

## STRATEGIC FACTOR MARKETS: EXPECTATIONS, LUCK, AND BUSINESS STRATEGY\*

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Much of the current thinking about competitive strategy focuses on ways that firms can create imperfectly competitive product markets in order to obtain greater than normal economic performance. However, the economic performance of firms does not depend simply on whether or not its strategies create such markets, but also on the cost of implementing those strategies. Clearly, if the cost of strategy implementation is greater than returns obtained from creating an imperfectly competitive product market, then firms will not obtain above normal economic performance from their strategizing efforts. To help analyze the cost of implementing strategies, we introduce the concept of a strategic factor market, i.e., a market where the resources necessary to implement a strategy are acquired. If strategic factor markets are perfect, then the cost of acquiring strategic resources will approximately equal the economic value of those resources once they are used to implement product market strategies. Even if such strategies create imperfectly competitive product markets, they will not generate above normal economic performance for a firm, for their full value would have been anticipated when the resources necessary for implementation were acquired. However, strategic factor markets will be imperfectly competitive when different firms have different expectations about the future value of a strategic resource. In these settings, firms may obtain above normal economic performance from acquiring strategic resources and implementing strategies. We show that other apparent strategic factor market imperfections, including when a firm already controls all the resources needed to implement a strategy, when a firm controls unique resources, when only a small number of firms attempt to implement a strategy, and when some firms have access to lower cost capital than others, and so on, are all special cases of differences in expectations held by firms about the future value of a strategic resource. Firms can attempt to develop better expectations about the future value of strategic resources by analyzing their competitive environments or by analyzing skills and capabilities they already control. Environmental analysis cannot be expected to improve the expectations of some firms better than others, and thus cannot be a source of more accurate expectations about the future value of a strategic resource. However, analyzing a firm's skills and capabilities can be a source of more accurate expectations. Thus, from the point of view of firms seeking greater than normal economic performance, our analysis suggests that strategic choices should flow mainly from the analysis of its unique skills and capabilities, rather than from the analysis of its competitive environment.  
(STRATEGY IMPLEMENTATION; EXPECTATIONS; LUCK)

### Introduction

Research on corporate growth through acquisitions and mergers suggests the existence of markets for buying and selling companies (Porter 1980, p. 350; Schall 1972; Mossin 1973; Copeland and Weston 1979). Most empirical evidence seems to suggest that these markets are reasonably competitive. That is, the price an acquiring firm will generally have to pay to acquire a firm in these markets is approximately equal to the discounted present value of the acquired firm (Mandelkar 1974; Halpern 1973; Ellert 1976). Indeed, if above normal returns accrue to anyone in markets for companies, research seems to suggest that they will most likely go to the stockholders of the acquired, rather than the acquiring firms (Porter 1980, p. 352; Ellert 1976).

To suggest that, on average, acquiring firms cannot expect above normal returns from their investments in corporate acquisitions is not the same as suggesting that no firms ever experience such returns. Indeed, to the extent that imperfect competition in

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these markets exists or can be created, acquiring firms may be able to obtain such returns. Porter (1980, pp. 353–354) has isolated several such competitive imperfections.

From a broader perspective, markets for companies are just one example of strategic factor markets. Whenever the implementation of a strategy requires the acquisition of resources, a strategic factor market develops. These markets are where firms buy and sell the resources necessary to implement their strategies (Hirshleifer 1980). In the case of markets for companies, firms wishing to implement a strategy of product diversification may decide to do so by acquiring other firms. In this sense, because an acquired firm is the resource required to implement a firm's diversification strategy, the market for companies is a strategic factor market.

