7 Powers: The Foundations of Business Strategy
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Summary

1. A book that discusses both the statics and dynamics of Strategy and identifies 7 types of Power that will give a business competitive advantages with durable returns.

Key Takeaways

1. **Foreward: Reed Hastings**
    a. Execution is table stakes so to succeed you need to get the strategy right.
    b. To think strategically, you need to explain what you are trying to do and more importantly what you are **not** trying to do (Michael Porter).
2. **Introduction**
    a. A Strategy framework must be simple, but not simplistic to be useful.
        i. Key Definitions covered in the rest of the book include:
            1. Strategy: the study of the fundamental drivers of business value; this study can be separated into two states: statics (being there) and dynamics (getting there).
            2. Power: a set of conditions creating the potential for **persistent** differential returns.
            3. strategy: a route to continuing Power in significant markets.
        ii. In public markets, value is determined and changes in the **expectations** of future free cash flow.
            1. Prices move in the short-term, but that doesn't make the market short-term.
            2. The market reacts to what current performance indicates about future performance and continually reshapes future expectations.
    b. Power has several recurring themes throughout the book.
        i. Power must be driven by persistent, differential returns.
        ii. Power has a magnitude component driven by a benefit to the company and a duration component driven by a barrier to the competition.
            1. The benefit is increased cash flow through some combination of increased pricing, decreased cost, or investment needs.
            2. The barrier is protection from competition that prevents Power from being arbitraged away.
                a. Always search for the barrier first as it rare.
        iii. Conditions that allow for Power will be driven by the intersection of Industry Economics and the Competitive Position of the company.
        iv. A company need not only worry about its direct and current Competition, but its economic substitutes and future Competition.
3. **Chapter 1: Scale Economies**
    a. Scale Economies is when unit costs decline as volume increases.
        i. The benefit results in reduced unit costs and increased cash flow.
        ii. The barrier is prohibitive costs to a challenger when it tries to gain share.
    b. Specialized sources of Scale Economies include:

        i. Physical world relationships related to the relationship between area and volume, otherwise known as the cube-square rule.
        ii. Increased distribution network density resulting in lower costs.
        iii. Purchasing economies because of increased scale.
        iv. Learning economies resulting in a combination of increased benefits or lower costs as production levels increase.
    c. How intense the Power in Scale Economies can be is a function of:
        i. The importance of fixed costs to Industry Economics and overall industry cost structure.
        ii. The Competitive Position, or relative scale of the leader to the next biggest.
    d. Netflix has a Scale Economies advantage today in that its **per subscriber** content costs are lower than that of its competitors.
        i. Competition can either spend the same amount ion content with fewer subscribers and burn cash or raise its prices and offer less content and value.
        ii. Netflix moved to exclusive and originals making content a fixed cost and using Scale Economies as a source of Power.

4. **Chapter 2: Network Economies**
    a. Network Economies is when the value of a product or service to a customer increases as the installed base increases.
        i. The benefit is in higher prices and cash flow that accrue to the leader as its gains users.
            1. The leader prices at a level that allows for both high margins and can keep the Competition out.
        ii. The barrier is prohibitive costs to a challenger as it tries to gain share.
            1. User increases and decreases are non-linear.
    b. The Power of Network Economies is a function of:
        i. The intensity of the network effects relative to Industry Economics.
        ii. The absolute difference in the installed base of companies determines the Competitive Position.
    c. Other key points around Network Economies include:
        i. Unique characteristics in that that they are usually winner take all, very bounded and defined by the network, and usually have the best product that is the first to scale.
        ii. A business can have Network Economies but no Power as the cost structure of the business needs to complement.
        iii. Attracting exclusive complements serves as an indirect network effect and can be important depending on the industry.

5. **Chapter 3: Counter-Positioning**
    a. Counter-Positioning describes when an entrant adopts a new superior business model and the incumbent is unwilling to respond because of collateral damage to its existing business model.
        i. The benefit is the new business model resulting in higher cash flow from a combination of higher revenue or lower costs or investment needs.
        ii. The barrier is the fear of collateral damage to the incumbent's existing business model by abandoning or shifting it.
    b. There are several reasons why the incumbent would not mimic the entrant:

