# CHAPTER TWO
# DISCOVERING POWER

The second natural advantage of many good strategies comes from insight into new sources of strength and weakness. Looking at things from a different or fresh perspective can reveal new realms of advantage and opportunity as well as weakness and threat.

## A SLUNG STONE

In about 1030 B.C., David the shepherd boy defeated the warrior Goliath. When Goliath stepped from the ranks of the Philistines and shouted a challenge, the army of King Saul cringed in terror. Goliath was over nine feet tall, his spear like a weaver's beam. His bronze helmet and body armor shone in the sunlight. David was not old enough to soldier like his brothers, yet nonetheless wanted to face the giant. Saul advised David that he was too young and the giant a skilled veteran, but relented and gave him armor. The armor was heavy and David discarded it, rushing to combat in shepherd's garb. Moving toward Goliath, he took a stone and launched it with his sling. Struck in the forehead, Goliath fell dead on the spot. David moved forward and took the fallen champion's head. The Philistines fled.

It is said that strategy brings relative strength to bear against relative weakness. Let's follow the advice of countless articles and textbooks and make a list of David's and Goliath's apparent strengths and weaknesses:

| | Strengths | Weaknesses |
|---|---|---|
| David | Very brave | Small, inexperienced |
| Goliath | Huge, strong, experienced, and brave | ? |

This mismatch must have been Saul's concern as he tried to hold David back, then relented and gave him armor. In the story, it is only after the stone is slung that the listener's viewpoint shifts and one realizes that the boy's experience with a shepherd's sling is a strength, as is his youthful quickness. Then the listener realizes that David discarded the armor because it would only slow him down; had he come close enough to receive a blow from the giant, bronze armor would not have saved him. Finally, when the stone strikes Goliath's forehead, the listener suddenly discovers a critical weakness—Goliath's armor didn't cover this vital area. David's weapon delivered force with precision over a distance, neutering Goliath's supposed advantages of size and strength. The story teaches us that our preconceived ideas of strength and weakness may be unsound.

It is the victory of apparent weakness over apparent strength that gives this tale its bite. More than the deft wielding of power, the listener experiences the actual *discovery* of power in a situation—the creation or revelation of a decisive asymmetry. How someone can see what others have not, or what they have ignored, and thereby discover a pivotal objective and create an advantage, lies at the very edge of our understanding, something glimpsed only out of the corner of our minds. Not every good strategy draws on this kind of insight, but those that do generate the extra kick that separates "ordinary excellence" from the extraordinary.

## WAL-MART

Much of my work with MBA students and companies involves helping them uncover the hidden power in situations. As part of this process I often teach a case about Wal-Mart's founding and rise, ending in 1986 with Sam Walton as the richest person in the United States.[1] In a subsequent session I will follow up by discussing the modern Wal-Mart, pushing into urban

areas, stretching out to Europe, and becoming the largest corporation on the planet in terms of revenue. But the older case portrays a simpler, leaner Wal-Mart—a youthful challenger rather than the behemoth it has become. Hard as it is to believe today, Wal-Mart was once David, not Goliath.

Before beginning the discussion, I copy a phrase from the case onto the whiteboard and draw a box around it:

***CONVENTIONAL WISDOM:***
***A full-line discount store needs a population base of at least 100,000.***

The question for the group is simple: Why has Wal-Mart been so successful? To start, I call on Bill, who had some experience in sales during the earlier part of his career. He begins with the ritual invocation of founder Sam Walton's leadership. Neither agreeing nor disagreeing, I write "Sam Walton" on the board and press him further. "What did Walton do that made a difference?"

Bill looks at my labeled box on the board and says, "Walton broke the conventional wisdom. He put big stores in small towns. Wal-Mart had everyday low prices. Wal-Mart ran a computerized warehousing and trucking system to manage the movement of stock into stores. It was nonunion. It had low administrative expenses."

It takes about thirty minutes for six other participants to flesh out this list. They are willing to throw anything into the bin, and I don't stop them. I prod for detail and context, asking, "How big were the stores?" "How small were the towns?" "How did the computerized logistics system work?" And "What did Wal-Mart do to keep its administrative expenses so low?"

