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On Competition

Introduction

Competition is one of the most powerful forces in society to make things better, in many fields of human endeavor. The study of competition and the creation of value, in their full richness, has preoccupied me for several decades. Competition is pervasive, whether it involves companies contesting markets, countries coping with globalization, or social organizations responding to societal needs. Every organization needs a strategy in order to deliver greater value to its customers.

This is truer today than ever before, because competition has intensified dramatically over the last several decades in almost all domains. It has also spread across geography, so that nations must compete to maintain their existing prosperity, much less enhance it. Competition has also spread to all sectors of society, including fields like the arts, education, healthcare, and philanthropy.

Today organizations in all spheres must compete to deliver value. Value is the ability to meet or exceed the needs of customers, and do so efficiently. Companies have to deliver value to their customers, and countries have to deliver value as business locations. This is now just as true for a hospital delivering health care, or a foundation making charitable contributions, as it is for a company producing a product or service. It is fast becoming as critical for organizations and agencies that seek to advance the public good.

In understanding competition and value creation, my aim is to capture the complexity of what actually happens on the ground. While trained as an economist and steeped in the discipline of economic reasoning, I have sought both to advance theory and make that theory operational for practitioners. My goal has been to develop rigorous and useful frameworks that effectively bridge the gap between theory and practice.

This book brings together, in one place, the full range of concepts and tools I have developed to understand competition and value creation. This includes both my newer work and the original foundations on which it is built. The articles here examine competition at multiple levels and in different settings, but with a common framework that connects them all.[1]

This expanded edition has five parts. Part I lays out the core concepts of competitive strategy for companies, first at the level of a single industry and then for multi-business or diversified companies. The drivers of industry competition, and the ways in which companies gain and sustain competitive advantage, and how to develop a distinctive strategy are at the core of competition. A sophisticated understanding of how to be competitive in a particular business provides the foundation on which other corporate choices are built. Diversification, for example, cannot be approached sensibly without linking it directly to competition in individual businesses. Also, the principles in Part I are as relevant for non-profits as for companies.

Part II addresses the role of location in competition. As competition has spread and intensified, interest in the competitiveness of nations, states, and cities has exploded. As

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[1] For a comprehensive bibliography of my work in all of these areas, including presentations and interviews, see the website of the Institute for Strategy and Competitiveness (http://isc.hbs.edu).

technology has allowed companies to become more global in their activities and as capital moves more freely across borders, many theorists claim that location diminishes in importance. The articles in Part II, however, challenge this notion. In them, I show how the prosperity of both companies and entire countries is dependent on the local environment in which competition takes place. Traditionally, the competitiveness of a region or a nation has been seen primarily as an issue for governments seeking to promote investment and job creation. The new model of competitiveness reveals unfamiliar roles for companies in shaping their competitive context; the need for a new type of relationship between business, government, and other local institutions; and entirely new ways of thinking about government policy. Understanding the influence of location on competition, together with the ideas in Part I, is also essential to setting global strategy for companies.

Part III, Competitive Solutions to Societal Problems, draws on the frameworks in Parts I and II to address important societal issues. The environment, urban poverty and income inequality, and health care, among others, are normally seen as social problems. However, each of them is inextricably bound up with economics and, more specifically, with competition. I am increasingly convinced that lasting, self-sustaining solutions to these problems lies in our ability to apply effectively the deepest lessons of competition. There are huge win-win opportunities for both society and for companies if we approach issues such as the environment, disadvantaged communities, and health care delivery in the right way. Creating positive-sum competition in these arenas will foster innovation that produces enormous value for society.

Part IV, Strategy, Philanthropy, and Corporate Social Responsibility, applies strategy principles to philanthropy and giving by both social organization and corporations. In a world of scarce public resources and rising aspirations to address social needs, the need for philanthropy to deliver value is urgent. The social sector must justify the enormous resources being devoted to giving, much of which is tax subsidized and thus supported by all citizens. The act of giving can no longer be seen as beneficial for its own sake. Instead, giving must achieve true social impact.

