Canback

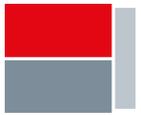**PREDICTIVE
ANALYTICS
INTEGRATORS**

OUR APPROACH TO STRATEGY

April 2018

CANBACK CONSULTING
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A member of The Economist Group

Founded by Dr. Staffan Canback, we are an elite management consulting firm anchored in predictive analytics and market knowledge.

Canback serves clients through five practices: Strategy, M&A Due Diligence, Sources of Growth, Corporate Finance, and Organizational Performance.

We operate globally with the world's largest companies as clients. This has taken us to 87 countries since our founding in 2004.

We also offer analytic services with the Canback Global Income Distribution Database (C-GIDD) as our cardinal product.

Canback is a subsidiary of The Economist Group since 2015.
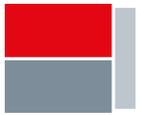
Boston   Chicago   Mexico City   London   Johannesburg   Beijing   Shanghai   Jakarta

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

Adapted from *Warfighting* by the US Marine Corps

Strategy is nowadays a fairly mature discipline. We use the two most important theoretical strands in our strategy projects, to help clients find sustainable comparative advantage

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** and how the company relate to these

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

EIU Canback combines the two views of strategy

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

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 how the **resources** available to management are configured

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

There is solid empirical evidence that RBV generates significant superior returns. SCP, with its focus on external (industry) factors, explains around half of RBV's level. Together, around 60% of profits are explained

SHARE OF CORPORATE PERFORMANCE EXPLAINED

Structure-Conduct-Performance

20%

Other and Chance

40%

40%

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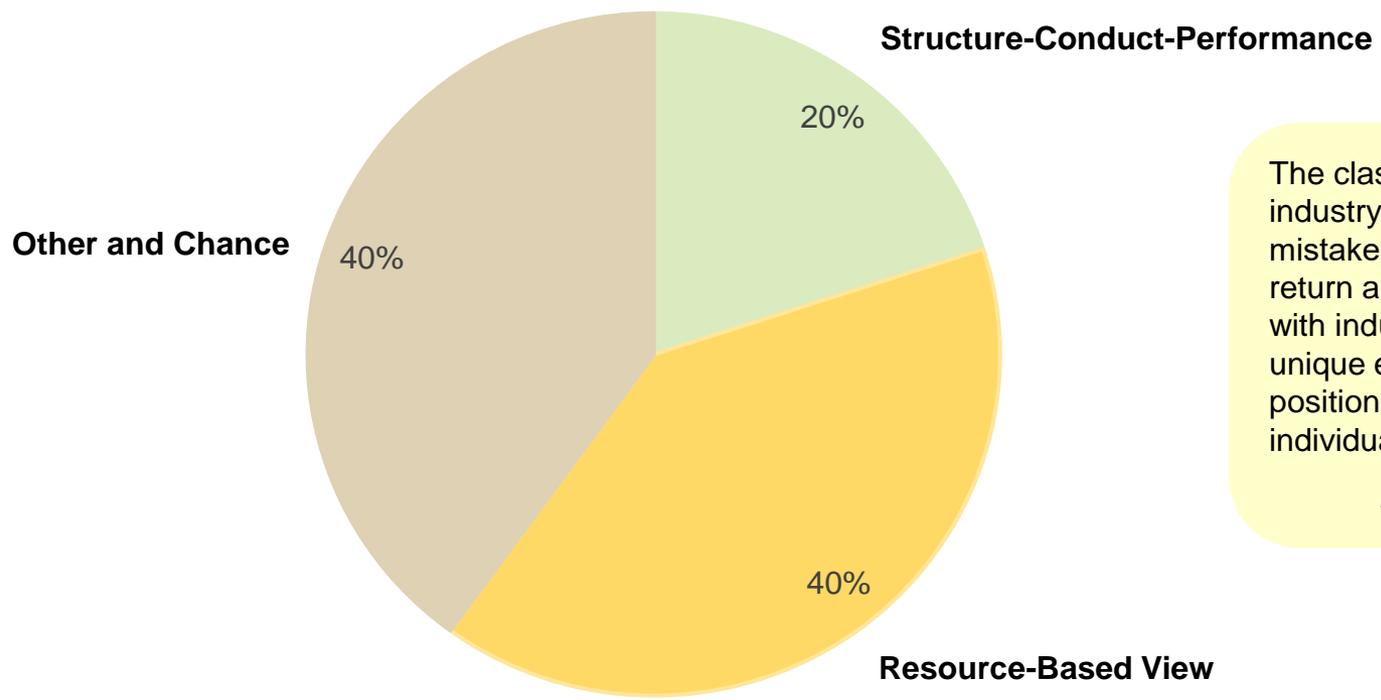
The classical focus on industry analyses is mistaken… long-run rates or return are not associated with industry, but with the unique endowments, positions, and strategies of individual businesses.

