

The Origins of Strategy

Background

Strategy is a term that can be traced back to the ancient Greeks who used it to mean a chief magistrate or a military commander-in-chief. Carl von Clausewitz's wrote, in the first half of the 19th century, whereas "tactics ...(involve) the use of armed forces in the engagement, strategy (is) the use of engagements for the object of the war.

The 1st industrial revolution (mid 1700s – 1800s) failed to induce much in the way of strategic thinking or behavior because companies lacked the power to influence markets. The chaotic markets of this era led economist Adam Smith to describe market forces as an "invisible hand" that remained largely beyond the control of individual firms.

The 2nd industrial revolution which began in the last half of the 1800s saw the emergence of strategy as a way to shape market forces and affect the competitive environment. The construction of key railroads after 1850s made it possible to build mass markets for the first time.

Adam Smith's

"invisible hand" came to be supplemented by what Alfred Chandler, Jr. termed the "visible hand" of professional managers.

The need for strategic things was first articulated by managers such as Alfred Sloan, the CEO of GM who devised a successful strategy based on the perceived strengths and weakness of his company's critical competitor, Ford Motor Co.

World War sharpened the problem of allocating scarce resources across the entire company. Von Neumann and Morgenstern published *The Theory of Games* (1944) which solved the problem of zero-sum games (mostly military from an aggregate perspective) and framed the issues surrounding non-zero sum games (mostly business situations). Also, the concept of “learning curves” became increasingly important. Peter Drucker argues that “management is not just passive, adaptive behavior; it means taking action to make desired results come to pass.” Drucker’s insight became the key rationale for business strategy—that is, by consciously using formal planning, a company could exert positive control over market forces.

A more direct bridge to the development of strategic concepts for business applications was provided by inter-service competition in the U.S. military after WW II. This led the Navy to become self-conscious about its “distinctive competence.”

Academic Underpinnings

John Commons wrote in 1934 about business firms’ focus on strategic or limiting factors in a way that was picked up later by Chester Barnard. Ronald Coase published a provocative article in 1937 that asked why firms exist. (Nobel Prize). Edith Penrose explicitly related the growth of business firms to the resources under their control and the administrative framework used to coordinate their use.

The 2nd industrial revolution witnessed the founding of many elite business schools (Wharton, 1881; Harvard, 1908). Harvard was among the first to promote the idea that managers should be trained to think strategically rather than just acting as functional administrators.

In the early 1950s, two professors at Harvard, George Smith, Jr. and C. Roland Christensen encouraged students to question whether a firm's strategy matched its competitive environment. In the 1960s, classroom discussions came to focus on matching a company's "strengths" and "weaknesses" – its distinctive competence – with the "opportunities" and threats" (or risks) that it faced in the marketplace.

In 1963 a business policy conference was held at Harvard that help diffuse the SWOT concept in both academia and business though it did not bring closure to the problem of actually defining a firm's "distinctive competence." To solve this problem, strategists had to decide which aspects of the firm were "enduring and unchanging over relatively long periods of time" and which were "necessarily more responsive to changes in the market place and the pressures of other environmental forces."

Theodore Levitt wrote a classic article in 1960 titled, Marketing Myopia, which was sharply critical of any firm that focused too narrowly on delivering a specific product, presumably exploiting its distinctive competence rather than consciously serving the customer.

Another leading strategist, Igor Ansoff, disagreed with this position arguing that Levitt asked companies to take unnecessary risks by investing in new products that might not match the firm's distinctive competence. Ansoff suggested four categories for defining the common thread of its business/corporate strategy.

The Rise of Strategy Consultants

The 1960s and early 70s witnessed the rise of a number of consulting practices. The Boston Consulting Group (headed by Bruce Henderson)

believed that “good strategy must be based primarily on logic, not...experienced derived from intuition.” BCG first developed its version of the learning curve-what it labeled the “experience curve” in 1965-66. The firm’s standard claim for the EC was that, for each cumulative doubling of experience, total costs would decline roughly 20-30% because of economies of scale, organizational learning and technological innovation.