The corporate sector is being asked to participate in social issues as never before, often under the banner of corporate social responsibility. How and where corporations should engage social issues, and how they should invest their philanthropic giving, is a pressing issue for every corporate leader. The key to doing this well is understanding that social issues and economic issues are not mutually exclusive but can be mutually reinforcing as highlighted in Part III. Thus, social considerations can and should become part of a company's strategy, not a separate agenda.

Part V, Strategy and Leadership, recognizes that leadership is needed to achieve superior value creation. For any organization,developing a strategy is an act of leadership, and strategy represents perhaps the most powerful tool available to leaders to get all the individuals in the organization aligned around a common purpose and direction. As crucial as leadership is, we still know surprisingly little about the role of leaders, especially the leaders of large complex organizations such as those that populate the Fortune 100 or Fortune 500. Such organizations are too large and complex for any leader to fully understand all of the businesses, manage the many thousands of employees, or make even a small fraction of all the decisions. In such organizations, the roles of leaders are subtle and indirect, and we have begun to explore these roles in recent work.

Competition and Strategy: Core Concepts

The collection begins with "The Five Competitive Forces That Shape Strategy" (2008), a new and updated version of the article that has helped to shape business practice and academic thinking since it first appeared in 1979. The performance of any company in a business can be divided into two parts: the first attributable to the industry and the second to a company's relative profitability in its industry. I am often asked where to start if one wants to understand my work. Even for those who feel they are familiar with "the Five Forces," this article is the essential entry point and I am pleased to have this updated version which has allowed me to further develop the implications of industry analysis for strategists and investors.

Many mistakes in strategy proceed from a fundamental misconception of what competition is and how it works. Competition is often defined too narrowly, as if it occurred only among direct rivals. This article presents a framework, grounded in economic theory, for assessing competition in any industry. It offers a systematic way to assess any industry's structure, and how it might change.[2] The five forces article concentrates on the first part, that is, explaining the large and sustained differences in the average profitability of industries and the implications for strategy. Using the "five-forces framework," consisting of the bargaining power of buyers, the bargaining power of suppliers, the threat of new entry, the threat of substitutes, and the intensity of rivalry, the long-term profitability of any industry can be understood, as well as how companies can influence industry competition in their favor.

"What is Strategy?" addresses the second part of the profitability equation: why some companies are able to outperform their rivals. I had tackled the subject of positioning, or the creation of an advantaged approach to competing in an industry previously, introducing the

[2] This article became the lead chapter of my book *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980).

concept of generic strategies.[3] "What Is Strategy?," first published in 1996, takes the concept of positioning a big step further. A company achieves superior profitability in its industry by attaining either higher prices or lower costs than rivals. In this article, I show how these price or cost differences among competitors come from two different sources: operational effectiveness, (that is, whether a company has attained best practice), and strategic positioning. Competing on best practices is what I call "competition to be the best." While all companies must continually improve operational effectiveness in their activities, however, this is a competition that is hard to win. Profitability differences most often arise from having a distinctive strategic position, or what I call "competition to be unique." Competing to be unique is ultimately more sustainable that competing to be the best, and this article explains why.

”What is Strategy?" presents the underlying theory of strategic positioning. Strategy differences rest on differences in activities in the value chain, such as the way companies go about logistics, order processing, product design, assembly, training, and so on. Strategies are sustainable because of tradeoffs, or choices that firms make to offer certain types of value but sacrifice others. Competitive advantage depends on offering a unique value proposition, delivered by a tailored value chain, involving tradeoffs different from those of rivals, and where there is fit among numerous activities.

The first two articles in Part I provide the core analytical frameworks for developing strategy at the level of an individual business: industry structure and competitive positioning. The next two articles in Part I—"How Information Gives You Competitive Advantage" and "Strategy and the Internet" examine the ubiquitous role of information technology in modern competition. These articles apply and extend these core frameworks and show how they can

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[3] For my earlier work on positioning, see *Competitive Strategy*, Chapter 2, and *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 1985).

address any innovation. “How Information Gives You Competitive Advantage” (1985) provides an overall framework for the role of information technology in competition. In it, Victor Millar and I suggest that information technology plays a role in both industry structure and competitive positioning. The five-forces framework provides the structure for analyzing the industry effect, while the value chain provide the structure for examining the competitive advantage effect. This article remains relevant, many years after it was written in a rapidly evolving field, because it exposes the underlying concepts rather than documents current trends. For that reason, the article continues to provide an approach to understanding the competitive significance of each new generation of information systems and software.

