Teaching the history of strategic management

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1. Teaching the History of Strategic Management

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Introduction

When learning about strategic management, it is not only important to study the main concepts and theories but also their historical evolution. The historical perspective provides us with an in depth understanding of what strategic management is all about. Importantly, learning about the history is not only learning about the theoretical developments and trajectories but also about changes in the business environment. Addressing these changes and new phenomena has forced and inspired scholars to refine the old concepts and theories or create new ones. We can say that the evolution has taken place in two ways: through accumulation of scientific knowledge and through empirical inputs from the changing business environment. Learning a history of a discipline of any kind may sound boring and irrelevant, but in fact it can be seen as an exciting journey to study how the theory and practice have coevolved and intertwined; how new phenomena and questions arise and how this evolutionary process deepens our knowledge and understanding.

It is worth noting that the history of the actual independent discipline of strategic management is fairly young. The early history goes back to the 1970's. Its main professional forum Strategic Management Society (SMS) was not established until the year 1981. Naturally, the field has long roots in the earlier developments of military and later business strategy that finally lead to the situation where the scholars of strategic management saw the need for creating a more solid foundation for the field. From the very beginning, the core question of strategic management has been why some firms are more successful than others and how firms can sustain their competitive advantage. What can be more relevant questions for business! Learning about the strategic management and its history provides us with a profound understanding to these highly important questions of every single entrepreneur.

Through its core question strategic management research expresses its practical relevance and a close link with the changes taking place in global business environment. The question has not become less relevant during the past decades. Quite the opposite. Since the establishment of the SMS in 1981, the business environment has gone through enormous changes, such as the rise of networks instead of conglomerates, keen competition based on globalization, and the digitalization-based rise of the platform ecosystems, to name of few. These all have disrupted and challenged established industries and companies' competitive advantage and made them ask the question how to sustain it.

From the practical perspective, the importance of strategic management is to be motivated by its ability to answer every day problems faced by companies. In a way, strategic management offers us a checklist to look at when trying to understand, for instance, why some companies in the industry outperform the others and why some formerly strong companies rapidly lose their leading position (e.g. Nokia vs. Apple). The answers given by strategy research help also understand more "local" problems. If you have to give answers why some of your neighborhood restaurants or corner shops succeed or fail just start to look at their competitive position following the guidelines of Porter. Or, if you would like to start a company of your own and you are asking which kind of resources you should have to be successful, have a look at the so-called VRIN (valuable, rare, inimitable, non-substitutable) attributes offered to you by the resource-based view. If your company or the company you are consulting is losing its competitive advantage due to rapid changes in business environment then it is advisable to look at the checklist given by the dynamic capability view. Briefly, to get to know the basic ideas of strategic management and its evolution helps you understand the business world much more than just analyzing it from the more specific perspectives of, let us say, economics, finance, accounting or marketing. Strategic management puts those complicated things together by asking how to achieve and sustain competitive advantage.

This chapter is organized as follows. After the introduction, the course design for teaching the history of strategic management is briefly presented followed by the main theoretical outlines of strategic management. The overview of the history is followed by suggestions for course assignments.

Course design

As a general advice for teaching the history of strategic management – or any discipline – I would emphasize the importance or "keeping it simple". It is important to focus on the main trajectories and core concepts and theories. Going into details may confuse and distract and even hamper learning especially for beginners. In the later and more advanced stage, it is possible to go into more refined and profound issues.

The course that I am suggesting would consist of lectures (12-15 hours) with some discussions and short team assignments in the class and a larger individual or team work conducted independently after the lectures. The bigger team (or individual) work could be e.g. an analysis of a case company or industry based on quantitative or qualitative analysis methods and using theories of strategic management. The course can be supported by online course material of lectures and articles. This would be the structure for a full module. When the history of strategic management forms only a part of a module I would suggest having some smaller scale assignments (see suggestions at the end of the chapter) instead of a larger assignment conducted individually or in teams.

This chapter provides the basic lecture material to cover the core developments, theories and concepts of strategic management. The course design is targeted especially to bachelor students but also master's and doctoral students with no previous knowledge of the discipline. The chapter includes some concepts that I would recommend only for students at a more advanced level (master's and PhD students), such as the discussion on transaction cost economics (Coase, Williamson) and the Chandlerian analysis on the structure and strategy. The teaching can be supported with some readings. This would be particularly recommended for students at a more advanced level. The chapter provides a rich reference list of articles for both teachers and students. For example, the students could be required to read 1-2 articles before class in order to be able to discuss and reflect them during class.

