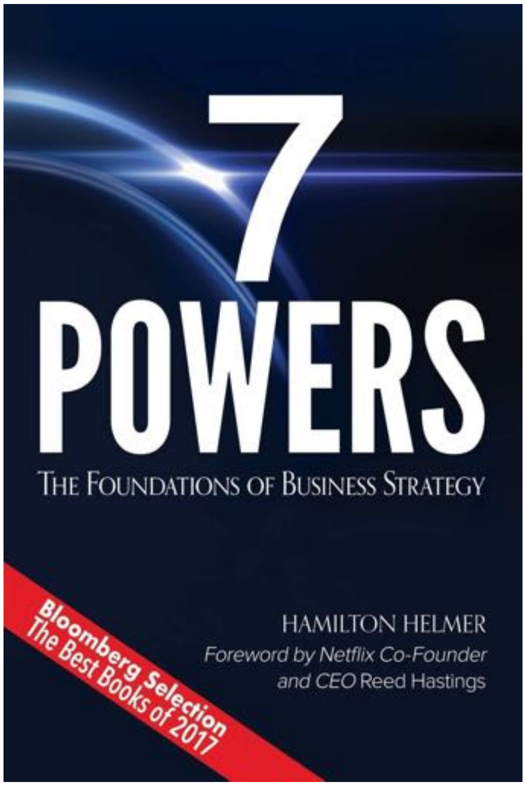
7 Powers — The Foundations of Business Strategy, by Hamilton Helmer

"This book is a uniquely clear and comprehensive distillation of strategy. It will change how you think about business and pull into focus your critical strategy challenges." —Reed Hastings, Netflix CEO



Summary: the book opens with a glowing foreword by Reed Hastings, CEO of Netflix. Hastings, with an enviable net worth of $6.2 billion (2021), describes his first meeting with author Hamilton Helmer as "Incisive. Extraordinary."

Helmer later became an early investor in Netflix, and influenced Hasting's approach to strategy. Netflix now has a market cap of nearly $300 billion (Nov-2021) with an enduring competitive advantage. They've nailed strategy.

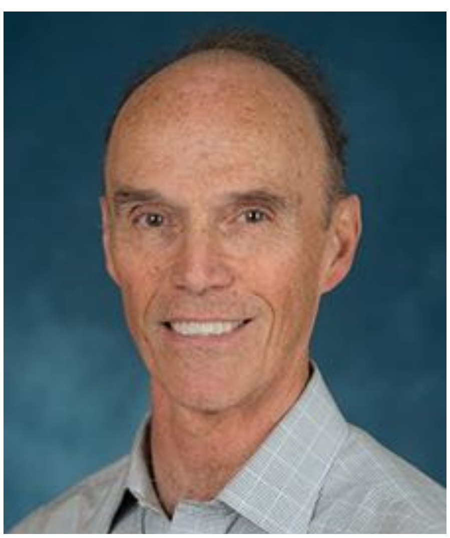
Power is defined as *"the set of conditions creating the potential for persistent differential returns,"* and **strategy** is *"a route to continuing Power in significant markets."*

Each of the 7 powers has a **Benefit** and a **Barrier**. The benefit augments cash flow, and the barrier protects against competitive arbitrage.

The goal of this book is to share a strategy framework that is "simple, but not simplistic," so leaders like you can actually use it in "high flux formative moments" that often make or break your company, e.g. WFIO moments.

7 Powers is one of the most useful books I've ever read.

"Strategy has one and only one objective: maximizing potential fundamental business value."