As the responses flood in, three diagrams take shape on the whiteboard. A circle appears, representing a small town of ten thousand persons. A large box drawn in the circle represents a forty-five-thousand-square-foot Wal-Mart store. A second diagram of the logistical system emerges. A square box represents a regional distribution center. From the box, a line marks the path of a truck, swooping out to pass by some of the 150 stores served by the distribution center. On the return path, the line passes vendors, picking up pallets of goods. The line plunges back to the square, where an "X" denotes cross-docking to an outgoing truck. Lines of a different color depict the data flows, from the store to a central computer, and then out to vendors

and the distribution center. Finally, as we discuss the management system, I draw the paths of the regional managers as they follow a weekly circuit: Fly out from Bentonville, Arkansas, on Monday, visit stores, pick up and distribute information, and return to Bentonville on Thursday for group meetings on Friday and Saturday. The last two diagrams are eerily similar—both revealing the hub structure of efficient distribution.

The discussion slows. We have gotten most of the facts out. I look around the room, trying to include them all, and say, "If the policies you have listed are the reasons for Wal-Mart's success, and if this case was published—let's see—in 1986, then why was the company able to run rampant over Kmart for the next decade? Wasn't the formula obvious? Where was the competition?"

Silence. This question breaks the pleasant give-and-take of reciting case facts. The case actually says almost nothing about competition, referring broadly to the discounting industry. But surely executives and MBA students would have thought about this in preparing for this discussion. Yet it is totally predictable that they will not. Because the case does not focus on competition, neither do they. I *know* it will turn out this way—it always does. Half of what alert participants learn in a strategy exercise is to consider the competition even when no one tells you to do it in advance.

Looking just at the actions of a winning firm, you see only part of the picture. Whenever an organization succeeds greatly, there is also, at the same time, either blocked or failed competition. Sometimes competition is blocked because an innovator holds a patent or some other legal claim to a temporary monopoly. But there may also be a natural reason imitation is difficult or very costly. Wal-Mart's advantage must stem from something that competitors cannot easily copy, or do not copy because of inertia and incompetence. In the case of Wal-Mart, the principal competitive failure was Kmart. Originally named the S. S. Kresge Corporation, Kmart was once the leader in low-cost variety retailing. It spent much of the 1970s and 1980s expanding internationally and ignoring Wal-Mart's innovations in logistics and its growing dominance of small-town discounting. It filed for bankruptcy in 2002.

After some moments I ask a more pointed question: "Both Wal-Mart and Kmart began to install bar-code scanners at cash registers in the early 1980s. Why did Wal-Mart seem to benefit from this more than Kmart?"

First used in grocery supermarkets, bar-code scanners at retail checkout stations are now ubiquitous. Mass merchandisers began to use them in the early 1980s. Most retailers saw the bar-code scanner as a way of eliminating the cost of constantly changing the price stickers on items. But Wal-Mart went further, developing its own satellite-based information systems. Then it used this data to manage its inbound logistics system and traded it with suppliers in return for discounts.

Susan, a human resources executive, suddenly perks up. Isolating one small policy has triggered a thought. I gave a talk the day before on "complementary" policies and she sees the connection. "By itself," she says, "it doesn't help that much. Kmart would have to move the data to distribution centers and suppliers. It would have to operate an integrated inbound logistics system."

"Good," I say, and point out to everyone that Wal-Mart's policies fit together—the bar codes, the integrated logistics, the frequent just-in-time deliveries, the large stores with low inventory—they are complements to one another, forming an integrated design. This whole design—structure, policies, and actions—is coherent. Each part of the design is shaped and specialized to the others. The pieces are not interchangeable parts. Many competitors do not have much of a design, shaping each of their elements around some imagined "best practice" form. Others will have more coherence but will have aimed their designs at different purposes. In either case, such competitors will have difficulty in dealing with Wal-Mart. Copying elements of its strategy piecemeal, there will be little benefit. A competitor would have to adopt the whole design, not just a part of it.

There is much more to be discussed: first-mover advantages, quantifying its cost advantage, the issue of competence and learning developed over time, the function of leadership, and whether this design can work in cities. We proceed.

With fifteen minutes to go, I let the discussion wind down. They have done a good job analyzing Wal-Mart's business, and I say so. But, I tell them, there is one more thing. Something I barely understand but that seems important. It has to do with the "conventional wisdom"—the phrase from the case I put on the whiteboard at the beginning of the class: "A full-line discount store needs a population base of at least 100,000."

I turn to Bill and say: "You started us out by arguing that Walton *broke* the conventional wisdom. But the conventional wisdom was based on the

straightforward logic of fixed and variable cost. It takes a lot of customers to spread the overhead and keep costs and prices low. Exactly how did Walton break the iron logic of cost?"

