
On Strategic Interaction

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Executive summary

The scope and limitations of strategy are investigated in this study. There is a plethora of definitions to choose from, since the concept is quite intricate. What is strategy then? Strategy is about combining activities, making trade offs and ultimately being unique. It involves capitalizing on changes (opportunities) and exploiting innovations, i.e. to challenge the old, break established, taken for granted rules and creating the future. Strategy is the creation of a unique, valuable and sustainable position. It involves coming up with new activities, or similar activities combined differently. In creating competitive advantages, growing out of the entire system of activities, this then becomes one's uniqueness.

To illustrate not only the challenges in using strategy, but also the potential, the pharmaceutical industry – its present and future opportunities – is investigated. The industry is characterized by a general focus on operational effectiveness, “me too” behavior and ultimately destructive competition. It is more about outlasting other firms rather than creating real advantage. To achieve sustainable profitability, however, strategy is needed. Successful business strategy entails looking at the world in a new way. It comprises not only adapting to changes, but also initiating them. In contrast to preserving the past or playing catch up, successful business strategy denotes shaping the future.

Purpose

The aim of this study is to analyze and reflect upon the complex yet rewarding concept of strategy. Numerous aspects of strategy are analyzed and it is discussed how firms can develop successful business strategies. The

present and future strategies of the pharmaceutical industry are described and reflected upon. It is also discussed how strategy can be used to create and exploit innovations and competitive advantages.

Theory

There are a various definitions of *strategy*. In citing a plethora of authors, Grant offers several, some of which are: “Strategy is a pattern of resource allocation that enables firms to maintain or improve their performance”; “A plan,

method, or series of actions designed to achieve a specific goal or effect”, and “What business

strategy is all about is, in a word, competitive advantage...”¹

Grant suggests that strategy is about choice and that “these key strategic choices revolve around two fundamental choices”², namely: *where* to compete and *how* to compete. Porter takes it one step further, in arguing that “strategy is the creation of a unique and valuable position, involving a different set of activities.”³ He argues that strategy involves defining a unique position and making clear trade offs and that strategic positioning means performing different activities from rivals’ or performing similar activities in different ways.

In exploring the meaning of the concept and reflecting upon the wide array of definitions of strategy, it might be of value to discuss what strategy is not. One common mistake is namely to confuse strategy with operational effectiveness, which involves continual improvement everywhere and means performing similar activities better than rivals perform them.⁴ While, strategy is about combining activities, operational effectiveness is about achieving excellence in individual activities.

It may at times be hard to fully recognize the difference between the two and numerous business leaders in various industries, including the pharmaceutical one, are guilty as charged. The trend has been downsizing, cutting costs and focus on increasing effectiveness. This instead of enhancing uniqueness and strengthening the strategic fit among activities to create innovations and competitive advantages. There has been an increasingly intense fight over the shrinking cake, rather than exploring

possibilities to expand the cake. Instead of creating the future by innovations and uniqueness, firms tend to look at each other and stick to old best practices. According to Hamel & Prahalad, the trend is indeed saddening: “Downsizing attempts to correct the mistakes of the past, not to create the markets of the future. But getting smaller is not enough. Recognizing that restructuring is a dead end, smart companies move on to reengineering. The difference between restructuring and reengineering is that the latter offers at least the hope, if not always the reality, of getting better as well as getting leaner. Yet in many companies, reengineering is more about catching up than getting up front.”⁵ On the same note, Christensen proposes that: “The problem is managers all too frequently use a one-size-fits-all theory. But the ground beneath them inevitably shifts. Strategies that worked so wonderfully in the past no longer suffice.”⁶ On the note on innovations and the future, Hamel suggests that: “Rule makers and rule takers are the industry. Rule breakers set out to redefine the industry, to invent the new by challenging the old.”⁷

Hence, a firm would benefit to challenge status quo, looking for opportunities to capitalize upon in e.g. structural changes and by aiming to redefine its industry and ultimately its strategy. In doing so, there is a plethora of useful models to exploit, including PEST⁸, SWOT⁹, Porter’s five

⁴ Ibid.

⁵ Hamel, G., Prahalad, C.K. (1994) “Competing for the future”, Harvard Business Review, July-August, pp.122-128

⁶ Christensen, C.M. et al (2003) “Six Keys to Creating New-Growth Businesses”, Harvard Management Update, January, pp. 3-6

⁷ Hamel, G. (1996) “Strategy as Revolution”, Harvard Business Review, July-August, pp. 69-82

⁸ Grant, R.M. (2005) Contemporary Strategy Analysis, p. 68

¹ Grant, R.M. (2005) Contemporary Strategy Analysis, p. 21

² Ibid.