Hamilton Helmer

Author bio: Hamilton Helmer is the Co-Founder and Chief Investment Officer of Strategy Capital. He has spent his career as a practicing business strategist: advising companies, investing based on strategy insights and teaching strategy. At Helmer & Associates (later Deep Strategy), a consulting firm he founded, he led over 200 strategy projects with major clients such as Adobe Systems, Agilent Technologies, Coursera, Hewlett- Packard, John Hancock Mutual Life, Mentor Graphics, Netflix, Raychem, and Spotify. With the Strategy Capital team, he continues to advise the founders of companies such as Brex, Scale AI, Lyft, Convoy, Insitro and Ginkgo Bioworks. In the last three decades he has also utilized his strategy concepts as a public equity investor, first with proprietary accounts and more recently with Strategy Capital. Prior to Helmer & Associates he was employed at Bain & Company. He holds a Ph.D. in Economics from Yale University and is a Phi Beta Kappa graduate of Williams College. Mr. Helmer taught Business Strategy in the Economics Department of Stanford University for a decade until 2018.

2-5-11-20: a distillation exercise, i.e. clarity via constraint.

- **This book in 2 words:** competitive advantage
- **This book in 5 words:** competitive advantage starts with invention
- **This book in 11 words:** competitive advantage starts with invention and requires power (persistent differential returns)
- **This book in 20 words:** competitive advantage starts with invention and requires power (persistent differential returns). “Barriers” are more valuable than “Benefits”. Timing is crucial.

This powerhouse of a book is divided into two parts: 1) Strategy *Statics* (description of the 7 Powers), and 2) Strategy *Dynamics* (how to achieve and retain said powers).

I’m going to give you the entrée upfront. Here are the 7 Powers, along with the companies highlighted:

1. Scale Economies: a business in which per unit cost declines as production volume increases.	NETFLIX, intel
2. Network Economies: a business in which the value realized by a customer increases as the user base increases.	BranchOut, LinkedIn, Facebook
3. Counter-Positioning: a new, superior business model which the incumbent does not mimic due to anticipated damage to their existing business.	Vanguard
4. Switching Costs: the value loss expected by a customer that would be incurred from switching to an alternative supplier for additional purchases; value is derived from compatibility across purchases from the incumbent firm over time.	SAP
5. Branding: the durable attribution of higher value to an objectively identical offering that arises from historical information about the seller (and subsequent willingness to pay).	TIFFANY & CO.
6. Cornered Resource: preferential access at attractive terms to a coveted asset that can independently enhance value.	PIXAR
7. Process Power: embedded company organization and activity sets which enable lower costs and/or superior product, and which can be matched only by an extended commitment.	TOYOTA

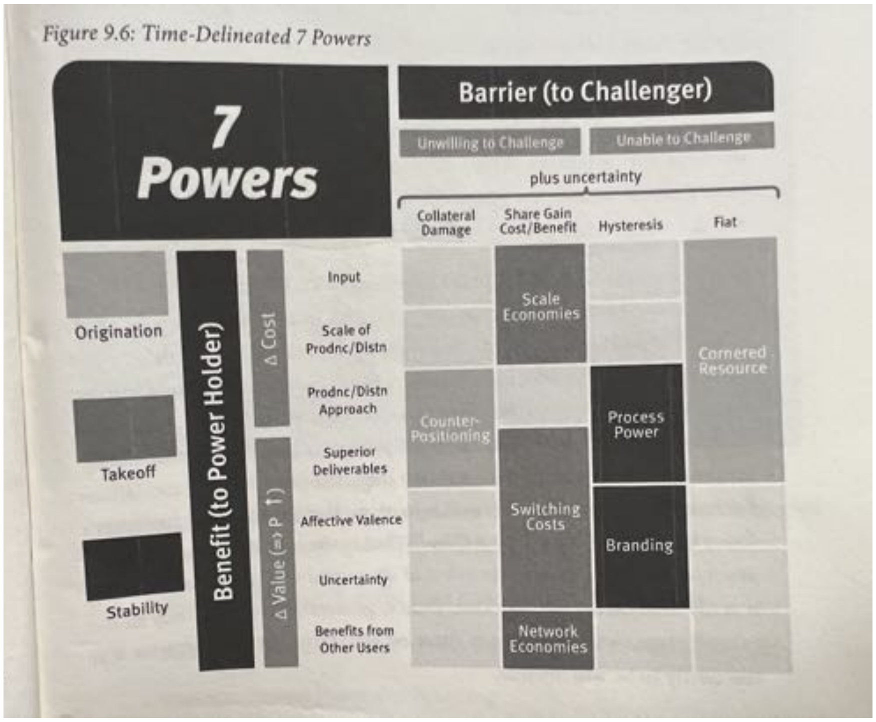


Figure 9.6: Time-Delineated 7 Powers

Each of the 7 Powers has a **Benefit** and a **Barrier** which we'll discuss more below.

