# The Strategic Management Frameworks

Arnoldo Hax

# The Frameworks for Competitive Positioning

- Porter
- Resource-Based View of the Firm
- The Delta Model

## Porter's Framework: Explaining the Profitability of a Business

**Competitive Positioning**

Achieving sustainable competitive advantage

**Industry Structure**

Factors affecting industry profitability

**Strategy Formulation and Implementation**

Defining and executing the managerial tasks

# Figure 5-1. Elements of Industry Structure: Porter's Five- Forces

## Barriers to Entry

- Economics of scale
- Product differentiation
- Brand identification
- Switching cost
- Access to distribution channels
- Capital requirements
- Access to latest technology
- Experience and learning effects

## Government action

- Industry protection
- Industry regulation
- Consistency of policies
- Capital movements among countries
- Custom Duties
- Foreign exchange
- Foreign ownership
- Assistance provided to competitors

## Rivalry among Competitors

- Concentration and balance among competitors
- Industry growth
- Fixed (or storage) cost
- Product differentiation
- Intermittent capacity increasing
- Switching costs
- Corporate strategic stakes

## Barriers to Exit

- Asset specialization
- One-time cost of exit
- Strategic interrelationships with other businesses
- Emotional barriers
- Government and social restrictions

**New Entrants**

Threat of New Entrants

**Industry Competitors**

Intensity of Rivalry

**Suppliers** — Bargaining Power of Suppliers

**Buyers** — Bargaining Power of Buyers

**Substitutes**

Threat of Substitutes

## Power of Suppliers

- Number of important suppliers
- Availability of substitutes for the suppliers products
- Differentiation or switching cost of suppliers products
- Suppliers threat of forward integration
- Industry threat of backward integration
- Suppliers contribution to quality or service of the industry products
- Total industry cost contributed by suppliers
- Importance of the industry to suppliers profit

## Availability of Substitutes

- Availability of close substitutes
- User's switching costs
- Substitute producer's profitability and aggressiveness
- Substitute price-value

## Power of Buyers

- Number of important buyers
- Availability of substitutes for the industry products
- Buyers' switching costs
- Buyers threat of backward integration
- Industry threat of forward integration
- Contribution to quality or service of buyers products
- Total buyers cost contributed by the industry
- Buyers profitability

## Figure 5-5. Porter's Five-Forces Model Applied to the Pharmaceutical Industry in the Early 1990s

### Barriers to Entry (Very Attractive)

• Steep R & D experience curve effects
• Large economies-of-scale barriers in R & D and sales force
• Critical mass in R & D and marketing require global scale
• Significant R & D and marketing costs
•High risk inherent in the drug development process
• Increasing threat of new entrants coming from biotechnology companies


### Bargaining Power of suppliers (Very Attractive)

• Mostly commodities
•Individual scientists may have some personal leverage

### Bargaining Power of Buyers (Mildly Unattractive)

• The traditional purchasing process was highly price insensitive: the consumer (the patient) did not buy, and the buyer (the physician) did not pay
• Large Power buyers, particularly plan sponsors and cost containment organizations, are influencing the decisions to prescribe less expensive drugs
• Mail-order pharmacies are obtaining large discounts on volume drugs
• Large aggregated buyers (e.g., hospital suppliers, large distributors, government institutions) are progressively replacing the role of individual customers
• Important influence of the government in the regulation of the buying processes

### Threat of Substitutes (mildly Unattractive)

• Generic and "me-to" drugs are weakening branded, proprietary drugs
• More than half of the life of the drug patent is spent in the product development and approval process
• Technological development is making imitation easier
• Consumer aversion to chemical substances erodes the appeal for pharmaceutical drugs

