

Tellusant on Strategy 202



#### Introduction

We show Tellusant's frameworks for strategy development. It builds on **Structure-Conduct-Performance** (SCP) and the **Resource-Based View** of the firm (RBV). This is what we automate in our cloud-based solutions.

Strategy is a big topic. This short introduction only describes the key concepts. Building a strategy takes months and requires experts with decades of experience.

To learn more, read our <u>full framework called EMIO</u> which follows the same logic, but with more detail and a fuller description of why strategies are developed with these methods.



# The strategy concept comes from military doctrine

STRATEGY	The coordination and focusing of the resources of the company for long-term success		
OPERATIONS	The functional and cross-functional plans for achieving the strategic goals, typically medium- to short-term		
TACTICS	The short-term management of the company		
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Adapted from Warfighting by the US Marine Corps



# Strategy is a mature discipline. We use the two most important theoretical strands

External perspective

# STRUCTURE-CONDUCT-PERFORMANCE (SCP)

Developed by Prof. Joe Bain\* in late 1950s

FIVE FORCES FRAMEWORK

SCP popularized by Prof. Michael Porter (1976)

Competitive advantage depends on market dynamics

**Pros** Logical and clear perspective on how a market works and a company's position within it **Cons** In most cases, not an important lever for superior profitability

Necessary but not sufficient for competitive advantage

Internal perspective

# RESOURCE-BASED VIEW (RBV)

Developed by Prof. Birger Wernerfelt in early 1980s

#### **CORE COMPETENCIES**

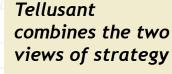
RBV popularized by Profs. C.K. Prahalad and Gary Hamel (1984)

Competitive advantage depends on available resources

Pros Well implemented, leads to superior profitability

Cons Difficult to use and often changes into a human resources perspective, rather than strategy

Necessary and almost sufficient for competitive advantage



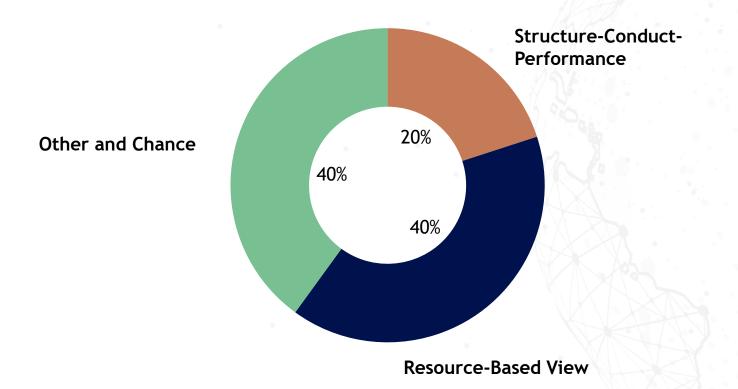
We work from first principle, so we use SCP and RBV



<sup>\*</sup> No relation to Bain & Company

# RBV explains more of a company's profitability than SCP, but both are important

# SHARE OF CORPORATE PERFORMANCE EXPLAINED



The classical focus on industry analyses is mistaken... long-run rates of return are not associated with industry, but with the unique endowments, positions, and strategies of individual businesses.

Prof. Richard Rumelt

# The SCP framework is the standard approach for understanding market dynamics

#### STRUCTURE-CONDUCT-PERFORMANCE FRAMEWORK

#### **External conditions**

#### Socioeconomic conditions

- Economic growth
- Demographic trends
- SEL composition
- Urbanization

#### **Government policies**

- Fiscal/monetary policy
- Taxes and subsidies
- Regulations
- Investment incentives
- Trade rules
- Antitrust policy
- Corruption
- Ease of doing business

#### Infrastructure

- Info and communications technology (ICT)
- Transport and logistics
- Education

#### Structure

#### Market demand

- Category dynamics
- Growth drivers
- Substitutes
- Price elasticity

#### **Industry supply**

- Level of competition
- Product differentiation
- Brand power
- Barriers to entry
- Efficiency
- Capacity utilization

#### Value chain economics

- Economies of scale / scope
- Supplier economics
- Marketing effectiveness
- Distribution economics

#### Conduct

#### Strategic priorities

- Market breadth
- Geographic reach
- Vertical depth

#### Commercial activities

- Product portfolio
- Pricina
- Marketing spending
- Route-to-market/channels
- New product development / innovation

#### Supply chain activities

- Production processes
- Procurement
- R&D priorities

#### **Finance**

- Financial resources
- Capital spending priorities

#### **Performance**

#### Market performance

- Market growth
- Price trends
- Share relative to substitutes
- Industry value and profit pools

#### Player performance

- Productivity
- Organizational effectiveness
- Growth
- Relative market shares and trends
- Profitability
- Share of profit pool



# **Example of SCP applied to the U.S. airline industry**

#### **External conditions**

 Partial deregulation in the late 1970s, but foreign competition not allowed

#### Structure

#### Market demand

 High demand growth over past 40 years

#### **Industry supply**

- Initially high level of competition after deregulation
- Lately, oligopoly with limited competition at most airports

#### Value chain economics

- Significant economies of scale in marketing (e.g., bonus programs)
- Low barriers to entry from a capex perspective, but high barriers at the gate at congested airports
- Initially strong labor power which was later weakened by low cost of new airlines

#### Conduct

#### Strategic priorities

- Initially, cost cutting, but within hub-and-spoke paradigm
- Later, point-to-point for efficiency
- Currently, market (airport) dominance to raise barriers to entry