Helmer uses a chart to depict all this. Note the **Benefit** is on the left Y-axis, and the **Barrier** is on the X-axis.

The 7 Powers tend to cluster around the phase of the company:

• *"Origination":* startups tend to obtain Counter-Positioning and Cornered Resource power
• *"Takeoff"*: Scale/Network Economies, Switching Costs
• *"Stability":* Branding, Process Power

"Always look for the barrier first."

A big miss? Helmer is transparent about excluding a large set of corporate America from this book when he writes: *"The special considerations arising from the interplay of multiple businesses under a single corporate roof is the subject matter of Corporate Strategy. This is beyond the scope of the current edition of this book."*

- A lot of companies have "multiple businesses" under their roof—not to mention multiple products—which create competing priorities and subsequent complexity that makes this whole endeavor so challenging.
- Alas, for those looking for these answers, I highly recommend *Zone to Win* by Geoffrey Moore.

I: Strategy Statics

Chapter 1: Scale Economies

Scale economies power, or economies of scale, represent a power bestowed on a business in which per unit cost declines as production volume increases. This is Econ 101-type stuff, but it never hurts to review: the lower unit costs unlock greater gross profit margin opportunities and also low-pricing power in the event of a competitor attack.

Remember **Blockbuster**? I wasn't aware that half of their revenue came from **late fees.** To compete with newcomers like **Netflix**, they'd have to eliminate late fees—the revenue equivalent of cutting off your limbs.

This gave Netflix time to scale up while Blockbuster—predictably, even rationally—did little to change.

Blockbuster would file for bankruptcy in 2010, just three years after Netflix eased into video streaming in 2007. Before then, Netflix was primarily a DVD-by-mail business since their founding in 1997).

House of Steel: But Netflix's true superpower wouldn't manifest until 2012 when they launched their first original: *House of Cards.* This strategic decision—advocated strongly by **Ted Sarandos, Chief Content Officer**—bet big on producing original content at a fixed cost. Netflix's growing subscriber base allowed them to realize *declining unit costs per subscriber.*

This advantage put other streaming competitors in a "competitive cul-de-sac," as Helmer calls it, where the competition is faced with two unattractive options: 1) compete toe-to-toe with Netflix on price & quality thereby crushing their P&L, or 2) offer less at a higher price and risk subscriber churn.

Intel vs. AMD: Helmer spills limited ink on this famous rivalry, but suffice to say Intel achieved the power of scale economies before AMD. As a result, Intel was able to successfully defend their market-leading position for decades.

Scale economies power, according to Helmer, can also emerge from sources beyond fixed costs:

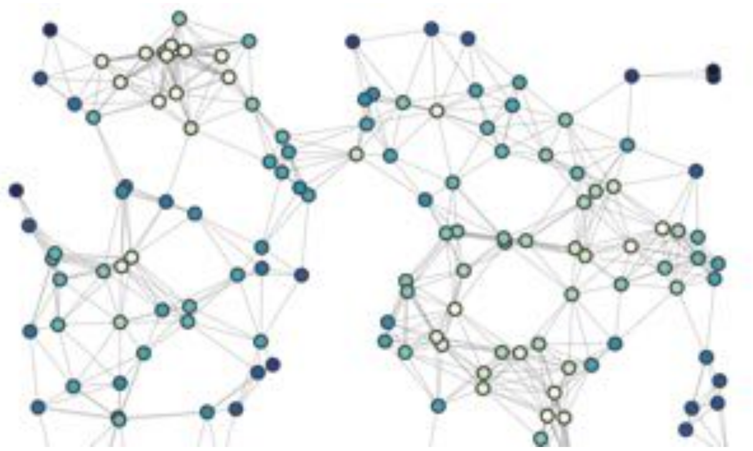
1. *Volume/area:* lower per-volume costs due to production costs tied to area with utility tied to volume, e.g. warehousing.
2. *Distribution networks density:* lower per-delivery costs due to proximity of recipients along route, e.g. Alto Pharmacy.
3. *Learning economies:* this one's a bit opaque, but Helmer suggests if learning is correlated with production levels, then a scale advantage accrues to the leader. No example provided.
4. *Purchasing economies:* lower cost per-item due to significantly larger order size, e.g. Wal-mart.

