REALISTIC BUSINESS STRATEGIES FROM UNREALISTIC MICROECONOMIC THEORIES

Paper delivered at the Economic Society of South Africa's Jubilee Conference on the Economic Empowerment of Southern Africa
13-14 September 2001, Muldersdrift

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1 INTRODUCTION

Of all the fields in economic theory, microeconomic theory, and specifically the theory of the firm, has the most to say about how firms should pursue business success. However, when reading some of the important textbooks on corporate strategy and management, one is struck by how often the field of economics (especially microeconomics) is subjected to scathing criticism. It is accused of being unrealistic and not being able to provide clear guidance to organisations on how to strategise in the current fast-changing business environment.

The following quote from Ansoff (1988:111-112) is but one of many jabs he takes at microeconomic theory in his classic text on corporate strategy:

> "According to micro-economic theory, success in a market-place is totally dependent on the price of a product or service... Two of the underlying assumptions of micro-economic theory are: (1) the products/services offered to the customers are undifferentiated, and (2) the customer seeks to minimize the cost of his purchases as the sole criterion in his decision. These assumptions were valid in the developed nations during the first half of the twentieth century... significant changes occurred in the market-success factors during the second half of the century."

Yet, economics remains a compulsory business course in most undergraduate and MBA programmes. Furthermore, one of the most celebrated corporate strategists of our time, Michael Porter, is also an economist, and has clearly built many of his frameworks on the basic ideas in microeconomics. This is particularly evident from his Five Forces analysis (Porter, 1979), Value System analysis and Generic Strategies matrix (Porter, 1990). While Ansoff criticises microeconomic theory as putting too much emphasis on price, Porter (1996:62) defends this emphasis in his award-winning article "*What is Strategy?*" as follows:

> "Ultimately, all differences between companies in cost or price derive from the hundreds of activities required to create, produce, sell and deliver their products and services..."

Microeconomic emphasis on the study of price is therefore justified, since all an organisation's operational and strategic activities will eventually be reflected in the price of its products. If this is not enough, consider that the richest and most successful businessman on earth stated that if Microsoft did not become so successful, he would have become an economist (Gates, 1995).

Even so, the critics won't be silenced. Microeconomic theory may be correct in its emphasis on price, but it seems to provide little guidance on how to develop strategic plans that will ultimately favourably reflect in cost or price. For this reason, top management is more likely to turn to the best management gurus or consultants money can buy, or simply stick to the good old SWOT analysis. Another point of criticism has been heard so often, we have become deaf to it: microeconomics is built on unrealistic assumptions. Brian Arthur expressed the same in Kermally (1999:2):

> "I would like to see economics become more of a science, and more of a science means that it concerns itself more with reality… We're facing a danger that economics is rigorous deduction based on faulty assumptions".

This leaves one with an interesting contradiction: microeconomic theory is not used but is seen as useful. Using the microeconomic theory of the firm as an example, this paper will demonstrate that the contradiction may be resolved if one divides the study of economics into substance and method. The theory of the firm may well be unrealistic in terms of the content of its theories (substance). However, in terms of its approach to thinking about business success (method) it remains so useful that business people and academics will continue to tolerate its lack of realism. Burton (in Naylor 1982:163) notes the words of one of his colleagues as confirming this view: "I always like to have economists around, 'cause they think good".

This paper will show that while the content of microeconomic theory of the firm is clearly unrealistic, this does not mean that it is useless as an approach to developing realistic business strategies. In fact, it turns out that the theory of the firm and its assumptions may be useful to strategists precisely because it is so unrealistic. However, it requires that one studies the principles of business success not from inside the individual theories, but rather from the outside, looking at the connections between the assumptions.

By looking at the gaps between the assumptions of perfect competition, monopolistic competition, oligopoly and pure monopoly and finding logical connections between them, some common sense business strategies can be derived. These derived strategies are not merely a few disconnected ideas, but rather form a sequence of strategies. The sequence shows how a small company could grow from insignificance to dominance. In the process it answers a popular question: "How can one turn a small business into the next Microsoft?"

This paper will first describe the basic concepts of economics and strategic planning. Thereafter it will investigate the expected, actual and ideal relationship between economic theory and strategic planning. Lastly, the theory of the firm will be shown as useful in the strategic planning and meta-strategy.

2 BASIC CONCEPTS IN ECONOMICS AND STRATEGY

To understand the relationship between the theory of strategic planning and economic theory, it is necessary to define some basic concepts. Corporate strategy concerns itself with how firms should manage their future in order to attain success. Economics

concerns itself with solving the scarcity problem: how to satisfy as many needs as possible with the limited resources given.

