The Strategic Management Frameworks and the Delta Model: Putting Customers Before Products

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Based on the Teachings of M.I.T. Professor Arnoldo Hax
However beautiful the strategy, you should occasionally look at the results

*Sir Winston Churchill 1874-1965, English statesman*
There is always a better strategy than the one you have; you just haven't thought of it yet

Sir Brian Pitman, former CEO of Lloyds TSB, Harvard Business Review, April 2003
Unless a variety of opinions are laid before us, we have no opportunity of selection, but are bound of necessity to adopt the particular view which may have been brought forward

*Herodotus, 5th century BC, Greek historian*
The processes used to arrive at the total strategy are typically fragmented, evolutionary, and largely intuitive

*James Quinn in Strategic Change: Logical Incrementalism, 1978*
In real life, strategy is actually very straightforward. You pick a general direction and implement like hell.

*Jack Welch in Winning, 2005*
How many senior executives discuss the crucial distinction between competitive strategy at the level of a business and competitive strategy at the level of an entire company?

*C.K. Prahalad and Gary Hamel, in their article: The core competence of the corporation, 1990*
What's the use of running if you are not on the right road

*German Proverb*
I claim not to have controlled events, but confess plainly that events have controlled me

Abraham Lincoln 1809-1865, sixteenth American president
Perception is strong and sight weak. In strategy it is important to see distant things as if they were close and to take a distanced view of close things

Miyamoto Musashi 1584-1645, legendary Japanese swordsman
Do not repeat the tactics which have gained you one victory, but let your methods be regulated by the infinite variety of circumstances.

Sun Tzu c. 490 BC, Chinese military strategist
The Frameworks for Competitive Positioning

- Porter
- Resource-Based View of the Firm
- The Delta Model
Porter’s Framework for 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
Elements of Industry Structure: Porter’s Five-Forces

Fig. 11.2 Elements of industry structure: Michael Porter’s five forces
Michael 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.

**Threat of Substitutes (Mildly Unattractive)**
- Generic and “Me-too” 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.

**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 of 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 process.

**SUMMARY ASSESSMENT OF THE INDUSTRY ATTRACTIONNESS (Attractive)**

Fig. 11.3 Michael Porter’s five-forces model applied to the pharmaceutical industry in the early 1990s
Make a business in an attractive industry where you can excel; then excel by achieving a low cost or differentiation though unique activities
Merck’s Value Chain

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

**Human Resources Management**
- Friendly & cooperative labor relations
- Strong recruiting programs in top universities
- Excellent training & development
- Excellent rewards & health-care programs

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

**Procurement**
- Vertical integration in chemical products

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<th>Inbound Logistics</th>
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<th>Operations</th>
<th>Marketing &amp; Sales</th>
<th>Service</th>
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<td>- Increasing manufacturing flexibility and cost reductions&lt;br&gt;- Stressing quality and productivity improvements&lt;br&gt;- Global facilities network</td>
<td>- Acquisition of Medco provides unique distribution capabilities and information technology support&lt;br&gt;- Medco is the number one mail-order firm</td>
<td>- Marketing leadership&lt;br&gt;- Large direct sales staff&lt;br&gt;- Global marketing coverage&lt;br&gt;- Leverage through Medco, including powerful marketing groups and sales forces, and proprietary formulary&lt;br&gt;- Medco IT infrastructure and database, covering patients, physicians, and drug uses&lt;br&gt;- Strategic alliances</td>
<td>- Medco’s service excellence has attracted major corporations and healthcare organizations as clients</td>
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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.
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!
Comments on Porter’s Framework

- Rigorous methodology to describe industry structure
- An economist’s perspective to understand how the industry rent is appropriated
- Emphasizes rivalry, threats, and bargaining power
- It aggregates and diffuses the role of the customer
Caveats on Porter’s Framework

If you are not careful Porter might lead you to the wrong conclusions:

- Putting the competitor as the driving force
- Leading toward imitation, congruency, and commoditization
- Creating a rivalry attitude between you and the key players
- Limiting strategic options to low-cost or differentiation, a very narrow set

Exactly the opposite should be done:

- Putting the customer as the driving force
- Studying your competitors not to imitate them
- Embracing the extended enterprise
- Opening your strategic options to a wider range of offerings
The Resource-Based View of the Firm Framework
The Cornerstones of Competitive Advantage: A Resource-Based View of the Firm

- **Unique Competencies**
  - Supported by resources and capabilities owned by the firm

- **Sustainability**
  - Lack of substitution and imitation by competitors

- ** Appropriability**
  - Retention of value created inside the firm

- **Opportunism/Timing**
  - Offsetting the cost of acquiring resources and capabilities