Chapter 2: Network Economies

Network economies represent a power bestowed on a business in which the value realized by a customer increases as the user base increases.

BranchOut: the classic story of a social media tech company attempting to "steal the graph" from Facebook. BranchOut peaked at 14 million users while attempting to build a bridge between Facebook and LinkedIn. One of their growth tactics was to spam post all your Facebook friends (a practice FB banned in 2012-2013).

Network economies—also referred to as network effects—can be found in many places outside of social media. Other network economy businesses include: landline telephones, IBM mainframes, Microsoft operating systems, ETFs. What do these businesses have in common?



As the network grows, the value derived by each participant increases. Think of the first two landline telephones: Jack can call Jill, and Jill can call Jack. That's about it. But each additional phone user makes the network way more interesting—and valuable.

For more on this topic, I highly recommend Ben Thompson's article, *The Moat Map*.

Network economies entitle the possessor with one massive advantage: **premium pricing.** The more valuable the network, the more the network can charge to access it.* Linkedin Recruiter = top dollar. Facebook Ads = premium price.

**In social media, the product is free because you are the product, so the premium price is paid by companies trying to access you.*

Lastly, Helmer cites a few additional attributes of network economies:

1. *Winner takes all:* the first company to achieve significant scale captures majority market scale
2. *Boundedness:* the inherent nature of the network, e.g. FB is "personal," Linkedin is "professional," and Tinder is, for lack of a better description, "people looking for other people to do stuff with."

Chapter 3: Counter-Positioning

Counter-positioning power entails a startup with a new, superior business model which the incumbent does not mimic due to anticipated damage to their existing business.

Vanguard takes center stage. Namely, John "Jack" Bogle who leveraged counter-positioning to great effect with his index fund approach. Helmer describes the challenge eloquently:

"Swimming against the riptide of self-interest in the investment business is not for the faint of heart."

Bogle didn't invent the idea of index fund, but he did draw inspiration from Wells Fargo's pioneering work, along with Paul Samuelson's wonderfully contrarian article *Challenge to judgment*, first published in *The Journal of Portfolio Management* in 1974.

Bogle faced a formidable adversary: all actively-managed mutual funds. Fidelity was the 300-pound gorilla in the space.

Here is Bogle at 35, the then Vice President of Wellington Management Company which would later back Jack's Vanguard startup.

One of the hallmarks of a successful counter-positioning strategy is the incumbents are glacially slow or unable to respond. Helmer cites multiple examples:

- Dell vs. Copaq
- Nokia vs. Apple
- Amazon vs. Borders
- In-N-Out vs. McDonalds
- Netflix vs. Blockbuster
- Charles Schwab vs. Merrill Lynch

The startup's new business model empowers them to **lower costs** (as in the case of Vanguard, by removing expensive portfolio managers and trading fees) and/or **charge higher prices**. The "barrier" of the counter-positioning power is **collateral damage for the incumbent** were they to shift business models.

Oftentimes it doesn't make rational business sense for the incumbent to disrupt their lucrative cash cow. Other times the incumbent underestimates the newcomer in the vein of Charlie Munger's "Dislike/Hating" psychological tendency. Whatever the reason, the incumbent rests on their laurels, watching the tide slowly turn against them.

> *"One of the ironies of Counter-Positioning is that the higher the incumbent's margins, the higher the SLM.* This of course simply reflects that the incumbent has more to lose by erosion of their old business model. Counter-positioning therefore can present a potent challenge to an entrenched highly successful incumbent."* Gotta love capitalism.