Being a younger field than economics, strategic planning does not have an equally well-developed body of theory. Different authors present different processes of strategic planning, but essentially strategic planning theory is divided into three parts:

- *Theory of analysis*: analysing the internal and external environment of the firm to determine what its current state is. The well-known SWOT analysis is the culmination of such strategic analysis;
- *Theory of search*: this includes the development of a picture of the firm's desired future and generating alternative ways of reaching this future;
- *Theory of choice*: evaluating and choosing among the alternatives to find the ones consistent with the firm's mission and most likely to lead it to bridge the gap between its current state and desired future.

Economic theory can be broadly divided into two fields. One field is microeconomics, which studies the behaviour of the individual firm and consumer. The other is macroeconomics, which studies aggregate variables at the level of the economy as a whole. The theory of the firm, as discussed in this paper, belongs to neoclassical microeconomic theory.

3 RELATION BETWEEN ECONOMICS AND STRATEGY

3.1 Expected relationship

Microeconomic and strategic theory are related in their understanding of what constitutes success for a firm. The question of value is at the centre of both fields.

Economic theory points out that the success of a firm depends on the extent to which it solves the scarcity problem. Maximisation of profit is an indication of success, since it implies that the firm is able to satisfy the needs of its stakeholders with the smallest relative amount spent on resources. But the scarcity problem cannot be solved without an understanding of what determines value, since value guides a firm in making the right choices.

The field of strategy sees the management of value as the main explanation of a firm's success. As Brandenburger and Nalebuff (1995:59) states: "The game of business is all about value: creating and capturing it." Strategies that consistently lead to the maximising of value within a firm can only be developed if there is an understanding of value, and this is provided by microeconomic theory.

Furthermore, neoclassical microeconomics explains how firms should go about to maximise the value they create and capture under different industry conditions. So, without prior knowledge of the field of strategic planning, one would expect microeconomic theory to be an integral part of the search and choice elements in the theory of strategic planning.

Macroeconomic theory should play an important role in the analysis element of strategic planning theory, since it enables a firm to understand the key variables in the economic environment that will affect its value-creating and value-capturing ability in the future. If combined with econometrics, it will allow firms to attach probabilities to various scenarios and prepare accordingly.

Lastly, economic theory offers a language that describes the realities of the world of business. Some of the most useful terms to be found in the language of neoclassical economics are:

- *Trade-offs*: As long as scarcity persists (i.e. as long as some value-creation takes place in the physical world), there will be trade-offs. Economists often express this through indifference curves, possibility curves and optimality graphs. When the indifference curve shifts outwards, this does not mean the trade-off has disappeared, but that it has simply moved to higher level. By proclaiming the death of the trade-off, many strategic thinkers (see for example Evans & Wurster (1997)) contributed to the acceptance of the unrealistic idea of the weightless economy and were therefore surprised when the virtual dot-com economy was firmly grounded in 1999;

- *Opportunity cost*: In a world of scarcity, everything costs something. Businesses will make more accurate value judgements if they look at the sacrifice incurred to obtain a certain benefit than the absolute benefit itself. Where synergy effects rule in business, opportunity cost gives a better indication of a factor's true value, not by measuring the value added by an additional unit, but by measuring the value lost when one unit is removed;

- *Relativity*: Absolute values are meaningless unless compared to other absolute values. Thinking in relative terms leads one to concepts such as comparative advantage, which is both important but not common sense;

- *Marginality*: Better decisions are made when they are based on the changes in absolute values rather than the absolute values themselves. The marginal rule is used to find the point at which the maximum utility is derived from the interaction of opposing forces e.g. the profit-maximising quantity or a setting a time limit on the search for new strategies;

- *Inherent correction mechanism*: Under conditions of scarcity, nothing can grow indefinitely. In all systems with a variety of goal-seeking participants there are inherent forces that will sooner or later counteract any change. The market mechanism is an example of this self-corrective tendency. The dot-com bubble was caused by ignorance of this principle.

Seeing that these terms have been found to be useful, one would expect the language of economics to permeate the field of strategy. Through its language, economic theory provides a way of thinking about business success. Wentzel (2001c) demonstrated how the language of economics can be used as a tool to think about one of the most perplexing issues in business management. In a fast-changing environment, proper thinking is more important than knowing the answers that were right in the past. When things change, having the right answers is much less important than skill in thinking that leads to the right questions, since only the right questions can expose the new right answers.

Wentzel (2001b) distinguished between strategic thinking and meta-strategy. If strategic thinking uses the same tried and tested frameworks that one finds in textbooks, it will generate the same strategies (answers) repeatedly. By offering not strategic frameworks, but a language for thinking, economic theory provides a framework for thinking about strategic thinking (or meta-strategy). Skill in meta-strategy means that a firm can create new frameworks for strategic thinking when change requires new strategies to be developed.