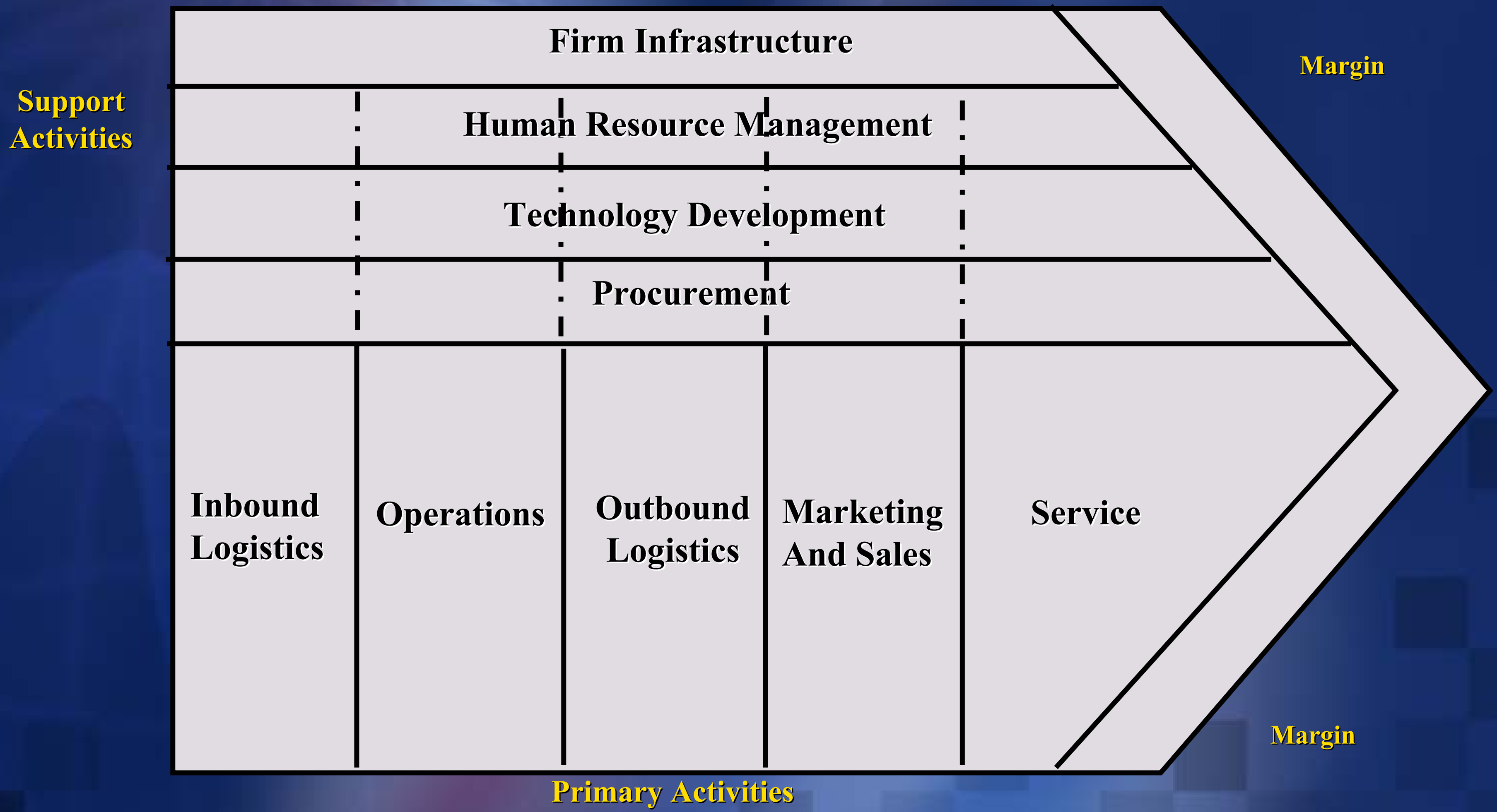
### Intensity of Rivalry (Attractive)

• Global competition concentrated among fifteen large companies
• Most companies focus on certain types of disease therapy
• Competition among incumbents limited by patent protection
• Competition based on price and product differentiation
• Government intervention and growth of "Me-too" drugs increase rivalry
• Strategic alliances establish collaborative agreements among industry players
• Very profitable industry, however with declining margins

SUMMARY ASSESSMENT OF THE INDUSTRY ATTRACTIVENESS (Attractive)

# Make a business in an attractive industry where you can excel; then excel by achieving a low cost of differentiation through unique activities

## The Value Chain




Source: This setup for the value chain was suggested by Michael E. Porter (1985).

# Merck's Value Chain

## Firm Infrastructure

- Very strong corporate culture
- One of America's best managed companies
- Superb financial management and managerial control capabilities
- Very lean structure
- Highly concerned about ethics, ecology, and safety

## Human Resources Management

- Friendly and cooperative labor relations
- Strong recruiting programs in top universities
- Excellent training and development
- Excellent rewards and health-care programs

## Technology Development

- Technology leader; developer of break-path drugs (e.g., Mevacor, Vasotec, Sinement
- Intensive R & D spending
- Strengthening technological & marketing capabilities through strategic alliances (DuPont, Astra, and Johnson & Johnson)
- Fastest time-to-market in drug discovery and drug approval processes

## Procurement

- Vertical integration in chemical products

## Inbound Logistics

## Manufacturing

- Increasing manufacturing flexibility and cost reductions
- Stressing quality and productivity improve-ments
- Global facilities network

## Outbound Logistics

- Acquisition of Medco provides unique distribution capabilities and information technology support
- Medco is the number one mail-order firm

## Marketing And Sales

- Marketing leadership
- Large direct sales staff
- Global marketing coverage
- Leverage through Medco, including powerful marketing groups
- Medco IT infra-structure & database, covering patients, physicians, & drug uses
- Strategic alliances

## Service

- Medco's service excellence has attracted major corporations and health-care organization as clients.