In the early 70s, the EC led to another powerful simplification by BCG, the Growth-Share Matrix. BCG’s recommendation was to maintain a balance between “cash cows” and “stars” while allocating some resources to feed “question marks” but divesting yourself of “dogs.”

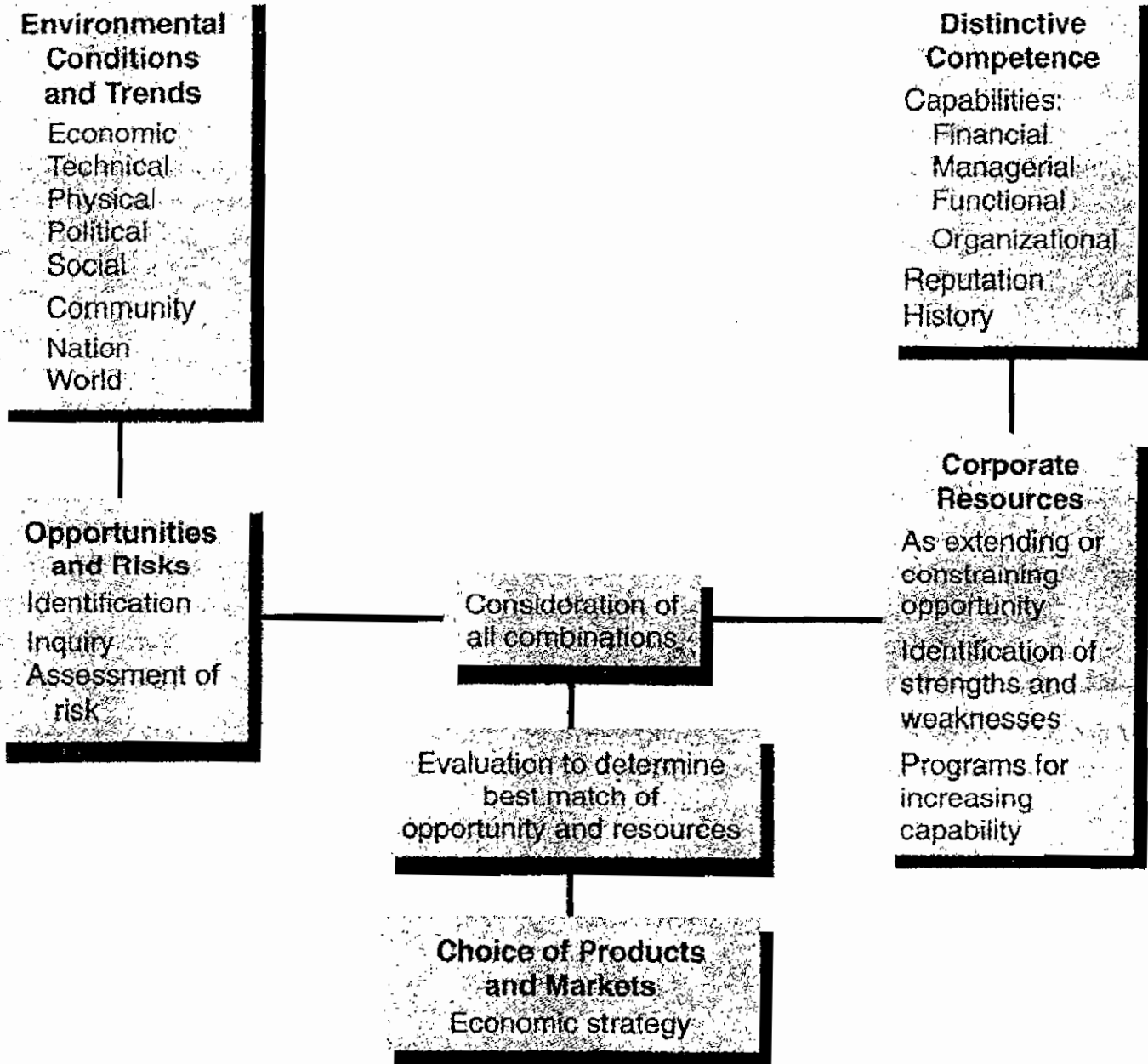
In 1968, Fed Borch, CEO of GE, asked McKinsey & Co. to examine GE’s corporate structure. McKinsey’s study recommended a formal strategic planning system which would divide the company into “natural business units,” which Borch later renamed SBU. McKinsey produced what came to be known as the GE/McKinsey nine-block matrix. The nine-block matrix used approximately one dozen measures to screen for industry attractiveness and another dozen to screen for competitive position, although the weights attached to those measures were not specified. Segmenting diversified corporations into SBUs became recognized as an important precursor to analyzing economic performance. This step forced “deleveraging of cost and performance numbers that had previously been calculated at more aggregated levels. In the 1970s virtually every major consulting firms used some type of portfolio analysis.