Overall, one would then expect economic theory to provide the larger thinking framework within which strategic planning takes place. Both microeconomic and macroeconomic theory would be expected to play a role in strategic planning, with microeconomic theory playing the more important role.

3.2 Actual relationship

A survey of strategic management textbooks will reveal that microeconomic theory plays a very small role in the field of strategy, despite the work that Michael Porter has done. A better understanding of the role of economic theory will be possible by investigating how it is used in each of the elements of analysis, search and choice within strategic theory:

- *External analysis*: In line with expectations, macroeconomics and econometrics play a role in helping firms to understand and anticipate changes in the broader business environment. Macroeconomic analysis is the "E" in the common PEST analysis, and concerns itself with crucial variables such as the business cycle, leading indicators, inflation, fiscal policy, interest rates and exchange rates. Microeconomic theory plays a more limited role in understanding the firm's industry, the most important tool being Porter's Five Forces analysis (Porter, 1979). The Five Forces analysis is reminiscent of the neoclassical theory of the firm and enables firms to determine the attractiveness of their industry;

- *Internal analysis*: A firm also needs to understand its own internal resources and how to manage it, but economic theory plays a very small role here. Porter's Value Chain and System analysis (Porter, 1985) allowed economic theory to make a late contribution in this area. Since then, the economic concept of value has been integrated with strategic analysis which has culminated in the resource-based view of the firm (see for example Collis & Montgomery, 1995);

- *Search*: In searching for new opportunities, economic theory plays virtually no role. Burton (in Naylor, 1982) points out that this is seen as the most damagaing criticism of economic theory for strategic planning. Whether this view is justified will be addressed in a subsequent section. The marginal rule is of some use: managers will search for opportunities for as long as the expected additional gain from the search effort exceeds the additional cost of the time spent on searching;

- *Choice*: If economics is the science of making choices, it plays a surprisingly small role in making strategic choices. Davies (1995), chief economist at British Petroleum at the time, explains how the use of economic theory is mainly limited to improving the quality of a firm's decision-making by setting the assumptions and constraints within which opportunities are chosen. The relatively small role of economic theory

may due to it incorrectly assuming that strategists regard the best choice as the one that leads to optimality. Furthermore, the mainstream neoclassical theories make other assumptions that do not describe the reality the strategist has to deal with e.g. a single goal of profit-maximisation, perfect knowledge of the industry environment, time-reversibility and certainty. Econometric modelling, game theory and the input-output matrix are seen to be more useful since they have a limited capability to show the probable effect of quantifiable strategies. However, basic criteria-based decision matrices are still the simplest to use, and therefore the preferred tool of strategists.

Some may argue that microeconomic theory plays a much more important role in strategic search and choice than presented above. However, its role is normally limited to finding opportunities for improving the allocative or productive efficiency of current operations. Porter (1996) explains that such efforts to improve the operational effectiveness of a firm cannot be regarded as engaging in strategic planning.

Porter uses a productivity frontier to illustrate the principle. A productivity frontier is the maximum value that a firm can deliver at a given cost given its existing resources. Strategic planning is about increasing the value a firm creates and captures, or an expansion of the productivity frontier. When a firm is improving its allocative and productive efficiency, it is still operating within the frontier and simply moving towards it. Microeconomic tools that help a firm to achieve optimality enable a firm to reach the frontier, but not expanding it. Only once the firm has reached the frontier can it truly expand the frontier and thus engage in strategy. Economic theory is therefore mostly used to enable a firm to reach the necessary conditions for successful strategic planning.

The language of economics is also not as pervasive in strategic planning as expected. The dominant language is that of accounting, finance and marketing. Gone are the good old days when a CEO had to have an education in philosophy, politics and economics. Today it seems as if a qualification and background in accounting and marketing favours the aspirant CEO.

In conclusion, economic theory does not feature as strongly as expected in the theory of strategic planning, and even less in practice. Also against expectations, macroeconomic theory seems to play a more important role than microeconomic theory. Economic theory overall seems to play its most important role in the area of strategic analysis. Since the substance of microeconomic theory is perceived as unrealistic, it is not used to the extent one would expect in either strategic search or strategic choice. Of the three elements of strategic planning, economic theory plays the smallest role in the area of strategic search.

3.3 Restoring the relationship

The relationship between economic theory and strategic planning is not as strong as one would expect. This can be improved in two ways: either make the substance (content) of economic theory more realistic or demonstrate how the method (approach to thinking) of economic theory can guide strategists regardless of its substance.

