

suggests that firms can earn above-average returns by producing either standardized products at costs below those of competitors (a cost leadership strategy) or by producing differentiated products for which customers are willing to pay a price premium (a differentiation strategy). We discuss the cost leadership and product differentiation strategies fully in Chapter 4.

As shown in Figure 1.2, the I/O model suggests that firms earn above-average returns by studying the external environment effectively as the foundation for identifying an attractive industry and implementing an appropriate strategy in it. For example, in some industries, firms can reduce competitive rivalry and erect barriers to entry by forming joint ventures. In turn, reduced rivalry increases the profitability potential of firms that are collaborating.⁸³ Companies that develop or acquire the internal skills needed to implement strategies required by the external environment are likely to succeed, while those that do not are likely to fail.⁸⁴ Hence, this model suggests that the characteristics

Figure 1.2 The I/O Model of Above-Average Returns

