The Delta Model -- Toward a Unified Framework of Strategy

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Source: Arnoldo C. Hax and Dean L. Wilde II
Two Fundamental Paradigms

In spite of the enormous proliferation of competing schemes in the business strategy literature, there are two fundamental paradigms that have emerged as the most influential in the last two decades.

First, Competitive Positioning, as proposed by Michael Porter from the Harvard Business School in the 1980’s, and, second, the Resource-Based View of the firm that evolved during the 1990’s.
Porter’s arguments are drawn from the work of organizational economists who place the industry as the central focus of strategic attention. According to Porter’s framework, structural characteristics of a firm’s industry best explain variations in firm performance.

In other words, Porters sees good industries, such as pharmaceuticals, where most players enjoy high margins; he also sees bad industries, such as trucking, where most participants suffer from low profitability.
A Successful Firm According to Porter

Using the language of economics, a successful firm is one that appropriates monopolistic rents. In other words, in the industry as a whole or in a segment of the industry, the firm establishes itself as the dominant (or sole) competitor.
Porter’s logical conclusion from this perspective is that there are only two ways to compete: through Low Cost or Product Differentiation. Most managers in the 1980s became familiar with Porter’s taxonomy. Cost leadership is achieved through the aggressive pursuit of economies of scale, product and process simplification, and significant product market share that allows companies to exploit experience and learning effects.
Differentiation

Differentiation calls for creating a product that the customer perceives as highly valuable and unique. Approaches to Differentiation can take many forms: design of brand image, technology, features, customer service, and dealer networks.
Product Economics

The strategic positions of Low Cost and Differentiation are centered on product economics. The resulting mentality of this approach, which is widely apparent in the business world, has enormous implications that we will address later.
The Resource-Based View of the Firm

Instead of looking at the industry as the source of profitability, the Resource-Based View of the firm argues that the attention should turn to the firm.

Instead of seeking profitability at the intersection of the products and markets, the Resource-Based View looks for value derived from resources, capabilities and competencies. Instead of relying on monopoly rents, premium returns depend upon what economists refer to as “Ricardian rents.”
What makes one firm different from another is its ability to appropriate resources that are valuable, rare, and difficult to substitute or imitate. The roots of this perspective go back to David Ricardo, a British economist who lived in the early 1800’s.

Ricardo tried to explain variations in farm profitability by pointing to differences in the supply of fertile land. Proponents of the Resource-Based View had the insight to recognize that management skills, information capabilities, and administrative processes can also be regarded as scarce factors able to generate Ricardian rents.
The Primary Role of Strategy According to Porter and the RBV

Porter’s framework and the Resource-Based View of the firm basically perceived the primary role of strategy as achieving a unique competitive advantage. We underline the word competitive because that seems to us to be the common principle.

In this sense, the objective of strategy becomes beating your competitor either by excelling in the activities of your value chain that allows you to establish a dominant position in your industry, or through the mobilization of unique resources and capabilities.
In contrast, Arnoldo C. Hax and Dean L. Wilde II have developed a new strategy framework that they called the Delta Model – Delta being the Greek letter that stands for transformation and change.

They felt that the new technology surrounding the internet provides novel and effective ways to link to the customer and to the extended enterprise, opening up new sources of strategic positioning that should be properly evaluated.
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They strongly believe that the Delta Model has the ability to complement the perspectives of Porter’s frameworks and the Resource-Based View of the Firm and provide the integrative glue that may result in one unified strategy framework.

We will now briefly describe the three frameworks. Our treatment is not intended to be exhaustive. We will deal with the frameworks at a level sufficient for the reader to understand the implications of our claim regarding unification.
Porter’s Competitive Positioning Framework

According to Porter, there are two basic determinants of the profitability of a business: the structure of the industry in which the business operates and the competitive positioning of the business within that industry.

These are the inputs that determine the Strategic Agenda of the business and that lead to the formulation and implementation of its strategy. Figure 1 captures the essence of the framework.
Porter’s Framework

Figure 1
The Basic 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

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Industry structure explains the value generated by the economic activity of the industry participants, as well as their ability to share in the wealth created.

Michael Porter postulates that there are five forces that typically shape industry structure: intensity of rivalry among competitors, threat of new entrants, threat of substitutes, bargaining power of buyers, and bargaining power of suppliers.
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These five forces determine prices, costs, and investment requirements, which are the basic factors driving long term profitability, and henceforth industry attractiveness.

