Perspectives on Strategy

Contributions of Michael E. Porter

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Porter's contribution to more general and dynamic strategy frameworks

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Introduction

Understanding why firms are successful is a very basic question in strategy both from a practitioner and a research perspective. In the strategy and management literature, however, we are confronted with different analytical frameworks, applicable at different levels of analysis such as the industry and the national level, providing different answers! Needless to say there is a clear necessity to create more integrative strategy frameworks. This concluding chapter is devoted to this topic by briefly describing Porter's contribution to a more integrated and dynamic strategy framework.

Table 10.1 presents basic questions and problems strategy research is currently facing. The basic questions in strategy all deal with the search for determinants of firm success. Although over time different analytical frameworks have been developed, a basic problem in strategy research is how to integrate these frameworks. This gives rise to a basic challenge in strategy research especially if such more integrative frameworks are of a dynamic nature. Dynamic frameworks provide us with answers that go beyond understanding why firms are

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successful at a given point in time. The real challenge is to understand why firms are successful over time. That is to understand *the dynamic processes* by which firms create and attain superior and sustainable competitive positions. In my opinion, Porter has made a major contribution to this subject in his article "Towards a dynamic theory of strategy", published in a special issue of the Strategic Management Journal (Winter 1991) devoted to the topic of "Fundamental Research Issues in Strategy and Economics".

Table 10.1: Basic questions and problems in strategy

Basic questions in strategy: Why are firms successful? Why do firms attain superior and sustainable competitive positions? What are the determinants of firm success over time? Are some determinants more basic than others? *Basic problem in strategy research*: Different analytical frameworks with different perspectives on the role of time in strategy at different levels of strategy provide different answers. *Challenge for strategy research*: Can these different frameworks be integrated into more general and dynamic frameworks and if so, how? *Example*: How to connect Porter's Five Forces Framework (industry level), Value Chain Framework (business level) and Diamond Framework (national level)?

Source: Author

The purpose of this chapter is to give a brief sketch of Porter's dynamic theory of strategy and by doing so to integrate the different frameworks discussed in the previous chapters into a more general and dynamic strategy framework.

Towards the origins of competitive advantage

The basic question in strategy "Why are firms successful?" can in principle be answered in two distinct ways: a static and a dynamic way. The static approach deals with the question "Why are firms successful at a given point *in* time?", that is given a particular competitive position of the firm. The dynamic approach deals with the dynamic process by which firms create and attain competitive positions. This approach focuses on the dynamic version of the basic question in strategy, that is "Why are firms successful *over* time?". Table 10.2 summarizes the key questions and issues of the static and dynamic approach. The questions raised in table 10.2 illustrate that the dynamic approach highlights the process dimension of strategy as discussed in chapter 1.

Table 10. 2:Basic questions in the static and dynamic approach to strategy

STATIC APPROACH

Why are firms successful at a given point in time?

a) What are the causes of superior firm performance at a given point in time?
b) What makes some industries and some positions within industries more attractive than others?

DYNAMIC APPROACH

Why are firms successful over time?

a) By which processes do firms attain a superior position?
b) Why is a particular firm able to get into an advantaged position?

Source: Author, based on Porter (1991)

The importance of distinguishing a static and dynamic approach in strategy becomes clear when one is interested in the origins of competitive advantage of firms. For example, it is tempting to analyze a firm's success in terms of the attractiveness of the industry structure and of the positioning of that particular firm within this industry. Although such an analysis is fruitful, it delves not deep enough to be helpful for practitioners, because we want to understand why a firm has an attractive position within the industry. This understanding can be of help for protecting and improving such a position. However, having analyzed why a firm has an attractive position within an industry in terms of cost, differentiation and scope of activities, the next question arises: "Why does that happen?" This means that we can keep delving towards a series of mutual related basic questions, labeled by Porter as the chain of causality.

