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Antitrust Insights from Strategic Management

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ANTITRUST INSIGHTS FROM STRATEGIC MANAGEMENT

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Antitrust law has long treated economics as a sister discipline. Yet antitrust law concerns business behavior, and business schools, not economics departments, the primary centers teaching business managers how to behave. Consequently, a growing number of scholars, in the legal and business academies, have suggested that the study of business may yield new insights into antitrust law.[1]

Two problems immediately confront anyone attempting to use business scholarship in antitrust law. First, one must pick from a plethora of business disciplines. Second, academic business scholarship does not enjoy the widespread readership among business managers that academic legal scholarship does among lawyers.[2] Consequently, academic writing may provide insights into business thinking and behavior, but even the top tier academic journals do not directly influence the thinking or behavior of business managers.

As to the first issue, strategic management presents one area with an unusually high potential for insight because it explicitly deals with issues that concern antitrust law such as the effects of competitor behavior on other firms in the market. Richard Posner, for example, noted the importance of strategic management even as he conceded that the Chicago School of antitrust analysis has

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1. *See, e.g.*, Spencer Weber Waller, *The Language of Law and the Language of Business*, 52 CASE W. RES. L. REV. 283 (2001); Harry S. Gerla, *A Micro-microeconomic Approach to Antitrust Law: Games Managers Play*, 86 MICH. L. REV. 892 (1988); Shelby D. Hunt & Dennis B. Arnett, *Competition as an Evolutionary Process and Antitrust Policy*, 20 J. PUB. POL'Y & MARKETING 15 (2001).

2. Sara L. Rynes et al., *Across the Great Divide: Knowledge Creation and Transfer Between Practitioners and Academics*, 44 ACAD. MGMT. J. 340 (2001) ("executives typically do not turn to academics or academic research findings in developing management strategies and practices"). A number of practitioner oriented business journals, however, do publish articles written by business scholars. *Harvard Business Review* is the most prominent of these journals, but others journal attempting to bridge the gap between business scholars and mangers include *Business Horizon* and the *Mid-American Business Journal.*

largely ignored the subject.[3] More particularly, strategic management offers richer and more dynamic models of competition and business behavior than the simple price theory model employed by Chicago School analysis.

As to the second issue, while academic writings about strategic management may not have much of an audience in the business community, academic research does find its way into the textbooks used in the strategic management courses that form a core component of the business school curriculum. Therefore, one should be able to gain some insight into what business managers believe, or at least what they have been led to believe, about how firms behave and how to deal with competition.

Strategic Management Textbooks

Publishers offer a considerable (and growing) number of strategic management texts. This study focuses on nearly a dozen of the most popular and therefore presumably most influential corporate strategy texts as well as Michael Porter's major works. Most of the texts were collected from publishers in response to requests for their best selling texts in this category. The remainder were identified as important texts in the field after informal consultation with strategic management faculty at various schools.

All of the texts overlap in their coverage to a great extent, but there are three basic approaches. The largest number of texts offer an almost mechanical or "how to" approach to the process of strategic management.[4] The second largest category of strategic management texts emphasize economics.[5] The third approach emphasizes psychology or a behavioralist approach to firm conduct.[6]

The different approaches to strategic management identified here are not mutually exclusive. Nearly all of the texts and Porter's

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3. Richard A. Posner, *The Chicago School of Antitrust Analysis,* 127 U. PA. L. REV. 925, 939 (1979).

4. *See, e.g.,* FRED R. DAVID, STRATEGIC MANAGEMENT: CONCEPTS (8th ed. 2001); J. DAVID HUNGER & THOMAS L. WHEELEN, STRATEGIC MANAGEMENT (6th ed. 1998).

5. Indeed, DAVID BESANKO ET AL., ECONOMICS OF STRATEGY (2d ed. 2000), is listed on its publisher's web site with the economics rather than the strategic management texts. *See also* JAY B. BARNEY, GAINING AND SUSTAINING COMPETITIVE ADVANTAGE (2d ed. 2002).

6. *See, e.g.,* L. J. BOURGEOIS ET AL., STRATEGIC MANAGEMENT: CONCEPTS FOR MANAGERS (2d ed. 1999).

work include considerable insights into the strategic management based on process, economics and behavior. It would also be inaccurate to suggest that these three basic approaches identified in this paper necessarily represent the major schools of thought in strategic management the way that "Chicago" and "Harvard" represented (and may still represent) distinct approaches to antitrust analysis. The texts themselves suggest that strategic management consists of a great many schools of thought,[7] and most try to incorporate concepts from a wide variety of approaches.

Finally, please note that these characterizations are those of the author of this paper, not the authors of the textbooks in question. Nor do the three types of texts identified here parallel the intradisciplinary fault lines of strategic management. Scholars of strategic management seem to divide themselves into camps along the lines of an internally focused "resource based" view and a more externally focused structuralist view of strategy formulation.