Improving the realism of the content of economic theory will be a long process, which will be met by constant resistance from mainstream academic economists. Among others, Brian Arthur has done some work together with the Santa Fe Institute, but progress has

been slow and has not received much support from the broader academic community. With the advent of the so-called new internet or knowledge-based economy, the challenge to economic theory has grown stronger. Some of the valid challenges to the pillars of economic theory that have been raised are:

- Increasing returns is starting to dominate the economy (Arthur, 1996);
- Scarcity of supply is becoming less important than scarcity of supply (Rayport & Sviokla, 1995);
- The consumption of an increasing numbers of products is no longer exclusive (DeLong & Froomkin, 2000).

To combine all the various challenges to the substance of economic theory into a new and coherent theory, will take years of inter-disciplinary labour. This paper will take the less ambitious approach - show how the method of economic theory can be used to develop realistic business strategies. This in itself is an ambitious goal, and for this reason the enquiry will be focused on the neoclassical theory of the firm, arguably one of the most substantially unrealistic economic theories.

4 MICROECONOMICS AS A FRAMEWORK FOR STRATEGIC THINKING

The importance of being able to think about strategic thinking (or meta-strategy) has already been pointed out. It is the ability to engage in meta-strategy that enables the various gurus and übergurus of management to continuously generate new frameworks for thinking. One framework is eclipsed by another in quick succession as one of South Africa's own gurus eloquently describes (Manning, 2001). Since meta-strategy seems to be causing even more confusion, one may ask whether there is any meta-strategic framework that has stood the test of time. From this section it will be clear that the neoclassical theory of the firm, that assumes a goal of profit maximisation, provides one such framework.

For the purpose of this paper, the theory of the firm will simply be divided into four sub-theories i.e. perfect competition, monopolistic competition, oligopoly and pure monopoly, in that sequence. Borrowing from Koutsoyiannis (1979), the assumptions of all the sub-theories will also be simplified and categorised as assumptions about the product, number of sellers, entry conditions, degree of knowledge, mobility of factors and extent of government regulation.

Given the fact that all these sub-theories are criticised as being static and based on unrealistic assumptions, it may be surprising that they will be used to provide a framework for strategic thinking. The key to overcoming the first point of criticism is to regards the sub-theories as a whole. As will be shown, they may be static in isolation, but when viewed as a sequential whole they are sufficiently dynamic to provide guidance in today's changing business environment.

The theories' assumptions and the substance developed from them may be unrealistic, but the method followed is realistic. Since substance is not resistant to even the smallest changes, method (meta-strategy) is more useful in a changing environment. In such a case, realistic substance may be an obstacle since it will detract from the thinking behind it. Assumptions, as tools for thinking, are a crucial part of the method behind the theories, and may be more useful than the substance derived from them.

By viewing the assumptions of the theories sequentially, and asking what conditions or actions may cause the assumptions to change, a framework for strategic thinking is revealed. This framework will identify the most important strategic variables that a firm must manage, as well as when the different strategic variables should enjoy priority. The causes of the changes in the assumptions are the important strategic variables while the assumptions themselves determine when certain strategic variables are more important than others. In short, this method outlined provides a basic framework for strategic search and choice, since it points out the strategic options available, when different options should be considered seriously and in which combinations they should be used.

In the sub-sections that follow, the assumptions of the different theories will be juxtaposed. Where the assumptions between the theories are different, the actions a firm can take to bring about this change is identified and briefly explained. A firm is assumed to start out small, resembling the type of firm found in the theory of perfect competition. However, such a firm will have no market power and make so-called normal profit. Its goal of generating maximum profit will be best realised if they are able to become monopolies. It cannot immediately wipe out its rivals and become a monopolist. But it can advance from perfect competition to monopolistic competition, then from monopolistic competition to oligopoly and finally from oligopoly towards pure monopoly.

4.1 Perfect competition

Since most firms start out small, perfect competition is an obvious starting point. Under perfect competition the firm is assumed to have no market power since there are too many sellers. The assumption of full mobility of production factors ensure that factor costs are equalised across firms and free entry and exit of firms ensure that no firm can make excess profit in the long run. No firm can gain a competitive advantage under the assumptions of perfect competition since the price is determined by the market as a whole, all products are homogenous and buyers have perfect knowledge of what is offered. Under these conditions there is no reason for the government to intervene.