Prof. Richard Rumelt

The SCP framework is a standard approach for understanding market dynamics. It is used by corporations and consulting firms all over the world for more than 50 years and is therefore well tested and recognized

STRUCTURE–CONDUCT–PERFORMANCE FRAMEWORK

External Conditions	Structure	Conduct	Performance

Socioeconomic conditions
- Economic growth
- Demographic trends
- Socioeconomic class composition
- Urbanization

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

Infrastructure
- Information and communications technology (ICT)
- Transport and logistics
- Education

Market demand
- Category dynamics
- Growth drivers
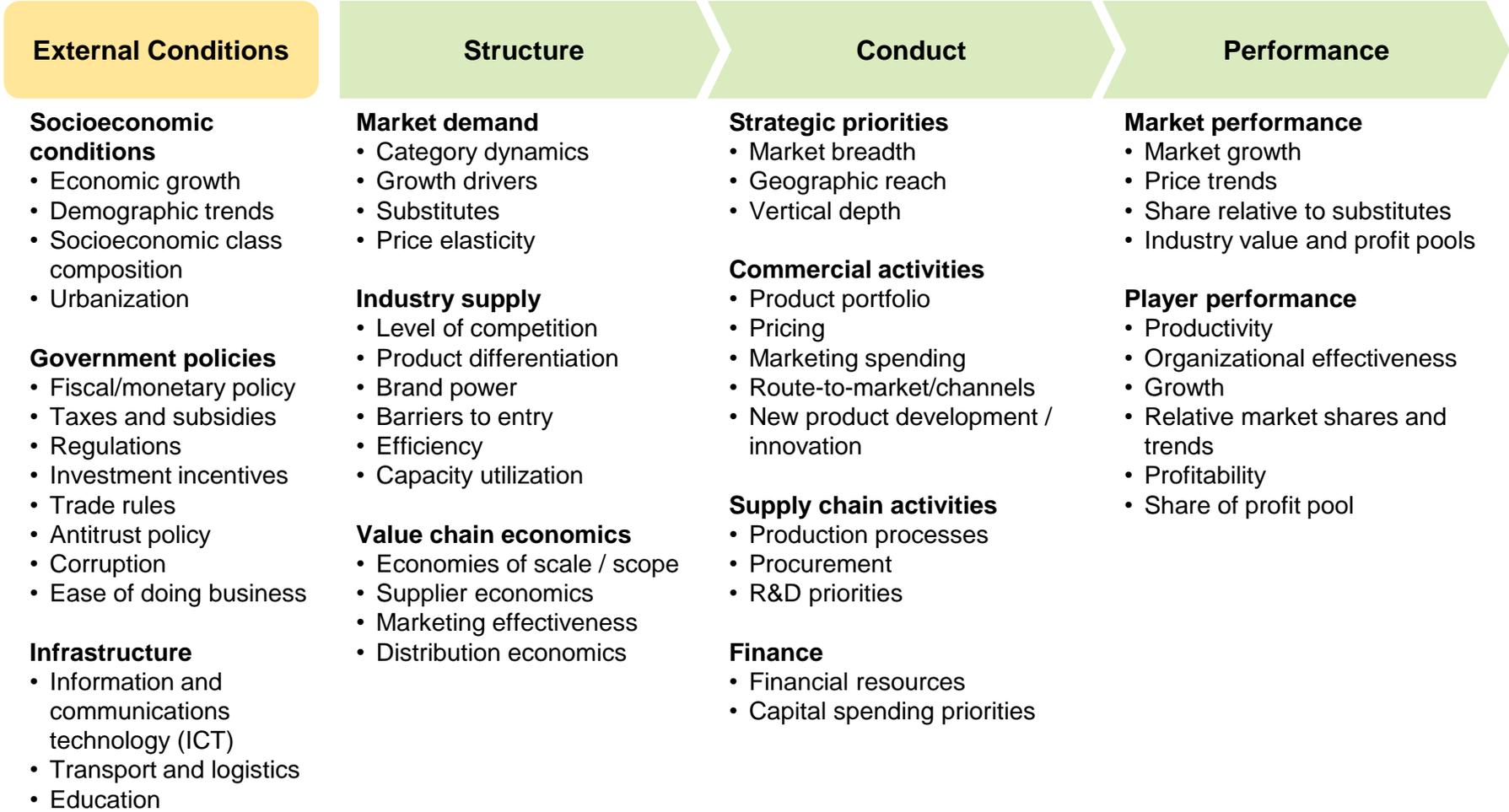- Substitutes
- Price elasticity