WHAT IS STRATEGIC MANAGEMENT?

The "classic approach" defines strategic management as a "combination of the *ends* (goals) for which the firm is striving and the *means* (policies) by which it is seeking to get there."[8] Or, more concisely, strategic management is the development and implementation of "a firm's theory about how to compete successfully."[9] These definitions, however, fail to capture the dynamic nature of strategic management. Nearly all the texts state that a well run firm

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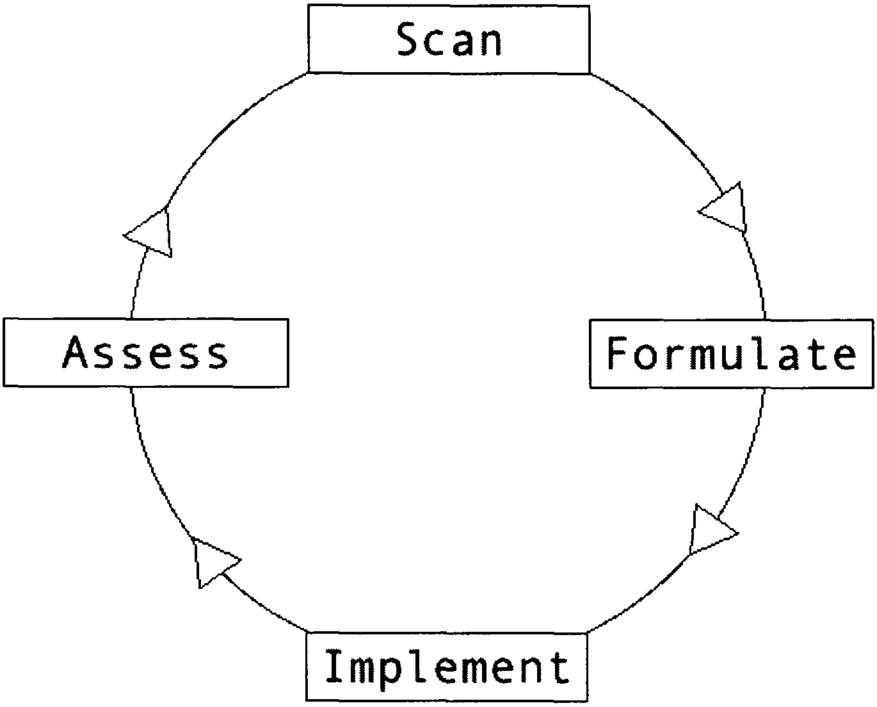
7. *See, e.g.*, JEFFREY S. HARRISON & CARON H. ST. JOHN, FOUNDATIONS IN STRATEGIC MANAGEMENT 8-12 (2d ed. 2002) (identifying and defining seven distinct perspectives on strategic management: situation analysis, external determinism, principle of enactment, deliberate strategy, emergent strategy, stakeholder management, and resource-based view); BESANKO ET AL., *supra* note 5, at 2 (suggesting mathematical game theory, psychology and organizational perspectives as alternatives to economics).

8. MICHAEL E. PORTER, COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS xvi (1980) (emphasis in the original); *accord* D. E. HUSSEY, STRATEGY AND PLANNING: A MANAGER'S GUIDE 1 (1999) (defining strategic management as "the process by which the long-term aims, the strategy, and its implementation are managed."); HARRISON & ST. JOHN, *supra* note 7, at 4 (Strategic management is "the process through which organizations analyze and learn from their internal and external environments, establish strategic direction, create strategies intended to help achieve established goals, and execute those strategies, all in an effort to satisfy key organizational constituencies, which are called stakeholders").

9. BARNEY, *supra* note 5, at 6.

continuously (1) scans its internal and external environment, (2) chooses and implements a plan based on its assessment of the environment, (3) evaluates its success, and (4) modifies its plans and implementation accordingly.[10] In other words, as shown in Exhibit 1, strategic management is a continuous process of scanning, formulation, implementation and assessment:

EXHIBIT 1



What the model stresses is the dynamic nature of the process and the interrelatedness of each of its steps.

Most texts distinguish between corporate and business strategy as the difference between the strategy for the overall firm (*corporate*) and the strategy of its operating divisions or subsidiaries (*busi-*

10. DAVID, *supra* note 4, at 5 (Strategic management is "the art and science of formulating, implementing and evaluating cross-functional decisions that enable an organization to achieve its objectives"); *accord* HUNGER & WHEELEN, *supra* note 4, at 3 (Strategic management "includes environmental scanning . . . , strategy formulation . . . , strategy implementation . . . , and evaluation and control") (emphasis omitted).

ness).[11] This distinction presumes that the firm consists of multiple businesses. While the firm may share certain core competencies across different markets or businesses, e.g., Philip Morris' consumer marketing skills have been applied to cigarettes, beer and breakfast cereals, the distinction between corporate and business strategy disappears when a firm concentrates on a single business or market, e.g., McDonald's almost exclusive emphasis on fast food. While the corporate strategies of conglomerate firms may also yield valuable insights for antitrust, antitrust law has thus far concentrated on the behavior of firms in specific geographic and product markets. Therefore, this article concentrates on business strategy.