*Surplus Leader Margin (SLM): the incumbent's profit margin if they were to price at the point where the competitor's margin is zero.

Chapter 4: Switching Costs

Switching costs power stem from the value loss expected by a customer that would be incurred from switching to an alternate supplier for additional purchases.

Think ERP, and other deeply integrated softwares that have been customized to power dozens—if not hundreds—of other systems, not to mention the specialized training to use them.

It's a bit like a **walled garden**, and even getting through is risky. Helmer cites the horror story of HP attempting to switch from a legacy system to SAP in 2004. Simply put, it did not go well and Carly Fiorina (then CEO) said **the blunder cost them $160 million**. Stories like this add a jigger of fear to the switching cost cocktail. For most, the drink is just too costly.

The time, money and resources required to replace all that webbing is massive, and therefore a disincentive to entertain a competitor. This is how SAP can keep customers despite horrendous customer service reviews and a [low NPS score](#) (4).

The **benefit** of Switching Costs power is the ability to charge higher prices for additional products to existing customers. Since the customer is "trapped" for lack of a better word, prices in the walled garden can get spendy. This results in fantastic net expansion and unit economics for SaaS companies.

The **barrier** of Switching Costs power is that competitors must (somehow) compensate customers for the massive switching costs, i.e. free pilots, heavily discounted pricing, waived implementation fees, the promise of reduced maintenance costs, and/or a vastly superior product + ecosystem.

Chapter 5: Branding

Branding power is "the durable attribution of higher value to an objectively identical offering that arises from historical information about the seller."

Tiffany & Co., Cartier, Prada, Christian Louboutin, Jordans, [insert expensive brand here]. You get the point. The brand has a reputation, and as a result they can command a higher price—and the accompanying profit margins to boot.

The Empire Diamond, by Tiffany & Co. It can be yours for $20 million. It's only 80 carats though. . .

I take issue with Helmer's requirement of an "objectively identical offering" because that is, in itself, somewhat subjective. Perhaps a Tiffany's diamond *could* be considered identical to a Costco diamond, but the "offering" is certainly not, e.g. shopping experience, service, packaging, provenance.

Counterpoint: I also see where Helmer is absolutely correct in identical offerings in the case of **Fiji Water** and **San Pellegrino** sparkling water, for example. Perhaps we could substitute "objectively identical" with "mostly similar".

Chapter 6: Cornered Resource

Cornered Resource power entails preferential access at attractive terms to a coveted asset that can independently enhance value. The example provided is somewhat debatable, but nevertheless compelling: Pixar, or more specifically, the Pixar "Brain Trust."

The Brain Trust is a small group of creative leaders at Pixar who oversee development on all movies. The group came about during the development of *Toy Story*.

The original group included **John Lasseter, Andrew Stanton, Pete Docter,** and **Joe Ranft**. There are now ~16 creative leaders in the Pixar Brain Trust.

The **benefit** of Cornered Resource power is increased revenue or decreased costs—due to the "cornered resource" asset. In the case of Pixar, the cornered resource is the Pixar Brain Trust which yields superior quality CGI feature films. A cornered resource could also be: a patent on a successful drug, rights to a large natural gas shale play, a hedge funds trading algorithm or research methodology. You get the point: something valuable, something proprietary.

The **barrier** of Cornered Resource power depends on the resource. It could be patent law, mining rights, and whatever creates the loyalty within the Pixar Brain Trust—Camaraderie? Chemistry? Congenial company? The feeling of producing world-class work with teammates? Helmer calls this barrier **"fiat"** which is a bit confusing, but who am I to judge it's his book.

Helmer gives a nod to George Fisher, the former CEO of Motorola, who Helmer applauds for doing "a fine job leading Motorola." But since Fisher had a good result at Motorola (growth), but later a bad result at Kodak (bankruptcy), Fisher doesn't qualify as a cornered resource. Hmmm. . .