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

Strategic priorities
- Market breadth
- Geographic reach
- Vertical depth

Commercial activities
- Product portfolio
- Pricing
- 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

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
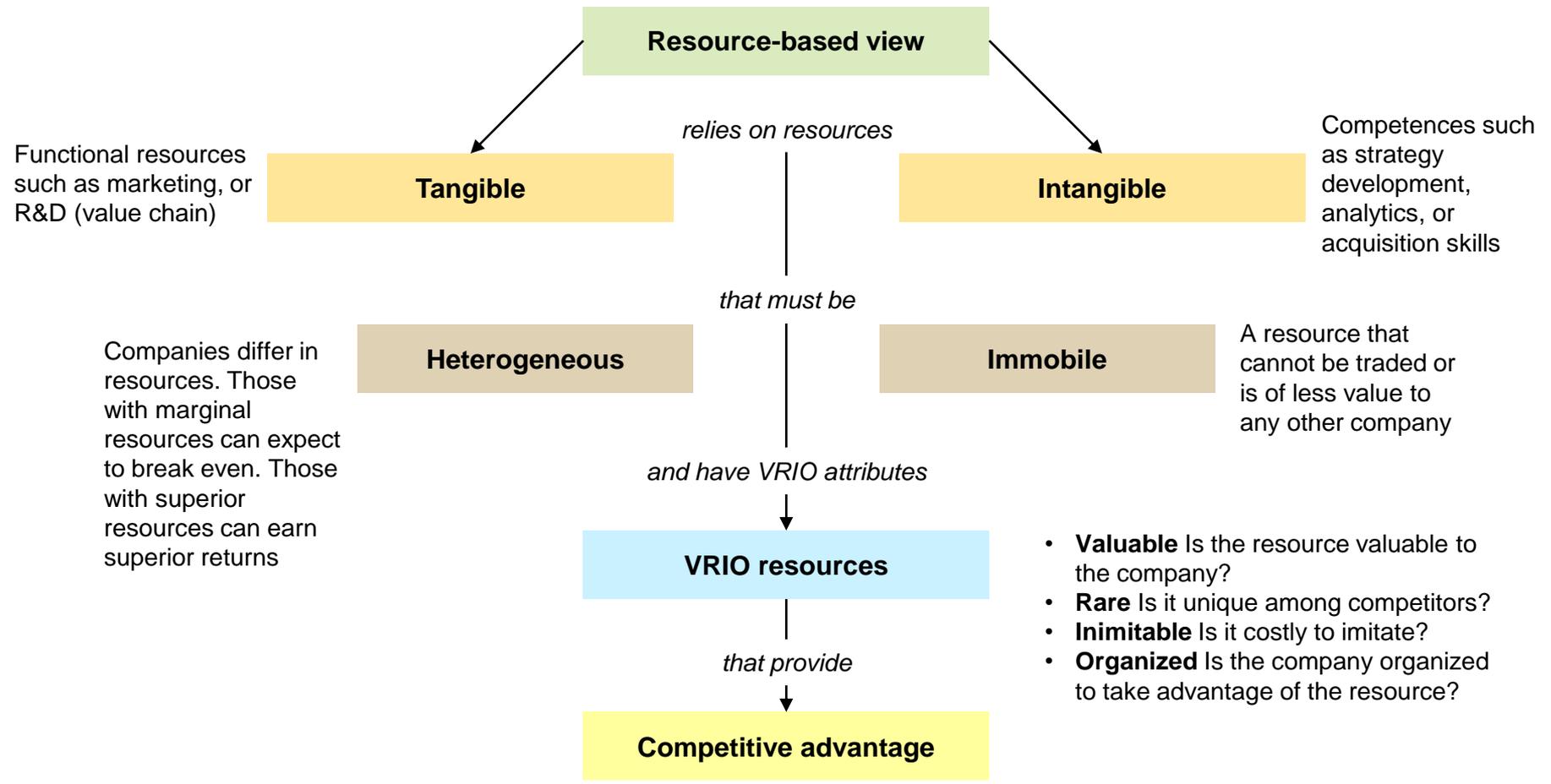
An illustration for how to use SCP can be taken from the US domestic airline industry. After many years of intense competition due to disadvantageous structure, the industry may now be at the brink of positive returns due to a consolidated structure