Some texts also formally identify competitive strategy as the subset of business strategy that "deals exclusively with management's action plan for competing successfully and providing superior value to customers."[12] Competitive strategy, thus defined, does not really differ from business strategy and this paper will use the terms interchangeably.

THE ROLE OF STRATEGIC MANAGEMENT IN THE BUSINESS CURRICULUM

The main accrediting body for business schools, the Association to Advance Collegiate Schools of Business International ("AACSB"), does not require schools to offer strategic management. Indeed, neither the phrase "strategic management" nor "strategy" appear in the AACSB's accreditation standards.[13] Nonetheless, a recent examination of the M.B.A. programs at some of the most prominent business schools revealed that nearly all required their students to take at least one course in strategic management as part of the core curriculum.[14] While comparisons are difficult given differences in credit hours, etc., several schools in-

11. *See, e.g.*, ARTHUR A. THOMPSON & A. J. STRICKLAND, STRATEGIC MANAGEMENT: CONCEPTS AND CASES 49 (12th ed. 2001); HARRISON & ST. JOHN, *supra* note 7, at 6-7; BOURGEOIS, ET AL., *supra* note 6, at 70-71; HUNGER & WHEELEN, *supra* note 4, at 12.

12. THOMPSON & STRICKLAND, *supra* note 11, at 150.

13. AACSB—the International Association for Management Education, Standards for Business Accreditation (2001).

14. The examination was conducted in June 2002 by going to the web sites of the business schools surveyed in LAWRENCE J. WHITE, *Microeconomics and Antitrust in MBA Programs: What's Thought and What's Taught*, 47 N.Y.L.S. L. REV. 87 (2003) (Table 1). Out of these thirty-three schools, only three, Duke University (Fuqua), the University of

cluding Stanford University, Dartmouth College and the University of Pennsylvania require two courses in strategic management.[15]

Strategic Management has evolved out of the Business Policy courses which originally served as the capstone in the M.B.A. curriculum. Business Policy attempted to teach the students how to coordinate the different functional areas of the firm, *e.g.*, accounting and marketing, to achieve the overall goals of the firm. Business Policy, however, begged the question of how the firm should formulate its goals. Michael Porter revolutionized the field with the 1980 publication of his book, *Competitive Strategy*. Porter turned the "Structure-Conduct-Performance" model inside out to provide managers with tools to understand the competitive landscape and develop appropriate strategies for the purpose of escaping competitive pressures. Within a decade, the field had begun to develop tools to identify a firm's core competencies. Consequently, it became possible to teach how a particular firm fit into the competitive environment and what to do about it.

With the new tools, the emphasis of the textbooks has gone from strategy *implementation* to strategy *formulation*. The major M.B.A. programs rarely teach strategy as a capstone course, choosing instead to introduce Strategic Management as part of the first year core curriculum. This is not to say that strategy has entirely lost its Business Policy roots. The first year core almost always surveys the different functional areas within a firm, and discussions of strategy cases often includes an examination of how different functional areas work or fail to work together to achieve the firm's goals. More importantly, most texts come with business cases for class study and discussion. For those textbooks without supplemental cases, business cases are readily available from Harvard, the University of Virginia, and other sources. From the study of business cases, M.B.A. students in strategic management see how well different firms implement their strategies and the tactics that they use. And the use of the case method itself teaches students to assess and reevaluate the firm's strategy.

Rochester (Simon) and the University of Texas (McCombs), did not include some form of strategic management as part of the core curriculum.

15. *Id.*

THE ROLE OF ANTITRUST LAW IN THE STRATEGIC MANAGEMENT CURRICULUM

Most strategic management texts pay scant attention to antitrust law. Only one of the two best selling textbooks mentions antitrust, and then only to mention that aggressive antitrust enforcement against vertical and horizontal mergers in the 1960s and 1970s may have played a role the conglomerate mergers of that era.[16] Besanko does somewhat better, mentioning that antitrust enforcers "are concerned about the high profits many monopolies earn" and presenting Harold Demsetz's argument that "restricting monopoly profits may hurt consumers in the long run by choking off innovation."[17] As far as specific legal doctrines go, Besanko mentions only the essential facilities doctrine.[18] In his chapter devoted to tacit collusion, Barney gives little more than passing mention to antitrust law.[19] Barney later devotes a page and a half to a discussion of how the Federal Trade Commission classifies and treats mergers.[20]

Saloner provides the most extensive discussion of antitrust law found in the strategic management texts. Only Saloner points out that price fixing is illegal.[21] Indeed, Saloner offers a fairly extensive discussion of Section 1 of the Sherman Act in his chapter on competition in concentrated markets, and he also alerts students to some of the differences between American antitrust law and the competition law of other countries.[22]

Consistent with the textbooks which are in some sense ultimately based on his work, Porter's two major works on business strategy also say very little about antitrust law. His first book only mentioned antitrust law insofar as private litigation by a competitor could serve as "a mild signal of displeasure relative to, for example,

16. MICHAEL A. HITT ET AL., STRATEGIC MANAGEMENT: COMPETITIVENESS AND GLOBALIZATION 254 (4th ed. 2001).

17. BESANKO ET AL., *supra* note 5, at 241.

18. *Id.* at 331.