How often have we heard the claim that “The Internet changes everything.” The article “Strategy and the Internet” (2001) addresses the role of the Internet in competition—exploring both what changes and what does not, and how any organization can evaluate the impact of the Internet on its competitiveness. Once again, industry structure analysis is shown to be a powerful source of strategic insight for organizations struggling to make sense of a powerful force for change. While many argued that the Internet would render strategy obsolete, the opposite has been true. The article shows why the Internet has tended to weaken industry profitability without providing proprietary advantages, thus making strategy more important than ever.

By extension, this article tackles the question of how to think strategically about any technological disruption to an existing industry. Most work on innovation presumes that it will be disruptive, and that incumbents will be the casualties. The tools of industry structure help managers predict whether an industry can remain profitable as it is impacted by the new technology. The logic of competitive advantage shows when incumbents may be able to harness new technology better than newcomers, and helps any firm (new or established) think about the profitable positions it can occupy if the industry is transformed. In the 21st Century, we can expect a steady stream of technological innovations that reshape prevailing industry economics. That is the inevitable thrust of the intensifying competitiveness that we see all around us. My observation has been that too often companies, to their detriment, suspend strategic thinking when they find themselves confronted with major technological change.

The first four articles in Part I address strategy in a single business, or what I call *competitive strategy*. Competition in an individual industry is the core level of strategy, because it is at this level that industry profitability is determined and competitive advantage is either won or lost. However, many firms diversify into multiple industries. The article “From Competitive Advantage to Corporate Strategy” (1987) addresses strategy at the other important level—the overall strategy of a corporation diversified into more than one business. I call this *corporate strategy*.

Many accounts treat diversification as a distinct question, separate from competitive strategy at the business level. This false dichotomy, however, starts to explain the dismal performance of most companies in diversifying, a result I first documented in this article. Bad things often happen to companies that separate their thinking about diversification from the realities of competing in their various businesses.

“From Competitive Advantage to Corporate Strategy” argues that while corporate strategy involves different questions from competitive strategy, the two must be intimately connected. From an industry perspective, corporate strategy is concerned with the choice of industries in which a company should compete and how it should enter them. From a competitive advantage perspective, the central question at the corporate level is how the competitive advantage of individual business units is enhanced (rather than undermined) by other units in the corporation. “From Competitive Advantage to Corporate Strategy” explores these questions, making use of the concepts of industry structure and the value chain. It shows how the notion of activities can be used to understand the strategic logic of diversification, and how corporate strategy must be linked to organization and management practices.

Companies have not lost their taste for diversification since this article was first published, and the diversification track record remains problematic. Discredited portfolio models of diversification have been supplanted by notions of core competencies and critical resources in many companies’ diversification. However, these ideas are simplistic, and diversification results continue to suffer. Experience has shown that diversification not closely tied to sustainable competitive advantage at the business unit level is more likely to destroy economic value than create it.

The Competitiveness of Locations

The core concepts of competitive and corporate strategy provide the foundation for examining any competitive situation. Today, that often means competition across borders. Firms compete across geographic locations with national, regional, and global strategies. At the same time, countries and regions must compete with other locations to provide a hospitable business environment. For both companies and countries, addressing competition across locations requires two new sets of ideas. The first concerns the role of location in competition. As firms compete across borders, they gain the ability to locate activities anywhere. How location affects competitive advantage is essential to firms but also crucial to guide policy for economic development. The second new issue raised by international competition is the way firms can gain competitive advantage by spreading and coordinating activities in the value chain across borders in regional or global networks. The value chain is being spread across borders as never before as barriers to trade and investment have fallen and new countries have provided cost-effective locations for outsourcing.