Resources can be classified into three broad categories

- **Tangible assets** 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.
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.
Organizational capabilities 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.
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 advantages sustainable by precluding imitation or substitution from competitors; 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!
Comments on the Resource-Based View of the Firm

- Corporate resources and capabilities rather than industry structure are the causes of superior performance.
- Resource-Based View of the Firm should therefore complement rather than replace Porter’s Framework
- It emphasizes the important concept of sustainability
Caveats on Resource-Based View of the Firm

- The greatest critique of this approach is the vagueness in which resources and capabilities are treated - what are the key resources and capabilities to acquire, how do we identify them, how do we nurture them, what purposes do they play, how will we obtain this elusive competitive advantage?

- Consequently the Framework seems to work better to explain how a firm has achieved competitive advantage (ex-post), rather than to help us to acquire a sustainable one (ex-ante)

- We need a framework to guide the framework
The Need for Reinventing Strategy

- This presentation is about an innovative, new approach to business strategy that better reflects the realities of the global marketplace in a networked economy.

- It was developed at MIT to help managers formulate, articulate, and implement more effective ways to achieve superior and sustainable financial performance and long-term profitability, providing a completely different perspective from the conventional strategic approaches used by most managers.
• The Delta Model (after the Greek letter delta, standing for transformation and change) encompasses a unique set of frameworks and methodologies that grew from Mr. Hax’s conviction that changes being experienced in the world of business were of such magnitude that existing managerial frameworks had become either invalid or incomplete.
Moreover, the emergence of the Internet, with its previously unimagined potential for communication, and the incredible technologies surrounding e-business and e-commerce are enabling completely different business approaches than had ever been possible before.
The Dangers of the Conventional Definition of Strategy – Strategy as Rivalry

• Until now, the prevailing view – shared by most practicing managers and academics – has been to define the goal of strategy as achieving sustainable competitive advantage.

• Most, if not all, of the most respected and popular frameworks that guide the strategy development process are anchored in this concept. According to professor Hax, this is a mindset likely to cause severe problems moving forward.
Strategy as Rivalry

• First, it puts our competitors at the center of our management process. Competitors become our driving force, our relevant benchmark. We look at strategy, and consequently at management, as rivalry. In order for us to succeed, we have to beat someone.

• Strategy is destructive; strategy is war. As recent history has confirmed, again, wars do not have victors.
• Second, and equally troublesome, using our competitors as a way to define our course of action basically anchors us in the past.

• On reflection, this is an approach that seems counterproductive in a time of revolutionary change, when we want to create discontinuities, not reaffirm old practices.
Strategy as Rivalry

• Often, companies seem obsessed with their competition, studying and watching it intensely to detect anything that could signal a way to operate more effectively.

• To separate ourselves from our competitors, we must offer our customers something that is truly unique and distinctive. How do we do that?
Strategy as Rivalry

• Third, the excessive concern about competitors can lead us, consciously or otherwise, into imitating their behavior. Our products begin to take on similar characteristics of those of the leaders.

• The development of our new products adheres to the prevailing standard of the industry, the channels of distribution that access our customer base are indistinguishable – in other words, the industry begins to converge into a well-established set of norms and standards.

The result of this congruency leads toward the commoditization of our business, which is the worst possible outcome for all players.
Reject Commoditization – The Essence of Strategy Is to Achieve Customer Bonding

• A large percentage of businesses have become commoditized. One of the fundamental objectives of any firm as a whole, as well as the individual businesses of the firm, is to achieve superior and sustainable financial performance as measured by long-term profitability.

• In order to achieve this outcome, we need to differentiate ourselves through leadership and a sense that our business is distinctive, which is exactly the opposite of a commodity. Commodities, by their nature, are ordinary and undifferentiated.
• It is not realistic to expect that a lackluster, commoditized business could generate any superior performance, let alone sustain it.

• The commoditization of an industry tends to erode everyone’s profitability because it exacerbates the rivalry among competitors primarily by driving down prices for standardized products.
• For superior financial performance to be sustainable, not only should the business aim at achieving a solid leadership position, but this position should be long-lasting, unassailable, and able to endure the inevitable changes that the environment will generate.

• This calls for flexible adaptation to new circumstances and the will and ability to transform the organization continuously.
The Delta Model

• We should look forward, not backward. We should never be complacent. We should experiment and engage in a continuous learning process that propels us into uncharted territory.