All strategies that require the acquisition of resources for implementation have strategic factor markets associated with them. Thus, for the strategy of being a low cost producer, a resource necessary for implementation may include, among other resources, large market share (Henderson 1979), and a relevant strategic factor market may be the market for market share (Rumelt and Wensley 1981). For a strategy of low volume, high margin sales (Porter 1980), a relevant resource may be a quality reputation, and a relevant strategic factor market may be the market for corporate reputations (Klein, Crawford, and Alchian 1978). For a strategy of being a product innovator, a relevant resource might be research and development skill (Thompson and Strickland 1980), and relevant strategic factor markets may include the labor market for research scientists (Hirshleifer 1980). For most strategies, management skill will be a resource required for successful implementation (Porter 1980). Thus, in this sense, managerial and other labor markets can also be strategic factor markets.

The existence of strategic factor markets has important implications for returns to product market strategies implemented by firms, for the size of the returns to product market strategies will depend on the cost of the resources necessary to implement them. And the cost of these resources will depend on the competitive characteristics of the relevant strategic factor markets. If strategic factor markets are perfectly competitive, then the full value of product market strategies will be anticipated when the resources necessary to implement these strategies are acquired, and firms will only be able to obtain normal returns from acquiring strategic resources and implementing strategies. Firms can only obtain greater than normal returns from implementing their product market strategies when the cost of resources to implement those strategies is significantly less than their economic value, i.e., when firms create or exploit competitive imperfections in strategic factor markets.

From a normative point of view, the existence of strategic factor markets suggests the importance of developing a conceptual framework that firms can use to anticipate and exploit competitive imperfections in strategic factor markets. Such a framework would assist firms in choosing high return product market strategies to implement. The primary objective of this paper is to begin to develop such a conceptual framework.

We develop our discussion of the competitive implications of strategic factor markets in two parts. In the first part, we argue that firms that wish to obtain expected above normal returns from implementing product market strategies must be consistently better informed concerning the future value of those strategies than other firms acting in the same strategic factor markets. We also argue that other apparent sources of advantage in strategy implementation are, in fact, either a manifestation of these special insights into the future value of strategies, or a manifestation of a firm's good fortune and luck. In the second part of the paper, we outline some ways that firms can become better informed about the future value of strategies being implemented, including through the analysis of a firm's competitive environment and through the analysis of its unique skills and capabilities. We conclude that environmental analysis, by itself, cannot create the required unique insights, while in some circumstances, the

analysis of a firm's unique skills and capabilities can. In a final section, our arguments are summarized and some of their implications for the practice and theory of strategy are discussed.

### **Competitive Imperfections in Strategic Factor Markets**

#### *Perfect Strategic Factor Market Competition*

When firms seeking to acquire resources to implement a strategy (strategizers) and firms who currently own or control these resources (controllers) have exactly the same, and perfectly accurate, expectations about the future value of product market strategies before they are actually implemented, then the price of the resources needed to implement these strategies will approximately equal their value once they are actually implemented. This is a conclusion of normal returns consistent with all perfect information models of competition where no competitive uncertainty exists (Hirshleifer 1980). Under these perfect expectation conditions, controllers will never sell their resources if the full value of those resources is not reflected in their price, nor will strategizers pay a price for a resource greater than its value in actually implementing a strategy. In such markets, all pure profits that could have been had when the strategy in question was implemented will be anticipated and competed away.

#### *Expectations in Strategic Factor Markets*

These perfect competition dynamics, and the normal returns from implementing strategies they imply, depend, of course, on the very strong assumption that all strategizer and controller firms have the same, and perfectly accurate, expectations concerning the future value of strategies. This is a condition that is not likely to exist very often in real strategic factor markets. More commonly, different firms in these markets will have different expectations about the future value of a strategy. These differences reflect uncertainty in the competitive environments facing firms. Because of these differences, some firm expectations will be more accurate than others, although firms will typically not know, with certainty, ahead of time how accurate their expectations are. When different firms have different expectations concerning the future value of a strategy, it will often be possible for some strategizing firms to obtain above normal returns from acquiring the resources necessary to implement a product market strategy, and then implementing that strategy.