Early history of the strategy concept

This chapter will briefly present the main trajectories, concepts and definitions of strategic management research. The word "strategy" has its origin in the Greek word "strategos" meaning "the art of a general" and referring to the "army" and "the art of leading". The Greek verb "stratego" means to "plan the destruction of one's enemies through effective use of resources" (Bracker, 1980, 219). Later many leading theoreticians of war strategy theoreticians, for example the Prussian general Clausewitz, used the concept of strategy when referring to the long-term goals of a nation and its ability to win wars instead of winning single battles. However, it was only after the World War II when the idea of a business strategy (or business policy as it first used to be called) and a bit later also the idea of strategic management were introduced. The goal of the business strategy was to achieve competitive advantage i.e. to outperform the rivals. According to Ansoff (1965), the rise of business strategy research was triggered by rapid changes in the business environments. Especially the increasing role of science and innovations contributed to rapid technological changes. In the more competitive environment, the firms were forced to react or, in fact, to pro-act to the maneuvers of the rivals (see Bracker, 1980).

The rise of modern strategic management

The rise of modern strategic management can be traced back to the late 1950s when a sociologist Philip Selznick (1957) and economist Edith Penrose (1959) published their insightful books. Selznick launched the concept of "distinctive competence" and emphasized the role of leadership thus focusing on firms' internal strengths as a source of competitive advantage over the rivals (Hoskisson et al., 1999, 421). In a bit similar way but from the perspective of economics, Penrose emphasized the importance of firm internal resources. She focused on leadership and management as the most important production factors and engines of growth. According to Penrose, firm-specific and path dependent resources and the ability to manage them makes it possible to explain the success (and failure) of organizations. As will be shown in the chapter, the later developments of strategic management, such as resource- and knowledge-based views and the dynamic capability view are based on these path-breaking ideas from the 1950s.

In the 1960s, strategy scholars focused on firms' internal success factors by conducting extensive case studies in order to demonstrate their impacts. These studies were titled as business policy studies, even if they, in fact, dealt with long-term strategy issues from the managerial perspective. A Harvard economic historian Chandler published in 1962 an important book called "Strategy and Structure" in which he managed to show how large multi-divisional companies developed their strategies to be successful. Chandler's main thesis was that "strategy creates structure". According to him, main administrative changes within an organization are reactions to new opportunities or threats created by competitive environments, very often by innovations. Chandler (1962, 13) also launched a compact definition for a strategy:

"The determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals."

The focus was on large companies, e.g. in chemical, automobile, energy and steel industries and Chandler managed to explain the rise of the multi-divisional organizational structure as a rational response to the changes in business environments. He also highlighted the important role of top managers as catalysts of organizational changes. In a way, Chandler also managed to validate the importance of transaction costs introduced by the Nobel laureate Coase already in 1937 in his influential article "The Nature of the Firm".

Coase's (1937) basic idea was that in addition to traditional production costs there are also costs of using markets - i.e. costs relating to information searching, negotiating, contracting, etc. - that he called transaction costs. When the market-based transaction costs happened to be higher than the costs of using the firm's own organization it was advisable to internalize the activity (transaction). According to Coase, this was the main reason for the rise of giant multi-divisional conglomerates since the 1920s. Chandler's (1962) influential historical case studies produced strong empirical evidence that supported Coase's theoretical idea.

About ten years after the publication of Chandler's book, another Nobel laureate Williamson further developed theoretical ideas of Coase and created an important branch in economics called transaction cost economics. It also had a strong impact on strategic management when trying to understand where the boundaries of a firm are. Williamson (1975; 1981; 1985) specified the determinants of transaction costs (e.g. bounded rationality, uncertainty, opportunism, small number of alternatives, and asset specificity) and claimed that the stronger these determinants are the better it is to internalize transactions instead of using the markets and vice versa. These ideas were largely utilized by strategy scholars when trying to explain diversification decisions of the firms. Later, in the 1980s and 1990s strategy scholars applied Williamsonian ideas when explaining the rapid rise of networks (or "hybrids" as Williamson (1991) called them) and the "flattening" of organizational hierarchies within the companies (Williamson, 1991; Teece, 1998). Briefly, the networks, such as joint ventures and strategic alliances, are outcomes from the situations where there exist both pro market- and pro hierarchy-determinants.

Another influential early strategy scholar was Ansoff (1965) who also used case studies as a method. He defined strategy (see Bracker 1980, 220)

> *"as a rule for making decisions determined by product/market scope, growth vector, competitive advantage, and synergy".*

In their historical case studies, Ansoff and Chandler were looking for managerial best practices that could be generalized. The role of top managers were highlighted, since their strategic decisions determined the organizational structures of companies. This perspective also indirectly resulted in the idea of sustainable competitive advantage i.e. the ability of a firm to outperform its rivals for a long period. Interestingly, however, the pursuit of achieving sustainable competitive advantage shifted the focal point of strategy research from firm internal strengths and weaknesses towards the externally determined opportunities and threats of competitive environments of the firm. At the end of 1970s strategic management research took the pendulum-like shift, as Hoskisson et al. (1999) aptly call it, from internal factors analyzed by business policy case studies towards more economics-based strategic analyses that emphasized the connections between the competitive situation of the firm, especially its ability to utilize monopoly power and its economic performance. (Hoskisson, 1999, 424-425). At the same time, the research methodology took a shift from large qualitative case studies towards quantitative surveys and increasing use of econometric methods when trying to identify factors behind successful performance of the companies.