Emerging Problems

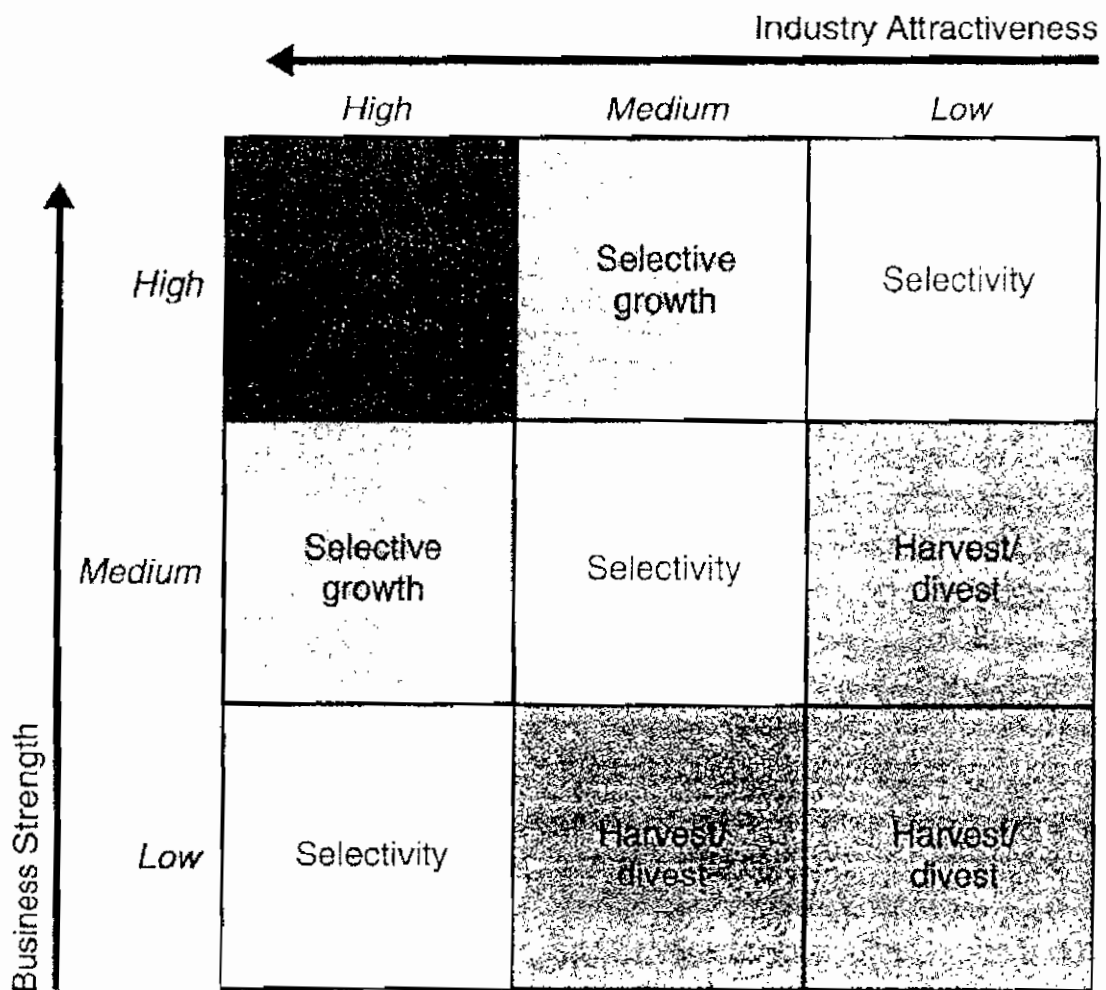
The high inflation and excess capacity induced by the oil shocks of 1973 and 1979 disrupted historical experience curves in many industries suggesting that BCG had oversold the concept. The consequence of intensively pursuing a cost-minimization strategy, for example, one based upon the EC was to reduced the ability of a firm to make innovative changes and to respond to those introduced by competitors.