Consider first the return potential of a firm that has more accurate expectations concerning the future value of a particular strategy than other firms. Two likely possibilities exist. On the one hand, several other firms might overestimate a strategy's return potential. This overestimation will typically lead to strategic factor market entry, competition, and the setting of a price for the relevant strategic resource *greater* than the actual value of that resource when it is used to implement a strategy. In this situation, firms with more accurate expectations concerning the return potential of a strategy will usually not enter the strategic factor market, for they will believe that in doing so they will probably sustain an economic loss by paying more for a strategic resource than that resource is worth in implementing a strategy. Thus, in the long run, firms with more accurate expectations will usually be able to avoid economic losses associated with buying overpriced strategic resources. Firms that do acquire these overpriced resources suffer from the "winner's curse," i.e., the fact that they successfully acquire the resources in question suggests that they overbid (Bazerman and Samuelson 1983).

The second possibility facing firms with more accurate expectations is that other firms, rather than overestimating the return potential of a strategy, might underestimate that strategy's true future value. Entry and competition in the strategic factor market

would, in this case, typically lead to a strategic resource price less than the actual future value of the strategy. In this situation, firms with more accurate expectations about the future value of the strategy in question will enter the strategic factor market and will pay the same for the relevant strategic resource as firms with less accurate (i.e., pessimistic) expectations. Firms with more accurate expectations will not be able to buy the relevant resource for less because of the inaccurate expectations held by ill-informed controllers and strategizers. And firms with more accurate expectations will certainly not want to buy these resources for more. As strategies are implemented, equal above normal returns will accrue to all those firms that acquired the resource and implemented the strategy, the well informed and ill-informed alike.

Thus, on the one hand, firms with more accurate expectations concerning the future value of a strategy can avoid economic losses due to the optimistic expectations of other firms. On the other hand, these firms will also be able to anticipate and exploit any opportunities for above normal returns in strategic factor markets when they exist. Thus, by avoiding losses and exploiting profit opportunities, these firms, over the long run, can expect to perform better than firms with less accurate expectations about the future value of strategies.

Despite the advantages of having a superior understanding of a strategy's return potential when acquiring the resources necessary to implement that strategy, firms without this superior insight can still obtain above normal returns when acquiring resources to implement strategies. This can occur when several of these firms underestimate the return potential of a strategy. Because of this underestimation, the price of the resources necessary to implement a strategy will be less than the actual future value of the strategy. In this sense, these firms are able to buy a strategy generated cash flow for less than the value of that cash flow. This is one definition of an above normal return. However, this above normal return must be a manifestation of these firms' good fortune and luck, for the price of the strategic resource acquired was based on expectations about the return potential of that strategy. Returns greater than what were expected are, by definition, unexpected. Unexpected superior economic returns are just that, unexpected, a surprise, and a manifestation of a firm's good luck, not of its ability to accurately anticipate the future value of a strategy.

Even well-informed firms can be lucky in this manner. Whenever *actual* returns to a strategy are greater than *expected* returns, the resulting difference is a manifestation of a firm's unexpected good fortune. The more accurate a firm's expectations about a strategy's return potential, the less of a role luck will play in generating above normal returns. In the extreme, though probably very rare, case where a firm knows with certainty the return potential of a strategy before that strategy is implemented, there can be no unexpected returns to that firm from implementing strategies, and thus no financial surprises. However, to the extent that a firm has less than perfect expectations, luck can play a role in determining a firm's returns to implementing its strategies.

#### *Other Apparent Competitive Imperfections*

Firms with consistently more accurate expectations concerning the return potential of strategies they are implementing can expect to enjoy higher returns from implementing their strategies over the long run. In this sense, differences in firm expectations constitute a strategic factor market competitive imperfection.

Some have suggested that other differences between firms, besides differences in firm expectations, can create competitive imperfections in strategic factor markets. These firm differences, it is thought, can prevent certain firms from implementing strategies that other firms can implement. However, close analysis of these other differences between firms suggests that, to the extent that they constitute competitive imperfections

in strategic factor markets, they are actually a manifestation of different expectations firms hold about the future value of strategies being implemented. In this sense, differences in firm expectations are the central source of above normal returns from acquiring resources from strategic factor markets to implement product market strategies. To see how other firm differences that can apparently give firms competitive advantages in strategic factor markets are actually manifestations of differences in firm expectations, consider the following examples.

