15.963 Advanced Strategy
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15.963: Reviewing 15.900
Fundamentals of strategy

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How can I make $$?

- Create the context:
  - “Choose” or “Build” a great industry

- Keep margins high:
  - Avoid competing too aggressively on price unless that’s really what you have in mind

- Compete like crazy for your share of the profits
  - Build enduring competitive advantage
Create the context: Choose or build (!) a great industry

– One with lots of demand
  • Big PIE
– With buyers & suppliers you can live with
  • Multiple, weak buyers/suppliers or partners that help you build PIE
– And with highly differentiated preferences
  • I really want diamonds, emeralds won’t do
Keep margins high

- Remember the case of Compass Minerals!
Compete like crazy – build:

- Institutional connections
  - Actually we’re the only company allowed to…

- Tightly held IP/unique assets
  - EMI, Blockbuster drugs, Tiger Woods…

- Economies of scope and scale
  - We’re larger, so we’re better/cheaper/faster, have more network externalities…

- Great organizational competencies (!)
Economies of Scope & Scale

“Raw” economies of scale (bigger plants are more efficient)
Brewing, Cement…

Sharing fixed costs across a larger volume
Diapers, Soap powder…

Sharing fixed costs across multiple products
Pharmaceuticals, Scientific instruments
Economies of scale and scope can demonstrate self reinforcing effects:

- As I get bigger, my costs go down – which leads me to get a larger share of the market, which drives down my costs…
- As I get bigger, I can spread my fixed costs out over more units – so that I can afford to spend more on marketing – or R&D – or training – or service and support -- so that my products become increasingly differentiated, so my sales go up, so I can spread my fixed costs….
- As I get bigger, there is more software available for my platform, and more people to exchange ideas with…
Self reinforcing dynamics in Marketing, Brand & Customer Awareness

- Industry Demand
- Order Share
- Differentiated Products
- Brand Equity
- Revenue
- Orders
- Investment in Marketing & Brand building

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Self reinforcing effects in R&D and Product Development

- Industry Demand
- Order Share
- New & Differentiated Products
- Investment in R&D, Product Development
- Orders
- Revenue

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Self reinforcing effects with Network Effects & Complementary Goods

- Industry Demand
- Order Share
- Orders
- Revenue
- Installed Base C. Goods
- Investment in Network effects & complementary goods

Direct & Indirect Network Effects
Sterman identifies more than ten potential self-reinforcing effects, including:

- Production costs
- Product awareness – brand, sales, advertising
- New product development
- Network effects, complementary goods
- Product differentiation – e.g. service and support, quality, reliability
- Workforce quality and loyalty – more profits, more growth, attract better people…

- Mergers and acquisitions
  - The ability to acquire reinforces all the other loops
- The cost of capital
  - Higher market value, stock price, lower cost of capital…
- The rules of the game
  - The bigger I am, the more I can shape the environment

Source: J. Sterman: Chapter 10, *Business Dynamics*
In successful firms, these effects often reinforce each other....

Diagram of self-reinforcing effects removed due to copyright restrictions.
WHAT’S GOING ON IN THE COMPANIES WHOSE STRATEGIES I ASKED YOU TO REVIEW?