The Evolution of Business Strategy

By Rich Horwath

While the underpinnings of the concept of strategy can be traced to military ancestry, the business application has gained in popularity and following. The daily newspaper business sections and the Wall Street Journal are filled with corporate strategies, investment strategies, and advertising strategies to name just a few. Business strategy drives companies of all shapes and sizes, ideally capturing the differences that can carry a company to success. A review of the seven phases of business strategy evolution and the two approaches to business strategy can provide a foundation for creating sound strategy in the future.

Phase I: Budgetary Planning (1950-1960)

One of the first individuals credited with developing and implementing strategy in the business landscape is Alfred Sloan, head of General Motors from 1923 to 1955. In 1921, Sloan reorganized GM as documented in his book entitled, *My Years with General Motors*, published in 1963. The other individual who worked around the concept of business strategy is management icon Peter Drucker. Drucker published *Concepts of the Corporation* in 1946 in which he examined Sloan's General Motors, General Electric, IBM and Sears, Roebuck. The findings of his studies concluded that the most successful companies were centralized and good at goal setting.

Drucker was also the first to see that the purpose of business is external in creating and satisfying customer needs. While Drucker moved the day's discussion closer to strategy, the period of the 1950's is marked by budgetary planning and control. Financial control was created through operating budgets, which also took into account investment planning and project appraisal.

Phase II: Corporate Planning (1960 – 1968)

The 1960's represent the acknowledged entrance of strategy into the business community and the popularization of corporate planning. Alfred Chandler Jr. was the first academic researcher of business strategy and he published a landmark work entitled, *Strategy and Structure*, in 1962. He, like Drucker, used an examination of prominent companies (du Pont, General Motors, Standard Oil and Sears, Roebuck) to illustrate his premises of business strategy. Chandler offers one of the first definitions of strategy in the business context:

> The determination of long-term goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out those goals.

Chandler advocated that firms should first determine their strategy and then develop their structure to support the strategy. In turn, he believed that large corporation's best chances for success resided in their move to decentralization. Chandler offers three basic business strategies:

1. Horizontal: Implies growth in markets which can be local, national or multinational.
2. Vertical: Implies absorbing functions that are either backwards toward suppliers or forwards toward ultimate consumers.
3. Diversification: Decision to enter into related or unrelated markets.

These three business strategies form his thesis: Horizontal strategy produces a unitary structure, while a vertical strategy produces a functional structure. The decision to enter into related or unrelated product lines produces the multidivisional structure. Chandler also recognized that strategic growth results from an awareness of opportunities and needs, which are created by changes in population, income and technology, to employ existing or expanding resources more profitably.

The popularity of corporate planning in the 1960's spawned corporate planning departments. The corporate planning departments were charged with forecasting, investment decision-making and the creation of long-term (5-10 year) plans. In 1965, H. Igor Ansoff wrote what was considered to be the bible of strategic planning and the first business strategy textbook entitled, *Corporate Strategy*. Ansoff advocated that the strategy process should be formalized through detailed procedure, including the use of checklists for delivering objectives and assessing synergy.

Phase III: Corporate Strategy (1968 – 1975)

Bruce Henderson founded the Boston Consulting Group, a management consulting firm, in 1963. One of the contributions of Henderson's group is the **Growth/Share Matrix**, which assesses the market growth rate in relation to a firm's relative market share. This accelerated adoption in the 1970's of portfolio planning, in which firm's literally plotted their products/business units in these matrices to evaluate their respective contributions. Corporate strategy's adoption in the 1970's was largely influenced by portfolio planning and large companies need to establish synergy between the business units and corporate parent.

The 1970's also witnessed the beginning of the mammoth **PIMS (Profit Impact of Market Strategy) study** in an attempt to understand the correlation between performance and strategy. Today, the database for the study includes over 600 companies contributing information, documenting the strategies and financial results of nearly 3,000 business units for periods between 2-15 years. The PIMS study has yielded six linkages between strategy and performance:

1. In the long run, the most important single factor affecting a business unit's performance is the quality of its products and services relative to those of competitors.
2. Market share and profitability are strongly related.
3. High-investment intensity acts as a powerful drag on profitability.
4. Many so-called "dog" and "question mark" businesses generate cash while "cash cows" are dry.