³ Porter, M.E. (1996) “What is strategy?” Harvard Business Review, November-December, pp.61-78

forces¹⁰, the value chain analysis¹¹ and the balanced score card¹². These tools are all valuable to understand the sources of competitive advantage in an industry, to assess the competitive position of a firm and for suggesting opportunities to enhance a firm's competitiveness. New strategic positions certainly arise as a consequence of structural changes in an industry.¹³ Adapting to and capitalizing on these changes can be enhanced by using these models. Furthermore, as suggested by Hamel & Prahalad, firms need to think about the future of the industry, rather than making up for mistakes in the past.¹⁴ How do we want the industry shaped in 5-10 years? What resources do we need and what capabilities must we begin to build now? Resources such as knowledge are strategically important and learning is one main capability for business organizations. Both are prerequisites to succeed, even survive, in this dynamic globalization era. Knowledge is also the fundamental basis of competition and competing successfully on knowledge requires either to align ones strategy to what the organization knows or to develop capabilities needed to support the strategy. Not only is it necessary for firms to know more than other players in the industry, but it is also pivotal to link knowledge to strategy. Thus, information and knowledge are fundamental but not enough; they need to

be metamorphosed into applicable strategies in order to capitalize on external opportunities.¹⁵

To illustrate not only the challenges in using strategy, but also the potential, the pharmaceutical industry – its present state and future opportunities – is investigated.

⁹ For a thorough discussion on the SWOT model and related tools see "SWOT analysis" by Fonduca Advisory

¹⁰ Grant, R.M. (2005) *Contemporary Strategy Analysis*, p. 74

¹¹ *Ibid.*, p. 145 and 291

¹² *Ibid.*, pp. 55-58

¹³ On ways to capitalize on changes in an innovative way, see "Value Processes" by Fonduca Advisory

¹⁴ Grant, R.M. (2005) *Contemporary Strategy Analysis*, p. 317

¹⁵ Zack, M.H. (1999) "Developing a Knowledge Strategy", *California Management Review*, 41(3), pp. 125-145

The pharmaceutical industry

Present situation. This industry is a fiercely competitive one. IP issues are ample; generics being a particularly troublesome issue. It takes on average fifteen years to bring a new product to market. R&D investments and development costs are substantial. The stakes are high. Drug development is like searching for a needle in a hay stack: only one in 10 000 substances screened eventually becomes a product used to treat patients.¹⁶ The top 10 companies have together more than 50% of the market share and that figure is increasing. There are also large entry barriers. The industry certainly reminds of an oligopoly type one.¹⁷ Pharmaceutical firms are quite dependent on each other and decisions are influenced by actions of other players in the industry. Firms try to gain competitive advantage by other means than price. There is a focus on advertising and differentiation – to gain perceived added value, competitive advantage and increased market share. There is a combination of cooperation and competition. On the one hand, we have strategic alliances and partnerships, M&As being one extreme. On the other hand, competition is intense, involving firms struggling to survive, aiming to maximize profit on the expense of competitors.

There appears to be a huge risk of destructive competition. The focus is on benchmarking, operational effectiveness and

imitating best practices – which make players even more alike. Firms tend to put more effort in copying each other rather than differentiating and being innovative. Also, outsourcing is undeniably very common. Most, of the top firms use similar or even the same outsourcing agents. Best practices are almost identical and there is a small group of top consultants that rotate among companies. Players in the pharmaceutical industry are struggling for leftovers and shrinking profits. To survive firms have to merge and acquire each other. What seems to separate the top pharmaceutical firms is indeed merely positioning and operational effectiveness – and this does not cut it any more, it is too static in today's dynamic world.

It might appear naïve to behave in a way that makes life increasingly miserable for everyone involved. This behavior is directly and indirectly affected by several stakeholders. Firms are driven by performance pressures as they need to deliver every single quarter. To make numbers look good, measures need to be taken. The trend is obvious, company after company buy up their rivals. Taking a peak at historical data, over the past 13 years, there has been a continuous process of consolidation and up to 20 major mergers. Today, there are fewer large pharmaceutical firms and fewer differences between the remaining ones.¹⁸ The companies left standing are those that outlasted others, rather than companies with real

¹⁶ Talk by Dr Franz B. Humer, “Innovation in the Pharmaceutical Industry – Future Prospects”, Zurich, 16 March 2005

¹⁷ Grant, R.M. (2005) Contemporary Strategy Analysis, p.73

¹⁸ Jürgen, D. (2003) “Strategic trends in the drug industry”, Drug Discovery Today, Vol. 8(9) May, pp. 411-420

advantage. Hence, there has been too much focus on operational effectiveness rather than strategy. Porter's statement¹⁹ is certainly valid in this context: "Although the resulting operational improvements have often been dramatic, many companies have been frustrated by their inability to translate those gains into sustainable profitability."