Part II begins with the issue of location. In “The Competitive Advantage of Nations” (1990), I develop a new theory of the competitiveness of nations, states, and other geographic areas. Most treatments of competitiveness have concentrated either on macroeconomic policies (government budget deficits, monetary policy, opening of markets, or privatization) or on comparative advantages due to endowments of inputs such as labor, natural resources, and capital. My article takes a very different approach, arguing that the competitiveness of locations is primarily rooted in the nature of the business environment they offer firms. Access to labor, capital, and natural resources no longer determine prosperity, because these have become widely accessible. Rather, competitiveness arises from the productivity with which firms in a location can *use* inputs to produce valuable goods and services. The productivity and prosperity possible in a given location depend not on what industries its firms compete in, but on how they compete. Traditional distinctions between high tech and low tech, or between manufacturing and services, have little relevance in an economy in which manufacturing and services have blurred and virtually all industries can employ advanced technologies and high skill levels to achieve high levels of productivity.

In “The Competitive Advantage of Nations,” I show how the roots of productivity lie in the national and regional environment for competition. This can be understood using a framework made up of four primary facets: factor conditions, demand conditions, the context for strategy and rivalry, and related and supporting industries. My ideas are now commonly referred to as “diamond theory.” Government policies can influence all four parts of the diamond positively or negatively. "The Competitive Advantage of Nations" explores these sources of competitiveness, how they change, and the implications for governments and companies. Diamond theory is not only a tool for managers but also a microeconomic-based approach to economic development for governments that is closely tied to actual competition.

"Clusters and Competition: New Agendas for Companies, Governments, and Institutions" (1998) explores one of the most important ideas in my overall competitiveness theory—the concept of clusters. Clusters are geographic concentrations of firms, suppliers, related industries, and specialized institutions that occur in a particular field in a nation, state, or city. This new article pulls together my learning about clusters both from research and in practice, in terms of cluster theory, the role of clusters in competition, and their implications for government policy, company and institutional behavior. Clusters are a prominent feature on the landscape of every advanced economy, and cluster formation is an essential ingredient of economic development. Clusters offer a new way to think about economies and economic development, raise new roles for business, government, and institutions, and provide new ways to structure the business-government or business-institution relationship. Many hundreds of cluster initiatives have sprung up in all parts of the world, and this article summarizes some of the learning gleaned from both advanced and developing economies.

The final article in Part II, "Competing Across Locations: Enhancing Competitive Advantage through a Global Strategy" (1999), brings together the two aspects of competing across borders—location and global networks. The concept of activities and the value chain, so important to understanding competitive advantage in general terms, provides the basic framework for international strategy as well. When competing across borders, firms can spread activities to multiple locations to harness their locational advantages, while coordinating among dispersed activities in a variety of ways to harness network advantages.

"Competing Across Locations" develops the implications of this framework for global strategy in a particular business. Global strategy taps the innovation and productivity advantages of locating headquarters or "home-base" activities in some cluster locations while spreading other activities to source low cost inputs and gain access to foreign markets. Coordination transforms this array of dispersed activities into a global network. Earlier thinking about global strategy, which focused only on globalness and networks, was clearly too simple. This article aims to take global-strategy thinking to the next level. It also makes clear that global strategy is just a special case of the more general issue of competing across geography. The same framework can be applied to inform the thinking of a local producer striving to become national.

Competitive Solutions to Societal Problems

A deep understanding of competition and value creation offers powerful insights into a wide variety of societal problems. Part III begins with an article on the environment, "Green and Competitive: Ending the Stalemate" (1995), written with Claas van derLinde. Environmental improvement is often seen as being at odds with economic competitiveness because dealing with environmental standards can impose costs on business. This view, however, derives from a static and oversimplified view of competition. Drawing on my work on competitiveness, "Green and Competitive" suggests that "environment versus competitiveness" is a false dichotomy.

In the new thinking, competitiveness arises from increasing productivity in the use of resources. Productivity improvements must be never-ending. Seen in this light, virtually all forms of corporate pollution are manifestations of economic waste; for example, resources used inefficiently, energy wasted, or valuable raw materials discarded. Improving environmental performance through better technology and methods, then, will often increase productivity and offset or partially offset the cost of making improvements, an idea which has come to be known in the environmental community as the Porter Hypothesis. This implies that environmental regulation should focus on raising performance standards versus specifying means, reducing unnecessary transactions costs of the regulation itself, and facilitating product and process innovation.[4] This article, once intensely controversial, is now quite widely accepted, especially in the practitioner community. Corporations should see environmental improvement not as a regulatory nuisance but as an essential part of improving productivity and competitiveness.