            i. **Stand-alone Unattractive?** If the stand-alone business seems unattractive on its own the incumbent will reject it but this is not Counter-Positioning.
                1. There are usually several similar conditions in this situation:
                    a. A new approach is developed with lower costs and/or improved features.
                    b. The new approach serves as a substitute to the old approach.
                    c. The incumbent has little advantage in the new approach and/or conditions for Power do not exist for incumbent or anyone.
                2. Kodak faced this situation when digital film replaced chemical film and its business model was set up for chemical film.
                    a. Conditions did not exist for Power in digital film making the opportunity unattractive on its own to Kodak.
            ii. **Stand-alone attractive?** Three types of Counter-Positioning:
                1. Milking, or Combined Negative NPV: the incumbent business model has better economics and adopting the new one will dilute its prospects so it will instead "milk" its existing business model; example in text of Vanguard and active management.
                    a. The incumbent may enter eventually, but the delay is the barrier.
                    b. The delay may seem irrational in retrospect, but economically it is rational.
                2. History's Slave: Incumbent may be biased and not accept new reality given uncertainty in the entrant's business model.
                3. Job Security: Incumbent may not invest because of incentives/agency issues.
        c. General Observations on Counter-Positioning:
            i. Counter-Positioning and Disruptive Technologies can occur together but they don't have to; Disruptive Technologies tell us nothing about Power since they don't inform on value.
            ii. Counter-Positioning is not an exclusive source of Power, like that of Scale Economies and Network Economies and only applies relative to the incumbent.
            iii. If the incumbent makes investments, but tends to dabble it could indicate they are not serious and could indicate Counter-Positioning.
            iv. An entrant should use the new business model as the barrier and not take an incumbent head-on.
            v. High margins can act as a strong barrier that work against the incumbent.
        d. The intensity of Power in Counter-Positioning can be is a function of:
            i. The degree of new business model superiority and the degree of resulting collateral damage in relation to Industry Economics.
            ii. The Competitive Position is binary as the entrant has the new business model and incumbent does not.
6. **Chapter 4: Switching Costs**
        a. switching costs occur when the customer expects a greater loss than value gained by switching to a competitor.
            i. The benefit results in higher pricing and cash flow, but arises only with existing customers and follow-on products.
            ii. The barrier is a challenger has to compensate customers for switching costs and it is likely uneconomic to do so.

   b. General Observations on switching costs:
      i. switching costs come in three broad categories: financial, procedural, and relational costs.
      ii. switching costs are a non-exclusive Power and can calculated and arbitraged over time.
      iii. switching costs can lead to other powers such as Network Economies based on complements and Branding.
      iv. A firm can strengthen its switching costs by launching new products and making acquisitions which happens in software.
   c. Intensity of Power with switching costs is a function of:
      i. The magnitude of switching costs in relation to Industry Economics.
      ii. The number of customers determines the Competitive Position.
7. **Chapter 5: Branding**
   a. Branding is an asset that conveys information to the consumer and invokes positive feelings that increases a buyer's willingness to pay, or wtp.
      i. The benefit is a price premium that stems from positive feelings or uncertainty reduction in the mind of the buyer.
      ii. The barrier is the time, cost (sunk costs), and uncertainty involved in building a brand.
   b. General Observations on Branding:
      i. Risks and limits to Branding include brand dilution, counterfeiting, changing preferences, and geographic boundaries.
      ii. Brand recognition and Power from Branding are not always equivalent.
         1. For example, Scale Economies allow Coke to increase its brand awareness from TV advertising and others may not be able to afford that so sometimes another Power can mask what others may think is Branding.
   c. Branding is a non-exclusive source of Power and is available to only certain types of goods.
      i. Power of Branding is higher in consumer markets than in B2B.
      ii. Products with high uncertainty costs display Branding advantages.
      iii. The duration of Branding needs to be long enough that the benefit cannot be easily arbitraged away.
   d. The intensity of Power in Branding is driven by:
      i. The magnitude of the Branding effect in Industry Economics.
      ii. The duration of Branding investment in terms of Competitive Position.
8. **Chapter 6: Cornered Resource**
   a. A Cornered Resource is access to an asset on attractive terms that enhances value.
      i. The benefit comes from a superior deliverable that results in an increased price or lower costs and can come in the form of a person, patent, or resource.
      ii. The barrier depends on the nature of the resource; it could be personal choice, property rights, or patent law depending on the nature of the asset.
   b. The intensity of Power with a Cornered Resource depends on:
      i. The price or cost improvement effect on Industry Economics.
      ii. Competitive Position determined by access at a non-arbitraged price.
      iii. Baseball players before free agency are an example of a Cornered Resource.
9. **Chapter 7: Process Power**

a. Process Power is a compounding of company activities to improve the product's benefits or lower its costs.
    i. The benefit is improvements in quality and cost that build up over time and do not disappear when employees leave.
    ii. The barrier is difficult to replicate as its done over a long period of time and is usually aided by complexity and opacity.
b. Operational excellence is **not** process power.
c. The intensity of Power with Process Power is driven by:
    i. The magnitude of increased benefits and reduced costs and its impact on Industry Economics.
    ii. The relative duration determines Competitive Position.