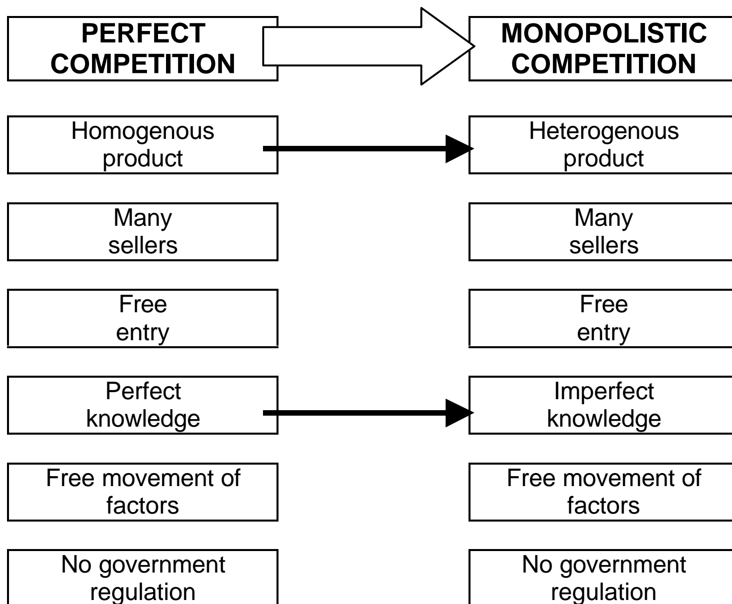
A firm is a price-taker under this sub-theory, and can sell any quantity it produces at the price determined by the market. Under the assumptions explained, the only strategic variable that a firm has control over is its output. As long as the conditions of perfect competition persist, there is no need for strategic planning - a firm simply produces as much as it can at the minimum cost. These conditions are heaven for consumers, but would not be acceptable to ambitious firm owners. To break out of perfect competition, strategic variables other than output need to be considered.

4.2 From perfect competition to monoplistic competition

The simplified and categorised assumptions for the theories are shown below. Arrows indicate the significant changes between the assumptions of the two theories shown.

The main changes happen in the assumptions regarding product and degree of knowledge. As products become heterogenous, they are more difficult to compare and buyers' information become imperfect. The crucial strategic variables at this stage are those that create product variety and in the process conditions of imperfect knowledge.

Diagram 1: Change in assumptions between perfect and monopolistic competition



A firm can follow the following strategies to bring about increased variety and imperfect buyer knowledge:

- Differentiate the product and establish a brand based on those differences. The brand must create the impression that the product superior to those of rivals. According to Davidson (1987:294), some of the ways the firm can create a brand are by changing the product design, adding features, expanding the range, changing the packaging, adjusting availability, advertising or enhancing a product's visibility;

- The differences created between the firm's product and those of its rivals, must be such that it makes it more difficult to compare products. This is achieved by structuring the market offering according to different elements. For example, is a universal life policy with a personal accident add-on at a monthly premium of R200 cheaper than an endowment policy with a limited payout after 10 years at monthly premium of R250? Other examples are cell phone contracts and travel packages. Nalebuff & Brandenburger (1996:222-8), in their book that popularised game theory, call this the tactic of 'stirring up the fog'.

Through these changes a firm should gain more market power. Unfortunately, due to the free entry of firms into the industry, profit margins will always be thin (normal profits). To significantly enhance the profit margin, a firm needs to follow the strategies that will take it to the level of an oligopolist.

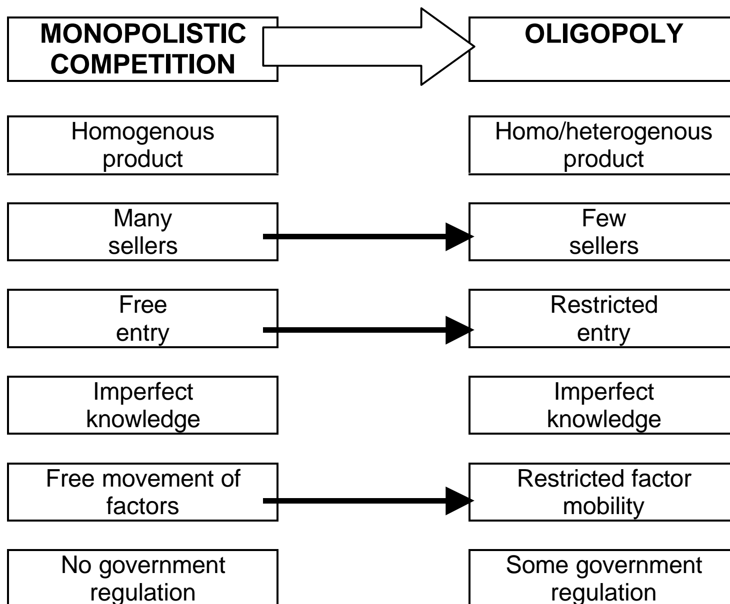
4.3 From monopolistic competition to oligopoly

At this point brands are established, customer loyalty is developing, buyers are less sensitive to price and buyers can only compare products with difficulty. With these conditions established, the firm now resembles one under monopolistic competition.