#### Commercial activities

 Competition moving from price competition to schedule and non-price attributes

#### Performance

#### Market performance

- Return of capital << cost of capital for many years
- Lately, signs of improvements and even return of capital > cost of capital

#### Player performance

- Winners have a) low operating and capital cost or b) dominance of hubs
- Weakest players bankrupt (several times) or absorbed by slightly stronger players



# RBV looks at available resources and how they combine to create competitive advantage

Resource-based view **Functional resources** relies on such as marketing, or resources **Tangible** Intangible R&D (value chain) that must be Companies differ in resources Those with Heterogeneous **Immobile** marginal resources can expect to break even. Those with superior resources can and have VRIO attributes earn superior returns **VRIO** resources that provide Competitive advantage

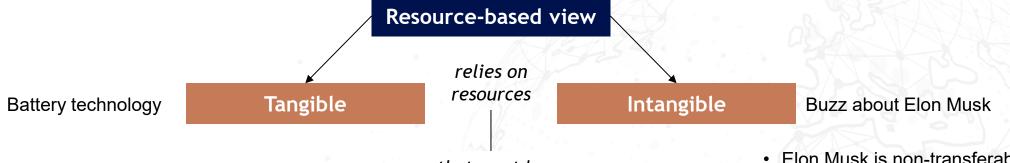
Competences such as strategy development, analytics, or acquisition skills

A resource that cannot be traded or is of less value to any other company

- **Valuable** Is the resource valuable to the company?
- Rare Is it unique among competitors?
- Inimitable Is it costly to imitate?
- Organized Is the company organized to take advantage of the resource?

Competence is the company's capability to deploy the resources for competitive advantage

# **Example of RBV applied Tesla in 2017**



Batteries: There are significant performance differences in the technology and whoever invents the best battery and patents it will have a long-term advantage

Musk: No other current auto company has staked out a reputation based on personality cult

that must be **Immobile** Heterogeneous and have VRIO attributes VRIO resources that provide Competitive advantage

Despite substitutes (combustion engine), Tesla may be on its way to revolutionize the automotive industry, and others will not be able to follow even though they are many times larger

- Elon Musk is non-transferable.
- The battery technology is less valuable to others because they lack Tesla's scale
- Valuable Batteries define car performance. Musk creates free marketing
- Rare No other company has these resources. However, combustion engine cars are a threat, especially when fuel prices are low
- Inimitable Batteries require massive investments and Tesla is well down the learning curve
- · Organized Tesla has organized in a nontraditional way with backward integration to capture the full benefits of battery technology



# RBV also includes the important VRIO (Valuable-Rare-Inimitable-Organized) concept

#### VRIO'S LINK TO COMPETITIVE ADVANTAGE

Valuable?	Rare?	Inimitable?	Organized?	Competitive implication
No				Competitive disadvantage
Yes	No			Competitive parity
Yes	Yes	No		Temporary competitive advantage
Yes	Yes	Yes	No	Unexplored competitive advantage
Yes	Yes	Yes	Yes	Sustainable competitive advantage

For more on VRIO, see this Wikipedia article For VRIO's pervasiveness in strategy literature, see these <u>images</u>

# We define strategy as a blend of RBV and SCP (internal and external views)

A strategy is an *integrated set of* actions chosen to convert available VRIO resources into core competencies within a *chosen market* to create sustainable competitive advantage



# This definition captures all keu aspects of SCP and RBV

Actions, not recommendations or analyses. A strategy has to be translated into implementation

VRIO = Valuable, Rare, Inimitable, and Organized

> The *market* should have attractive SCP characteristics

Integrated across the value chain from sourcing to marketing

A strategy is an integrated set of actions chosen to convert available VRIO resources into core competencies within a *chosen market* to create

sustainable competitive advantage

Competitive advantage is measured as financial performance

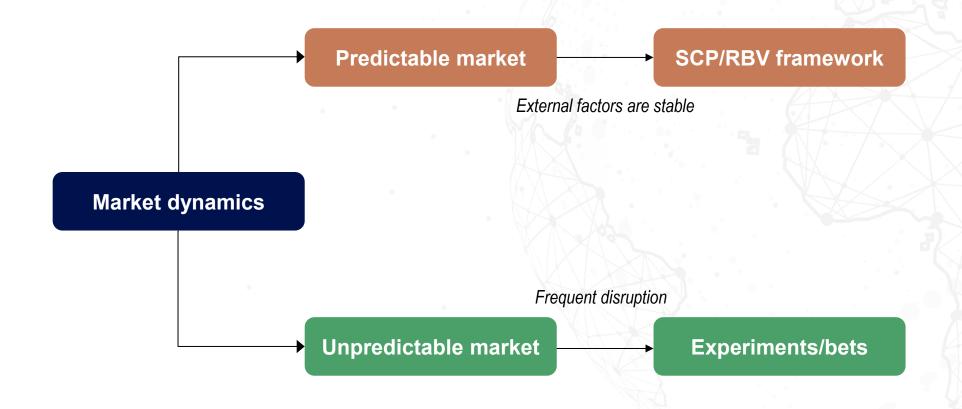
Available resources are both internal and external (e.g. distributors, professional service firms)

> Core competencies is what the company is uniquely good at

Sustainable in the 3 to 7-year range because nothing is forever

# Not all strategies should be based on SCP and RBV. Experiments and bets play an important role too

Although SCP and RBV succeed in predictable industries, less predictable markets require experiments and placing bets



# TELLUSANT Streamlining Corporate Decision Making



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