Sustainable competitive advantage and Porter's five forces model

As Nag et al. (2007, 636) state, perhaps the first scholars who renamed the field of business policy as strategic management were Schendel and Hofer (1979) in their influential text book called "Strategic Management". According to their definition (ibid. 516),

> *"Strategy provides directional cues to the organization that permit it to achieve its objectives, while responding to the opportunities and threats in its environment"*

At the same time, the first attempts to use economics-based concepts in the context of strategic management took place. The Harvard economist Michael Porter (1980; 1981; 1985) started to analyze the relationship between the firm's competitive environment and its performance. Porter used the traditional monopoly model and especially the anti-trust ideas developed in the context of the industrial organisation (IO) tradition launched by Bain (1939) and his student Mason in the early 1950s. The IO school launched the so-called "Structure-Conduct-Performance"-model to fight against the monopoly power of large companies (cf. Scherer, 1980). The idea was simple. IO scholars looked at the industrial structure, especially its concentration ratios that were interpreted as a measure of the monopoly power in the industry, and the way how the firms conducted their pricing strategies. If high concentration rates and monopolistic behavior were associated to high rates of profit, the antitrust authorities used their anti-trust policy instruments to weaken the monopoly power of large companies concerned. The idea was, of course, to minimize the social cost of monopoly power and to promote more competition in order to increase the social welfare. Interestingly, Porter's idea was to turn this model upside down: What was bad for the customers was good for the companies. Porter concluded that the more monopoly power the firm can gain and the less dependent it is on the bargaining power of the rivals the more competitive advantage it could achieve.

In order to concretize this basic view Porter launched the so-called *five forces model* in which the main idea was to position the firm so that it can maximize its monopoly power at the same time when the bargaining power of other players was minimized. In the five forces model, the players were *competitors*, *suppliers*, and *customers* on the horizontal level and the threat of *new entries* and the threat of *new substitutes* on the vertical level. The idea was to look at all of these five factors and to evaluate the threats related to them from the perspective of monopoly or bargaining power. For instance, the less there are potential suppliers or customers the more dependent the firm is on them and the more bargaining power the suppliers and/or customers have. Porter called the use of five forces model as a competitive analysis. The model provided a tool for a firm to create its competitive strategy in order to achieve and sustain its competitive advantage. According to Porter, the main strategies for a firm are (i) the *cost leadership strategy* based on the economies of scale and scope, (ii) the *differentiation strategy* based on the ability to differentiate its products/services i.e. to make its demand curve more inelastic, and (iii) the *focus-based* or *niche strategy* based on the ability to find a small market segment or niche that is not too attractive for larger companies.

The *cost leadership strategy* can be applied by large companies, which already have a dominant position in the market based on economies of scale and scope and nowadays even more on network externalities as e.g. Facebook, Google and Amazon manifest. By means of its monopoly power, a dominant firm can achieve lower unit costs than its rivals or control the whole supply chain. The idea of the *differentiation strategy* is to create brands that offer unique value to some buyers/customers who are not price-sensitive and who have unsatisfied needs i.e. they are willing to pay extra for the products/services. The *niche strategy* focuses on small market segments where the threat of substitutes is small and the competition is not too keen.

Porter's strategy view based on the idea of analyzing firm-external factors arising from competitive environment was very successful in the 1980s both on the practical as well as theoretical level. Nowadays almost every company makes its competitive analysis along the lines of Porter and looks at their external threats from this perspective. Theoretically, Porter's main contribution was to put strategic management on a higher scientific level based on microeconomics. His approach made it possible to utilize advanced econometric methods and extensive databases in order to identify the determinants of competitive advantage. He focused on the industry level thus following the anti-trust tradition of Bain and Mason. Later, Porter and his followers analyzed also the so-called strategic groups within one industry and tried to find out the determinants behind their success.

Unfortunately, however, Porter's theoretical success was shadowed by new empirical results that showed that the role of firm-external competitive advantage determinants were minor when compared to the firm-internal determinants, such as resources, competencies, and capabilities (Rumelt, 1991). These findings caused a new swing of a pendulum in the strategic management research (Hoskisson et al., 1999), this time from firm-external to firm-internal determinants of competitive advantage. Interestingly, now the shift was based on strong empirical evidence gained by sophisticated econometric methods. The theoretical challenger this time came from the group of microeconomics-oriented strategy scholars who were also looking for the market imperfections and monopoly profits associated with them. Interestingly, now the focal point was on the resource markets instead of Porterian product/service markets. The founding fathers of the challenging theoretical school, called *the resource-based view*, had their eye on factor market imperfections and hence mainly on firm-internal resources, routines, capabilities and on different ways to utilize them to achieve sustainable competitive advantage.