Portfolio analysis was associated with an even more serious set of difficulties. Not only was it implicitly based on the assumption that financial capital was the scare resource on which top management had to focus, but even worse, technique-based strategies rarely beat existing competition and often left businesses vulnerable to unexpected thrusts from companies not previously considered competitors.

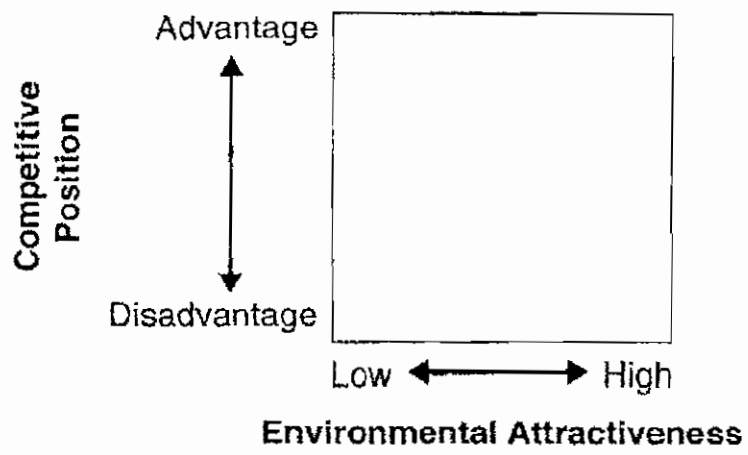
Andrews' Strategy Framework



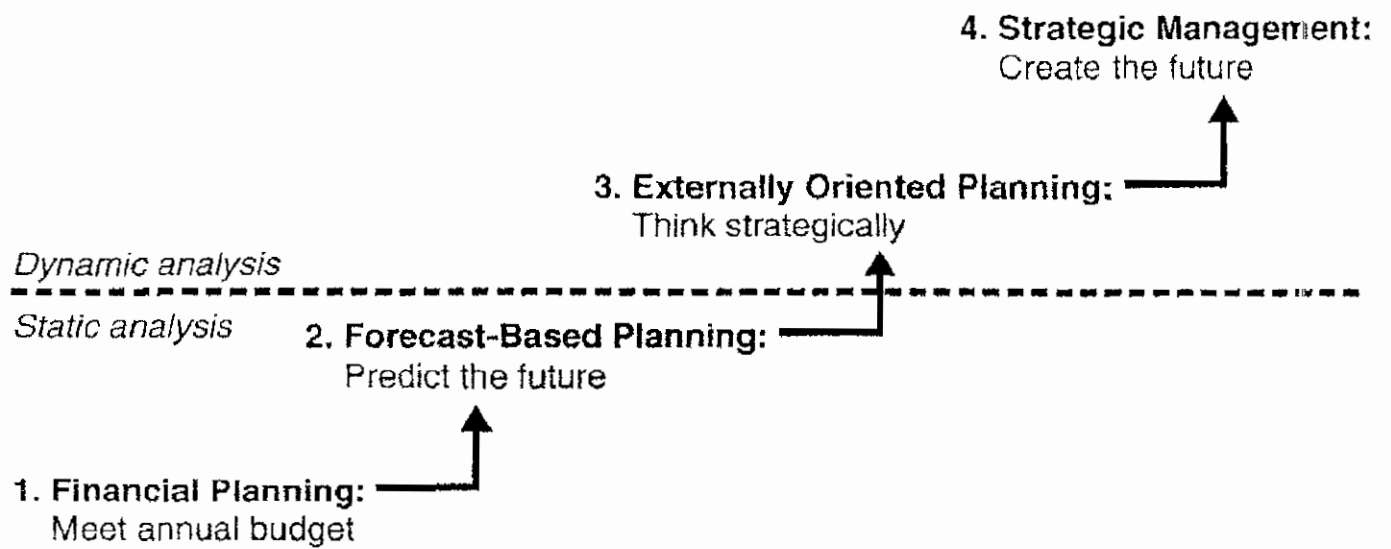
The Industry Attractiveness–Business Strength Matrix