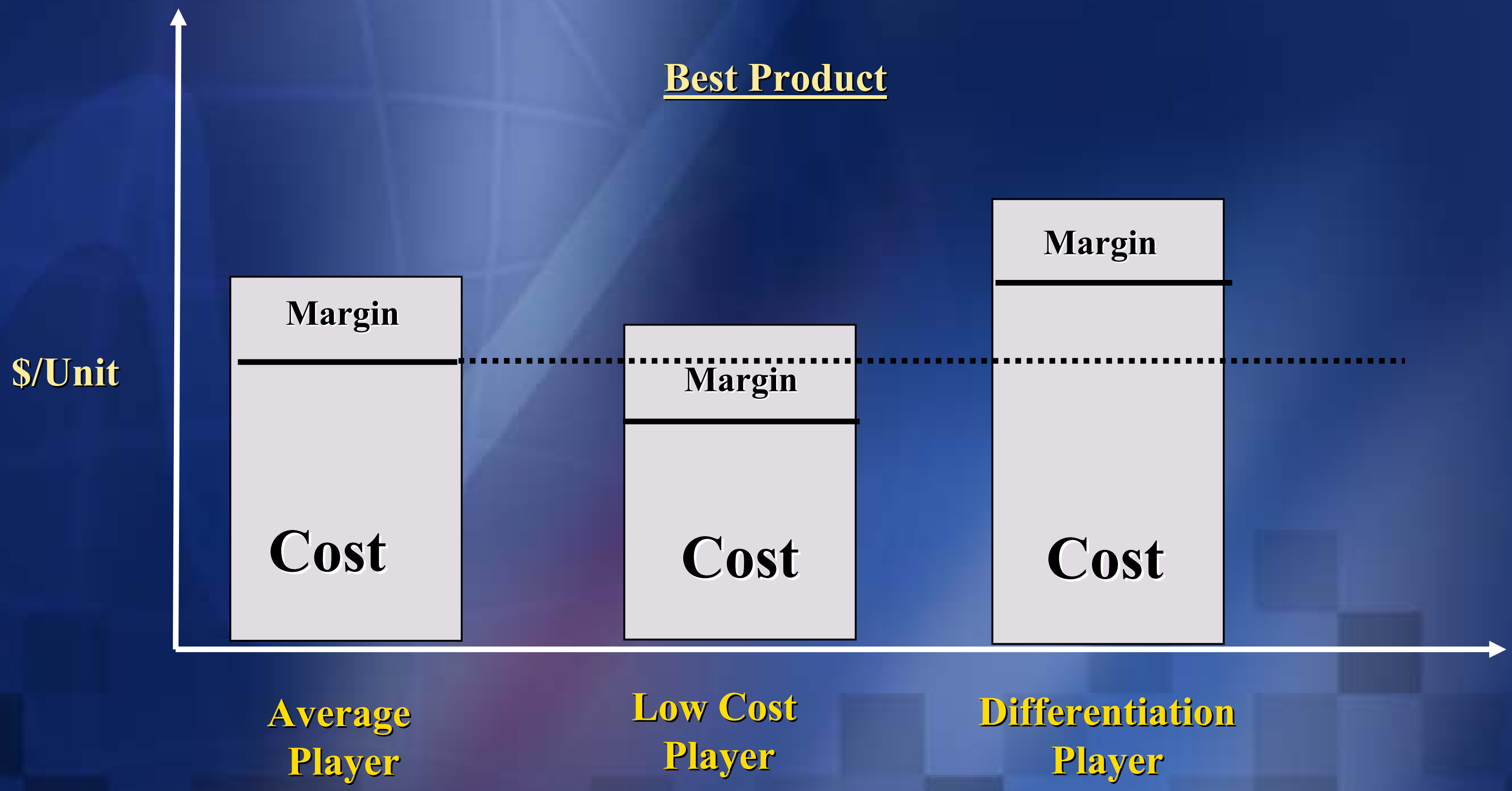
Margin

Margin

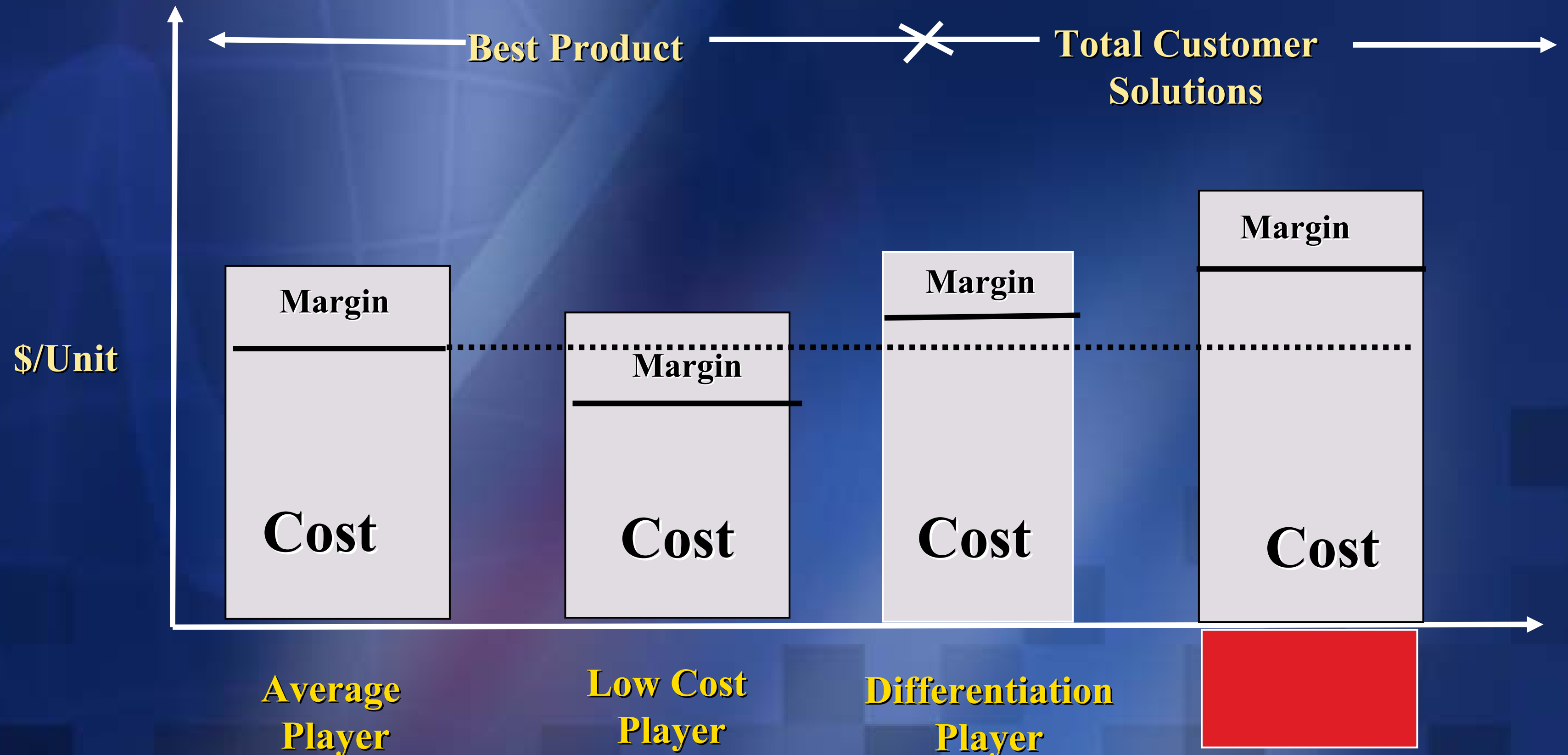
# There are two ways to compete: Low Cost or Differentiation

***The efficiency of the low cost provider's cost structure allows pricing below the average competitor, which in the long run may put average competitors out of business.***

***This is why the alternative to low cost needs to be differentiation, offering unique product attributes that the customer values and will pay a premium for.***



*However, the Total Customer Solutions positioning offers a possible preferred alternative by introducing significant cost savings (and/or revenue increases) to the customer*



# Critical Elements in Porter's Frameworks

| | Porter |
|---|---|
| Focus of Strategic Attention | Industry/ Business |
| Types of Competitive Advantage | Low Cost or Differentiation |
| Basic Unit of Competitive Advantage | Activities |

# Porter's Winning Formula

Pick a business in an attractive industry in which you can excel. Notice that Porter's Framework stressed rivalry and competition. Therefore, an attractive industry is one in which we can achieve as close to a monopolistic position as possible. In turn, the message of the value chain is to achieve sustainable advantage by beating your competitors, if not in all, at least in those activities that are most crucial to competition.