STRUCTURE–CONDUCT–PERFORMANCE FRAMEWORK

External Conditions	Structure	Conduct	Performance

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 (city pairs) 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
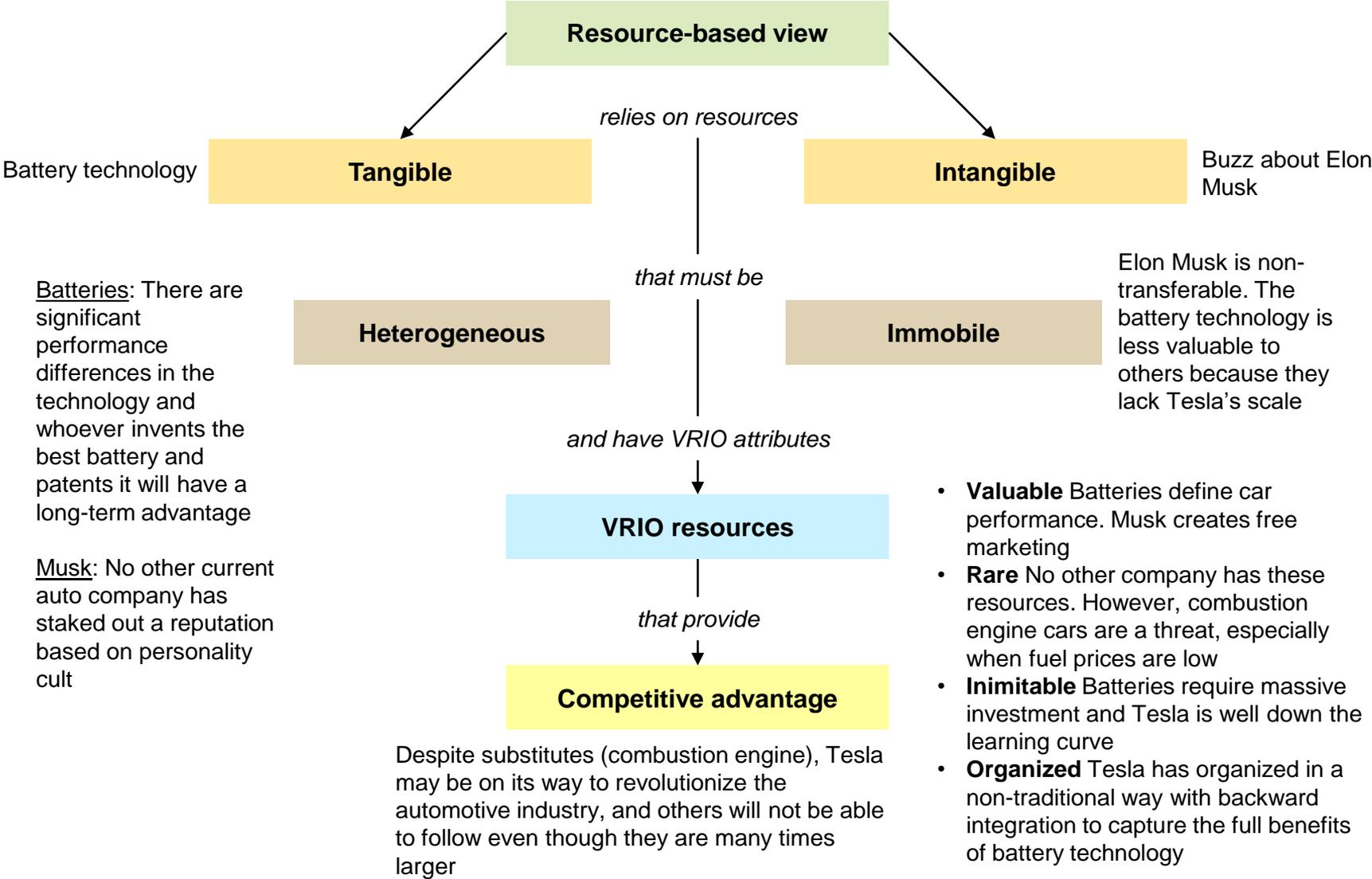
Wernerfelt's "resource-based view of the firm" looks at the resources available to a company and how they can be combined to create sustainable competitive advantage. Most executives have probably not seen this framework, so it is a bit of a head scratcher