Figure 2 illustrates the generic structure of an industry as represented by its main players (competitors, buyers, suppliers, substitutes, and new entrants), their interrelationships (the five forces), and the factors behind those interrelationships that account for industry attractiveness.
Figure 2
Elements of Industry Structure: Porter’s Five Forces

BARRIERS TO ENTRY
- Economies 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

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 contribution by suppliers
- Importance of the industry to suppliers’ profit

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
- Contributions to quality or service of buyers’ products
- Total buyers’ cost contributed by the industry
- Buyers’ profitability

SUBSTITUTES
- Availability of close substitutes
- User’s switching costs
- Substitute producers’ profitability and aggressiveness
- Substitute price-velocity

Intensity of Rivalry

The Value Chain Model

The *competitive position* establishes the basis for achieving a sustainable advantage, which is a business’ relative standing against its key competitors. According to Porter, the value chain model is the guiding framework for assessing the competitive position of a business.

The underlying principle is that all the tasks performed by the business organization can be classified into nine broad categories. Five of them are called *primary activities* and the other four, *support activities*. Figure 3 provides a full representation of the value chain.
Figure 3
Porter’s Value Chain

<table>
<thead>
<tr>
<th>Firm Infrastructure</th>
<th>Margin</th>
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<tbody>
<tr>
<td>Human Resource Management</td>
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<td>Technology Development</td>
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<td>Procurement</td>
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<tr>
<th>Inbound Logistics</th>
<th>Operations</th>
<th>Outbound Logistics</th>
<th>Marketing and Sales</th>
<th>Service</th>
</tr>
</thead>
</table>

Primary Activities

Source: This setup for the value chain was suggested by Michael E. Porter (1985)
The Primary and Support Activities

The *primary activities* involve the physical movement of raw materials and finished products and the marketing, sale, and servicing of these products. They can be thought of as the classical management functions of the firm, where there is an organizational entity with a manager in charge of a very specific task, and with full balance between authority and responsibility.

The *support activities* are more pervasive. Their role is to provide support not only to the primary activities, but to each other. They provide the managerial infrastructure of the business: all processes and systems intended to ensure proper coordination and accountability. Examples include human resource management, technology development, and procurement.
The Value Chain as a Diagnostic Tool

Since the value chain is composed of the set of activities performed by the business unit, it provides a very effective way to diagnose the position of the business against its major competitors, and to define the foundations for action aimed at sustaining a competitive advantage. As opposed to the forces that determine the industry structure of the business – which are largely external and not controllable by the firm – the activities of the value chain are factors that companies can control as they strive to achieve competitive superiority.

By analyzing these activities, managers can identify the success factors central to competing well and to understanding how to develop the unique competencies that provide the basis for sound business leadership.
Porter’s Winning Formula

Porter’s framework offers a simple approach to business success: pick an attractive industry in which you can excel. The framework and the language Porter uses to describe it stress rivalry and competition. Therefore, an attractive industry is one in which a business can achieve as close to a monopolistic position as possible.

The message of the value chain model to managers is that they must achieve sustainable advantage by beating their competitors in as many key activities as possible. According to Porter, then, strategy is war!
The Resource-Based View of the Firm

The Resource-Based View of the firm represents a major departure from Porter’s approach that is based on market-driven factor considerations. Porter posits that industry structure plays a central role in creating opportunities for superior profitability.

The Resource-Based View, on the other hand, argues that the central forces of competitive advantage are factor-driven; that is, they depend on the firm’s development of resources and capabilities. Figure 4 illustrates the essence of the Resource-Based View, which has four key components:
The Essence of the Resource-Based View

1. Competitive advantage is created when resources and capabilities owned exclusively by the firm can generate unique core competencies.
2. The resulting advantage can be sustained due to the lack of substitution and imitation capacities by the firm’s competitors.
3. The benefits derived from these advantages are retained inside the firm: they are not appropriated by others.
4. The timing of the acquisition of the necessary resources and capabilities is so opportune that their cost will not offset the resulting benefits.

*If all these conditions are met, then the competitive advantage that is created will generate economic value for the firm.*
Building on Figure 4, we will now explore the components of the Resource-Based View in more detail.
1. Unique Competencies

The firm’s resources and capabilities are the sources of its unique competencies. Resources can be tangible (e.g., financial and physical assets) or intangible (for example reputation, customer orientation, and technological superiority).

Resources are converted into capabilities when the firm develops the necessary routines to use them effectively. Often, resources and capabilities are the results of investment in durable, specialized, and non-tradable factors.
This is what Pankaj Ghemawat has defined as commitment. In his view, commitment explains the persistence in an individual firm’s performance, and the differences in profitability enjoyed by different firms competing in the same industry. These investments represent both sticky factors that are not easily lost to competition, and major bets that are not easily reversed.
2. Sustainability

For a business unit’s competitive advantage to be sustainable, its resources must be valuable, scarce, and difficult to imitate or substitute.
3. Appropriability

A strategy that is both unique and sustainable generates significant economic value. The issue of appropriability addresses the question of who will capture that value. Sometimes the owners of the business do not appropriate all the value created because of a gap between ownership and control. Non-owners might control complementary and specialized factors that divert the cash proceeds away from the business.