Strategy is War!

# The Resource-Based View of the Firm Framework

# Resources can be classified into three broad categories

- <u>Tangible assets</u> are the easiest to value, and often are the only resources that appear on a firm's balance sheet.  They include real estate, production facilities, and raw materials, among others.  Although tangible resources may be essential to a firm's strategy, due to their standard nature, they rarely are a source of competitive advantage.  There are, of course, notable exceptions.

# Resources can be classified into three broad categories (continued)

- Intangible assets include such things as company reputations, brand names, cultures, technological knowledge, patents and trademarks, and accumulated learning and experience.  These assets often lay an important role in competitive advantage (or disadvantage), and firm value.

# Resources can be classified into three broad categories (continued)

- <u>Organizational capabilities</u> are not factor inputs like tangible and intangible assets; they are complex combinations of assets people, and processes that organizations use to transform inputs into outputs. The list of organizational capabilities includes a set of abilities describing efficiency and effectiveness: low cost structure, "lean" manufacturing, high quality production, fast product development.

Source: David Collis and Cynthia Montgomery

## A Resource-Based Approach to Strategy Analysis: A Practical Framework

4. Select a strategy which best exploits the firm's resources and capabilities relative to external opportunities

**Strategy**

3. Appraise the rent-generating potential of resources and capabilities in terms of :
   a) Their potential for sustainable competitive advantage, and
   b) The appropriability of their returns

**Comparative Advantage**

2. Identify the firm's capabilities: What can the firm do more effectively than its rivals? Identify the resources inputs to each capability, and the complexity of each capability

**Capabilities**

1. Identify and classify the firm's resources. Appraise strengths and weaknesses relative to competitors. Identify opportunities for better utilization of resources.

**Resources**

5. Identify resource gaps which need to be filled

   Invest in replenishing, augmenting and upgrading the firm's resource base

Source: Robert M. Grant

# The Resource-Based View: Elements of Competitive Advantage


Source: Adapted from Peteraf (1993) and Ghemawat (1991).

## The Resource-Based View of the Firm Winning Formula

**Develop resources and capabilities which are rare, valuable non-tradeable, that form the basis of the core competencies of the firm; make those resulting advantage sustainable by precluding imitation or substitution from competitors; appropriate the resulting economic rent by preventing negative hold-up and slack conditions; and make sure that the implementation process is done in such a way that its associated costs do not upset the resulting benefits.**

**It is Strategy by Real Estate!**

# Comparison of Critical Elements in Porter's and Resource-Based View Frameworks

| | Porter | Resource-Based View |
|---|---|---|
| Focus of Strategic Attention | Industry/Business | Corporation |
| Types of Competitive Advantage | Low cost or Differentiation | Resources, Capabilities Core Competencies |
| Basic Unit of Competitive Advantage | Activities | Core Products, Strategic Architecture |