"The Competitive Advantage of the Inner City" (1995) addresses the economic distress of America's urban cores. Urban poverty has been seen primarily as a social problem, and proposed solutions have focused on meeting the pressing human needs of inner-city residents. But the problem is equally an economic one. No community can be truly healthy without a healthy economy. Without accessible jobs and opportunities for income and wealth creation, social investment will be insufficient to achieve lasting benefits. While there have been numerous efforts at inner-city economic development, too many have tried to defy the laws of the marketplace. Based on the presumption that inner cities face many competitive disadvantages as business locations, "economic" development has often consisted largely of creating non-profits and relocating government buildings. Alternatively, large subsidies have been used in attempts to influence companies' location choices.

Rather than concentrate on competitive disadvantages, "The Competitive Advantage of the Inner City" turns the question on its head. In it, I argue that only by focusing on the inherent

[4] A companion article develops the theory and implications for regulation in more detail for the academic reader. See "Towards a New Conception of the Environment-Competitiveness Relationship," *The Journal of Economic Perspectives*, Vol. 9, No. 4 (Autumn, 1995): 97-118.

competitive advantages of inner-city locations will economic development be sustainable. I apply my broader work on competitiveness to inner cities, outlining the advantages of inner cities that have given rise to many thousands of successful inner-city-based companies in major cities all across the country. An economic development approach that builds on these advantages, while tackling frontally the competitive disadvantages of inner cities as a business location, offers a much better model for addressing our most distressed communities. There is nothing inevitable about the decline of cities if we shift our focus from reducing poverty to creating jobs, income, and wealth. The thesis of this article gave rise to a non-profit, the Initiative for a Competitive Inner city (ICIC), which has extended the research on inner city economies and helped put the ideas into practice.[5] I have also applied this thinking to address the challenges of economic development in rural areas.[6]

Health care is another pressing social concern facing the U.S. and every nation. In the U.S., high costs and the large number of people without health insurance have triggered a national debate on how best to restructure the system. In "Redefining Competition in Health Care" (2004), Elizabeth Teisberg and I argue that the wrong kinds of competition have made a mess of the American health care system. In contrast, the right kind of competition, focused on creating value for patients, will provide a sustainable solution. Value is defined as patient health outcomes per dollar spent. Only through continued innovation focused on improving value in the delivery of care can the cost of health care be controlled without rationing care or eroding its quality. In fact, the only way to truly reduce the cost of health care is to improve its quality, because good health is inherently less expensive than poor health.

[5] For further information and citations see http://www.icic.org and http://isc.hbs.edu.
[6] "Competitiveness in Rural U.S. Regions: Learning and Research Agenda," Economic Development Administration, February 2004.

The article explores why health care competition has become zero-sum, with system participants dividing value instead of increasing it. Competition takes place at the wrong level and over the wrong things. There is rampant cost shifting and the accumulation of bargaining power to extract more revenue or capture patients from other actors. Fixing the system will require that the locus of competition shifts from "Who pays?" to "Who provides the best value?" We lay out a vision for what positive sum competition in health care would look like. This vision has subsequently been extensively elaborated in our book, *Redefining Health Care* (2006), which shows how health care delivery can be transformed and how each system actor can create value in terms of patient health.

The articles in Part III represent the beginnings of a new integration of economic and social policy. Traditionally, economic and social policy have been seen as distinct and often conflicting. Economic policy concerns itself with creating wealth by providing incentives, encouraging savings and investment, and minimizing government intervention. Social policy has concentrated on providing for public education and other human needs, aiding disadvantaged groups, protected citizens through various forms of regulation, and, recently, preserving the environment. Social policy has relied heavily on market intervention, subsidies, and redistribution.

Social policymakers tend to see the market as the problem and consequently attempt to modify its outcomes. Economic policymakers tend to see government intervention as the problem. Social advocacy groups often view business as the problem. Businesses see social concerns as outside their realm of interest, and often view social organizations as special interests. Businesses point to a strong economy, unshackled by counterproductive intrusions, as the best social program.

