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FEATURING
"What Is Strategy?"
By Michael E. Porter

On Strategy

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What Is Strategy?

by Michael E. Porter

I. Operational Effectiveness Is Not Strategy

For almost two decades, managers have been learning to play by a new set of rules. Companies must be flexible to respond rapidly to competitive and market changes. They must benchmark continuously to achieve best practice. They must outsource aggressively to gain efficiencies. And they must nurture a few core competencies in race to stay ahead of rivals.

Positioning—once the heart of strategy—is rejected as too static for today's dynamic markets and changing technologies. According to the new dogma, rivals can quickly copy any market position, and competitive advantage is, at best, temporary.

But those beliefs are dangerous half-truths, and they are leading more and more companies down the path of mutually destructive competition. True, some barriers to competition are falling as regulation eases and markets become global. True, companies have properly invested energy in becoming leaner and more nimble. In many industries, however, what some call *hypercompetition* is a self-inflicted wound, not the inevitable outcome of a changing paradigm of competition.

The root of the problem is the failure to distinguish between operational effectiveness and strategy. The quest for productivity, quality, and speed has spawned a remarkable number of management tools and techniques: total quality management, benchmarking, time-based competition, outsourcing, partnering, reengineering, change management. Although the resulting operational improvements have often been dramatic, many companies have been frustrated by their inability to translate those gains into sustainable profitability. And bit by bit, almost imperceptibly, management tools have taken the place of strategy. As managers push to improve on all fronts, they move farther away from viable competitive positions.

Operational effectiveness: necessary but not sufficient

Operational effectiveness and strategy are both essential to superior performance, which, after all, is the primary goal of any enterprise. But they work in very different ways.

A company can outperform rivals only if it can establish a difference that it can preserve. It must deliver greater value to customers or create comparable value at a lower cost, or do both. The arithmetic of superior profitability then follows: delivering greater value allows a company to charge higher average unit prices; greater efficiency results in lower average unit costs.

Ultimately, all differences between companies in cost or price derive from the hundreds of activities required to create, produce, sell, and deliver their products or services, such as calling on customers, assembling final products, and training employees. Cost is generated by performing activities, and cost advantage arises from performing particular activities more efficiently than competitors. Similarly, differentiation arises from both the choice of activities and how they are performed. Activities, then, are the basic units of competitive advantage. Overall advantage or disadvantage results from all a company's activities, not only a few.[1]

Operational effectiveness (OE) means performing similar activities *better* than rivals perform them. Operational effectiveness includes but is not limited to efficiency. It refers to any number of practices that allow a company to better utilize its inputs by, for example, reducing defects in products or developing better products faster. In contrast, strategic positioning means performing *different* activities from rivals' or performing similar activities in *different* ways.

Differences in operational effectiveness among companies are pervasive. Some companies are able to get more out of their inputs

Idea in Brief

The myriad activities that go into creating, producing, selling, and delivering a product or service are the basic units of competitive advantage. **Operational effectiveness** means performing these activities better—that is, faster, or with fewer inputs and defects—than rivals. Companies can reap enormous advantages from operational effectiveness, as Japanese firms demonstrated in the 1970s and 1980s with such practices as total quality management and continuous improvement. But from a competitive standpoint, the problem with operational effectiveness is that best practices are easily emulated. As all competitors in an industry adopt them, the **productivity frontier**—the maximum value a company can deliver at a given cost, given the best available technology, skills, and management techniques—shifts outward, lowering costs and improving value at the same time. Such competition produces absolute improvement in operational effectiveness, but relative improvement for no one. And the more benchmarking that companies do, the more **competitive convergence** you have—that is, the more indistinguishable companies are from one another.

Strategic positioning attempts to achieve sustainable competitive advantage by preserving what is distinctive about a company. It means performing *different* activities from rivals, or performing *similar* activities in different ways.

than others because they eliminate wasted effort, employ more advanced technology, motivate employees better, or have greater insight into managing particular activities or sets of activities. Such differences in operational effectiveness are an important source of differences in profitability among competitors because they directly affect relative cost positions and levels of differentiation.

Differences in operational effectiveness were at the heart of the Japanese challenge to Western companies in the 1980s. The Japanese were so far ahead of rivals in operational effectiveness that they could offer lower cost and superior quality at the same time. It is worth dwelling on this point, because so much recent thinking about competition depends on it. Imagine for a moment a *productivity frontier* that constitutes the sum of all existing best practices at any given time. Think of it as the maximum value that a