19. BARNEY, *supra* note 5, at 355 (pointing out that government antitrust action is more likely against firms in highly concentrated markets).

20. *Id.* at 485-86.

21. GARTH SALONER ET AL., STRATEGIC MANAGEMENT 203 (2001).

22. *Id.* at 211-13.

a competitive price cut."[23] In his second book, Porter suggests that a firm's competitors may provide a strategic benefit insofar as "the presence of viable competitors may . . . reduce the risk of antitrust scrutiny."[24] Porter has received some criticism for his neglect of antitrust issues in business strategy.[25] In his subsequent work on public policy, Porter strongly favors aggressive national policies to foster competition.[26]

The bottom line is clear. Even under the best of circumstances, business students learn next to nothing about antitrust law in their strategic management courses.

THE RELATIONSHIP OF STRATEGIC MANAGEMENT TO PROFIT MAXIMIZATION

At the heart of the Chicago School approach to antitrust is an *assumption* from price theory that businesses rationally seek to maximize profits.[27] Often called the "theory of the firm,"[28] Robert Bork considered the profit maximization assumption "crucial" to the Chicago approach.[29] Given its central importance to Chicago School antitrust analysis, the theory of the firm provides a logical starting point to determine whether strategic management may yield new and different insights for antitrust law.

Strategic management texts provide precious little support for the theory of the firm. Only two texts, Besanko and Saloner, bother to include either "profit maximization" or "theory of the firm" in their indices.[30] Even among the texts with a hard core economics bent, only Besanko specifically suggests that businesses actually seek

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23. PORTER, *supra* note 8, at 86.

24. MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE 206 (1985). To be fair, Porter does identify other strategic advantages from having the right type of competitors.

25. *See, e.g.,* Vance H. Fried & Benjamin M. Oviatt, *Michael Porter's Missing Chapter: The Risk of Antitrust Violations,* 3 ACAD. MGMT. EXECUTIVE 49 (1989).

26. *See, e.g.,* MICHAEL E. PORTER, THE COMPETITIVE ADVANTAGE OF NATIONS (1990).

27. RICHARD A. POSNER, ANTITRUST LAW, AN ECONOMIC PERSPECTIVE 9 (1976).

28. *See, e.g.,* BESANKO ET AL., *supra* note 5, at 30-32.

29. ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 119 (1978).

30. BESANKO ET AL., *supra* note 5, at 644 ("theory of the firm"); SALONER ET AL., *supra* note 21, at 438 ("profit maximization").

to maximize profits.[31] Besanko, however, acknowledges that this point of view is the subject of some dispute.

And indeed it is. According to Hussey, for example, the theory of the firm "happens to be untrue: no company is prepared to do absolutely *anything* for profit."[32] Saloner rejects profit maximization as simply "too broad to have much strategic content."[33]

Hussey states that strategic management is "as much concerned with the human aspects of management as it is with markets, factories and finance."[34]

None of the texts denigrates the importance of profitability. Hunger & Wheelen, for example, acknowledge that "profitability is a corporation's major objective."[35] While David argues that "profit alone is not enough to motivate people," he also notes that profit may be "the primary corporate motivator."[36] But profitability *is not* the equivalent of profit maximization. Thompson and Strickland would measure the success of strategic management in terms of *both* financial and strategic performance.[37] They concede that a company must achieve an *acceptable* level of profits to gain access to capital and avoid bankruptcy. Nonetheless, they stress that strategic performance, defined as improving the firm's long-term business position and competitiveness, often matters more to the firm's long-term survival than achievement of short term financial objectives.

A number of texts explicitly suggest that a firm's financial objectives go beyond mere profitability. Barney, for example, would define corporate success in terms of "above-normal performance" or the earning of "economic profit or an economic rent."[38] Hitt teaches that "above average returns" serves as the "primary objec-

31. BESANKO, *supra* note 5, at 30 ("If, over the long haul, a firm's managers did not strive to achieve the largest amount of profit consistent with industry economics and its own particular resources, the firm would either disappear or its management would be replaced by one that better served the owner's interests.")