These old dichotomies are false ones and represent an increasingly obsolete perspective. Social and economic goals are not inherently conflicting in the long run. A productive and growing economy requires educated, safe, healthy, decently housed workers who are motivated by a sense of opportunity. Economic competitiveness can be enhanced by better environmental performance, because corporate pollution results from unproductive use of resources. The only real conflict lies in means. Efforts to advance social goals via redistribution, subsidies, and market distortion usually fail and, in the process,inflict steep economic costs, as illustrated in my articles on the environment and inner city economic development. Similarly, efforts to boost profits at the expense of worker training, safety, and a sense of well being will fail in the long run.

The articles in this section set forth a new approach based on harmonizing and pursuing simultaneously economic and social goals. This can be done through a central focus on competition, innovation and value—working through the market rather than against it. Social programs must prepare individuals to succeed in the market system, not insulate them from it. Efforts to address social issues, such as pollution and the high costs of health care, must harness innovation and competition to address underlying causes, rather than attempt to shift the costs onto some other group within society.

The articles in Part III illustrate these principles, using as examples health care, the environment, and urban poverty. The same principles, however, can be applied to many social issues, including social security, education, or housing.

Strategy, Philanthropy, and Corporate Social Responsibility

To address social problems, society has moved away from a reliance solely on government. Today, philanthropy involving foundations, corporation, and countless NGOs is deploying hundreds of billions of dollars to address some of society's most intractable challenges, often in collaboration with government. The performance of this enormous investment of scarce resources is of growing concern.

Part IV begins with the question of how to create value through philanthropy. Most philanthropy focuses on the act of giving, with the presumption is that giving does good. However, in "Philanthropy's New Agenda: Creating Value" (1999), Mark Kramer and I make the case that much philanthropic giving delivers limited social benefit, and certainly much less social benefit than is possible. The huge and growing resources being deployed by philanthropists, and especially by foundations, heightens the lost opportunity for society.

This article, which has been controversial, makes the case that foundations create little value by giving money alone. To truly create value, foundations need a conscious strategy to do more than dole out grants to worthy causes. The article provides a framework for how foundations can add value through the selection of grantees, providing assistance to grantees in expanding and increasing their social impact, and investing systematically to advance the state of practice in fields where the foundation can become truly expert. All of this requires that foundations make clear strategic choices to define the fields in which they will operate, and the activities through which they will be distinctive in catalyzing social impact.

In "The Competitive Advantage of Corporate Philanthropy" (2002), we apply these general principles of philanthropy to giving by corporations. Corporations, more than almost any other institution in society, have powerful assets with which to create value in addressing social issues. However, the ability of corporations to create value comes only from selecting those social issues where there is a long term connection to their business, giving them the skills, resources, and relationships to make a difference. The article offers tools that companies can use to make their giving more strategic, by finding those areas where there is a win-win opportunity to improve social performance while enhancing the long term competitive position of their business.

The final article of Part IV, “Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility” (2006), tackles the broad question of the relationship between corporations and the society in which they operate. Companies are being scrutinized and held accountable for social impacts as never before, but many companies have treated corporate social responsibility defensively and worried more about image than social impact. However, company competitiveness and social progress are not separate and conflicting, but interdependent, as discussed previously. This article provides a framework for understanding the points of intersection between a company and the communities in which it operates, which will guide how the company can make social responsibility integral to strategy. Many companies can integrate a social dimension into their strategy, which can make the strategy more sustainable.

Taken as a group, the articles in Part III and Part IV show how strategy principles are fundamental to social progress, not just to economic progress. Thinking in terms of value will separate those organizations that will truly make a difference from those satisfied with the act of giving to worthy causes.

Strategy and Leadership

Part V introduces an emerging body of work on the role of leadership. No company, country, or social organization can create the maximum value without effective leadership. Yet we still know little about this subtle topic, especially in large complex organizations.

