Joan Magretta's latest book is *Understanding Michael Porter* : The *Essential Guide to Competition and Strategy* (Harvard Business Review Press, 2011). Over two decades she has worked closely with Professor Porter on many publications, starting when she was the strategy editor at *Harvard Business Review* . Prior to joining *HBR* she was a partner at the consulting firm Bain and Company, and she is now a Senior Associate at Porter's Institute for Strategy and Competitiveness at Harvard Business School. In her introduction to the book she notes that "too many managers get their Porter second hand and what they usually end up getting is both inadequate and inaccurate. I'll try to fix that by laying out Porter's theories ideas as concisely as possible without dumbing them down. Along the way I'll highlight the most common misconceptions about strategy and Porter's work." Magretta was interviewed by two veteran *Strategy & Leadership* contributing editors, Robert J. Allio, a consultant and the author of *The Seven Faces of Leadership,* and Liam Fahey, a consultant and the author of *Competitors* .

**Strategy & Leadership** : From your perspective, what is Porter's most important contribution to the theory of strategic management?

**Joan Magretta** : Porter's classic frameworks - the five forces, competitive advantage, the value chain-and, more recently, his five tests of strategy, provide the economic foundation of competition and strategy. Managers who can put these pieces together will have a general theory that applies in all cases. Why are some industries more profitable than others? Why are some companies more profitable than others? Porter's answers to these questions define the unchanging core, the set of logical, fundamental relationships between profitability and the choices companies make as they compete.

**S&L** : What are the key lessons for practitioners about strategy, rivalry, customers, and business model that have emanated from Porter insights over the years?

**Magretta** : First, keep a direct line of sight between your strategy and your financial performance. If strategy is to have any meaning at all, it must link directly to a company's results. Anything short of that is just talk.

Second, a distinctive value proposition is essential for strategy. But don't confuse strategy with marketing. If your value proposition doesn't require a specifically tailored value chain to deliver it, it will have no strategic relevance.

Third, No strategy is meaningful unless it makes clear what the organization will *not* do. Making trade-offs is the linchpin that makes competitive advantage possible and sustainable.

Fourth, don't feel you have to "delight" every possible customer out there. The sign of a good strategy is that it deliberately makes some customers unhappy.

**S&L** : One of your stated reasons for revisiting Porter's work is that parts of it are often wrongly interpreted by executives and theorists. What are some of Porter's most misunderstood or misapplied strategy propositions?

**Magretta** : In one sense, Porter is the victim of his own success. Managers use the terms he created or popularized, but they have become buzzwords, diluted and drained of their meaning. "Competitive advantage" is the best example of this. Used loosely, as it most often is, it has come to mean little more than anything an organization thinks it is good at. But for Porter, the term is both concrete and specific. If you have a real competitive advantage, it means that compared with rivals, you operate at a lower cost, command a premium price, or both. And your ability to do that arises from the activities in your value chain. So competitive advantage, for Porter, is the result of specific choices you've made about your value chain, choices that aim to shift relative price or relative cost in your favor. That's the source of sustainably superior performance.

Of course, what ultimately matters for managers isn't the way they use words, but the way they make choices. When your understanding of competitive advantage is grounded in economics, it then becomes clearer what you have to do to create it and to sustain it. And while it's become somewhat fashionable to think that advantages can no longer be sustained, a deeper understanding of competitive advantage will lead you to choices that make a strategy sustainable over time.

Let me just mention several important misconceptions surrounding industry structure. Using five forces analysis primarily to declare an industry attractive or unattractive is one of them. Good five forces analysis is far more powerful, allowing you to see through the complexity of competition, and it opens the way to a host of possible actions you can take to improve performance. Here's another misconception: Managers often mistakenly assume that a "high-growth industry" will be an attractive one. But growth is no guarantee that the industry will be profitable. And finally there is the persistent misconception that Porter sees industry structure as something fixed, static and unchanging. Not so.