Resource-based view

Following the old Ricardian (1817) land rent idea that the ownership of a scarce, value creating resource can be very profitable for its owner, the resource-based view theoreticians Wernerfelt (1984), Barney (1986; 1991) and Rumelt (1984) managed to show that especially the scarce firm-internal resources can create market imperfections and result in sustainable competitive advantage.

A Danish economist Birger Wernerfelt (1984) elegantly launched a simple mathematical model that showed how resource markets really could create monopoly profits for the owners of scarce resources in imperfect markets. Jay Barney (1986) wrote the same Ricardian story in a more pragmatic way emphasizing the strategic factors that the firm can use in order to create sustainable competitive advantage. In his very influential article, Barney (1991) finally revealed the core of the resource-based view by explicating the so-called VRIN attributes that a successful resource should have. The resource should be (i) valuable (V) i.e. able to create new value for the customer, (ii) rare (R), (iii) inimitable (I), and (iv) non-substitutable (N). Because resources and their use are based on cumulative firm-specific learning processes, firms are necessarily heterogeneous in terms of their resources. The firm's main strategic function is to organize its business model so that it can profit from resource market imperfections by means of VRIN resources.

Richard Rumelt (1984) contributed to the theory building by launching an idea of *isolation mechanisms* that are needed to make the resources inimitable and non-substitutable. The isolation mechanisms can be based e.g. on causal ambiguity or tacit knowledge. The first one means that it is impossible for an outsider to see what the relationship between the resource bundle used and its ability to create new value is. Walmart has often been mentioned as a good example of this. All the rivals know that the secret of the success lies in Walmart's ability to utilize its extensive logistic databases efficiently but no one seems to know how they exactly do it. Deployment of tacit knowledge assets that are deeply embedded in a firm's internal organization can also efficiently hinder imitation. Together with legal means to protect knowledge assets, such as patents, trademarks, copyrights, etc. tacit knowledge creates the so-called *appropriability regime*. As Teece (1986; 1998) has shown, the tighter the appropriability regime is the harder it is to copy the value creating strategies and the more sustainable the competitive assets are.

During the last thirty years, the resource-based view has no doubt become the dominant strategy school that has been utilized by both strategy consultants and strategy scholars when explaining the sustainability of competitive advantage (see Peteraf, 1993). Together with the Porterian competitive analysis that analyzes the threats and opportunities arising from external competitive environment, the resource-based view focusing on the firm's internal resources and their ability to create sustainable value are nowadays the building blocks of a useful strategy.

However, there are some drawbacks also in the resource-based view. The main problem when using it in the real world is its static or at least retrospective nature. The strategy view offered by the resource-based view is like a snapshot picture. It tells where we are and perhaps also why we are there where we are but it does not tell us that much about the future. A good example can be found from the recent mobile smart phone market. In the beginning of the year 2007, the Finnish company Nokia was a dominant market leader with a market share of about 40 percent and there existed many good resource-based explanations why they were so dominant. Especially their capability to orchestrate global supply chain and their excellent technological resources were highlighted. Everything seemed to be fine with Nokia. However, at the end of the same year, Nokia had lost its leading position and after some more years they stopped manufacturing smart phones. What happened? Apple's iPhone came to the market with quite different killing VRIN-attributes and stopped the rise of Nokia. Similar stories can be told, for example, about Kodak and Polaroid, which did not manage to overcome the disruption realized by digitalization.

Nokia, Kodak, Polaroid and many other companies exemplify the main problem of the resource-based view. Because of its static nature it is unable to deeply analyze change processes and to take into account the pressures arising from rapid changes in the competitive environment. These changes can be traced back into the changes in technologies, consumers' preferences, regulations or power structures. Even if the resource-based view is very useful when trying to have a bird-eye view of the threats and potentials of a company in terms of a resource gap analysis, it is not that useful when trying to analyze the future prospects of a company. In brief, it is too retrospective. Something more is needed and this time the swing of the pendulum does not go from internal factors to external factors but from the static analysis (typical also for the Porterian strategy view) to the more dynamic and evolutionarily inspired analysis. This leads us the domain of the dynamic capability view.

The *knowledge-based view* (Kogut and Zander, 1992; Grant, 1996) can be interpreted as a special case of the resource-based view emphasizing the role of intangible knowledge assets. A piece of knowledge has peculiar properties that deserve~~s~~ some extra comments. Knowledge can be either *codified* i.e. information that is easy to transfer but hard to protect or it can be *tacit* that is hard to transfer and copy but easy to protect and appropriate. From the strategic management perspective, tacit knowledge is perhaps more relevant, since it enables the knowledge creator/holder to profit from knowledge assets. Following the famous quotations of Polanyi (1967) tacitness means that one knows more than can tell. Therefore tacit knowledge is easy to protect and hard to transfer. Based on the Teecean idea of the appropriability regime one can conclude that the more tacit the piece of knowledge is the tighter the appropriability regime is and the easier it is to the firm to sustain its knowledge-based competitive advantage. As the role of science-based innovations becomes more important all the time, it is clear that also knowledge becomes a more powerful resource as a special source for market imperfections.