• This will never happen if we are simply imitating or following in our competitors’ footsteps. As professor Hax stated, using competitors as a benchmark leads to sameness, and sameness will never lead us to greatness.
The Selection of a Strategy and the Identification of the Required Competencies – A Preview of the Delta Model
The Delta Model

• One of the most distinctive aspects of the Delta Model is that it *provides you with guidance on how to select the strategic positioning of your business and gives you the analytical tools to achieve it*. This is a feature that is not available in any other business model, as far as we know.
The Delta Model

• How do you begin to develop a strategy based on a granular understanding of individual customer needs? As we have already asserted, the fundamental strategic objective is to obtain customer bonding – that is to *attract, satisfy, and retain the customer*.

• The Delta Model offers you three distinct options to reach that objective which can be applied, if you wish, one customer at a time. The three strategic options are presented in the triangle in Fig. 1.1.
Three Delta Model Strategic Options

The Delta Model —

Three Distinct Strategic Options

System Lock-In
- System Economics
- Market Dominance
- Achieving Complementor Share

Enabled Through Effective Use of Technology

Total Customer Solutions
- Customer Economics
- Cooperation
- Achieving Customer Share

Best Product
- Product Economics
- Rivalry
- Achieving Product Share
The Strategic Tasks of the Delta Model

Enables Through Effective Use of Technology

System Lock-In
Establish dominance in the market

Total Customer Solutions
Provide the customer with a customized solution to the most pressing needs

Best Product
Attract the customer by the characteristics of a superior product

Fig. 1.1 The triangle - the three strategic options of the Delta Model
The Delta Model

• In the **Best Product** option, the customer comes to you because of the superiority of your price offering – due to your low-cost infrastructure – or for some aspect related to the product functionality, brand, or appearance that differentiates itself from the competitive offers.

• In the **Total Customer Solutions** option, the customer is attracted because you are offering something beyond the product itself, which implies transferring knowledge and services that address pressing needs the customer has.

• In the **System Lock-In** option, you have achieved such a strong dominance in the marketplace that the customer does not have options better than yours.
The Delta Model

• Figure 1.2 offers a highly summarized description of the characteristics of each of the three primary strategic options of the Delta Model and the necessary competencies that are required for their support.

• The resulting eight competencies that are part of the Delta Model framework are presented in Figure 1.3
The Delta Model

• We will elaborate in later modules the step-by-step process you must undertake in order to develop a customer bonding strategy tailored to your own organization.

• Our objective here is to introduce you to the idea that there are options other than the simple offering of a product – which is the dominant mindset of most executives – on which to base a successful business strategy.
Moreover, the Delta Model framework assists you in examining the state of your existing competencies and – most importantly – in identifying the competencies you need to acquire to develop a truly winning strategy.

We believe these two perspectives – strategic options and competencies – make the Delta Model an exceedingly useful device to guide your strategic thinking.
**The Strategic Tasks of the Delta Model**

**Best Product** – The customer is attracted by the inherent characteristics of the product being offered. This is accomplished through a low cost – which allows offering the lowest price to the customer resulting from an efficient infrastructure – or by offering a differentiated product that the customer values and is willing to pay a premium for.

![Delta Model Diagram](image)

**Fig. 1.2** The Delta Model – the three strategic options
The Eight Strategic Positions of the Delta Model

- **Dominant Exchange**: Provide an interface between buyers and sellers that is very hard to displace once it achieves critical mass.
- **Proprietary Standard**: Capture an extensive network of complementors that enhance our product offering.
- **Exclusive Channel**: Significant barriers in place to make it hard for competitors to access the customer.
- **Horizontal Breadth**: Satisfy all the meaningful customer needs ("one stop shopping").
- **System Lock-In**:
- **Total Customer Solutions**:
- **Best Product**:
- **Low Cost**: Lowest cost provider is an undifferentiated product category.
- **Redefining the Customer Relationship**: Provide a unique experience to the customer throughout the complete cycle of ownership.
- **Differentiation**: Development of features and functionalities that make the product unique and command a price premium.
- **Customer Integration**: Transfer knowledge to the customer to enhance its performance.