The main changes happen in the assumptions regarding number of sellers, entry conditions and factor mobility. As the number of sellers decreases and because this is not counteracted by new entrants, a firm's market power will increase. And since factor movement becomes more difficult, a firm can hold on its best factors for longer, making it easier for it to maintain an advantage over rivals.

Though the firm will continue to build on the foundation of increased variety and imperfect knowledge, the crucial strategic variables at this stage are those that reduce the number of sellers, restrict the entry of new firms into the industry and makes it difficult for factors of production to exit from the firm.

Diagram 2: Change in assumptions between monopolistic competition and oligopoly



To build on the conditions of variety and imperfect knowledge that have now been created, the firm can do the following:

- Once a brand is firmly established, the firm can further strengthen customer loyalty by rolling out a customer loyalty programme, similar to those at firms such as SAA, Exclusive Books or Clicks. Nalebuff & Brandenburger (1996:131-43) see such programmes as one of the most effective ways to create and capture value from a firm's relationship with buyers;

- The firm should advertise its products with special emphasis on its brand image and on what makes the firm and its product different. The aim is to show that the firm's market offering is unique and not comparable to those of its rivals. This creates a virtuous cycle: advertising creates a perception that the product is different, which reduces comparability and buyer knowledge, thus creating a further need for advertising;

- Increased customer loyalty and diminishing product comparability means lower price sensitivity. The firm can exploit this by raising prices in order to fund its advertising

and other differentiation efforts, but it should be careful not to raise the price by more than the buyer's additional willingness to pay more.

A firm can follow the following strategies to reduce the number of sellers, restrict new entrants and create factor immobility:

- The fastest way for a firm to reduce the number of sellers and thus gain more market power is to proceed with an expansion strategy based on acquisitions. Firms with large and/or loyal customer bases make the best targets for acquisition;

- Acquisition is one way of gaining market power; creating less formal alliances (linkages) is another. Creating linkages within the value system, comprising suppliers, channels and customers, enables the firm to capture more of the value created in the larger system of value generation. Exclusive contracts with low cost suppliers, wide-scope distributors and anticipatory buyers are some of the options. Microsoft's linkage with IBM in its early years, was probably the major reason for its success;

- The field of microeconomics contains a well-developed theory of barriers to new competition, based on the work of Bain (Koutsoyiannis 1979:287-301). The main barriers to new entrants are barriers emanating from product differentiation, absolute cost advantage, initial capital requirements and economies of scale (real and pecuniary). Branding and advertising contribute to product differentiation barriers, and have already been pointed out as useful strategies at this stage. Absolute cost advantage barriers can be erected by employing and retaining expert management, controlling the supply of key raw materials, exclusive arrangements with participants in the value system (as discussed), using patents and superior techniques or vertical integration. Real economies of scale barriers can arise from using more efficient large-scale machinery, spreading a fixed managerial input over a larger amount of output and greater labour specialisation. Pecuniary economies of scale barriers arise from bulk-buying at preferntial prices and lower transport and advertising costs per unit. If the firm is able to increase its size through its acquisition and vertical integration strategies, it will be easier to raise barriers to entry;

- Making it more difficult for factors of production to leave the firm is a way to erect barriers to entry. Intellectual and management capital (labour) is becoming more important than natural resources and capital in today's business environment. The firm can use executive compensation schemes and restraint-of-trade agreements to retain key skills and expertise. Knowledge management is another method that has gained popularity since it allows a firm to retain the expertise of a worker even after the worker has left. The firm can of course follow strategies similar to its competitive strategies e.g. differentiate itself as an employer, making compensation packages less comparable, create exit barriers through firm-specific training and roll out an employee loyalty programme.

As the number of firms in an industry decreases, the firms themselves will become more secretive. Combine this with increased variety and incomparable products, and it will no longer just be buyers who will have imperfect knowledge; the firms themselves will have imperfect knowledge about their rivals and their products. This situation will eventually create a business environment that is highly competitive and uncertain, almost warlike. The best way to deal with the increasing uncertainty, is not to wait for the uncertainty to

increase, but to create the uncertainty through continuous improvement and product innovation. By doing this, the firm is not only in a better position to cope with uncertainty but develops a core competence in innovation, which will be needed once the cutthroat oligopolistic industry is fully established.