In "Seven Surprises for New CEOs" (2004), NitinNohria, Jay Lorsch, and I examine the underlying nature of leadership in complex business organizations by distinguishing how the role of CEOs differs from other senior managerial roles in a corporation. We draw on the unique perspective gained from Harvard's New CEO Workshop, an intensive program to assist newly appointed CEOs in setting their agenda and making the personal transitions necessary. More than 100 new CEOs of multibillion dollar corporations have participated. The article describes the surprises awaiting new CEOs about the job, and the lessons these hold for CEO effectiveness. Strategy proves to be an especially crucial tool for CEO success. This article is the first from a body of research on CEO leadership that is continuing.

Expanding Frontiers

As I hope is evident, all my work rests on a core set of ideas about competition and embodies a consistent perspective. Yet my ideas continually evolve and have broadened over time to encompass new dimensions. The *five forces* have become shorthand for the idea that industry structure defines the playing field on which competition unfolds. The *value chain* has become shorthand for an activity-based view of competitive advantage, that is, superior profitability can be traced to differences in activities that allow a company to lower costs or in its ability to charge higher prices. *Strategic positioning* versus *operational effectiveness*has become the essential distinction in understanding the nature of strategy and how it is different from other managerial agendas. The *diamond* and *clusters* have become shorthand for the way location affects competition. This set of core frameworks cuts across all my work, including the work on social issues. My understanding of each one, and of the connections among them, is continually being deepened and extended.

As I explored one question in trying to understand competition and strategy, the next question was suggested, and the next. Thinking about competition and strategy in a single industry, for example, led me to an interest in the influence of diversification on industry competition. My early work on positioning provided the impetus for the activity-based view of the firm, which provided a framework for thinking about value creation. As I struggled with how strategy was different from all the other things managers did, I began to see the distinction between strategy and operational effectiveness. Thinking about activities led me to puzzle over the influence of globalization or spreading activities across geography, which in turn raised the question of how location mattered. A focus on location led to the source of competitiveness of nations and regions, and the role of government in competition, not just companies. As I looked more closely at countries and communities, I was drawn to explore how competition and the principles of value creation, properly understood and channeled, could be put into service to address a number society's most pressing challenges, from environmental sustainability, urban poverty, to quality health care. As more of society's resources were deployed through foundations and other philanthropic organizations, I turned my attention to how such organizations could be more effective.

Over time, I have been led to explore new units of analysis. My initial work stressed the *industry* at a time when the firm as the unit of analysis was dominant. As I understood that competitive advantage did not arise from the firm as a whole, my subsequent work stressed the *activity*. When focus in management thinking was almost exclusively on what went on inside firms, I added consideration of the *geographic location*. When industrial policy concentrated on the industry or the country, I highlighted the role of the *cluster*. In health care, while the dominant focus was on the insurance, hospitals, or clinics, our work identified the medical condition as the essential value creation unit.

As each new question arose and each new set of ideas developed, I have been led to re-examine what came before. The activity-based view of the firm caused me to refine and extend my earlier thinking about generic strategies. The distinction I now make between operational effectiveness and strategy ("What Is Strategy?") both builds on earlier work and informs it. The new theory has deepened my understanding of positioning, and linked it more tightly to activities. Through this new work, I was also able to extend the activity view of the firm through the concepts of tradeoffs and fit.

The distinction between operational effectiveness and positioning also sheds new light on a wide variety of other issues. Financial market pressures, for example, can be desirable motivators of operational improvement, but often lead companies to compromise their unique strategic positions by pursuing growth in segments where they lack any real advantage. Another example of the distinction is in evaluating the role of information technology in competition. Much of the new information technology is being directed at improving best practice—operational effectiveness—rather than enabling unique positioning. The lurking danger with the new generation of IT tools, however, is that too many companies will apply them in the same way. This will have the unwitting effect of homogenizing competition, limiting customer choice, and triggering mutually destructive rivalry.