At times it felt like Helmer couldn't quite figure out what to do with the humans/people that run businesses, so he lumped them into "coveted assets" along with patents, mineral rights, and proprietary technologies. And while no one can deny the remarkable, company-changing value of good people, finding them in the "Cornered Resource" power feels a bit forced.

Chapter 7: Process Power

Process Power is derived from embedded company organization and activity sets which enable lower costs and/or superior product, and which can be matched only by an extended commitment.

The example provided is the **Toyota Production System (TPS)**—how they make cars—which results in unsurpassed quality and durability.

The **benefit** of Process Power is improved product quality and/or lower costs as a result of process improvements embedded within the company.

The **barrier** of Process Power is described as "hysteresis," a somewhat antiquated term usually reserved for magnetics. I think what Helmer's getting at with process power is it's **hard to replicate**. If the complexity is high enough, there are no evolutionary shortcuts to iterate and evolve as effectively as Toyota. It's a bit of a circular argument because Helmer cites that process power is basically operational excellence, *but only if the process is inimitable.* Interestingly, Toyota is the only example of Process Power provided.

Fun fact: A Model-T, a groundbreaking yet simply-designed car, has 7,882 assembly steps. Made me wonder if process power is more likely to be found in *highly-complex* products or services.

Reference: Helmer gives a nod of admiration to Professor Richard R. Nelson for his "seminal contributions" to Strategy. This made me want to read his book, *An Evolutionary Theory of Economic Change*, written with Sydney Winter in 1984, from which we quote:

"Our firms are modeled as simply having, at any given time, certain capabilities and decision rules. Over time these capabilities and rules are modified as a result of both deliberate problem-solving efforts and random events."

Professor Nelson's influence on Helmer is noticeable throughout this book, and I imagine Nelson also influenced Matt Ridley's brilliant book, *The Evolutions of Everything* (2016), which DBT readers may recognize.

Professor Richard R. Nelson

Chapter 8: The Path to Power

If you memorize these five words, you've grasped chapter 8: **All Power starts with invention.**

Some call it "innovation," others might favor "creativity." In the case of Netflix, they decided to invest 1-2% of their DVD-driven revenue into streaming ~2005. In early 2007 they launched "Watch Now" with about 1,000 titles (their DVD business had 100,000+). And while Netflix didn't "invent" streaming, they iterated a path to perfecting it—with many proprietary inventions along the way, e.g. machine learning clustering of recommendations, database architecture, etc.

"Operational excellence is not a strategy." —Professor Michael E. Porter

Netflix paid $100 million to produce *House of Cards* (2 seasons, 26 episodes). This was a quantum leap of "invention" for Netflix in two primary ways: 1) the *quality* of the show earned 9 Emmy nominations, and 2) the cost was *fixed*. **Starting in 2013, Netflix would go on to produce 160 originals in 4 years!**

Invention. Netflix is also known to A/B test almost everything about their streaming software, a process by which they operationalize improvement, and occasionally invention. **Netflix was a client of mine when I worked at Optimizely.*

“Action, creation, risk—these lie at the root of invention. Business value does not start with bloodless analytics. Passion, monomania and domain mastery fuel invention. . .”

Perhaps overly simplified, Helmer also cites *“breakthrough products, engaging brands, innovative business models”* as examples of invention.

Chapter 9: The Power Progression

“As a strategist and value investor, I cringe every time a CEO or CFO says they are pleased by the entrance into their market of a well-heeled competitor, insisting it “validates the market.”

Why does Helmer cringe? Because during the “takeoff” phase, businesses fiercely compete to achieve relative scale first—”and there can be only one winner.”

Helmer shares his framework for dealing with power over time: **origination** → **takeoff** → **stability**, with a focus on Network Economies, Scale Economies, and Switching Costs which, if not achieved within the takeoff window, are lost forever.

Power is most likely to be achieved during a certain phase of a company’s evolution:

Origination	**Takeoff**	**Stability**
• Cornered Resource • Counter-Positioning	• Network Economies • Scale Economies • Switching Costs	• Branding • Process Power

If you like Helmer’s stuff, then I’d highly recommend the below podcasts with him (click for link):