The strategies suggested above are in line with one of the important schools of thought in strategic planning - the so-called resource-based view (RBV) of the firm (Collis & Montgomery, 1995). RBV states that firms gain a competitive advantage because they possess a combination of inimitable and durable resources that can generate value no other rival can match. The use of pure pricing strategies does not feature, since price advantages are not sustainable.

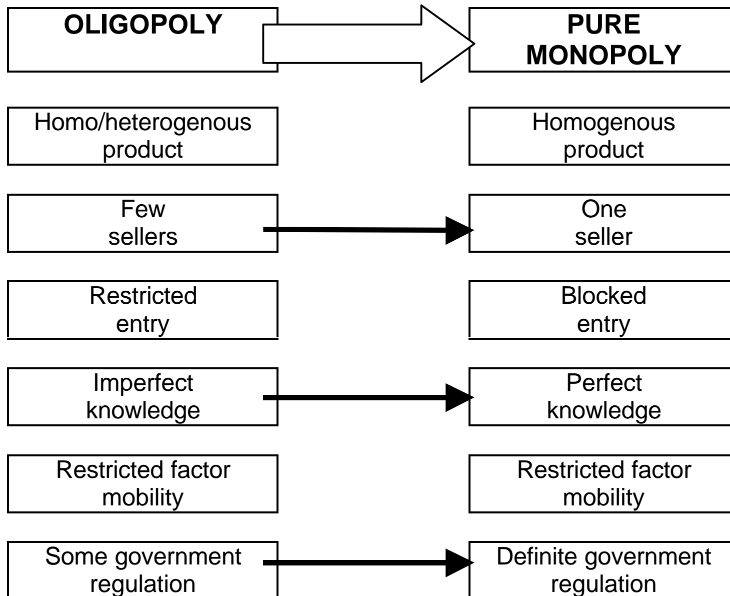
Kay, one of the fore-runners of the RBV, did a study on what makes firms successful (Lynch, 2000:283-5). From this he concluded that successful firms have three types of core resources namely architecture, reputation and innovation. The strategies suggested above are also in line with his thinking. Strategies focused on forming alliances within the value system and creating factor immobility contribute to the firm's architecture, while branding and advertising build the firm's reputation.

If the firm is successful during this stage, its profit margins should increase. Unfortunately, as the number of sellers decrease, the firm's strategies will have a more significant impact on its rivals. The industry will slowly become highly competitive as firms try to protect their share of the value created while trying to capture value from their rivals. The only way for the firm to reduce this competitiveness is to attempt to become the only seller by following strategies that will lead it to the level of the monopolist.

4.4 From oligopoly to pure monopoly

With intense rivalry, restricted entry and restricted factor movement, the firm now resembles one under oligopoly. In the move toward monopoly the main changes happen in the assumptions regarding number of sellers, degree of knowledge and government regulation. Perfect knowledge returns because there is only one seller with a homogenous product. But one seller has sufficient market power to exploit production factors and customers, and the government will therefore intervene to prevent a monopoly from forming. Government relations is added to the collection of crucial strategic variables that include the further reduction in the number of sellers and the complete blocking of new entrants.

Diagram 3: Change in assumptions between oligopoly and monopoly



A firm can follow the following strategies to eliminate all other sellers, block new entrants and develop a strong relationship with the government:

- An acquisition strategy can still be employed, but as firms increase in size, mergers may be the only viable method of reducing the number of sellers. An acquisition strategy should now be more focused on eliminating the substitutes for the firm's product;

- In addition to maintaining the barriers to entry, the firm should now have the resources to practice limit-pricing. This involves reducing prices pre-emptively to make it unviable for new entrants to enter the industry. Pricing strategies should however not be used to try and gain market share from existing rivals, since this is easily copied and may lead to a price war. A recent cautionary example of this was the battle between SAA and Comair's kulula.com;

- As the number of firms approach one, the firm can only survive if it is able to stay ahead of its rivals and anticipate their actions. Continuous environmental scanning, scenario planning and competitive intelligence become essential. The smaller the number of rivals, the more the firm can expect a competitive reaction to every action it takes. With such interdependence, a familiarity with the principles of game theory would be most useful to the firm;

- Monopolies are seen as exploitative. A capitalist government will not tolerate the existence of a monopoly, or if it does, it will impose taxes and restrictions to counteract any perceived exploitation. Since the government is able capture more of the value created by the firm than any rival can, it is in the firm's interest to build political capital by engaging in social responsibility projects on a large scale and developing personal relationships with top politicians and political parties.

Once the firm is a monopoly, it will have achieved the maximum market power and profit, but will also face new challenges. There will always be those who want a share of the value pie created by the monopoly. This calls for different strategies.