*Lack of Separation.* It has been suggested that a competitive imperfection in a strategic factor market exists when a small number of firms seeking to implement a strategy already control all the resources necessary to implement it (Thompson and Strickland 1980). In this setting, these firms do not need to buy the resources necessary to implement a strategy, and thus apparently stand in some competitive advantage. An example of this lack of separation might include a uniquely well-managed firm seeking to implement a low cost manufacturing strategy. Such a firm already controls most, if not all, the resources necessary to implement such a strategy and thus is at an advantage compared to firms that would have to improve their efficiency in order to implement such a strategy (Porter 1980). However, from another point of view, whether or not a lack of separation between strategizers and controllers of this type is a competitive imperfection depends on the expectational characteristics of earlier strategic factor markets.

Firms begin their history with a relatively small endowment of strategy relevant resources (Lippman and Rumelt 1982; Kimberly and Miles 1981). Most resources for implementing strategies must be acquired from a firm's environment at some point in a firm's history (Pfeffer and Salancik 1978; Hannan and Freeman 1977). Once acquired, they can be combined and recombined in a variety of ways to implement different strategies. It certainly may be the case that a firm, some time ago, acquired the resources necessary to implement some strategy that it would now like to implement. If the value of these resources in their current strategic use was anticipated by strategizers and controllers at the time it was originally acquired, then these resources would have been priced at a competitive level. Thus, no competitive imperfection currently exists, even though the firm controls all the resources necessary to implement a strategy, because these resources were competitively priced in a previous strategic factor market.

If, as seems more likely, the resource was acquired for one purpose, and only recently did its value in implementing another strategy become known, then its current value was unanticipated when the resource was acquired. That is, this original strategic factor market was imperfectly competitive because of imperfect expectations held by firms at that time. Thus, any current above normal returns to a firm because it controls all the resources necessary to implement a strategy are attributable to this prior imperfectly competitive strategic factor market. From our previous discussion of expectations in such markets, we can conclude that either the firm in question had more accurate expectations about the ultimate value of these strategic resources when they were acquired, or that this firm did not expect these current advantages when the resources were acquired, in which case its current above normal returns from implementing a strategy are a manifestation of its good luck.

*Uniqueness.* Others have argued that when only one firm can implement a strategy, then a strategic factor market competitive imperfection exists. Such a firm may have a unique history or constellation of other assets, and thus may uniquely be able to pursue a strategy. IBM, for example, has a very large installed base of users that allows it to implement strategies that cannot be implemented by firms, like Honeywell and Burroughs, without such a base (Peters and Waterman 1982). In such settings,

competitive dynamics cannot unfold, and uniquely strategizing firms could obtain above normal performance from acquiring strategic resources and implementing strategies.

However, as before, a firm's uniqueness is actually a manifestation of the expectational attributes of a previous strategic factor market. The key issues become, how did the strategizing firm obtain the unique assets that allow it to develop the unique strategy it is implementing, what price did this firm have to pay for these assets, and what price must potential strategizers pay in order to reproduce this set of organizational assets so that they can enter and create a competitive strategic factor market? If the current value of "unique" resources in implementing a strategy was anticipated at the time those resources were acquired, then they would have been competitively priced, and any anticipated above normal returns would have been competed away. Thus, any current above normal returns enjoyed by a firm because of its ability to uniquely implement a strategy must either be a reflection of that firm's more accurate expectations of the value of that resource when it was acquired or, if the firm had no special expectations concerning the value of the resource when it was acquired, these above normal returns are a manifestation of a firm's good fortune and luck.