Resource-based view

relies on resources

Functional resources such as marketing, or R&D (value chain)

Tangible

Intangible

Competences such as strategy development, analytics, or acquisition skills

that must be

Companies differ in resources. Those with marginal resources can expect to break even. Those with superior resources can earn superior returns

Heterogeneous

Immobile

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

and have VRIO attributes

VRIO resources

- **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?

that provide

Competitive advantage

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

We illustrate RBV with Tesla Motors and why it may have a sustainable competitive advantage. We look at two aspects of resources (there are others): batteries and Elon Musk

Resource-based view

relies on resources

Battery technology

Tangible

Intangible

Buzz about Elon Musk

that must be

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

Heterogeneous

Immobile

Elon Musk is non-transferable. The battery technology is less valuable to others because they lack Tesla's scale

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

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

- **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 investment and Tesla is well down the learning curve
- **Organized** Tesla has organized in a non-traditional way with backward integration to capture the full benefits of battery technology

VRIO is of paramount importance in strategy development. Only businesses with clear VRIO characteristics can achieve sustainable competitive advantage with financial returns above the cost of capital

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 images

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

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

Integrated across the value chain from sourcing to marketing

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

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

VRIO = Valuable, Rare, Inimitable, and Organized

Core competencies is what the company is uniquely good at

The *industry* should if possible have attractive SCP characteristics

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

Competitive advantage is measured as financial performance
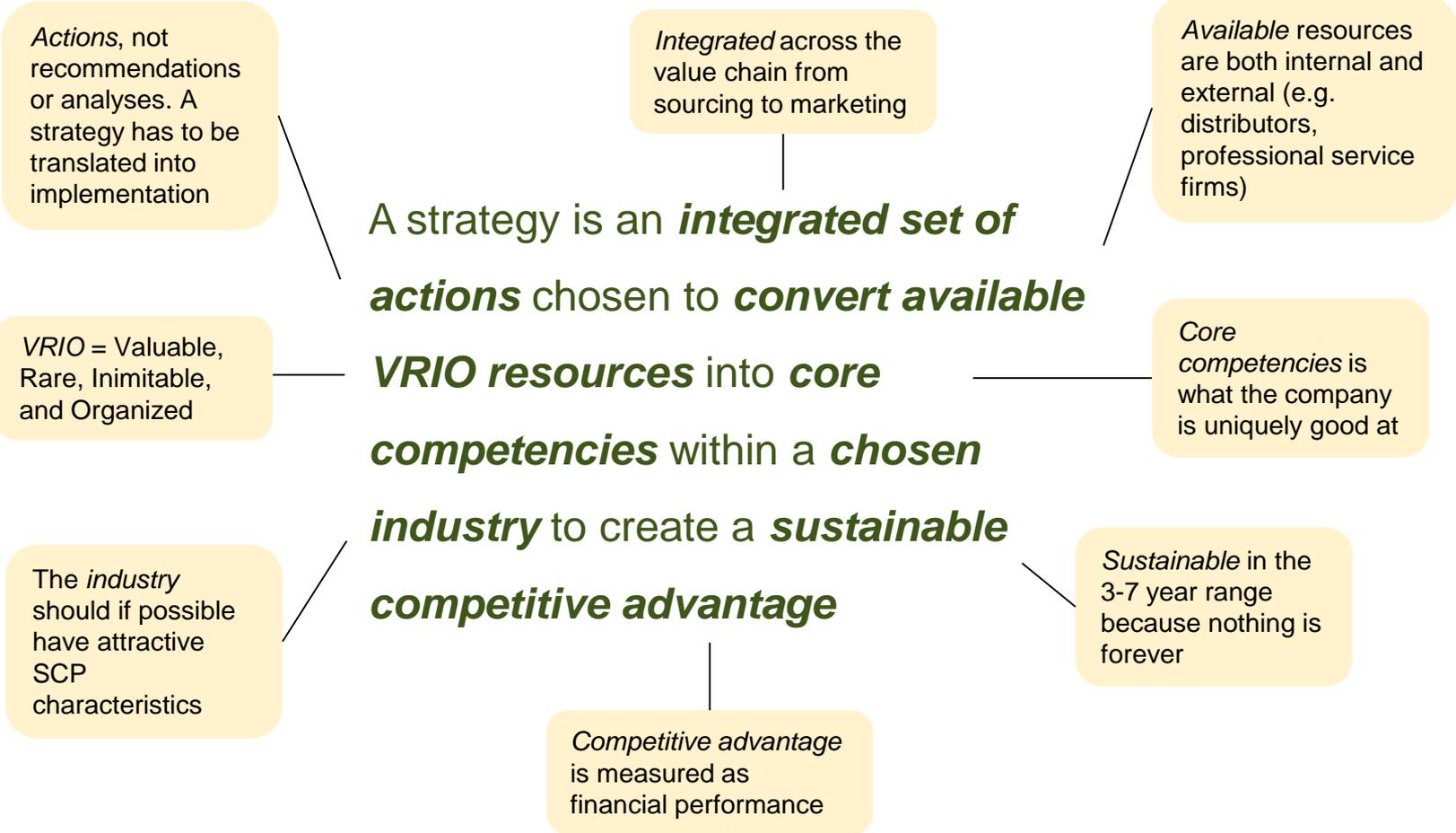
This is our process for strategy development. We always start with SCP because it is familiar to most executives and gives a strong factual base. Only when there is a common understanding around SCP do we turn to RBV, which is much more complicated