4.5 Beyond pure monopoly

At this point the firm is the only seller in its industry, with no close substitutes for its product existing outside of the firm. The government, substitutes arising through innovation and monopsonies will all want to capture piece of the value created and protected by a monopoly. The crucial strategic variables at this stage is anything that helps the firm to its long term profit potential and power.

- Even if the government has allowed a monopoly to develop, it can use its regulatory powers at any time to significantly increase taxes or dismantle the monopoly. The firm therefore needs to maintain and enhance its relationships with the government and regulatory bodies. It should clearly show how its existence is crucial to the country's economy, be an active supporter of the government's economic and social policies and ensure that its success is in the interest of government officials. Since support from the voting public is an important swing variable in government decision-making, the firm needs to create and maintain a good public image through a continuous public relations campaign. Building a strong following amongst consumers and a network of supporting firms will further protect the monopolist from possible government hostility;

- Reduced mobility of factors of production has its downside as well, since it could lead to an monopsony. The firm should therefore increase labour mobility to limited extent (for example by supplementing exclusively firm-specific training with general training) to prevent it from becoming too dependent on a certain source;

- A monopolist must be aware of firms that innovate, even outside its industry boundaries, since innovation causes the nature of an industry to change. If an industry's nature changes without the monopolist changing its definition of the industry accordingly, it will be blind to true rivals (i.e. substitutes) that operate outside the perceived boundaries of the industry. A classic example is post offices who defined their industry as being postal services, and was therefore slow to respond to substitutes in the form of the fax and internet;

- One sure way for a monopolist to stay secure is to innovate ruthlessly. With its size and network advantage, a monopolist that creates change by making its own products obsolete will make it difficult for any upstart firm or substitute to keep up, let alone compete. With its greater control over prices, a monopolist should consider raising prices to fund its innovation;

- A monopolist that can segment the market, is in position to use price discrimination in order to increase its profit even further. The conditions are that the segments must have different price elasticities and that no trading can take place between the segments.

All the above strategies remind one of those followed by Microsoft in recent years. Microsoft may well be one of the best examples of a company that followed the strategies suggested by microeconomic theories (probably unknowingly) and developed

from being an insignificant firm resembling a perfect competitor to one resembling a monopoly.

4.6 The meta-strategy of the theory of the firm

As explained, strategic thinking is about finding the right answers while meta-strategy is about asking the right questions. The right questions depend on the position of the firm in the sequence, and will determine the crucial strategic variables. The derived meta-strategy or framework for strategic thinking is summarised in table 1 below.

Table 1: Broad framework for strategic thinking

Position of firm	Questions	Strategic variables
Perfect competition	(No strategy)	Quantity of output
Perfect competition to monopolistic competition	How to differentiate?	Branding Structure of market offering
Monopolistic competition to oligopoly	How to form a strong and impregnable value system?	Loyalty programmes Advertising Acquisitions and alliances Human capital management Raise barriers to entry
Oligopoly to monopoly	How to destroy competing value systems while protecting your own?	Mergers Limit-pricing Competitive intelligence Government relations
Beyond monopoly	How to protect and exploit the position of power?	Innovation Government relations Public relations Labour relations Price discrimination

From the paper it is clear that firms have two main types of dispositions; disposition towards value and towards competing value chains. The strategies above can be summarised according to the disposition matrix in diagram 4 below.

Diagram 4: Disposition matrix

		COMPETING VALUE CHAINS	
		Aggressive	Defensive
VALUE	Create value	Perfect competition to monopolistic competition	Monopolistic competition to oligopoly
	Capture/protect value	Oligopoly to pure monopoly	Beyond pure monopoly

With the framework for strategic thinking and the strategic disposition matrix derived from the neoclassical theory of the firm provide a basis for strategic search and choice, thereby overcoming the main points of criticism against microeconomic theory.

5 CONCLUSION

This paper attempted to show that economic theory has a much larger contribution to make to strategic planning than is seen in the theory and practice of strategic planning. Some of the connections were briefly discussed, but the connection between the neoclassical theory of the firm and corporate strategy was investigated in more detail Through this connection, a time-tested framework for strategic planning was developed.

The neoclassical theory of the firm was really only a case study, showing how that the method of economic theory can be applied to make the field more useful to business. But this need not be limited to the method of neoclassical economics, or to theories that assume profit maximation as the goal. Even the sequence from perfect competition to pure monopoly was a narrow approach: indications are that the sequence may be reversed in pure knowledge-based firms. Future research will therefore focus on applying the thinking method of the broader economic theory to business and political issues.

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