Dynamic capability view

Dynamic capability view was launched in the 1990s by Teece et al. (1997) who took an important step towards dynamizing the static perspective of strategic management. Following Selznick's (1956) idea about distinctive competence and especially the evolutionarily inspired ideas of Nelson and Winter (1982) Teece et al. focused on the fundamental question of how an organization can cope with rapidly changing environment so that it manages to sustain its competitive advantage.

Nelson and Winter (1982) used the analogies borrowed from the evolutionary theory in which evolution takes place through the three mechanisms called variation, retention and selection. In the business context, Schumpeterian (1932) entrepreneurs who were able to produce new combinations (products, processes, services, business models, etc.) create the variation. The retention is established by routines that made it possible to replicate organizational structure, whereas the selection takes place through market competition. The key concept is a routine that is a cumulatively learned pattern that helps solve decision problems in the satisficing (not optimizing) way. Since the decision-makers are only boundedly rational and they are facing uncertainty they cannot normally optimize. Instead, they use heuristic rules of thumb that result in satisficing solutions (Simon, 1962; Cyert and March, 1963). According to Nelson and Winter, there are first order routines (capable for pure replication of the existing structure) and higher-order routines (capable for changing first order routines).

Teece et al. (1997) combined the dynamic evolutionary view of Nelson and Winter (1982) and the basic ideas of the resource-based view in a way that resulted in the dynamic capability view. Based on this view, dynamic capabilities are needed enhance change of resource-base, i.e. assets and capabilities, to address the changing business environment. According to the seminal definition launched by Teece et al. (1997, 519), "*a dynamic capability is the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments*".

There are many different definitions of dynamic capabilities. For instance, Eisenhardt and Martin (2000: 1017) define dynamic capabilities simply as

> "*the firm's processes that use resources—specifically the processes to integrate, reconfigure, gain and release resources—to match and even create market change. Dynamic capabilities thus are the organizational and strategic routines by which firms achieve new resource configurations as markets emerge, collide, split, evolve, and die*".

As for the definition of Eisenhardt and Martin, dynamic capabilities are interpreted as best practices. Hence, competitive advantage obtained by them can be only temporary. This characterization of dynamic capabilities does not highlight entrepreneurial evolutionary elements emphasized in the Teecean view.

One of the most cited definition that summarizes the main idea of dynamic capabilities is the one of Helfat et al. (2007, 4) *"A dynamic capability is the capacity of an organization to purposefully create, extend, or modify its resource base"*. It demonstrates the purposeful use of dynamic capabilities and links them to Schumpeterian entrepreneurial thinking where innovations ("new combinations") are of great importance. Teece (2007; 2012; 2014) has also stressed the role of entrepreneurial thinking when looking for micro foundations of the dynamic capability view.

One can conclude that the dynamic capability view sees a firm consisting of routines and bundles of routines called capabilities. As Sidney Winter (2003) aptly shows there are both *operational capabilities,* whose main function is to replicate the existing resource base and learning-based capabilities and there are *dynamic capabilities*, whose main function is to change the existing resource base and capabilities in order to better cope with changes of competitive environments (due to changing preferences of customers and technological or regulatory changes). When the competitive environment is not changing drastically the firms using mainly operational or "simple" dynamic capabilities interpreted as best practices (see Eisenhardt and Martin, 2000) can do their job in a satisficing manner. However, the more rapidly the competitive environments change and the higher the uncertainty faced by the firms the more demanding dynamic capabilities are needed and the more important the role of entrepreneurial attitude of top managers is (Teece, 2012; 2014).

In his much cited and celebrated article David Teece (2007) launched the idea of the micro foundations of the dynamic capability view. Teece focused on three capacities, *sensing, seizing* and *reconfiguring (transforming*), that are necessary conditions for the effective use of dynamic capabilities. Sensing deals with the ability to sense weak signals and to recognize strategic options that may prove to be successful. The more turbulent the business environment is the more important it is to have this entrepreneurial instinct.

Seizing deals with the ability to efficiently invest in new strategic options and capabilities necessary for building up them. In many cases, the firm has also to be able to disinvest in already existing path-dependent capabilities that may have been the engines of earlier success. This kind of situation often results in difficult internal conflicts within the organization because of the change resistance due to organizational rigidities.

Reconfiguring or transforming follows sensing and seizing. It simply means the ability to change the existing resource base and operational/dynamic capabilities in a way that promotes necessary organizational renewal.