I push ahead, putting Bill into a role: "I want you to imagine that you are a Wal-Mart store manager. It's 1985 and you are unhappy with the whole company. You feel that they don't understand your town. You complain to your dad, and he says, 'Why don't we just buy them out? We can run the store ourselves.' Assuming Dad has the resources, what do you think of his proposal?"

Bill blinks, surprised at being put on the spot for a second time. He thinks a bit, then says, "No, it's not a good idea. We couldn't make a go of it alone. The Wal-Mart store needs to be part of the network."

I turn back the whiteboard and stand right next to the boxed principle: "A full-line discount store needs a population base of at least 100,000." I repeat his phrase, "The Wal-Mart store needs to be part of the network," while drawing a circle around the word "store." Then I wait.

With luck, someone will get it. As one student tries to articulate the discovery, others get it, and I sense a small avalanche of "ahas," like a pot of corn kernels suddenly popping. It isn't the store; it is the *network* of 150 stores. And the data flows and the management flows and a distribution hub. The network replaced the store. A regional network of 150 stores serves a population of millions! *Walton didn't break the conventional wisdom; he broke the old definition of a store*. If no one gets it right away, I drop hints until they do.

When you understand that Walton redefined the notion of "store," your view of how Wal-Mart's policies fit together undergoes a subtle shift. You begin to see the interdependencies among location decisions. Store locations express the economics of the network, not just the pull of demand. You also see the balance of power at Wal-Mart. The individual store has little negotiating power—its options are limited. Most crucially, the network, not the store, became Wal-Mart's basic unit of management.

In making an integrated network into the operating unit of the company, instead of the individual store, Walton broke with an even deeper conventional wisdom of his era: the doctrine of decentralization, that each kettle should sit on its own bottom. Kmart had long adhered to this doctrine, giving each store manager authority to choose product lines, pick vendors, and set prices. After all, we are told that decentralization is a good thing.

But the oft-forgotten cost of decentralization is lost coordination across units. Stores that do not choose the same vendors or negotiate the same terms cannot benefit from an integrated network of data and transport. Stores that do not share detailed information about what works and what does not cannot benefit from one another's learning.

If your competitors also operate this kind of decentralized system, little may be lost. But once Walton's insights made the decentralized structure a disadvantage, Kmart had a severe problem. A large organization may balk at adopting a new technique, but such change is manageable. But breaking with doctrine—with one's basic philosophy—is rare absent a near-death experience.

The hidden power of Wal-Mart's strategy came from a shift in perspective. Lacking that perspective, Kmart saw Wal-Mart like Goliath saw David—smaller and less experienced in the big leagues. But Wal-Mart's advantages were not inherent in its history or size. They grew out of a subtle shift in how to think about discount retailing. Tradition saw discounting as tied to urban densities, whereas Sam Walton saw a way to build efficiency by embedding each store in a network of computing and logistics. Today we call this supply-chain management, but in 1984 it was as an unexpected shift in viewpoint. And it had the impact of David's slung stone.

## ANDY MARSHALL

I first met Andy Marshall in mid-1990. He is the director of net assessment for the Defense Department, and his normal habitat is a small suite of offices in the Pentagon, just down the hall from the secretary of defense. Since the Office of Net Assessment was created in 1973, there has been only one director: Andrew Marshall. His challenging job is to think broadly about the security situation of the United States.

Andy Marshall and I were both interested in how the process of planning shapes strategic outcomes. He explained to me how during the Cold War the traditional budget cycle of the military and the Congress had created a reactive mindset.

“Our defense planning,” he said, “had become driven by the annual budgeting process.” Each year, he explained, the Joint Chiefs developed an assessment of the Soviet threat, which was essentially an estimate of their present and planned weapons inventory. The Pentagon then developed a response to the threat that amounted to a shopping list. Congress would appropriate some fraction of what was requested, and the cycle would begin again.

“This process of justifying expenditures as counters to Soviet expenditures conditioned U.S. actions on Soviet strengths, expressed as threats, not on Soviet weaknesses and constraints. We had a war strategy—a catastrophic spasm—but no plan about how to compete with the Soviet Union over the long term.”

Soft-spoken, Marshall watched my eyes, checking that I understood the implications of his statements. He took out a document, a thin sheaf of paper, and began to explain its meaning: “This document reflects thoughts about how to actually use U.S. strengths to exploit Soviet weaknesses, a very different approach.”