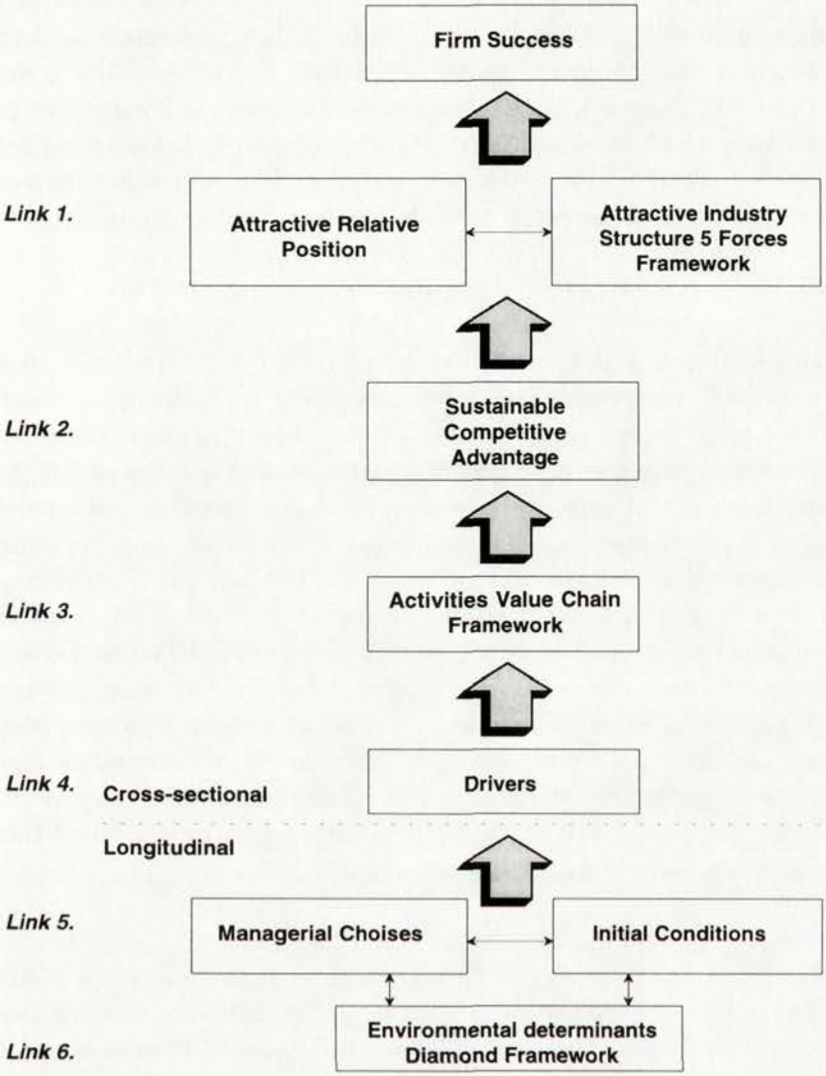
Chain of causality

Porter's concept of the chain of causality visualizes the search for the origins of success of firms. The chain consists of a number of successive links. Each link deals with a question and a (partial) answer to that question. For our purpose it is interesting to note that each link represents more or less one of Porter's frameworks such as his Five Forces framework and Value chain framework. Porter describes his chain of causality as representing "the determinants of success in distinct businesses". Looking in that way to the chain of causality shows in a sense the "determinants of determinants" of firm success over time as illustrated by figure 10.1. This figure is based on Porter's graphical illustration of the chain of causality. I added to his figure the notion of links, numbered one to five and supplemented the figure with the diamond framework as the last and sixth link, in figure 10.1. The dotted line indicates the "barrier" between the static and dynamic approach. The first approach is labeled by Porter as the cross-sectional problem in strategy in which, as is pointed out above, a given competitive position has to be explained. Below this barrier, indeed a barrier in theories of strategy, the questions posed deal with the process dimension of strategy and are of a real dynamic nature. Porter labels this as the longitudinal problem in strategy research in which the process by which firms attain a superior position is investigated. Below I will briefly sketch for each of the successive links in figure 10.1 the key determinants of firm success as proposed by Porter and the framework used.

Porter's contribution to dynamic strategy frameworks.

Towards the origin of competitive advantage of firms, Porter's chain of causality framework.

Figure 10.1: Towards the origin of competitive advantage of firms, Porter's chain of causality framework.