Certainly, some firms are able to get more out of their inputs than others since they employ more advanced technology or motivate employees better. These types of differences actually lead Japanese companies, such as Toyota in the 1980s in challenging Western companies – by observing, imitating and improving – and achieving superior profitability. That might have been more than enough then. Nowadays, it might still be easy to copy – although, it might not be sustainable. With the rapid diffusion of best practices, new entrants can rapidly get into the game. Competitors quickly imitate management techniques, new technologies, input improvements, and superior ways of meeting customer needs. Today's dynamic world makes competition fast and fierce. Generics may be great for customers but a nightmare for firms. Information transparency makes it easier for customers to find and compare offers. Hence, competing in terms of operational effectiveness only, will make your business mediocre at best. Pharmaceutical firms certainly appear to be racing down identical paths that no one can win.

Future opportunities. Were there only one ideal position, there would be no need for strategy. But there are several and that is why not only exploring new and improved ways of

using resources and capabilities, but also exploiting innovations and strategic fit are all needed. It is essential to come up with new activities, different from rivals, or in the case of similar activities, in different ways to create a unique and valuable position.

As we have seen, however, presently there is little or no strategic fit for firms in the pharmaceutical industry. As a consequence, there is no distinct strategy and little sustainability. In fact: "Management reverts to the simpler task of overseeing independent functions, and operational effectiveness determines an organization's relative performance."²⁰ As a result, differentiation is needed. In the quest to become unique, it is valuable to examine how one is structured and how strategic decisions are being made. Certainly, hundreds of strategic R&D decisions are carried out to get one drug to market. The know-how, embedded in resources, can be transformed into competitive advantages through capabilities. Competitive advantages depend on sales (marketing resources), technological strengths and having a unique product with a differentiated advantage. Technological resources are necessary for innovations. Hence, rather than continuously optimizing for drug development, firms could try and implement different structures for the early discovery process and then transforming these innovations to drug projects. Instead of being second or third imitator in the industry, firms could find new strategic positions.

Furthermore, besides adding POPs (points of parity) to match industry competitor's features, PODs (points of difference) need to be induced from time to time, to acquire the competitive edge and to be able to offer unique

¹⁹ Porter, M.E. (1996) "What is strategy?" Harvard Business Review, November-December, pp.61-78

²⁰ Ibid.

value propositions. Having said that, trade offs are a must. To keep on adding POP after POP is neither viable nor sustainable in the long run. You might end up being mediocre at everything. Besides you would not be using positioning or segmentation to your advantage. Trade offs protects from imitator and avoids the “me too” trend and thus destructive competition. Yet a solution to avoid the latter is to limit competition – and this might indeed be what pharmaceutical firms are attempting to simulate, by their constant M&A activities.

Instead of trying to cover most parts of the market, chasing for POPs, focus could be put on a very limited amount of therapeutic markets – preferably in those in which the firm already has high potential, to acquire competitive advantages. This rather than struggling in imitating and lagging behind competitors in all therapeutic area in which it competes. Certainly, trade offs are paramount, since without them there would be no need for strategy and operational effectiveness alone would determine performance. Trade offs create the need for choice and persistently limit what the company offers.

Finally then, what is successful business strategy? Hamel²¹ offers: “To discover opportunities for industry revolution, one must look at the world in a new way, through a new lens.” And successful business strategy indeed requires looking at the world in a new way. It involves the promotion and exploitation of innovations, to challenge the old and breaking established rules. Achieving successful business strategies requires establishing and sustaining competitive advantages. This in turn demands profound insight into the nature of the

industry and the process of competition within the same. In choosing a new position, it is also necessary to be able to make trade offs and leverage a new system of complementary activities into sustainable advantages. Ultimately successful business strategy means shaping the future.

²¹ Hamel, G. (1996) “Strategy as Revolution”, Harvard Business Review, July-August, pp. 69-82

Conclusion

Were there only one ideal position, there would be no need for strategy. But there are several and that is why exploring new, improved ways of using resources and capabilities, in addition to exploiting innovations and strategic fit among activities, are all needed. As we have seen, strategy is the creation of unique and valuable position. Thus, differentiation is needed. In the quest to become unique, it is valuable to examine how the firm is structured and how strategic decisions are made. Trade offs are

paramount, since without them there would be no need for strategy, and operational effectiveness alone would determine performance. Trade offs create the need for choice and persistently limit what the company offers. In conclusion, successful business strategy entails looking at the world in a new way. It comprises not only adapting to changes, but also initiating them. Successful business strategy denotes shaping the future.

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