5. Vertical integration is profitable strategy for some kinds of businesses but not for others.
6. Most of the strategic factors that boost ROI also contribute to long-term value.

Phase IV: Industry and Competitive Analysis (1975 – 1985)

These six findings led experts to believe that the structure of the industries in which the firm competes and the competitive position of the firm's businesses within these industries are the key determinants of performance. These final two points lead into the major focus for the period of the late 1970's to the early 1980's, which is the analysis of industry and competition. Firms began taking a closer look at their choice of industries, their markets, segments and positioning within those segments. Putting a depth charge into this field of thought was Harvard Business School Professor Michael Porter, writing perhaps the most influential book on business strategy entitled, *Competitive Strategy*, in 1980. Porter's work propelled the analysis of industry and competition through models such as the "Five Forces," which assesses a company based on their position relative to five factors:

1. Potential entrants into the market
2. Threat of substitute products or services that could be used in place of the company's offering
3. Bargaining power of buyers (customers)
4. Bargaining power of suppliers
5. Current industry competition as seen in the rivalry among existing firms

Phase V: Internal Sourcing of Competitive Advantage (1985 – 1995)

The microeconomic perspective on strategy was followed in the late 1980's through the early 1990's with a focus on the quest for competitive advantage. However, the path for seeking competitive advantage changed, to one seeking sources of competitive advantage *within* the firm. Embodying this shift in thinking was the work by Gary Hamel and C.K. Prahalad entitled, *Competing for the Future*, published in 1994. Hamel and Prahalad introduced the term **core competencies** to represent the sources of competitive advantage inherent in the firm. They define core competencies as a bundle of skills and technologies that enables a company to provide a particular benefit to customers, representing the sum of learning across individual skill sets and individual organizational units. The sourcing of competitive advantage from within the firm follows the **Resource-Based Theory**, which focuses on the firm's assets and capabilities and how these internal strengths provide advantage over rivals.

Phase VI: Strategic Innovation and Implementation (1995 – 2001)

Strategic innovation and implementation have dominated the period of the mid 1990's through 2001. The importance of strategic innovation has been exacerbated by the application of technology to the business process. Companies that once aspired to securing sustainable competitive advantage have realized that it no longer exists. The goal now is to exploit dynamic sources of competitive advantage that can be leveraged to finance the next wave of innovation. The other facet of business strategy that has received significant attention recently is the implementation process. Too many companies have realized all too well that even the most wonderfully conceived strategy is irrelevant if not properly implemented. C. Davis Fogg's work entitled, *Implementing Your Strategic Plan* (1999) advocates five broad categories for successful implementation of strategy:

1. Setting accountability
2. Enabling and aligning action
3. Fixing the organization
4. Providing an environment in which people can excel
5. Judging and rewarding

A tool called the **Balanced Scorecard** was introduced in the book, *The Strategy-Focused Organization*, written by Robert Kaplan and David Norton. The Balanced Scorecard is intended to highlight three dimensions of a new management system:

1. Strategy: make strategy the central organizational agenda
2. Focus: create incredible focus
3. Organization: mobilize all employees to act in fundamentally different ways

The Balanced Scorecard and strategy maps provide a framework for assessing strategy's value creation potential from four different perspectives:

1. Financial: the strategy for growth, profitability and risk viewed from the perspective of the shareholder.
2. Customer: the strategy for creating value and differentiation from the perspective of the customer.
3. Internal business processes: the strategic priorities for various business processes, which create customer and shareholder satisfaction.
4. Learning and growth: the priorities to create a climate that supports organizational change, innovation and growth.

One of the chief critics of the Balanced Scorecard process is Professor Thomas Johnson of Portland State University. Professor Johnson suggests that management through metrics is fundamentally dangerous, causing business managers to focus on the end results rather than the people and processes that lead to those end results. While the Balanced Scorecard Process has come under some criticism, it nevertheless has been adopted by a number of companies including Exxon Mobile, Fannie Mae, Cigna and MDS Inc.