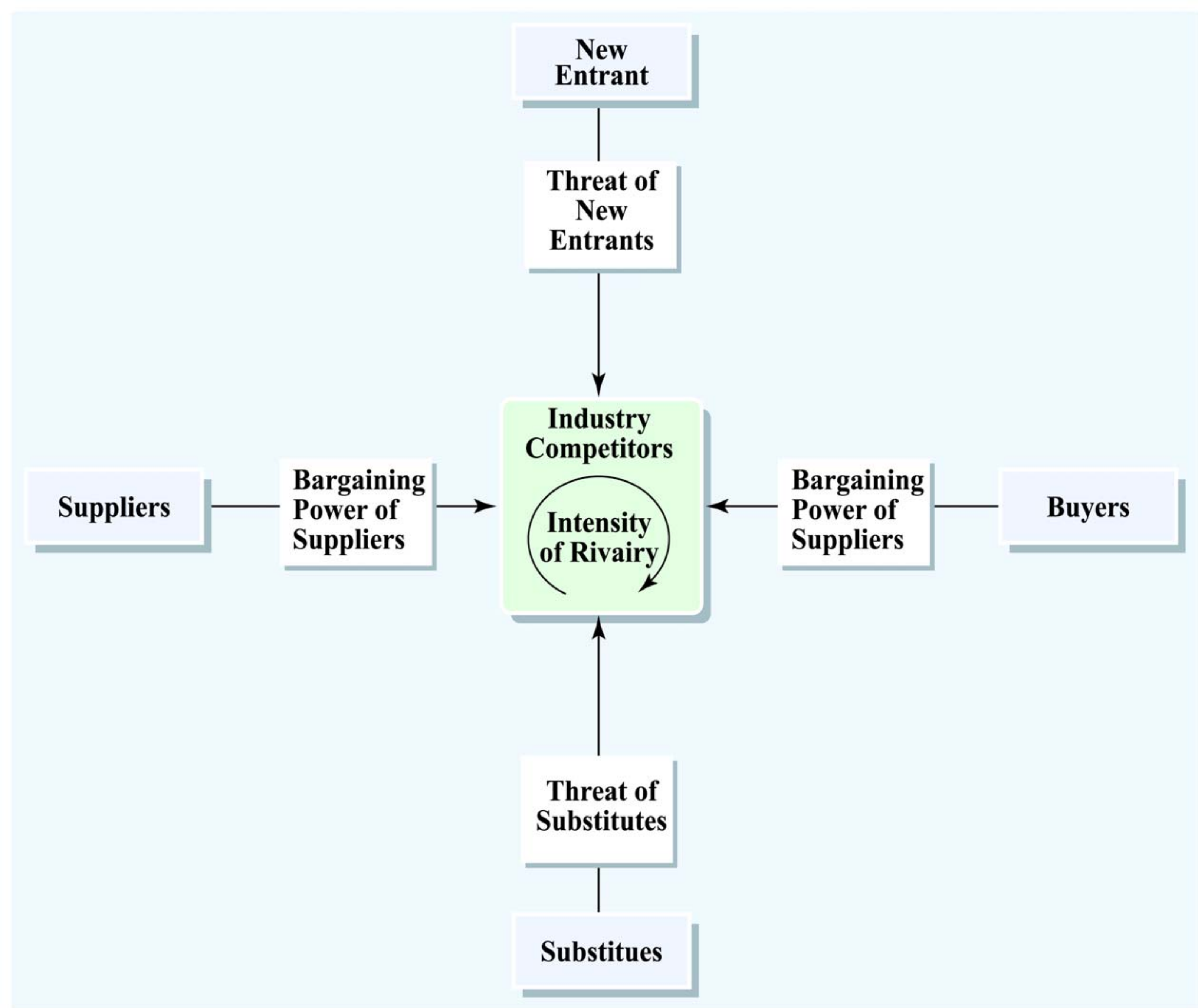
# Comparison Among Strategy Frameworks

| | Porter | Resource-Based View | Delta Model |
|---|---|---|---|
| Focus of Strategic Attention | Industry/ Business | Corporation | Extended Enterprise (The Firm, The Customers, The Suppliers and The Complementors) |
| Types of Competitive Advantage | Low cost or Differentiation | Resources, Capabilities, Core Competencies | Best Product, Total Customer Solutions, System Lock-In |
| Basic Unit of Competitive Advantage | Activities | Core Products, Strategic Architecture | Adaptive Processes: Operational Effectiveness, Customer Targeting, Innovation |
| Strategy As | Rivalry | Real Estate | Bonding |