The research on location has opened up important new connections as well. The most obvious one is an enriched conception of global strategy. Locational factors clearly play a role in industry structure and competitive advantage, and influence feasible forms of competing. The state of the diamond and the depth of the cluster can raise or lower barriers to entry into an industry, shift the power of customers and suppliers, and set the mix and threat of substitutes. Locational factors also influence the forms of rivalry that take place in a national economy, which can range from imitation and price competition in developing economies to innovation and differentiation in advanced ones. In developing economies, locational deficiencies create difficulties in attempting to enter attractive industries and in avoiding destructive price rivalry. At the same time, government intervention and a shortage of capital often suspend competitive forces and preserve monopolies.

Location also strongly influences competitive advantage and the types of strategies firms can choose and successfully implement. The state of local infrastructure, the skills of local employees, and other diamond conditions contribute directly to operational effectiveness. Diamond conditions, such as local demand sophistication, unique skill pools, and the local presence of related industries, can also shape the types and variety of strategic positions chosen, in terms of customer segments or product varieties. The business environment at a location not only influences the choice of strategy, but also the ability to carry out strategies. At the level of activities, it is also evident that access to many of the resources, capabilities, and skills that contribute significantly to a firm's uniqueness depends on the nature of the local environment.

Location also bears on corporate strategy. Diamond conditions influence the types of corporate value added that truly affect competitive advantage. In developing countries, value is created by a corporate parent's ability to provide capital access and to introduce professional management. This helps explain the prevalence of conglomerate groups in many emerging economies. In more advanced economies, portfolio management adds little value, and other approaches to diversification are needed. Conditions in the diamond, such as in logistical system and supplier industries, affect the kind of synergies that are feasible.

Many readers have noted an apparent contradiction between my work on strategy and my ideas on location. The industry-structure framework shows how powerful buyers and suppliers and intense rivalry can depress profitability, while diamond theory suggests that local rivalry, demanding customers, and sophisticated local suppliers foster competitiveness by stimulating and supporting high productivity and rapid innovation. How can these perspectives be reconciled? First, we must distinguish between an industry in a single location, and the industry globally. The presence of a favorable diamond in one location, including intense local rivalry, allows firms based there to achieve collectively a higher level of productivity and also to progress faster than firms based in other locations. Profitability in the local market may be lower, but the global profitability of firms based there will be superior. Another way of making the same point is to recognize that diamond conditions will affect the ability of firms based in a location, on average, to gain a competitive advantage over firms based elsewhere. Average industry profitability globally will be dependent on average industry structure globally.

The work on location addresses the determinants of productivity, and highlights the importance of dynamic improvement to competitiveness. The industry-structure and activity frameworks provide the intellectual framework to understand the firm and its markets. My early investigations were more cross-sectional (for example, answering such question as why some industries are more profitable than others at a given time or why one rival is more profitable than another). These were the logical first questions.

My more recent work on operational effectiveness and positioning, however, begins to bridge positioning, location, and dynamic improvement. It stresses the necessity of continual improvement in operational effectiveness but emphasizes the need for continuity in strategy. Both operational effectiveness and strategy are influenced by location.

A deeper understanding of competition and value creation, enriched by work on location, has opened up a whole new frontier for exploring the connection between competition and social issues. Economic competitiveness and social progress can be harmonized and improved together. Social organization can make huge strides in performance by embracing the principles of value creation. Competition can stimulate rapid progress in the social sector if it is channeled toward value.

Finally, the effort to understand the connection between competition and social issues led me to a major focus on the philanthropic sector. How to deploy the rapidly growing resources flowing to this sector in ways that deliver greater value to society is an urgent priority, as the limits of government in solving all of society's problems are recognized.

New connections remain to be discovered, and my learning about competition and value creation is unlikely to stop anytime soon. Any number of new opportunities are emerging, which will find their way into theory and practice. One is the evolving relationship between firms and capital markets, now that most capital is invested by large, often activist, institutions rather than long term individual holders. Another development is the fusion of economic and social strategy, in which social goals (e.g., environmental stewardship) are addressed in a market framework. However, these trends, and others, will not themselves hold the key to value creation. Instead, it will come from the ability to see an organization and its context holistically. Strategic thinking will be rarer and more precious than ever.

Whatever the future holds, one thing is certain. As competition continues to evolve, it will be both unsettling and the source of much of our prosperity. If this collection could convey only one message, I would want it to be a sense of the staggering power of competition to make things better—both for companies and for society.