strength of their defence against the five forces determines whether they earn above or below-average profits. Porter argues that there are in general three generic strategies available to firms to defend their positions against the market forces: firms may *position* themselves to outperform their rivals, by developing (i) a *cost* advantage or (ii) *differentiation* advantage that somewhat insulates them from the five forces. or, firms may identify (iii) a market *niche* in which the five forces are less severe. The strategic positions refer also to strategic groups following the same strategy along the strategic dimensions (cost, quality, and focus). The profit differences of firms in strategic groups is often different because the five competitive forces do not have the same impact on different strategic groups.

Porter argues that those firms that successfully pursue one of these generic strategies earn above-average profits, and those firms that engage in each generic strategy but fail to achieve any of them are 'stuck-in-the-middle', i.e. in disadvantageous positions. This is because there is a trade off between the generic strategies, for example, the pursuit of differentiation advantage is usually incompatible with the pursuit of cost advantage, since they require a conflicting set of organisational arrangements, resources and capabilities, organisational culture, motivation system, etc.

Resource-Based Approach

Contrary to the positioning approach's outside-in perspective (taking market as departing point to explain strategic phenomena), the resource-based approach to the economics of the firm differentials takes an inside-out organisational perspective to explain interfirm differentials. For the theorists of the resource-based approach, firm differentials originate in firms resources. In other words, as Prahalad and Hamel argue, competitive advantages emerge through processes of resource accumulation, and deployment, so that a strategic position must be defined by the resources held by a given firm, not by market forces.

Theorists of the resource-based approach assert that "competitive advantage does not rest in industry structure or the firm's membership in a collective (e.g. strategic groups), but rather in its possession of unique difficult-to-imitate skills, knowledge, resources or competencies." In other words, the argument is that being in an 'attractive' or 'unattractive' market is not the ultimate determinant of the firm performance in the long term. It is not difficult to find outperforming firms in markets lack of attractiveness or poorly performing firms in attractive markets. As Verdin and Williamson argues, "industry is not destiny ... being in an 'attractive' industry is no guarantee for success, while lack of industry attractiveness is not a sentence to poor performance." The ultimate determinant is, then, not the degree of market attractiveness, but the degree of productive resources and capabilities that firms possess. Therefore, firms differ along dimensions of their resources and capabilities that they have developed over time. If all firms have equal access to the resources and capabilities to reap benefits of market opportunities, then there will be no advantageous and disadvantageous firms.

What makes a firm different in terms of its profitability vis-à-vis its competitors is its position of some idiosyncratic resources and capabilities. Therefore, firm specific resources are crucial in explaining firm differentials. What are distinctive resources then? Wernerfelt broadly defines a resource as 'anything which could be thought of as a strength or weakness of a given firm.'"" Grant goes further and makes a distinction between resources and capabilities: "Resources are inputs into the production process ... include items of capital equipment, skills of individual employees, patents, brand names, finance, and so on. ... Capabilities are what it can do as a result of teams of resources working together." In other words, resources are the individual assets of a firm, whereas capabilities are the working of resources together. Capabilities are firm-specific, and developed over time, through complex interactions among resources.

As Barney points out,"" not all resources and capabilities are strategically important to create significant sustainable profit differentials between firms. Only does a *limited* number of resources and capabilities contribute to the firm long-term profit differentials. This means that, there are strategically 'core' and 'non-core' resources and capabilities in a firm, of which only core competences make significant persistent differences.

What makes a competence 'core'? Prahalad and Hamel suggest three tests to identify core competencies in a firm: (i) a core competence provides potential access to a wide variety of markets- "core competencies are the gateways to new markets; (ii) a core competence makes a disproportionate contribution to customer-perceived value this distinction between core and non-core competencies rests partly on a distinction between core and non-core customer benefits; and (iii) a core competence is difficult for rivals to imitate, i.e. it must be competitively unique."" Hamel adds two more tests to distinguish core from non-core: (iv) a core competence is an integration of skills, i.e. is a bundle of skills and technologies, rather than a single skill or technology; and (v) a competence is an accumulation of learning, an activity, not an 'asset' in the accounting sense, so competencies clusters of activities that a firm does especially well in comparison with other firms.

The resource-based approach has not been fully developed because, as Grant points out, first, the various contributions lack a single integrating framework, and second, little effort has been made to develop the practical implications of this theory. Grant attempted to make progress on both respects, proposing a framework for the resource approach. Nevertheless, the diversity of views within the approach has been continuing.

References

Andrews, K., *The Concept of Corporate Strategy*, Homewood, IL, Irwin, 1971.

Barney, J.B., 1986, Strategic Factor Markets: Expectations, Luck and Business Strategy, Management Science. Vol. 42, pp. 1231-1241.

Barney, J. B. and Hesterly, William S., Strategic Management and Competitive Advantage Concepts, Pearson, 6th Edition, 2020, pp.26-30.

Barcadurmus, M. 2000, Economic Foundations of Strategic Management - On the Economic Conceptualisation of the Nature and Sustainability of Profit Differentials among Firms, Doctoral Thesis submitted at the University of Leicester, UK.

Camerer, C., 1985, Redirecting Research in Business Policy and Strategy, Strategic Management Journal, Vol. 6, p. 1-15.

Chandler, A., *Strategy and Structure: Chapters in the History of the American Industrial Enterprise,* Cambridge, MA, MIT Press, 1962, p. 13.

Chaffee, E.E., 1985, Three Models of Strategy, Academy of Management Review, Vol. 10, No., 1, pp. 89-98.

Kuhn, T.S., 1970, The Structure of Scientific Revolutions, Chicago: University of Chicago Press, p. 163.

Lakatos, I., 1970, Falsification and the Methodology of Scientific Research Programmes, in I. Lakatos and A. Musgrave (eds.) Criticism and the Growth of Knowledge, Cambridge: Cambridge University Press, pp. 91-196.

Mintzberg, H., 1990, Strategy Formation. Schools of Thought, in J.W. Frederickson (eds.) London: Harper Business, pp. 105-235.

Montgomery, C.A. and Porter, M.E., 1991, Introduction, in C.A. Montgomery and M.E. Porter (eds.) Strategy; Seeking and Securing Competitive Advantage, Boston: Harvard Business School, pp. xi-xxiii, p. xi.

Porter, Michael E., 1996, What is Strategy, Harvard Business Review, November-December, p 61-78.

Porter, M. E. Competitive Strategy: Techniques for Analyzing Industries and Competitors. New York: Free Press, 1980. (Republished with a new introduction, 1998.)

Prahalad, C.K. and Hamel, G., 1990, The Core Competence of the Corporation, Harvard Business review. Vol. 68, No. 3, pp. 79-91.

Teece, D., 1980, Economics of Scope and the Scope of the Enterprise, Journal of economic Behaviour and Organisation, Vol. 1, pp. 223-247.

Wernerfelt, B., 1984, A Resource Based View of the Firm, Strategic Management Journal, Vol. 5, pp. 171-180.

Whittington, R., 1993, What is Strategy and Does It Matter?, London: Routledge, pp. 2-41.

@@@