10. **Chapter 8: The Path to Power - "Me Too" Won't Do**
    a. Power always starts with invention.
    b. It is useful to study both statics and dynamics for a few reasons:
        i. It is worth studying statics to ensure the journey is worth taking.
        ii. Conflating the two can lead to an erroneous assumption that may not provide Power.
            1. For example, scale is not necessarily Power and just increasing market share may not lead to Power.
    c. The dynamics of Netflix:
        i. Netflix carefully crafted a strategy in streaming over time by going from licensing, to exclusives, and finally originals that lead to Power.
        ii. Various features such as the user interface, the recommendation engine and IT infrastructure are important but they can be replicated.
        iii. Making content into fixed costs is what allowed Scale Economies to flourish and changed the Industry Economics and this was endogenous.
    d. How do you get there with each Power?
        i. The business model needs a source of Scale Economies and you need to achieve the majority position as relative scale is important.
        ii. The business model needs Network Economies and you have to build an installed base quickly.
        iii. For a Cornered Resource, you need to make sure you have secure and exclusive access to the resource on attractive terms.
        iv. Branding involves wise decision making and being a careful steward while building a brand.
        v. Counter-Positioning involves having a new and more attractive business model and making its unattractive to the incumbent.
        vi. With switching costs, you need a customer base and this Power often arises in conjunction with Scale Economies and Network Economies.
        vii. You need to develop a complex process that cannot be duplicated within a reasonable period of time with Process Power.
    e. Invention and Power:
        i. The dynamics of achieving Power is not driven by planning, but rather by invention, adaptation, action, creation, and risk. powerful ideas
        ii. Invention packs a powerful value punch in that it not only opens the door for Power, but it can also expand the market size and create more value.
            1. The Key Equation for Strategy: Value = Market Size * Power.

            2. Value gets created when consumers get more for less.
            3. By achieving Power, a company hopes to capture some of that value that it creates to split with the rest of its value chains.
            4. Invention results from some combination of external flux in industry conditions combined with a company's capabilities which may lead to Power.
        iii. Power comes from invention whether it’s in a product, process, brand, or business model.
    f. To attain Power, a company needs to generate compelling value:
        i. Compelling Value: A mix of meeting customer needs, your capabilities, and something the competition does not offer.
            1. capabilities-led compelling value is a when a company tries to take some capability and morph it into a product with compelling value.
                a. Example used in the text of Adobe Acrobat Reader.
            2. customer-led compelling value is when multiple companies see an unmet need but don't know how to satisfy it.
                a. Example used in the book of Corning Fiber Optics.
            3. competitor-led compelling value is when a competitor has brought to market something people want and a company must produce something much better to create new value. –
                a. The uncertainty here is driven by:
                    i. will the new features be enough?
                    ii. will the competition respond?
11. **Chapter 9: Power Progression - Turn, Turn, Turn**
    a. This chapter attempts to answer **when** does Power become available?
    b. Intel represents a good case study as we can contrast its memory (no Power) and microprocessor businesses (Power).
        i. intel sources of Power included:
            1. Scale Economies driven by fixed costs of chip design and fixed costs in factory design.
            2. Network Economies from using intel compatible chips.
            3. switching costs from moving from a PC.
        ii. If you don't establish Power, arbitrage will come for you.
    c. Invention leads to the potential for Power, but you need a barrier to obtain it. powerful ideas
    d. Power Progression by Stage and when it may be available:
        i. Origination: Power in the form of Cornered Resource and Counter-Positioning can come in this stage.
        ii. Takeoff: You can obtain Power with Scale Economies, Network Economies, and switching costs in this stage.
        iii. Stability: You obtain Power in this stage with Branding and Process Power.
    e. The nature of the barrier tends to be specific to a stage too:
        i. Hysterisis as a barrier available in Branding and Process Power available in stability.
        ii. Collateral damage results from new business model and usually available in origination with Counter-Positioning.
        iii. Fiat also available in origination with a Cornered Resource.

    iv. The pain of share gains occurs in takeoff with Scale Economies, Network Economies, and switching costs.

f. Power is established by some combination of leadership, timing, execution, cleverness, and luck.

What I got out of it

1. Strategy and strategy are not the same thing; the former is a discipline to study and the latter is a crafted process in search of Power.
2. By observing where an industry is in flux, you may be able to determine whether the Power is real and if the barrier is relevant.
3. Invention is essential to creating value and opening up new markets but does not guarantee Power.
4. A discussion of strategy must address a path to Power; this is a filter to use going forward.

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