*Lack of Entry.* Another source of an apparent competitive imperfection in a strategic factor market exists when firms that could enter such a market by becoming strategizers do not do so. This lack of entry, however, like separation and uniqueness, is actually a special case of the expectations firms hold about the future value of strategies. Lack of entry might occur for one of at least three reasons. First, firms that, in principle, could enter, might not because they are not attempting to act in a profit maximizing manner. Second, potential strategizers may not have sufficient financial strength to enter a strategic factor market and compete for strategic resource. Finally, firms that, in principle, could enter, may not know how to, for they may not understand the return generating characteristics of the strategies that current strategizers are implementing. We will consider each of these possibilities in order.

*Profit Maximizing.* While certain examples of firms in strategic factor markets not behaving in profit maximizing ways can be cited (Porter 1980, p. 354), overall this is probably a rare event. Usually, firms do not knowingly abandon profit maximizing behavior (Hirshleifer 1980), although firms can be mistaken in their expectations about the potential value of a strategy (Roll 1985). These incorrect expectations could lead them to fail to enter a strategic factor market when more correct expectations would suggest that entry was appropriate. But this lack of entry is typically due to a firm's imperfect expectations about the true value of a strategy, not the abandonment of profit maximizing behavior (Roll 1985).

*Financial Strength.* Another apparent strategic factor market competitive imperfection exists when only a few firms have enough financial backing to enter a strategic factor market and attempt to acquire the resources needed to implement a product market strategy. Because only a few firms are competing for the relevant strategic resources, perfect competition dynamics are less likely to unfold, and it may be possible to obtain above normal economic returns from using the acquired resources to implement a strategy. IBM may, once again, be an example of a firm with this type of financial advantage, for its vast financial resources allow it to engage in strategic behaviors not possible for smaller firms. However, even such large differences in financial strength typically reflect expectational differences in strategic factor markets rather than differences between the financial strengths of firms, per se. Two ways in which differences in financial strength represent these differences in firm expectations are considered below.

First, in some circumstances, the actual future value of a given strategy may be the same for whatever firm implements it. In this case, if capital markets are efficient and

well informed concerning the actual future value of a strategy, then funds will flow to firms wishing to enter a strategic factor market with anticipated above normal returns. Sources of capital will recognize the possibility of above normal returns and will provide whatever funds are necessary to ensure that potential strategizers will enter and become actual strategizers (Copeland and Weston, 1979). The same holds true for controllers. In this way, competition within a strategic factor market will grow, and any anticipated pure profit will approach zero. This entry will only *not* occur if capital sources are underinformed about the possibility that firms can obtain above normal returns from acquiring resources to implement a strategy. In this situation, potential strategizers and controllers would not be able to obtain adequate financial backing from underinformed sources of capital to enter into the strategic factor market. This lack of entry creates the possibility of pure profits for firms that do enter.

However, when are capital sources likely to be underinformed concerning the anticipated returns from implementing a strategy? If potential strategizers and controllers are as well informed as actual strategizers and controllers, then it seems likely that the relevant information needed to generate return expectations falls into the general category of "publically available information," and thus would be taken into consideration by capital sources in making funding decisions (Fama 1970; Copeland and Weston 1979). Thus, only when actual strategizers and controllers have expectational advantages over potential strategizers and controllers is it likely that sources of capital will be underinformed. Thus, in this case, the lack of entry into a strategic factor market due to insufficient financial backing is, once again, a reflection of the expectational advantages enjoyed by some firms in a strategic factor market.

In an efficient capital market, when the actual future value of strategies does not depend on which firm implements them, then the inability of firms to attract sufficient financial support to enter and compete for strategic resources must reflect differences in expectations among current and potentially competing firms. However, sometimes a strategy implemented by one firm will have a greater future value than that same strategy implemented by other firms. In this situation, and under the assumption of efficient and well-informed capital markets, capital will flow to high return potential firms, while low return potential firms may not receive such financial backing (Copeland and Weston 1979). This lack of financial backing may prevent entry, and thus constitute a competitive imperfection in a strategic factor market.