Titled “Strategy for Competing with the Soviets in the Military Sector of the Continuing Political-Military Competition,”[2] it had been written in 1976, near the end of the Ford administration, and bore marginal notations by President Carter’s secretary of defense, Harold Brown. It had evidently received attention. (Its authors were Andy Marshall and James Roche, who was, at that time, his assistant director.)*

This fascinating analysis of the situation worked to redefine “defense” in new terms—a subtle shift in point of view. It argued that “in dealing effectively with the other side, a nation seeks opportunities to use one or more distinctive competences in such a way as to develop *competitive advantage*—both in specific areas and overall.” It then went on to explain that the crucial area of competition was technology because the United States had more resources and better capabilities in that area. And, most important, it argued that having a true *competitive* strategy meant engaging in actions that imposed exorbitant costs on the other side. In particular, it recommended investing in technologies that were expensive to counter and where the counters did not add to Soviet offensive capabilities. For instance, increasing the accuracy of missiles or the quietness of submarines forced the Soviet Union to spend scarce resources on counters without increasing the threat to the United States. Investments in systems that made

Soviet systems obsolete would also force them to spend, as would selectively advertising dramatic new technologies.

Marshall and Roche's idea was a break with the budget-driven balance-of-forces logic of 1976. It was simple. The United States should actually compete with the Soviet Union, using its strengths to good effect and exploiting the Soviets' weaknesses. There were no complex charts or graphs, no abstruse formulas, no acronym-jammed buzz speak: just an idea and some pointers to how it might be used—the terrible simplicity of the discovery of hidden power in a situation.

As Andy Marshall and I spoke about this fourteen-year-old document in 1990, the Soviet Union was faltering. A year earlier the Berlin Wall had fallen. It would be another sixteen months before the USSR dissolved. But in 1990, when we discussed policy processes, before revisionists of all stripes started to rewrite history, it was clear that the Soviet Union was faltering because it was overextended. It was going broke economically, politically, and militarily. The United States' more accurate missiles, the rise of integrated circuits and the yawning technology gap, forward missile placements in Europe, Ronald Reagan's Strategic Defense Initiative, and investments in underwater surveillance had all put an unbearable pressure on the USSR to invest. But at the same time, its resources were limited: Saudi Arabia and the United Kingdom (with its new North Sea production) worked to keep oil prices down, denying the Soviet Union extra foreign exchange and making Europeans less anxious to buy Russian gas. The USSR's closed system and status prevented easy access to Western technology. The Soviets' war in Afghanistan had sapped money and internal political support. Behind almost all of these forces and events lay the indirect competitive logic that Marshall and Roche expressed in 1976: *use your relative advantages to impose out-of-proportion costs on the opposition and complicate his problem of competing with you*.

All my life, the Soviet Union had dominated discussions of politics, war, and peace. I had grown up diving beneath my third-grade desk until the all-clear sounded, and worrying about Sputnik. During my undergraduate years at the University of California, Berkeley, professors had me read Karl Marx, Lenin, John Reed's vivid account of the Russian Revolution (*Ten Days That Shook the World*), and articles on worker-peasant self-management during the revolution. Today, we know that during the five years I heard lectures on the wonders of revolution at Berkeley (1960–65),

about 1.5 million people were killed in the Soviet gulag. During the whole post-WWII period, the Soviet Union murdered upward of 20 million people, its own citizens and others under its control, a grisly improvement over the 40 million executed, purposefully starved, and worked to death in the 1917–48 period. As that strange and deadly empire collapsed, how much of the implosion was due to internal contradictions, and how much to the costs imposed on it by U.S. policy? As in any complex event, there were many causes. If Marshall and Roche's strategy was one of them, and I believe it was, then it compels our attention. Their insight was framed in the language of business strategy: identify your strengths and weaknesses, assess the opportunities and risks (your opponent's strengths and weaknesses), and build on your strengths. But the power of that strategy derived from their discovery of a different way of viewing competitive advantage—a shift from thinking about pure military capability to one of looking for ways to impose asymmetric costs on an opponent.

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Marshall and Roche's analysis included a list of U.S. and Soviet strengths and weaknesses. Such lists were not new, and the traditional response to them would have been to invest more to tip the "balance" in one's favor. But Marshall and Roche, like Sam Walton, had an insight that, when acted upon, provided a much more effective way to compete—the discovery of hidden power in the situation.