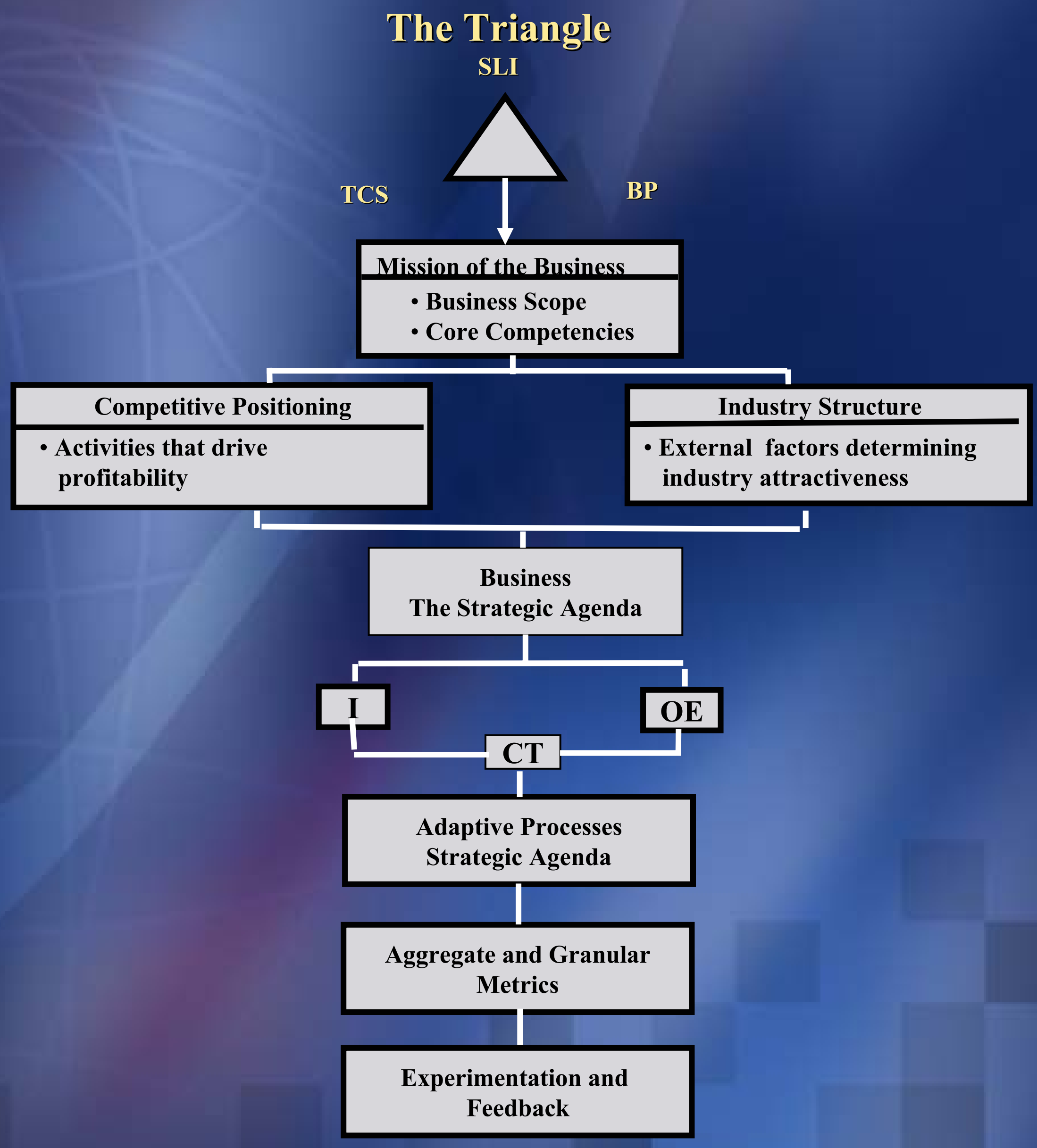
# The Delta Model and The Three Strategic Options