32. HUSSEY, *supra* note 8, at 25.

33. SALONER ET AL., *supra* note 21, at 21.

34. HUSSEY, *supra* note 8, at 1.

35. HUNGER & WHEELEN, *supra* note 4, at 231.

36. DAVID, *supra* note 4, at 56.

37. THOMPSON & STRICKLAND, *supra* note 11, at 42-45.

38. BARNEY, *supra* note 5, at 27 (2d ed. 2002).

tive" of strategic management.[39] But it is important to note that doing better than average is hardly the equivalent of profit maximization. Furthermore, even these texts point out that firm survival depends on merely earning an "average" or "normal" rate return.[40]

Few texts provide explicit reasons for their rejection of the theory of the firm. Hussey suggests that it is simply impossible to determine when a firm has achieved profit maximization.[41] Barney ultimately reaches the same conclusion about "above normal returns."[42] Yet the implicit reasoning of many texts would appear to be a rejection of the notion that corporations exist exclusively for the benefit of their *shareholders*. As will be seen *infra*, a great many texts teach that management seeks to satisfy (or escape from) the demands of an array of *stakeholders*.

THE ALTERNATIVE TO PROFIT MAXIMIZATION: SUSTAINABLE COMPETITIVE ADVANTAGE

Students are rarely taught profit maximization as a conscious objective or method of measuring business performance. But this begs the question, what is the point of strategic management?

The holy grail of strategic management is not profit maximization, but *sustainable competitive advantage*.[43] In the words of one popular text, what "separates a powerful business strategy from a weak one is the strategist's ability to forge a series of moves, both in the marketplace and internally, that are capable of producing sustainable competitive advantage."[44] David bluntly states that the ultimate purpose of strategic management "is to achieve and maintain competitive advantage."[45]

The concept of a sustainable competitive advantage is perhaps best described as "the set of factors or capabilities that allows firms

39. HITT ET AL., *supra* note 16, at 5.

40. *Id.*; *see* also BARNEY, *supra* note 5, at 28.

41. HUSSEY, *supra* note 8, at 25 ("[N]obody knows what [profit maximization] really means, and there is no method of telling when it has been achieved.").

42. BARNEY, *supra* note 5, at 28.

43. SALONER ET AL., *supra* note 21, at 40 ("The search for the underlying sources of such 'specialness' is an obsession in strategic management; it is the field's version of the search for the Holy Grail.").

44. THOMPSON & STRICKLAND, *supra* note 11, at 55.

45. DAVID, *supra* note 4, at 5.

to consistently outperform their rivals."[46] Stated somewhat differently, a "company has competitive advantage whenever it has an edge over its rivals in attracting customers and defending against competitive forces."[47] Regardless of how one measures performance, the emphasis is one firm's performance relative to another.

One can define competitive advantage in economic terms and relate it to profits. Besanko, for example, states that when a firm "earns a higher rate of economic profit than the average rate of economic profit of other firms competing within the same market, the firm has a competitive advantage in that market."[48] And a firm "can achieve competitive advantage in a market only if it can create more economic value than its competitors."[49] Simply put, economic value is the difference between the cost of a good or service and the perceived benefit to the consumer.[50]

Saloner points out that a business must do more than simply create value, a business "must also be able to *capture* the value it creates," and "to create *and* capture value the firm must have a sustainable competitive advantage."[51] In what may have important implications for antitrust,[52] Saloner even argues that "a firm can capture value other firms create."[53] Besanko recognizes this possibility, but rejects what it calls "value redistribution" as basis for sus-

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46. BOURGEOIS ET AL., *supra* note 6, at 56; *accord* HARRISON & ST. JOHN, *supra* note 8, at 12 ("A sustainable competitive advantage is an advantage that is difficult to imitate by competitors and thus leads to higher-than-average performance over a long period of time.").

47. THOMPSON & STRICKLAND, *supra* note 11, at 149.

48. BESANKO ET AL., *supra* note 5, at 389 (emphasis omitted); *accord* MICHAEL A. HITT, ET AL., *supra* note 16, at 5 ("By achieving strategic competitiveness and successfully exploiting its competitive advantage, a firm is able to accomplish its primary objective: the earning of above average returns.").

49. BESANKO ET AL., *supra* note 5, at 389; *see also* BARNEY, *supra* note 5, at 9-10 (A firm experiences *competitive advantages* when its actions in an industry or market create economic value and few competing firms are engaging in similar actions. . . . A firm experiences *competitive parity* when its actions create economic value but when several other firms are engaging in similar actions. . . . Finally, a firm has a *competitive disadvantage* when its actions fail to create economic value.).