However, when can one firm implementing a strategy obtain higher returns than other firms implementing that same strategy? The answer must be that the higher return firm already controls other strategically relevant assets not controlled by firms with a lower return potential (Chamberlin 1933; Copeland and Weston 1979). Thus, this firm's ability to attract financial backing is a reflection of its unique portfolio of strategically valuable assets and resources, resources not controlled by low return potential firms. In this sense, lack of entry is simply a special case of a firm implementing a unique strategy, and our previous discussion of expectations in strategic factor markets applies here as well. In short, firms with unique resources that give them a higher return potential are either exploiting special insights they had into the future value of those resources when those resources were acquired, or, if they enjoyed no such insights, they are simply enjoying their good fortune.

*Lack of Understanding.* The final reason entry might not occur is that entrants may not understand the return generating processes underlying a strategy. Firms form their return expectations about specific strategies based on their understanding of the economic return generating processes underlying these strategies, i.e., on their understanding of the cause and effect relations between organizational actions and economic returns (Lippman and Rumelt 1982). Some of this understanding may be of the "learning by doing" variety (Williamson 1975), and thus not available to potential

strategizers and controllers. When potential entrants do not understand the relationship between organizational actions and returns as well as current actors in a strategic factor market, potential entrants are likely to incorrectly estimate the true value of strategies. If they underestimate this value, then these firms will not enter the strategic factor market, even when expectations set with a more complete understanding of a strategy's return generating processes would suggest that entry was appropriate. Again, this lack of entry, and the competitive imperfection that it might create, reflects the different expectations firms have about the return potential of strategies to be implemented.

### Developing Insights into Strategic Value

Thus far we have argued that, in perfectly competitive strategic factor markets, the cost of the resources necessary to implement a strategy will approximately equal the discounted present value of that strategy once it is implemented. We have also argued that competitive imperfections in this market can give firms opportunities for obtaining above normal returns when implementing strategies, but that the existence of these imperfections depends on different firms having different expectations concerning the future value of a strategy. Other apparent competitive imperfections in strategic factor markets, including lack of separation, uniqueness, and lack of entry, in fact, reflect the expectational characteristics of either current or previous strategic factor markets.

In imperfectly competitive strategic factor markets, firms can obtain above normal returns from acquiring the resources necessary to implement strategies in one or a combination of two ways. First, firms with consistently more accurate expectations about the future value of a strategy than other firms can use these insights to avoid economic losses and obtain economic profits when acquiring resources to implement strategies. Second, firms can obtain above normal returns through luck when they underestimate the true future value of a strategy. Thus, because luck is, by definition, out of a firm's control, an important question for managers becomes, "How can firms become consistently better informed about the value of strategies they are implementing than any other firms?" Firms that are successful at doing this can, over time, expect to obtain higher returns from implementing strategies than less well-informed firms, although, as always, firms can be lucky.

There are fundamentally two possible sources of the informational advantages necessary to develop consistently more accurate insights into the value of strategies: the analysis of a firm's competitive environment and the analysis of organizational skills and capabilities already controlled by a firm (Barney 1985a,b; Porter 1980; Stevenson 1976; Lenz 1980). We briefly consider each of these possibilities below.

#### *Environmental Analysis*

Of these two sources of insights into the future value of strategies, environmental analysis seems less likely to systematically generate the expectational advantages needed to obtain expected above normal returns. This is because both the methodologies for collecting this information (Porter 1980; Thompson and Strickland 1979) and the conceptual models for analyzing it (e.g., Porter 1980; Henderson 1979) are in the public domain. It will normally be the case that firms applying approximately the same publicly available methodology to the analysis of the same environment will collect about the same information. And these same firms applying publicly available conceptual frameworks to analyze this information will typically come to similar conclusions about the potential of strategies. Thus, analyzing a firm's competitive environment cannot, on average, be expected to generate the expectational advantages that can lead to expected above normal returns in strategic factor markets.