Phase VII: Strategic Thinking & Simplification (2003 and beyond)

The emphasis on execution, objectives and metrics has left many business practitioners wondering, "How do I go about creating strategy in the first place?" There has been very little in the way of instruction on the keys to strategic thinking and moving from strategy on an annual basis to strategy as a daily practice. The primary problem is that many companies view strategic thinking and strategic planning as one in the same, and have failed to allocate sufficient time to the two distinct activities.

The shifting emphasis for strategy will now move toward strategic thinking and simplification: people learning the tangible skills of strategic thinking and using them in simple frameworks that allow strategy development to be an on-going, daily occurrence rather then an annual trek to the Mecca of strategy gods resting high above the corporate hierarchy. Learning to use strategic thinking on a regular basis will have the following benefits:

1. It will give you a deeper sense of purpose regarding your work
2. It will grow your business
3. It will enhance your decision-making ability, resulting in a better use of resources
4. It will become a part of your daily routine, not an additional time-consuming activity
5. It will help you solve problems in new and creative ways
6. It will immediately increase your value to the company
7. It will advance you faster in your career than any other skill you possess

Two Approaches to Business Strategy

The evolution of business strategy over the past 50 years has been significantly influenced by two general approaches: **Structure-Conduct-Performance and the Resource-Based approach**. Both perspectives were developed from leading academic centers and have managed to stand the test of time, albeit with occasional cosmetic changes.

The Structure-Conduct-Performance (S-C-P) approach originated in the Harvard School of Industrial Economics. It identifies the causal relationship in that an industry structure determines firm strategy or "conduct," which in turn determines performance.
The industry structure variables include the number of sellers and buyers, barriers to entry and cost structures. Strategic or conduct variables are comprised of pricing behavior, product strategy, advertising, research and innovation, plant investment and legal tactics. The performance variables are made up of production and allocative efficiency, technological progress, full employment and distributional equity.

In the 1960's, the Chicago School of Industrial Organization developed a body of work that disagreed with the S-C-P approach. The Chicago School asserted that the principal managerial objective is profit maximization achieved through cost savings efficiencies. The implicit role of the individual manager in this efficiency view would become one of the key points of departure from the S-C-P view. Profit maximization was believed best achieved through the development of specialized, high quality resources and capabilities. Firms also possess mental models at the cognitive level that become intertwined with routines at the behavior level. Thus, their firm strategies can be considered as the interrelationship between managerial cognition and conduct. It is this competition between heterogenous mental models that gives their resource bundles meaning.

The resource-based approach emphasizes that the two key sources of the heterogenous nature of a firm are resources and mental models, both of which contribute to the heterogeneity in their performance versus one another. The resources can be financial, human, intangible (ie "brand"), organizational, physical, and technological. This can be traced back to the focus on non-monopoly rents generated by sources other than collusion and government cooptation; namely Ricardian rents, based on the possession of scarce, valuable resources (resources) or Schumpeterian rents, based on successful entrepreneurial development of new combinations of resources (mental models) that are a source of rents for a significant period of time. Rent creation through distinctive capabilities and unique mental models is at the foundation of the Resource-Based approach.

Michael Porter and R.E. Caves attempted to rescue the S-C-P approach by combining structural and behavioral (strategic) variables, recreating it as "Conduct-Structure-Performance" and proposing that "strategic groups" explain firm conduct and performance (1977). They defined a strategic group as "a set of firms competing within an industry on the basis of similar combinations of scope and resource commitments. The development of the "strategic groups" concept started to bring the two approaches closer together, with Industrial Economics supporting the "industry" perspective of S-C-P and Microeconomics emphasizing the "firm." Now, the S-C-P (strategic groups) and Resource-Based approaches make up two branches of the Strategic Management perspective, which places equal weight on the industry *and* the firm.

Conclusion

The evolution of business strategy has moved through the following phases:

1. Budgetary Planning
2. Corporate Planning
3. Corporate Strategy
4. Industry and Competitive Analysis
5. Internal Sourcing of Competitive Advantage
6. Strategic Innovation and Implementation
7. Strategic Thinking & Simplification

These phases have been concomitantly influenced by the two primary approaches to business strategy: Structure-Conduct-Performance (strategic groups) and the Resource Based Approach. Taking time to look back at the business strategy landscape will only help in forging future paths to business success.

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