	SCP Structure – Conduct – Performance	**RBV** Resource-based view	**Strategy formulation**	**Implementation planning**
Timing*	1 ½ month	1 1/2 months	1 ½ month	½ month
Objectives	• Analyze market/industry SCP and the various players within it • Predict future "as is" market size and player shares • Quantify profit pool	• Analyze company using RBV tools • Identify and quantify VRIO levers • Estimate impact on profit pool	• Build the strategy based on SCP and RBV insights • Quantify "to be" and compare to "as is" (demand, profits, shareholder value) • Identify VRIO resource gaps and what is required to fill them	• Convert strategy into concrete implementation steps around a few themes • Assign responsibilities
Deliverables	• Findings as seen through the SCP lens with market and player predictions from a demand and profit perspective on an "as is" basis	• Findings as seen through the RBV lens • Comparison of SCP and RBV opportunities	• Full strategy document • Resource needs (capital and human) • Shareholder value creation	• Implementation plan by month and year with executives/units responsible

QUANTIFICATION METHODS

Area	Information Sources
SCP (industry/external)	Competitor reports, analyst reports, syndicated 3rd party market data and statistics, government data, desktop research, previous client strategy reports
RBV-tangible resources (e.g. supply chain efficiency)	Client internal data including sales statistics, manufacturing metrics, fulfillment metrics, R&D metrics, financial statements, previous strategy reports, ad agencies
RBV-intangible resources (e.g. innovation)	Management interviews using systematic scorecards, interviews with industry experts, specialist employee surveys

Finally, in our consulting work, we aspire to be VRIO to our clients so that we truly contribute to their sustainable competitive advantage

PROJECT CHECKLIST

V	Valuable	Is the project of material value to the client?
R	Rare	Is what we have to offer rare? Do our specialized skills stand out?
I	Inimitable	Can what we do be easily imitated by our competitors at a lower cost?
O	Organized	Is the client organized to receive our findings? Does it have a partnership agreement with us? Will there be workshops? Are there high level audiences for our presentations? Will there be a plan for knowledge transfer?

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