Source: Author, adapted from Porter (1991, figure 2)

Link 1: *firm success is a function of industry structure and of its relative position in that industry*

The question "Why are firms successful?" can be answered by observing two determinants at the industry level: (1) the attractiveness of the industry structure as such and (2) the attractiveness of the relative position of a firm vis-à-vis its rivals; see link 1 in figure 10.1. Porter contributed to understanding this link by his very wellknown Five Forces framework discussed in chapters 2 and 3. With that framework it is possible to analyze the industry structure and to determine the competitive forces that explain the sustainability or the degree of sustainability of profits of firms. However, as Porter (1991, p. 101) observes: "An attractive position is, of course, an outcome and not a cause". The question becomes "why, or how did the attractive position arise?" This link gives rise to the second link in figure 10.1.

Link 2: *Firm success is a function of a sustainable competitive advantage*

This second link deals with the question of the determinants of a sustainable competitive advantage. According to Porter in his book *Competitive Strategy* of 1980, there are two basic types of competitive advantage: lower costs compared to the rivals and the ability to differentiate and earn a premium price that exceeds the additional costs of differentiation. He adds a third determinant, scope, because competitive advantage cannot be examined without considering competitive scope, such as the choice of products and demand segments served and the degree of vertical integration. So link 2 offers three determinants: cost, differentiation and scope. But again, delving deeper, the question arises where do these advantages regarding cost, differentiation and scope come from? How can we understand the cost position of firms? Why are there differences with respect to differentiation strategies between firms within the same industry? This type of questions brings us to link 3 in figure 10.1.

Link 3: *Firm success grows out of discrete activities*

This third link proposes as determinants of firm success the value chain and value system and particular discrete activities and linkages between activities. These concepts are developed in Porter's book of 1985 *Competitive Advantage: creating and sustaining superior performance* and briefly discussed here among others in chapter 4. Looking from this "activity perspective" a firm's strategy defines its configuration of activities and how these activities are interconnected by linkages. From this perspective the determinants of the preceding link can be explained. As Porter (1991, p. 102) observes: "Competitive advantage results from a firm's ability to perform the required activities at a collectively lower cost than rivals or perform some activities in unique ways that create buyer value and hence allow the firm to command a ways that create buyer value and hence allow the firm to command a premium price. The required mix and configuration of activities, in turn, is altered by competitive scope." An attractive aspect of this "activity perspective", in my opinion, is the challenge to analyze strategically relevant activities outside the boundary of the firm involved as well. For example, buyers of the firm products have value chains as well. Investigating how these buyers perform their activities related to the firm's product or service increases the understanding of potential sources of differentiation for the firm's own product or service. If firm success grows out of discrete activities, again the question can be raised what are the determinants of the discrete activities and linkages of a value chain? Why are some firms able to perform particular activities in such a way that it creates more value than the rivals? This leads to the next link.

Link 4: *Firm success grows out of drivers*

The fourth link in the chain of causality proposes drivers as determinants of firm success. According to Porter (1991, p. 104): "Drivers are structural determinants of differences among competitors in the cost of the buyer of activities or group of activities." The same set of drivers determines both the relative cost of activities and differentiation possibilities. Examples of the most important drivers of competitive advantage in a particular activity are the scale at which the activity is performed, cumulative learning in the activity, the ability to share the activity with other units within the firm. This last example plays a role in the preceding chapter 4 on corporate strategy. Porter stresses the fact that delving to the level of the drivers, increases our understanding of the sustainability of competitive advantage: drivers constitute the underlying forces of competitive advantage. But again, the question can be raised what are the determinants of these drivers? Why do firms achieve superior positions vis-à-vis the drivers in the value chain? To answer these questions we must "cross the barrier", that is the dotted line in figure 10.1. We cannot any longer operate within the static approach of analyzing firm success given a competitive position. We must focus now on the process by which superior positions are attained. This leads us to the fifth link.

Link 5: *Firm success grows out of initial conditions and managerial choices*

Porter proposes two determinants of this fifth link: firm's initial conditions and managerial choices. These initial conditions may reside within the firm, such as skills, and outside the firm in its business environment. Managerial choices define, according to Porter, the firm's concept for competing, its configuration of activities and the supporting investments in assets and skills. These two determinants can be interrelated. As Porter (1991, p. 106) observes: "Earlier choices, which have led to the current pool of internal skills and assets, are a reflection of the external environment surrounding the firm at the time. The earlier one pushes back in the chain of causality, the more it seems that successive managerial choices and initial conditions external to the firm govern outcomes." These initial conditions external to the firm give rise to the next and last link in figure 10.1.