Fig. 1.3  Identifying the competencies of the business – the eight strategic positions as a guiding framework
Companies and the Delta Model

The Triangle: Options for Strategic Positioning

- System Lock-In
- Dominant Exchange: eBay, Yellow Pages
- Proprietary Standard: Microsoft, Intel
- Exclusive Channel: rural Wal-Mart
- Horizontal Breadth: Fidelity
- Low Cost: Southwest Airlines, Nucor
- Total Customer Solutions
- Customer Integration: EDS
- Best Product
- Redefining the Customer Relationship: Saturn
- Differentiation: Sony Wega

Enabled Through Effective Use of Technology
The Strategic Tasks of the Delta Model

**Total Customer Solutions** – Customer bonding results from enhancing the capabilities of the customer by offering integrated solutions to address its critical needs. It is accomplished by a close proximity to the customer (Redefining the Customer Relationship), by transferring substantive capabilities and knowledge (Customer Integration), and by providing a full spectrum of products and services that satisfy most, if not all, of its needs (Horizontal Breadth).
The Strategic Tasks of the Delta Model

**System Lock-In** – The firm achieves a dominant position in the market that gives it uncontested leadership. This is accomplished through the development and ownership of the standards of the industry (Proprietary Standard), by becoming the interface between the customer and its suppliers (Dominant Exchange), or by becoming the sole source of the customer needs (Restricted Access).
The Delta Model

• The Delta Model, as we have argued in this introductory module, provides innovative new concepts and ideas that will make you see your business strategy from a fresh perspective, not anchored in the transitions of the past.

• It also provides you with a set of pragmatic tools to help you to carry on a rigorous, systematic, and thoughtful process of diagnosis and formulation of your own successful business strategy. My formal course and presentation addresses that need.
What We Have Learned

• Keep the planning process as simple as possible, while retaining the ability to perform a careful, highly practical examination of the complex environments and circumstances that surround your business.

• It is an enormously challenging and exciting task: to give purpose and direction to an organization and end up with an agenda that assures the proper implementation of a well-designed strategy. To that end, the Delta Model has identified five broad tasks that will help you do this work, illustrated in Fig. 1.4.
• Throughout the formal course I will explain these tasks with considerable detail and provide real-life applications to illustrate how we have used them – and you can use them – in practice.
Fig. 1.4 The Strategic Tasks of the Delta Model

- Customer Segmentation and Customer Value Proposition
- The Mission of the Business
- The Strategic Agenda
- Monitoring the Strategy Execution:
  - The Intelligent Budget
  - Balanced Scorecards
- The Existing and Desired Competencies of the Firm
The Challenge to Decommoditization:

Transforming the organization from best product to total customer solutions, while seeking opportunities for System Lock-In.
Central Lessons

If the heart of strategy is the customer, an appropriate customer segmentation and a creative value proposition is often the most important critical step in strategic thinking. Be creative, be bold, be fast. The winning formula is to have the overall network as your primary scope. Don’t play the game alone. It is not just you serving the customer. It is you, your critical suppliers and the key complementors. In a large, diversified corporation often the most important complementors are in your own firm.
The Delta Model Haxioms

1. The center of strategy is the customer

This is the core of the Delta Model. It places the customer as the driving force of management, and if we accept this imperative, everything else follows. We need to understand the customer, and our challenge is how to provide our spectrum of customers the most creative, unique, and high value-added value proposition.

2. You don’t win by beating the competition; you win by achieving customer bonding

If the central focus of management is the customer, the essence of strategy is to achieve customer bonding. Bonding is realized when the relationships characterizing our involvement with the customer are based on fairness and transparency, producing long-lasting, mutual benefits. Bonding goes beyond intimacy and proximity, it denotes trust and affection.
The Delta Model Haxioms

3. Strategy is not war; it is love

By rejecting the notion that strategy is rivalry and its ultimate goal is to defeat your competitors, we open a much more constructive mindset. Instead of perceiving ourselves as in confrontation with our key constituencies, we should adopt the attitude of cooperation, understanding, and love.

It sounds rather clichéd, but we really mean it. Imagine how much better the world would be if we all would assume this posture. We sincerely believe that this behavior constitutes a better and more effective way to manage. Caring about the customer with a high sense of integrity is the smartest way of doing business.
The Delta Model Haxioms

4. A product-centric mentality is constraining; open your mindset to include the customers, the suppliers, and the complementors as your key constituencies

Don’t play the game alone. The relevant entity is the *extended enterprise*. It is not important how many resources we might have access to. Given the complexities of global business, we will never be self-sufficient.

We should accept that from the start and recognize how important it is to draw from all our natural partners to provide the elusive unique value proposition to our customers.
The Delta Model Haxioms

5. Try to understand your customer deeply. Strategy is done one customer at a time

We have to focus our attention on the customer in a granular way, meaning that ideally we should consider each customer individually.

We can accomplish this personally if the importance of the customer warrants it, or electronically if the personal contact is economically infeasible.

The capabilities of the Internet are making possible something that was unimaginable in the past.
Gone are the days that we define abstract business units, that we used to call the Strategic Business Units – or SBUs for short – as the focus of strategic analysis.