Teece (2012) gives a good example of the smart phone business. Until the year 2007 Nokia was the leading company in this field with very good VRIN resources but within few years it lost its market share for its rivals iPhone and Samsung. According to Teece, one of the main problems of Nokia was the lack of important dynamic capabilities that would have made it possible to generate the efficient operating system and to manage consumer friendly very complicated copyright issues relating to different applications. Apple had already done this job when creating its successful iPod. In addition, Apple's ability to sense the preferences of customers played an important role.

Cognition and strategy

During past decades starting in the 1990s, there has been an increasing interest in the research of managerial and organizational cognition (Kaplan, 2011). The focus has been especially on the managerial cognition with the question of how managers' knowledge structures affect a company's strategic actions, performance and renewal capacity. Organizations can be regarded as interpretation systems (Daft and Weick, 1984) where knowledge structures are created and applied to make sense of the complex reality and facilitate information processing and decision-making. Following Walsh's definition (1995: 281),

> *"A knowledge structure is a mental template that individuals impose on an information environment to give it form and meaning".*

In strategic management studies, knowledge structures are called e.g. mental models, dominant logic, strategic frames or schemas, to name a few. Dominant logic is one of the concepts used in studies of managerial cognition. It specifically relates the managerial cognition within the company's business context. The concept of dominant logic was launched by Prahalad and Bettis (1986: 490) who define it as

> *"the way in which managers conceptualize the business and make critical resource allocation decisions – be it in technologies, product development, distribution, advertising, or in human resource management".*

Dominant logic is the managerial worldview defining the key imperatives of the business. At the same time as dominant logic acts as an information filter (Bettis and Prahalad, 1995) it also provides the common strategic understanding and interpretation schema to facilitate managerial decision-making. The idea is that the key elements of dominant logic become embedded in the organizational behavior - mindsets, routines, capabilities, and processes (Bettis et al., 2011). This embeddedness may cause severe challenges in times of disruptive changes. In times of discontinuities, managers should transform their dominant logic in order to address the new demands of the changing business environment. Because of its persistent nature the established dominant logic embedded in the organizational behavior does not change easily and may act as a blinder (Prahalad, 2004) preventing the managers – especially those of incumbent firms – from sensing the weak signals and the rising opportunities (Vecchiato, 2017)

There is a large body of research showing how managerial cognition affects the strategic renewal and ability to adopt and address disruptive changes (Kaplan, 2011). One of the focal articles is the Porac et al. (1989) study on how managerial cognitive categorization of the competitive groups in the business led to the decline of the Scottish knitwear industry in the 80s. Another classic in this field is Tripsas and Gavetti's (2000) study on how managers' cognitive rigidity hampered Polaroid's ability to adopt from print to digital technology. Furthermore, the story of Blockbuster and Netflix is illustrative. Blockbuster failed to reframe and transform itself from the brick-and-mortar video rental to the online streaming service provider (Raffaelli et al., 2019), whereas Netflix adopted the new business design. The story of Nokia is another good example of how managerial cognitive inertia hinders necessary strategic renewal (Vuori and Huy, 2016).

In the strategic management research, the research on cognition and strategy has diffused in various research areas, such as capabilities (Laamanen and Wallin, 2008; Eggers and Kaplan, 2009) and incentives (Kaplan and Henderson, 2005). Cognition has been used as an underlying element in some conceptual developments. Cognition has also been part of the trend toward research on a more micro foundational level. For example, Helfat and Peteraf (2015) link cognition with the concept dynamic capabilities to provide a frame to analyze managerial cognitive capabilities. Using Teece's (2007) model (of sensing, seizing and reconfiguring) they define what cognitive competences constitute managerial sensing, seizing and reconfiguring capabilities. Likewise, managerial cognition is one of the three underpinnings – in addition to managerial human and social capital – of the concept of *dynamic managerial capabilities* launched by Adner and Helfat (2003). In line with the general definition of dynamic capabilities (Teece et al., 1997), they define dynamic managerial capabilities as "*the capabilities with which managers build, integrate, and reconfigure organizational resources and competences"* (Adner and Helfat, 2003: 1012). The idea of the new concept is to analyze how individual managers differ in terms of their decision-making and change management.

Ambidexterity and change management

In the past few decades, ambidexterity has become a widely used concept of strategic management to analyze companies' ability to manage change. It is originally based on the March's (1991) study on organizational learning and the concepts of exploration and exploitation. Later especially O'Reilly and Tushman (Tushman and O'Reilly, 1996; O'Reilly and Tushman, 2004) have refined the concepts of exploration and exploitation in their research on ambidexterity (ambidextrous organization). According to the basic idea of ambidexterity, managing change requires the ability to simultaneously exploit the current businesses and explore new businesses. This is especially relevant during disruptive changes during which companies need to radically renew themselves to adopt to the new business logics. During the transformation, the current business provides the required stability and necessary resources to run the old business whereas exploration is needed to constantly search and create new business opportunities (March, 1991). In terms of the concepts presented in this chapter – resources, capabilities and cognition – exploitation can be said to be based on current and learned resources, capabilities and cognition whereas exploration requires new and often very different resources, capabilities and cognition.