Link 6: *Firm success grows out of the four determinants of the diamond framework*

Although Porter (1991) in his graphical representation of the chain of causality framework ends with link five, he points out: "The environment, via the diamond, affects both a firm's initial conditions and its managerial choices." and "The diamond, then, begins to address a dynamic theory of strategy early in the chain of causality." (p. 114-115). That is why I add a sixth link in figure 10.1 showing the business environment as depicted by the diamond framework discussed in chapter 6. However, this last link in the search for the origins of a firm's competitive advantage raises again a very fundamental question: "Does the competitive advantage reside in the business environment or in the firm?"

Does the business environment as the origin of competitive advantage eliminate the role of strategy?

On the basis of Porter (1991) a brief answer to this provoking question can be given: No! As Porter (1991, p. 110) stresses: "Competitive advantage, then, may reside as much in the environment as in the individual firm." Although the environment is shaped over time through a process of mutual reinforcement of the four diamond determinants, firms play a key role in this process as well. As Porter stresses in his book *The competitive advantage of nations*, firms must work actively to improve their home base by upgrading the determinants. Indeed, a firm has a strategic stake in making its home base or diamond a better platform for international competitive success. But in doing so "causality becomes blurred". The determinants of the diamond framework influence managerial conditions and are deliberately influenced by firms. That is why in figure 10.1 I connect link 5 and 6 in an interacting way. Hence, the origins of competitive advantage reside over time both in the business environment and in the firm itself. Managers must understand and benefit from their business environment by deliberately upgrading the environmental determinants of competitive advantage. As this challenge is not perceived by all firms in a certain industry within a particular region or nation, differences in international competitive success of these firms come into being, as has been shown in Porter's *Competitive advantage of nations* book.

Having concluded that the origins of competitive advantage reside over time both in the environment and in the firm, Porter raises a few unanswered questions; the first two of his questions I will mention. The first question deals with the *balance* between environmental determinism and strategic choice in creating a firm's competitive advantage. According to Porter, it is still unclear in how far a company is able to pick its own strategy and in how far the environment determines a company's success. His second unanswered question deals with the widely observed phenomenon of the degree of stickiness or *inertia* in competitive positions once a firm stops progressing. How important is a firm's existing competitive position vis-à-vis its ability to renew? Although both questions are very intriguing, empirical research based on Porter (1991) is scarce. This stimulated me and my co-author Warmerdam to apply a part of Porter's chain of causality framework to a successful international Dutch firm, thus illustrating the origins of the competitive advantage of this firm and the inertia in its competitive positions. Based on our research (Van den Bosch & Warmerdam, 1994, 1995) it appears that Porter's chain of causality framework can contribute to finding interesting answers to the questions raised above. For example, in our empirical research we found that the balance between environmental determinism and strategic choice (Porter's first question) can change over time.

Conclusion

The question "Why are firms successful?" is one of the basic questions in strategy. However, the strategy literature contains a lot of different frameworks with different time perspectives at different levels of analysis, each providing different answers pertaining to the origin of competitive advantage. This lack of theoretical coherence is recognized as one of the basic problems in strategy research. Furthermore, the necessity to improve our understanding of the nature of strategic change and of the process dimension of strategy in particular stresses the importance to take time seriously in strategy research. In fact, dynamic theories of strategies are still in their infancy (Van den Bosch, 1995). Therefore, a real challenge for strategy research is the development of more general and in particular dynamic strategy frameworks aimed at explaining the question "Why are firms successful *over* time?".

After having developed different, widely appreciated strategy frameworks on various levels of analysis, Porter delivered another contribution to strategy theory with his chain of causality framework. In my opinion, this contribution shows that indeed it is possible to develop integrated and dynamic strategy frameworks that make sense from a dual perspective. Indeed, both practitioners and strategy researchers can benefit from Porter's chain of causality framework. Practitioners can try to understand, benefit and influence the determinants of their firm's success over time. Strategy researchers can keep searching for the origins of competitive advantage of firms, thereby taking Porter's chain of causality framework as a very interesting and important point of departure.

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