**S&L** : You suggest that strategy is one of the most dangerous concepts in business! Why? What are the risks?

**Magretta** : Using the strategy vocabulary gives executives an air of authority. When people talk about "competitive advantage" and "disruptive technology" and "monetization" and "scaling," it sure sounds like there's a lot of deep expertise and mathematical rigor behind what they say. But scratch the surface and often ... there's nothing but surface.

On the one hand, this creates massive communication problems. You think everyone in your organization buys into the strategy, but that consensus turns out to be superficial. Everyone can agree at some very high level, but then when you get into the detail, you realize that people don't understand, don't agree, and they act at cross-purposes.

For me the biggest danger is self-deception. You think you have a strategy when you don't. And "armed" with strategy, you lead with a false sense of confidence. Read Shakespeare's history plays. Each army heads into battle believing they can't lose because God is on their side. I think a lot of executives fall into a similar trap, thinking strategy is on their side.

**Competition**

**S&L** : As you explain, Porter decries the competition to be the best. But don't the best firms in their industry or market segment generally exhibit the highest profitability? For example, didn't Jack Welch's original "Be #1 or #2" mandate, serve GE well?

**Magretta** : The implicit model behind the "Be #1" mandate is that companies win by getting bigger and, ultimately, by dominating their industries. But Porter's work finds no systematic evidence to support the view that industry leaders are the most profitable firms.

To be clear, there are economies of scale and advantages to being bigger in most businesses. This was certainly the case in some of GE's scale-intensive businesses during the Welch era. But before you assume that bigger is always better, it is critical to run the numbers for your business. Too often the goal is chosen because it sounds good, whether or not the economics of the business support the logic. In industry after industry, Porter notes that economies of scale are exhausted at a relatively small share of industry sales.

Companies only have to be "big enough," which rarely means they have to dominate. Yet companies focused on size tend to pursue illusory scale advantages. In doing so, they are likely to damage their own performance by cutting price to gain volume, by overextending themselves to serve all market segments, and by pursuing overpriced mergers and acquisitions. This is what Porter means when he talks about competing to be the best.

**S&L** : Price competition, you caution us, is the most damaging form of competition. But if I'm the low-cost producer in a mature industry, won't competing on price win the battle for me? And isn't Apple winning the tablet wars in part because of its pricing strategy?

**Magretta** : As with all the hard questions managers have to face, a lot depends on the specifics of the situation. You say you're the low cost producer, but what's the basis for your low-cost position? For Porter, a sustainable low-cost strategy reflects a tailored value chain that rivals can't easily copy or neutralize. You choose to perform activities and to make key tradeoffs that are different from your rivals. Think of a company like Dell in the 1990s, for example, with its direct model.

That's hugely different, say, than a new airline whose low-cost position derives from the fact that its planes happen to be newer and more fuel-efficient. Let Upstart Air compete on price and as its fleet ages and The Next New Airline is launched, it will no longer be the low cost producer, and all it will have succeeded in doing is further damaging the profitability of everyone in the industry.

Apple is another story altogether. I don't think there are too many customers out there who buy an iPad based on price alone, and that's really the essence of mutually destructive price competition. It's when companies have so completely imitated each other's products and services, that price becomes the only dimension on which customers choose. That's when competition becomes most destructive.

Your question is really important because it illustrates how Porter's frameworks are often misapplied. Use them to help you think more deeply about the particular situation you face. If you really understand Porter, you will ask the right questions, you will think through the problem more rigorously. But don't expect Porter to tell you what to do. He doesn't offer prescriptions like "low-cost producers should always compete on price."

**S&L** : Could you elaborate on your assertion that firms "compete for profits"? Isn't profit the result of competing for customers? And isn't the arrant quest for profit one of the fundamental weaknesses of recent corporate behavior.

**Magretta** : Let's put that assertion back in its context. Most people think of competition too narrowly as a contest between rivals. But the real point of competition is not to beat your rivals, or win a sale. The point is to earn profits. Competing for profits is more complex, involving multiple players, not just rivals, over who will capture the value an industry creates. Customers are just one player, along with suppliers, existing rivals, potential entrants, and producers of substitutes.