50. BESANKO ET AL., *supra* note 5, at 395.

51. SALONER ET AL., *supra* note 21, at 39 (emphasis in the original).

52. *See* discussion *infra.*

53. SALONER ET AL., *supra* note 21, at 40.

tainable competitive advantage because "the competition to redistribute value is likely to be fierce."[54]

Operationally, a firm creates more value and thereby enjoys a competitive advantage only if it can out perform its competitors with respect to some or all of the activities needed to bring the product to consumers.[55] For a firm to achieve a *sustainable* competitive advantage, its performance must be based on resources (assets) or capabilities (skills) that its competitors lack.[56]

Of course, it does not take much effort to see the Chicago response to the argument that sustainable competitive advantage is an alternative to profit maximization. While no firm may calculate the maximum potential profit or assess its performance against that number, if every firm seeks to attain above average performance, the result will be the same. If, for example, a 10% return is this years average performance, next year every firm will try to attain an 11%, which will make for an 11% average return next year, and so, in the following year, everyone will try for 12%, and so on, until all firms are in fact maximizing their profits.[57]

As the wide range and heterogeneity of performance measure suggests,[58] students are not taught skills which will easily or quickly lead them in a unified direction toward profit maximization. Nonetheless, the Chicago counter argument has some merit.

The Absence of a Rational Man

Price theory as applied to business through Coase's theory of the firm, *assumes* not only that firms seek to maximize profits, but that they go about it in a rational manner. The occasional irrational firm is of no consequence, because rational competitors will quickly eliminate the aberrant business from the marketplace. Eliminate the rational man assumption, however, and the self-correcting nature of markets becomes subject to doubt.

54. BESANKO ET AL., *supra* note 5, at 408-09.

55. *Id.* at 405.

56. *Id.* at 405-07.

57. For a similar argument in the strategic management literature, *see* BARNEY, *supra* note 5, at 26-27.

58. *See, e.g.*, BARNEY, *supra* note 5, at 28-65 (discussing alternative measures of performance).

While all strategic management texts attempt to train business students to pursue their companies' strategic goals in a rational manner, a divide exists between those texts which share the Chicago assumption of rational behavior and the behavioralist influenced texts which assume that the behavior of firms depends at least in part on emotional and psychological factors.

Bourgeois, for example, stresses that "managerial decision making is typically anything but a rational and well-informed 'grand plan.'"[59] The belief system of managers, or "mental maps" in Bourgeois' terminology, significantly constrain the options that they will consider as well as the decisions they will make.[60] The mental maps of managers suffer from a number of predictable deficiencies. For example, most people, including managers, tend to suffer from cognitive bias such that they pay attention to information which confirms their preexisting beliefs while ignoring information that challenges those beliefs.[61] The "psychic costs of ending a relationship" can constitute a switching cost which inhibits new entry into an industry.[62] Not only the individual beliefs of managers, but the shared values and beliefs or culture of the firm both enables and constrains its behavior.[63]

Although he is rightly credited with bringing economic analysis to the process of strategy formulation, Porter also acknowledged the role that non-economic factors have in firm behavior. Porter noted, for example, that "emotional barriers" may cause a firm to stay in an industry when such a decision is economically unjustified.[64]

While it may not yield immediate policy recommendations, strategic management's willingness to accept behavioralist explanations for firm behavior may enable policy makers to understand firm conduct which strains the conventions of game theory.[65]

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59. BOURGEOIS ET AL., *supra* note 6, at 27.

60. *Id.* at 31.

61. *Id.* at 39.

62. HITT ET AL., *supra* note 16, at 72.

63. SALONER ET AL., *supra* note 21, at 88.

64. PORTER, *supra* note 8, at 21.

65. *See* PANKAJ GHEMAWAT ET AL., STRATEGY AND THE BUSINESS LANDSCAPE: TEXT AND CASES 79-81 (1999).

COMPETITIVE ANALYSIS

The structure-conduct-performance concepts remain alive and well in most strategic management text books. Even strong behavioralists such as Bourgeois concede that "firm performance levels depend a great deal on the attractiveness of the industries in which firms compete,"[66] although they are quick to point out evidence that "the difference between the performance of the highest- and lowest-performing firms in any particular industry will be six times greater than the difference between the performance of the highest- and lowest-performing industries."[67]

Not surprisingly, strategic management includes an analysis of competitive conditions as part of the environmental scanning process. What is surprising, however, is the extent to which virtually all the textbooks rely on the Michael Porter's model for competitive analysis.[68] Indeed, all of the strategic management texts examined to date use Porter's "Five Forces" model to some extent.[69]

Michael Porter argues that the "state of competition in an industry depends on five basis forces":[70]

1. Threat of new entrants into the market
2. Bargaining power of suppliers
3. Bargaining power of buyers
4. Threat of substitute products
5. Rivalry among existing firms

Typically, these forces are illustrated with some variation on the diagram originally used by Porter,[71] and replicated here as Figure 2:

66. BOURGEOIS ET AL., *supra* note 6, at 81.

67. *Id.* at 84.