Two Determinants of Profitability



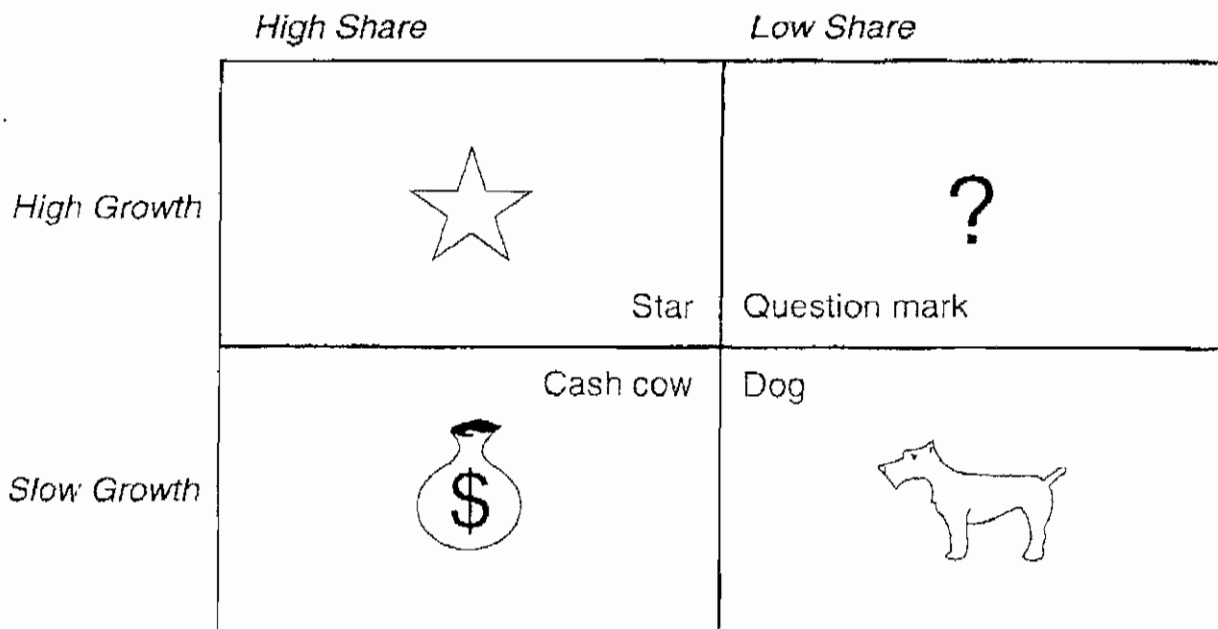
Four Phases of Strategy



Ansoff's Product/Mission Matrix

	<i>Present Product</i>	<i>New Product</i>
<i>Present Mission</i>	Market penetration	Product development
<i>New Mission</i>	Market development	Diversification

BCG's Growth-Share Matrix



Experience Curve for Semiconductor Memories

(Source: Integrated Circuit Engineering Corporation)