This was a composite of products and markets aggregated in a form that obscured our capacity to provide tailor-made solutions to individual customers.
The Delta Model Haxioms

6. **Commodities only exist in the minds of the inept**

The commoditization of a business results when we cannot claim any differentiation from what our competitors are offering. It is typically the consequence of paying excessive attention to the competition, which often leads to imitation and sameness.

It is a prevailing situation in many businesses in the world.

It is the most undesirable state to fall into because it deprives us of achieving any form of leadership, of gaining superior financial returns, of serving our customers uniquely, and of attracting top talent.
The Delta Model Haxioms

7. The foundations of strategy are two:

Customer Segmentation and Customer Value Proposition

The Firm as a Bundle of Competencies
The Delta Model Haxioms

We have to understand both the demand and the supply sides of the business. The customer represents the demand. Our first task is to segment the customer – so that we do not treat every customer in the same way – and to develop unique, sustainable, and high value-added propositions that create a great deal of bonding.
The Delta Model Haxioms

The supply is represented by our firm’s capabilities. The Delta Model provides a singular methodology to assess our existing and desired competencies according to our abilities to develop a full spectrum of strategic positions.

The Delta Model gives us the conceptual understanding and the portfolio of tools that allow us to develop these two foundations of strategy.
The Delta Model Haxioms

8. Reject the two truisms:

“The customer is always right,” and

“I know the customer needs and how to satisfy them.”

We are not selling standardized products; we are dealing with customer solutions.
The Delta Model Haxioms

9. The strategic planning process is a dialog among the key executives of the firm – seeking consensus on the direction of the organization.

The most important output of the strategic planning process is the process itself.

The Delta Model approach for a proper process is to engage all the key executives of the business in an open dialog, where ideas are candidly debated, that ultimately leads to consensus.
The Delta Model Haxioms

10. **Metrics are essential; experimentation is crucial**

Metrics are essential to quantify the value we create for our customer and ourselves and to monitor the progress we make in the implementation of the proposed strategic agenda.

The granularity requirement of the Delta Model demands that we develop a customer data bank, which contains information about the potential market available for each customer and the value created by our propositions.
Comparisons among Porter, the Resource-Based View of the Firm, and the Delta Model Frameworks

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<td>Resource Capabilities, Core Competencies</td>
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<td>Strategy As</td>
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How the strategy framework deals with environmental scan and internal scrutiny

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<td>The Firm as a Bundle of Competencies – The Eight Strategic Positionings</td>
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Value Creation by Each Strategic Option: Empirical Evidence

• In conclusion, we want to examine the comparative economic value created by each of the strategic options of the Triangle. Total Customer Solutions strategy is superior to a Best Product strategy, and, in turn, the System Lock-In strategy is better than Total Customer Solutions.

• It is very hard to demonstrate this claim because of the inherent idiosyncratic differences that exist among businesses and firms. Economic results might depend on a host of complex behavioral and economic circumstances. Being conscious of these limitations, we attempt to address the issue.
Value Creation...

• Economic returns vary markedly by strategic position. Hax collected empirical evidence from over 100 companies occupying a range of strategic positions. His sample included firms drawn from the Fortune 500 whose corporate-wide strategies could be clearly categorized as emphasizing one of the three alternatives in the Triangle.

• The acid test in terms of the merits of each option is the economic value that the companies are able to create for their shareholders. Hax uses two common, and very popular, performance measurements: market value added (MVA) and market - to- book ratio (M/B).
Value Creation...

• Market value added measures the difference between a company’s total market value of equity and debt and its book value, which is the total amount that investors of equity and debt have contributed to the company.

• On this measure, System Lock-In businesses produce an MVA, which, on average, is over four times that of Best Product companies; Total Customer Solutions firms generate over 1.6 times the MVA of Best Product organizations.
Value Creation…

• The market-to-book ratio compares the value that shareholders place in the business based upon their assessment of the expected future cash flows relative to the past resources that have been committed to the business.

• In other words, if a total of $1 million has been invested in a business that today the market values at $2 million, then the market-to-book ratio is 2.
Value Creation…

• The empirical data show that the System Lock-In companies had an M/B ratio that is on average twice as large as the Best Product companies.

• The Total Customer Solutions companies have an average M/B that is 20% higher than that of the Best Product firms.
Value creation by each strategic option: empirical evidence

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<td>Mean</td>
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<tr>
<td>Best Product</td>
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<td>14.26</td>
<td>16.57</td>
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<tr>
<td>Total Customer</td>
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