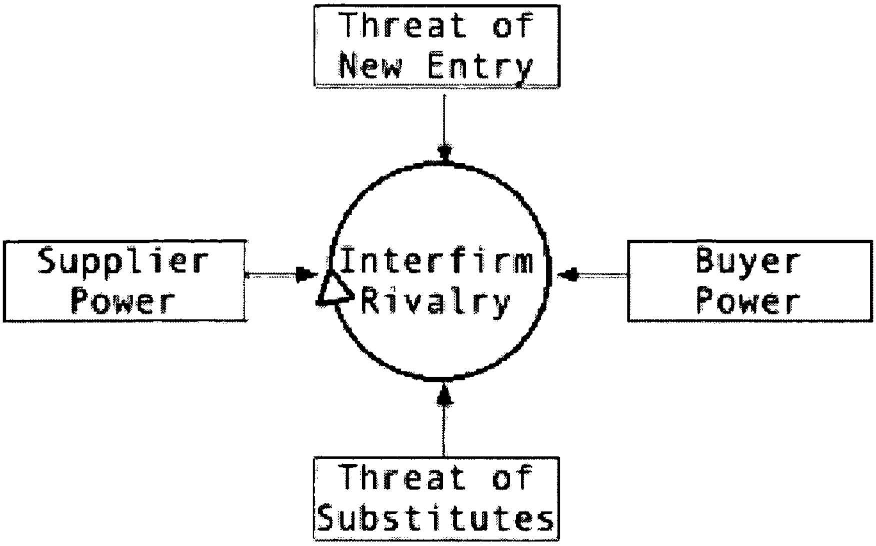
68. PORTER, *supra* note 8.

69. BARNEY, *supra* note 5, at 78-102; HARRISON & ST. JOHN, *supra* note 7, at 25-30; DAVID, *supra* note 4, at 99-102; SALONER ET AL., *supra* note 21, at 126; HITT ET AL., *supra* note 16, at 68-80; THOMPSON & STRICKLAND, *supra* note 11, at 79-93; BESANKO ET AL., *supra* note 5, at 360-65; BOURGEOIS ET AL., *supra* note 6, at 87-105; GHEMAWAT ET AL., *supra* note 65, at 24-31 (1999); DAVID J. COLLIS & CYNTHIA A. MONTGOMERY, CORPORATE STRATEGY: A RESOURCE-BASED APPROACH 49-54 (1998); HUNGER & WHEELEN, *supra* note 4, at 60-64.

70. PORTER, *supra* note 8, at 3.

71. *Id.* at 4.

FIGURE 2



Porter views competition broadly as anything which drives down profits.[72] Thus, for example, consumers are competitors as well as other firms in the industry.[73] Some texts accept this definition without question or elaboration.[74] So conceived, the task of strategic management becomes an effort to defend against the Five Forces or influence them in the firm's favor.[75]

Threat of New Entry

Porter teaches that entry, which can include the acquisition of an existing firm by a larger parent company, typically "reduces profitability" because new entrants bring additional capacity, desire for market share and new resources to the industry.[76] The threat of

72. *Id.* at 5 ("Competition in an industry continually works to drive down the rate of return on invested capital toward the competitive floor rate of return, or the return that would be earned by the economist's 'perfectly competitive' industry.").

73. *Id.* ("[C]ompetition in an industry goes well beyond the established players. Customers, suppliers, substitutes, and potential entrants are all competitors.")

74. *See, e.g.*, THOMPSON & STRICKLAND, *supra* note 11, at 79-93.

75. PORTER, *supra* note 8, at 7.

76. *Id.* at 7.

new entry depends on the presence of barriers to entry and the expected reaction from existing competitors.[77]

Barriers to Entry

Porter identifies six major barriers to entry: economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scale, and government policy.[78] Porter emphasizes not only that barriers to entry change over time, but that "the firm's strategic decisions also can have a major impact."[79]

Expected Retaliation

Porter argues that potential entrants consider not only the barriers to entry, but also the expected reaction of incumbent firms.[80] The threat of retaliation is especially strong, and, therefore, the threat of entry is reduced, when the industry has a history of retaliation, incumbent firms have substantial resources to use in retaliation, incumbent firms have highly illiquid assets devoted to the industry, and the industry suffers from slow growth.[81] Again, it appears that incumbent firms can manipulate these factors to deter entry.

Bargaining Power of Suppliers

Consistent with his equation of competition with low profits, Porter notes that suppliers who have bargaining power can "squeeze the profitability out of an industry" by raising prices or reducing the quality of the supplied goods and services.[82] Suppliers have significant bargaining power if: their industry is more concentrated than the buyers', substitutes for the suppliers' products are lacking, the buyers' industry is not an important customer for the suppliers, the suppliers provide an important input to the buyers' industry, there is product differentiation among the suppliers,

77. *Id.*
78. *Id.* at 7-13.
79. *Id.* at 15.
80. *Id.* at 14.
81. *Id.*
82. *Id.* at 27.

there are significant switching costs in changing suppliers, and the suppliers pose a credible threat of entry into the buyers' industry.[83] Although less subject to manipulation than many of the other competitive forces, Porter suggests that firms may still exert some influence over supplier bargaining power.[84]