So yes, I agree that profits are a result, but they're not simply a result of winning more customers. In fact, it's very easy to win lots of customers - and at the same time go broke. Just give customers everything they might want, including prices so low they don't cover your full costs. But successful, positive-sum competition means you are creating economic value and then capturing some of it for yourself. Sustainable profitability is the sign that you're creating economic value, using resources effectively to meet customers' needs.

That's the goal every organization should be focused on, companies as well as nonprofits. In my opinion, the arrant quest for profit, to use your term, shifts the focus from creating value - which is the proper mind-set for competition - to extracting it, by whatever means you can. It's perverse, but unfortunately some companies manage to get away with it.

**S&L** : Porter's five forces model is widely used, replacing the historic SWOT analysis in many firms. But if properly applied, doesn't a SWOT analysis yield the same results? Is the problem that the Strengths and Weaknesses portion of the analysis often fails to consider the externalities of the business?

**Magretta** : How does SWOT analysis go wrong? Let's count the ways. SWOT sessions are most often about making lists, not actually gathering relevant data and doing analysis. I agree with you that strengths usually end being the one function in the company that seems stronger, or simply less weak, than the others. So if you're better at customer service than you are at R&D, you try to build a strategy around service - even if six companies out there run rings around your service. But each of the four SWOT letters has its problems.

What's really wrong with SWOT is that there is no underlying theory or principles around how you define each one of the sets of factors. And that's exactly what you do have with Porter's five forces. His framework tackles the economic fundamentals of competition in a way that highlights how external forces constrain or create strategic opportunities for your company.

SWOT, at least in my experience with it over the years, usually leads you right back where you started: the most powerful guy in the room has been itching to buy ACME Tech, and by golly, that turns out to be the best opportunity on the list, while the greatest threat is that somebody else will beat you to it.

**Innovation**

**S&L** : What advice would Porter give to those executives who are striving to innovate? How should they proceed? How does the example of Steve Jobs, who brought Apple to its current dominance by introducing products like the iPhone and iPad that customers never imagined they would need, fit with this advice?

**Magretta** : First, that it's easier to innovate if you have a strategy to begin with. Especially in uncertain times, there's a tendency to think that "staying flexible" is the answer. But if you don't have a strategy, you have no way of sifting through all the possible ways you might innovate, and you will be chasing one fad after another.

Second, don't copy. You can learn a lot from the good ideas of other companies, but instead of copying you should think about what that innovation accomplishes, and how the idea could be adapted and used to reinforce what makes you unique. Porter would ask of any innovation whether it's relevant to the needs you're trying to serve. If you have a strategy you don't have to jump on every trend. But if the trend is relevant, Porter would advise you to tailor it to your strategy.

When Steve Jobs returned to Apple in 1997, he refocused the company on what had made it distinctive in the first place: user-friendly technology and elegant design for consumers. That is, he returned to Apple's strategy. The innovative products you refer to came later, as Apple deepened and extended its original positioning.

**S&L** : You urge "continuity of strategy," with an emphasis primarily on innovation in the delivery process. But don't we need to give equal attention to innovation in the product itself and to innovation in the management processes?

**Magretta** : I can see where my phrasing may have confused you. I said that continuity of strategy doesn't mean that an organization should stand still. As long as there is stability in the core value proposition, there can, and should, be enormous innovation in "how it's delivered." So let's go back to your question about Apple's innovative products. The iMac was one way to deliver user-friendly technology elegantly designed. And then so were the iPod, iTunes, the iPhone, and the iPad. Innovative new products and services, then, are absolutely ways to "deliver" a company's core value proposition. Similarly, Wal-Mart is a leader in categories Sam Walton never dreamed of selling, but its basic value proposition, the core of needs the company meets and its relative prices are unchanged.

The heated rhetoric about change and disruption that is so pervasive masks the fact that successful companies rarely have to reinvent themselves because they are constantly reinventing their methods, their management processes, their offerings. They keep getting better at what they do. They keep searching for ways to create more value.