The challenge for managers is how to balance exploration and exploitation. The more radically the business is changing the more exploration is needed. However, as March (1991) emphasizes, too much exploration on the expense of exploitation may destroy valuable resources and routines that are needed to run the current business. On the other hand, too much exploitation may lead to stagnation and inability to maintain competitive advantage in the changing business environment. Especially incumbent firms with strong learned work cultures have the bias toward exploitation (March, 1991). The balance between exploration and exploitation creates challenges for managers to find ways to overcome the organizational rigidities and manage the tensions that arise between the often opposite activities of exploration and exploitation (Smith and Tushman, 2005; Raisch et al., 2009; O'Reilly and Tushman, 2011). As O'Reilly and Tushman (2016) emphasize, ambidexterity requires good leadership skills from managers to cope with the many challenges and commit the organization to pursue toward the same strategic goal.

The ambidexterity literature provides solutions and tools for managers to manage and organize the two often opposite activities of exploitation and exploration (O'Reilly and Tushman, 2016). The literature identifies three solutions to implement ambidexterity: structural, contextual and temporal ambidexterity (O'Reilly and Tushman, 2013; Birkinshaw et al., 2016). Structural ambidexterity is based on establishing separate development units for exploration activities. In contextual ambidexterity, exploitation and exploration are pursued within the same unit. Contextual ambidexterity emphasizes individuals and their possibility to make choices between exploration and exploitation on everyday basis (Gibson and Birkinshaw, 2004). Temporal ambidexterity means sequential alteration between exploitation and exploration. In practice, they all have their pros and cons (O'Reilly and Tushman, 2013) and therefore companies may end up applying a mixture of different solutions.

During the current times of technological discontinuity, it is clear that there is an urgent need for ambidexterity in practically all industries. It could be claimed that ambidexterity is needed now more than maybe ever before. No matter what industry – banking, travelling services, automobile, media etc. – digital technologies are disrupting the dominant business logics at all levels and dimensions.

The evolution of strategic management in a nutshell

The above section launched a brief and compact history of the rise and development of the "strategic management" concept. After a very short historical review the rise of the so-called "business policy" was discussed and its focus on firm internal, historically motivated case studies was stressed. These analyses were mostly practical and meant to help managers when facing uncertainties arising from the changes in the business environment. During the 1970s, the analysis took a more scientific stance trying to use statistical data and trying to derive more generalizable conclusions relating to strategic managerial problems. Following and extending the "swings of a pendulum" idea introduced in the insightful article of Hoskisson et al. (1999) we then looked at the rise of the micro economics-based Porterian view that highlighted the strategic importance of the competitive environment and especially the role of strategic moves of the competitors, suppliers and customers as well as the threat arising from the new entries and new substitutes. Now the focus was clearly on the firm external side and the methods used in strategy research were largely based on large databases and econometrics thus following the lead of economics.

In the mid-1980s, however, we again noticed the swing of a pendulum, this time towards the firm internal factors. Based on empirical criticism of the Porterian five force model some economists (Wernerfelt) and strategy researchers (Rumelt, Barney and Peteraf) challenged the Porterian view according to which the competitive advantage was mainly based on the ability to exploit market imperfections in the product/service markets. Instead, the followers of this new resource-based view gave a look at firm internal factors, such as resources, routines and capabilities and the resource market imperfections as main sources of competitive advantage. We also saw a change or, to put it more exactly, an extension in the field of research methodology. Also the historical case analyses were allowed to use again even if large survey-based econometric analyses dominated.

In the late 1990s, the next swing of a pendulum took place. This time the static nature of both the Porterian and resource-based view was challenged by evolutionarily inclined dynamization of the resource-based view. The new approach, called the dynamic capability view, analyzed the firm’s ability to transform its resource and knowledge base in order to better cope with drastic changes of competitive environment. Especially the apt operationalization of the dynamic capability view launched by David Teece (2007) opened up a new and more detailed way to look at the challenges faced by modern companies. Teecean concepts “sensing”, “seizing”, and “reconfiguring” enabled a researcher to analyze more carefully different strategic actions taken be entrepreneurially oriented business managers and also the many problems that relate to renewal processes. Mostly they are due to old path dependent organizational routines and capabilities that create rigidities. Figure 1 below illustrates the idea of the swing of a pendulum utilized in this chapter.