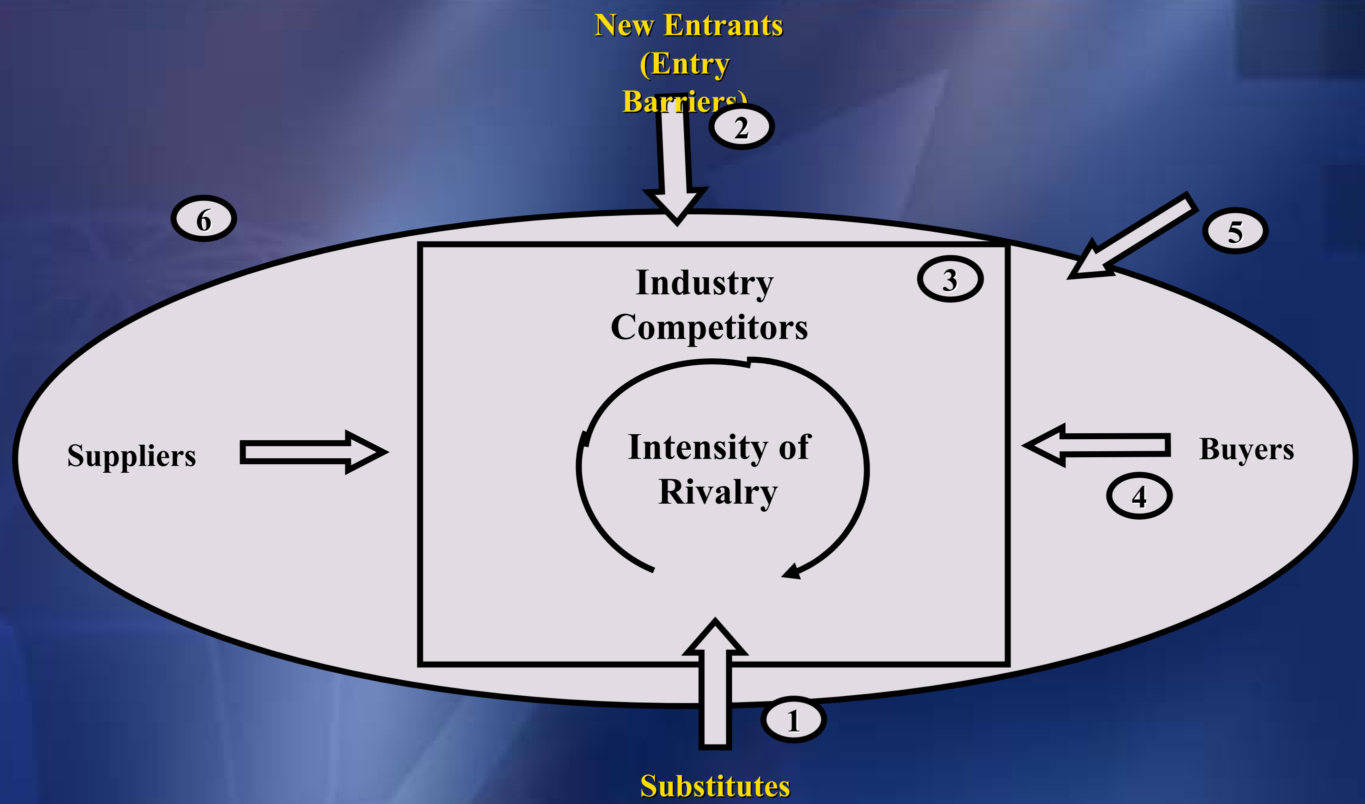
| The Elements of the Delta Model | The Three Strategic Options | | |
|---|---|---|---|
| The Triangle: The Source of Strategic Options | Best Product | Total Customer Solution | System Lock-In |
| Business Mission: | | | |
| Product Scope | Driver | | |
| Market Scope (customer, consumer, channel) | | Driver | |
| Complementor Scope | | | Driver |
| Geographical Scope | | (Either Local-Regional-Global) | |
| Core Competencies | | Align with Strategic Option | |
| Industry Structure: Relevant Industry Focus | Business Industry Plus | Customer Industry Plus | Complementor Industry |
| Competitive Positioning: Relevant Value Chain Focus | Internal Value Chain: Business | Integrated value chain: Business and Customer | Systems Value Chain: Business Complementor and Customer |
| Business Strategic Agenda | | Align with strategic option | |
| Adaptive Process Priorities: | | | |
| OE | 1st | 2nd | 3rd |
| CT | 3rd | 1st | 2nd |
| I | 2nd | 3rd | 1st |
| Aggregate/Granular Metrics | | Align with strategic option | |
| Experimentation and Feedback | | Align with strategic option | |

# Porter's Five Forces Model



# The Delta Model- An Integrative Strategic Framework






1. Create a powerful 10x force to change the rules of the game. Reject initiation of competitors, a product-centric mentality, and a commoditization mindset.
2. Generate significant barriers around the customers through a unique customer value proposition based on deep customer segmentation, and consumer understanding.
3. Do not use competitors as a central benchmark to guide your strategic actions. The key industries to concentrate on are those of your customers, suppliers, and complementors. Strategy is not war with your competitors; it is love with your customers, suppliers, consumers, and complementors.
4. Develop and nurture the integrated value chain with your key suppliers and customer. Bring in all the power of B2B and B2C to accomplish this objective. This is critical for customer lock-in.
5. Add a new player: the complementors. Seek complementor support and investment in your business. Make them key partners in seeking the delivery of Total Customer Solutions. Extend the unique value proposition to include complementors, as well as suppliers. This is the key for obtaining complementor lock-in, competitor lock-out, and ultimately System Lock-In.
6. If your customer, suppliers, and complementors are numerous and fragmented you could also provide them with state-of-the-art management practices and a wealth of information and intelligence that they could never acquire otherwise. Your lock-in will be admirably enhanced.

# The Required Resources and Capabilities for the Delta Model

1. First and foremost, you need a deep customer and consumer understanding obtained via a detailed segmentation and supported by aggregated and granular metrics.

2. This understanding should also be extended to critical suppliers and complementors. Do not get trapped in your industry trends alone.

3. The implementation of the new business model is realizable mostly because the opportunities and potentials offered by the Internet and its associated technologies: e-business, e-commerce, e-systems. The appropriation of this skill is essential.

# The Required Resources and Capabilities for the Delta Model (continued)

4. Create the dynamic and entrepreneurial environment of risk-taking and reward-sharing originated by the professional challenges associated with the "new technologies."

5. The ultimate output is the development and implementation of unique and exciting value propositions for all the key players: customers, consumers, suppliers, and complementors. The first mover advantage is overwhelming. You have to be fast.