Bargaining Power of Buyers

The bargaining power of buyers is the flip side of suppliers' bargaining power. Buyers' power is enhanced if: they are more concentrated than the sellers', they make large volume purchases, the products purchased constitute a significant portion of the buyers' costs, the products are undifferentiated, switching costs are low, the buyers earn low profits, the buyers pose a credible threat of entry into the sellers' industry, the quality of the sellers' product is unimportant to the buyers, the buyer has complete information regarding the sellers' industry.[85] Despite the similarities of buyer and seller bargaining power, Porter expresses more optimism about a firm's ability to alter the bargaining power of its customers.[86]

Substitute Products

Substitute products perform the same function as the industry's product, and they effectively place a ceiling on the industry's prices.[87] In competitive analysis of an industry, one should focus attention on substitute products with a trend toward improving the price-performance tradeoff relative to the industry product and substitute products produced by industries enjoying high profits.[88]

Intraindustry Rivalry

Porter defines intraindustry rivalry as the "jockeying for position" by existing competitors through the use of "tactics like price competition, advertising battles, product introductions, and increased customer service."[89] Porter believes that the intensity of ri-

83. *Id.* at 27-28.
84. *Id.* at 28.
85. *Id.* at 25-26.
86. *Id.* at 26-27.
87. *Id.* at 23.
88. *Id.* at 24.
89. *Id.* at 17.

valry derives from a number of structural factors. In particular, he stresses that rivalry intensifies whenever industries are characterized by: numerous competitors, slow growth, high fixed costs, lack of product differentiation, lack of switching costs, capacity must be added in large quantities due to economies of scale, firms that have high stakes in achieving success in that industry, and high exit barriers.[90]

Perhaps the most important insight for antitrust purposes, however, is the dynamic relationship between intraindustry rivalry and the other four factors. As the traditional mapping of the five factors implies, each of the four factors bears down on intraindustry rivalry like wind blowing on the blades of a fan. While he does not stress the interrelationship of the five forces, Porter does point out that rivalry "occurs because one or more competitors feels the pressure or sees the opportunity to improve position."[91] Although Porter's model creates a new way of looking at these issues, the threats of new entry and substitution are well accounted for in antitrust concepts such as market definition, potential competition and elasticity of demand.

The dynamic relationship between intraindustry rivalry and the power of suppliers and buyers, however, suggests that firms can use vertical restraints to weaken competition. Good buyers are not just found, they are made.[92] For the past quarter century, the Supreme Court has generally accepted the Chicago School dogma that vertical restraints rarely cause anticompetitive effects.[93] Relying heavily on this hard form of price theory, the Supreme Court struck down the *per se* rule against territorial restrictions[94] and maximum resale price maintenance,[95] while it reluctantly upheld *per se* treatment of minimum resale price maintenance out of deference to *stare decisis*.[96]

From a strategic management prospect, vertical restraints such as territorial restrictions and minimum resale price maintenance

90. *Id.* at 18-21.

91. *Id.* at 17.

92. *Id.* at 110 ("a firm can not only find good buyers, it can *create* them").

93. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, xxx (1977).

94. *Id.* at 36.

95. State Oil Co. v. Khan, 118 S. Ct. 275 (1997).

96. Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

may reduce intraindustry rivalry at the manufacturer level by reducing rivalry at the buyer level. Buyers who face intense competitive pressures will seek concessions from their suppliers.[97]

CONCLUSION

The effort to glean new antitrust insights from strategic management is at an early stage. Yet several conclusions are immediately apparent. First, strategic management offers a richer and more realistic view of firm behavior than the rigid notion of rational profit maximization offered by the Chicago School. By incorporating both economic and behavioralist insights into firm behavior, strategic management may provide the basis not only for critiquing the Theory of the Firm, but also new methodologies for developing antitrust policy. Second, strategic management's reliance on Porter's Five Factor Analysis of Competition may not incorporate radically different evidence than that used in current antitrust analysis such as the government's Merger Guidelines, but reorganization and different emphasis placed on the evidence can yield new insights into antitrust problems. The Five Forces model, for example, suggests the need for stronger doctrines in the area of vertical restraints. Finally, the examination of the relationship between the strategic management curriculum and antitrust law reveals an appalling deficit in the education of business leaders. Even texts with substantial discussion of potentially anticompetitive competitive behavior such as tacit collusion make only the most fleeting mention of the legal implications of these tactics.

These insights, limited and tentative though they may be, suggest that the antitrust community should engage in more careful and thorough research into strategic management. Important concepts such as strategic intent need examination. Research into the specific tactics advocated by strategic management, especially in the areas of entry deterrence and signaling to competitors may prove especially fruitful. Indeed, strategic management along with the other business school disciplines may eventually create a new antitrust revolution.

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97. HARRISON & ST. JOHN, *supra* note 7, at 27 ("Customers who earn low profits are under constant pressure to keep the costs of their purchases down").