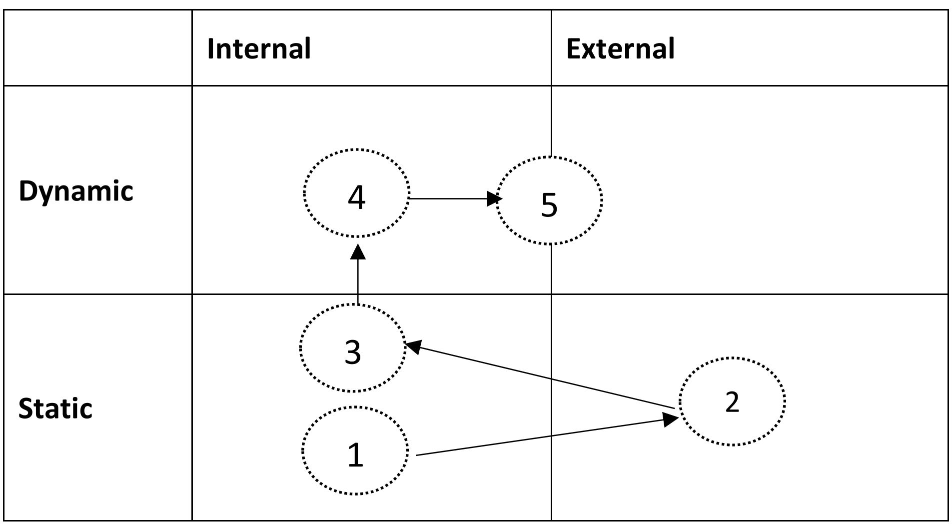

Figure 1: The development of the basic ideas of strategic management

Figure 1 shows first the swing from the historically oriented and case-based business policy models (1) towards the economics-based Porterian view (2) that stressed the product/service market imperfections. The next swing went towards the resource-based view (3) stressing the role of firm internal factors and market imperfections related to them. The last swing went from the staticness towards dynamics and resulted in the rise of the dynamic capability view (4). My guess is that the next swing will be the step towards what I would call "the modern synthesis" (5) that simultaneously includes both resource- and product/service market imperfections and analyzes them in the dynamic context. Some recent advances in the field of the dynamic capability view already hint to this direction (see Teece, 2018; Helfat and Raubitschek, 2018). These insightful analyses look at the dynamic capability view in the context of new digital platform-based ecosystems, in which strong network externalities create quite new sources for competitive advantage.

Conclusions

The target of the course that I am suggesting in this chapter is to provide a clear understanding of the main concepts and theories and the main trajectories of strategic management since the 1970's when it became an independent discipline. In addition, the students should understand the relevance of the concepts and theories for managers. Students should be able to apply these concepts in real-life business cases to better understand their relevance as managerial tools in decision-making and managing change.

The application of theoretical concepts in real life cases is significant but naturally also challenging. Therefore the teacher's role and support are of great importance in helping and guiding the students to understand the theories' practical relevance and impact. Furthermore, it is important that students dedicate time to assignments and discussions during the course. Below I suggest some assignments that help and guide students to reflect theories of strategic management through real life examples.

Assignment 1:

The assignment can be carried out as a group discussion in the classroom or as a written assignment carried out as a group work or individually.

Read the following article:

Barney, J.B. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17(1), 99–120

1. Discuss/Review the main ideas of the article focusing on the following questions:
    - What are the resources defined by RBV? What are the so called VRIN resources?
    - What are they like and why are they relevant for firms?
    - What are the mechanisms that help sustain the competitive advantage?
    - How firms can use and benefit from applying the RBV frame?
2. Think of a firm, organization, sports team etc. which is a market leader having a competitive advantage over others. Make reflections of the case by analyzing e.g. the following questions:
    - Why is this case interesting?
    - How would you explain the success of your case company (team) in terms of the resource-based view (which resources might be behind the success etc.)
    - How would you study this case by using the RBV (research target/s, methods)?

Assignment 2

The assignment can be carried out as a group discussion in the classroom or as a written assignment carried out as a group work or individually.

Read the following article:

Tripsas, M. and Gavetti, G. (2000). Capabilities, cognition, and inertia: Evidence from digital imaging. *Strategic Management Journal*, 21(10–11), 1147–1161.

1. Discuss/Review the main ideas of the article focusing on the following questions:

- Based on the case study, what is managerial cognition and why is it relevant for firms' strategy?
- Make reflections on the Polaroid story: how did managerial cognition affect Polaroid's business? (What was Polaroid's dominant logic in the beginning? How did the technology challenge the business? etc.)

2. Think of a firm, which has succeeded or failed in renewing its business.
    - Describe the case and its business context?
    - What do you think about the role of managerial cognition in the success or failure?

3. Think of a firm or industry that is currently facing a disruptive change. Make reflections of the case in terms of managerial cognition and ambidexterity, e.g.:
    - Describe the case. What does generate the disruption?
    - How do you see that the changing business environment is challenging existing and path-dependent managerial cognition?
    - How would you see the renewal process in terms of ambidexterity?

Assignment 3

The assignment can be carried out as a group discussion in the classroom or as a written assignment carried out as a group work or individually.

Think of a firm (or sports club etc.) that is more successful than others in their business area. Describe the case and industry and analyze the firm's superior performance in terms of

a) Porter's five forces model
b) Resource-based view
c) Dynamic capability view.

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