**S&L** : Your interpretation of Porter's position on Red vs. Blue Ocean strategy, a model championed by W. Chan Kim and Renée Mauborgne, raises a question. Porter appears to assume that industry structure is fixed, whereas the Blue Ocean model argues that industry structure and market boundaries can be reconstructed, yielding new market opportunities. What lesson should executives take away from this debate?

**Magretta** : I think the most important lesson for executives is that there really is no debate here, but there is a mystery. I should offer a prize to anyone who can solve it. I have read pretty much all of Porter. I have sat in on his classes. I've read transcripts of his public appearances. Over and over he says, with unfaltering clarity, that industry structure is dynamic, not static. When you do industry analysis, you are taking a snapshot of the industry at a point in time, but you are also assessing trends in the five forces because in any industry, there is always change. His research does show that in most industries, structural change is a lot slower than you'd think. But however fast or slow it is, change is a given. The better your grasp of industry structure, the more likely it is you will spot and exploit new strategic opportunities or moves that could reshape industry structure in your favor.

So here's the mystery. Why does this misunderstanding persist when Porter himself could not be clearer? My guess is that people must be getting their Porter second hand, trusting someone else's characterization of his work. My book, *Understanding Michael Porter,* will, I hope, encourage managers to assess Porter's work for what it actually says, not for what others mistakenly think it says.

**Tools and techniques**

**S&L** : Portfolio analysis, promoted extensively by BCG, ADL, and [McKinsey](http://search.proquest.com.ezproxy.trident.edu:2048/docview/923390520?pq-origsite=summon), isn't mentioned in your summary of strategic methodologies. Doesn't this have a place in the corporate planning inventory of analytic tools?

**Magretta** : Porter focuses on business-unit strategy because his early research showed that overall corporate return in a diversified corporation is best understood as the sum of the returns of each of its businesses. While the corporate parent can contribute to performance - or, as has been known to happen, detract from it - the dominant influences on profitability are industry specific. So for Porter, "strategy" always means "competitive strategy" within a business. The business unit, and not the company overall, is the core level of strategy.

That's not to say that he hasn't provided important insights into corporate level strategy. Porter would approach the business logic of a multiple-business company, through value chain analysis. If there is a real economic basis for assembling a portfolio of businesses, you should be able to identify the specific value chain activities that will be affected by the portfolio.

**S&L** : None of your exposition of Porter's positioning model addresses the merit of the alternative orthodoxy: the resource-based strategy selection process, which argues that strategy should originate with the internal resources of the firm, such as its competencies, and how they can be deployed to yield competitive advantage. Doesn't this approach have merit?

**Magretta** : Yes, I think it has merit. But what has less merit for practitioners, is to position these as "alternative orthodoxies." Let me give you an example. In chapter 4, I address the question of where to begin when you set out to discover a new strategic position. Grace Manufacturing, today known for its Microplane line of kitchen products, was once a contract manufacturer of steel printer bands, a product that was fast becoming obsolete. Grace's principal asset was a proprietary masking and etching process that produced bands with razor-sharp edges. So they asked themselves, "What can we make that's sharp?" Porter would say they started with their value chain, with the unique set of activities they performed. The resource folks might say that Grace began with its "competencies" or its "internal resources." At the risk of upsetting both camps, my experience in practice tells me that this is, for managers, a distinction without a difference. For managers, the language of "skills" or "core competences" is a bit more natural than "activities." But ultimately, managers just think of these as "strengths" or "what they're good at." Fortunately for Grace Manufacturing, they didn't just have a strength in making sharp things. Most essential for strategy, it was a unique strength that could be deployed in a configuration of activities that creates real economic value.

In describing a strategy after the fact, the value proposition - the core of positioning - is the logical place to begin. But discovering new positions is a creative act. What triggers the initial insight often varies from one person, and one organization, to the next. Some discover unmet needs - that is, unoccupied positions - and figure out how to meet them. Some discover new uses for their competencies, or their assets.