Some would suggest that it is not the availability of these environmental methods



of data collection and analysis that is important, but rather the skill with which these methods are applied. More skilled firms can thus generate the required expectational advantages through an analysis of the competitive environment. However, the skills of environmental analysis can be "rented" from various investment banking and consulting firms, and thus skill advantages in analyzing competitive environments will typically only be temporary.

It may be the case that, in the collection of information concerning the value of a strategy from a firm's competitive environment, a firm might "stumble" onto some information that gives it an expectational advantage over other firms. However, if such information was obtained through the systematic application of environmental analysis techniques, then other firms besides the firm that has this information would have obtained it, and it would no longer give an advantage. Thus, only if the information was obtained through nonsystematic means can it give a firm expectational advantages. However, such information, because it does not result from the systematic application of environmental analysis methodologies, must be stochastic in origin. Any informational advantages obtained in this manner must reflect a firm's good fortune and luck, not their skill in evaluating the return potential of strategies.

### *Organizational Analysis*

While firms cannot obtain systematic expectational advantages from an analysis of the competitive characteristics of their environment, it may be possible, under certain conditions, to obtain such advantages by turning inwardly and analyzing information about the assets a firm already controls. Firms will usually enjoy access to this type of information that is not available to other firms. If these assets also have the potential to be used to implement valuable product market strategies, *and* if similar assets are not controlled by large numbers of competing firms, then they can be a source of competitive advantage. Examples of the types of organizational assets that might generate such expectations include special manufacturing know-how (Williamson 1975), unique combinations of business experience in a firm (Chamberlin 1933), and the teamwork of managers in a firm (Alchian and Demsetz 1972). Firms endowed with such organizational skills and abilities can be consistently better informed concerning the true future value of strategies they implement than other firms by exploiting these assets when choosing strategies to implement.

### **Summary and Implications**

In summary, firms seeking to obtain above normal returns from implementing product market strategies must have consistently more accurate expectations about the future value of those strategies when acquiring the resources necessary to implement them, although firms can be lucky. Moreover, while it is usually not possible to obtain these advantages through the analysis of a firm's competitive environment, firms can sometimes obtain them when choosing to implement strategies that exploit resources already under their control.

These conclusions have important implications for the practice and theory of strategy. For example, firms that do not look inwardly to exploit resources they already control in choosing strategies can only expect to obtain normal returns from their strategizing efforts. For a strategy of diversification through acquisition, this implies that firms that fail to discover unique synergies between themselves and potential acquisitions, but rather rely only on publicly available information when pricing an acquisition, can only expect normal returns from their acquisition strategies, though these firms might be lucky and acquire a firm with an unanticipated synergy. For a low cost manufacturing strategy, our arguments suggest that firms without any special

skills at low cost manufacturing can only expect normal returns from imitating the lost cost manufacturing strategies of other firms, while firms with cultural or other advantages in low cost manufacturing, if few other firms have these same advantages, can exploit them to obtain above normal returns from implementing a low cost strategy (Ouchi 1981; Peters and Waterman 1982). Also, firms that currently enjoy above normal returns may do so because of unique insights and abilities they controlled when the strategies generating high current returns were chosen. On the other hand, these firms might also have been lucky. Thus, above normal economic performance may not always be a sign of strategizing and managerial excellence (Peters and Waterman 1982).

Our emphasis on competition for the resources needed to implement strategies differs from much current work in the field of strategy. Much of this research is based on the observation that firms which compete in imperfectly competitive *product* markets enjoy above normal returns (Porter 1980). As a description of the correlation between imperfect product market competition and above normal returns, this research has significant theoretical and empirical support (Hirshleifer 1980). Its implications for managers are less clear. Simply because firms that compete in imperfectly competitive product markets enjoy above normal returns does not necessarily imply that firms that adopt strategies to *create* these product market imperfections will enjoy above normal returns. As we have suggested, this will depend on the competitive characteristics of the markets through which the resources necessary to implement these strategies are acquired, that is, on the competitive characteristics of strategic factor markets.<sup>1</sup>

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