This type of dissipation of value is called *holdup*. A well-known example of hold-up took place in the personal computer industry, in which Intel and Microsoft captured 80% of the total market value of the industry, value lost to the computer manufacturers themselves.
The second threat related to the appropriability of economic value is referred to as \textit{slack}. It measures the extent to which the economic value realized by a business is significantly lower than what it could have been. Slack is often the result of inefficiencies or unwarranted benefits that prevent the accumulation of economic rents by a business.

One of the major sources of slack in the U.S. has been confrontations between management and labor unions. It has been reported, for example, that General Motors loses $2 billion annually to its bottom-line due to strikes.

\textit{While hold-up changes the distribution of the total wealth created, slack reduces the overall size of this wealth.}
4. Opportunism and Timing

The final necessary condition for competitive advantage comes (or fails to come) prior to the establishment of a superior resource position. The cost incurred in acquiring the resources must be lower than the value created by them. In other words, the cost of implementing the strategy should not offset the value generated by it.
C.K. Prahalad and Gary Hamel popularized the Resource-Based view of the firm. They establish three main ideas in their paper. First, that competitive advantage derives from an ability to build, less expensively and more rapidly than competitors, the core competencies that spawn unanticipated products. The real source of advantage is to be found in management’s ability to consolidate company-wide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities.
Second, the tangible link between identified core competencies and end products is what they call the core products, the physical embodiment of one or more core competencies. And third, senior management should spend a significant amount of its time developing a corporate strategic architecture that establishes objectives for competency building.

Strategic architecture is the road map to the future; it helps determine which core competencies to build and helps identify their constituent technologies.
The Resource-Based View of the Firm’s Winning Formula

Based on the original Resource-Based View unmodified by Prahalad and Hamel, the winning formula is very simple:

- Develop resources and capabilities that are unique, valuable, and non-tradable, and that constitute the unique competencies of the firm
- Make the resulting advantages sustainable by preventing imitation or substitution by competitors
- Appropriate the resulting economic rent by preventing negative hold-up and slack conditions
- Ensure that the implementation process is done in such a way that its associated costs do not overwhelm the resulting benefits.

In other words, it is strategy by real estate.
If we further extend the winning formula to account for Prahalad and Hamel’s message, we would add three more elements: *develop core competencies at the corporate level; apply them to create core products as opposed to end products; and use a strategic architecture to guide competence building.*
Porter’s framework and the Resource-Based View differ in explaining the sources of profitability. Porter associates it with *monopolistic rent that flows from industry structure*. The Resource-Based View of the firm ties it to the *corporation’s internal capabilities*. They share the perspective that business is akin to war and that designing business strategy is akin to playing a zero-sum game. Profitability accrues to those who are superior to their competitors.

The Delta Model takes issue with this almost obsessive focus on competition.
The Delta Model: Customer Bonding is the Driving Force in Strategy

We believe that a firm owes itself to its customers. They are the ultimate repository of all the firm’s activities. At the heart of management and, certainly, at the heart of strategy, resides the customer. We have to serve the customer in a distinctive way if we expect to enjoy superior performance. The name of the game is to attract, to satisfy, and to retain the customer.
Classic Strategy Frameworks

Classic strategy frameworks emphasize a product orientation. They pit competitor against competitor in a rivalry where the outcome is determined by who has the best product. Consequently, most companies are typically consumed by a product-centric mindset. They tend to commoditize the customers by offering standardized products, through mass distribution channels, making limited attempts to recognize and satisfy individual customer needs.

Frequently, the point of contact with the client organization is the client’s purchasing department through a conventional sales force (its own or another’s) commissioned to sell products or services. This institutes an arm’s length relationship that inhibits any deep knowledge to be nurtured and developed.
Distribution Channels

The physical nature of distribution channels presents barriers that block the firm from its final consumers.

Michael Dell thought that he was simply reducing costs when he decided to skip the wholesale and retail channels and deal directly with the customers. However, he discovered that this new business model opened up a world of intelligence and information that could be put to use in offering customized solutions to key customers that could have not been generated under the old distribution scheme.
The Networked Economy

The intimacy and connectivity of a networked economy offer opportunities to create competitive positions based upon the structure of the customer relationship. A business can establish an unbreakable link, deep knowledge, and close relationship that we refer to as customer bonding.

These bonds can be directly formed with the customer, or indirectly formed through the complementors that the customer wishes to access. Both are powerful sources of margin and sustainability. The bonds represent investments made by customers and complementors in and around the business’ product. Competition based upon the product alone misses entirely a primary force driving profitability. Bonding emerges as a central force in shaping strategy.
Product-centric Mentality

We have observed that most companies, even those which are in consumer oriented industries, lack the intimate customer knowledge needed to address this issue properly, or they are so absorbed in a product-centric mindset that it can be a challenge to relate to this kind of strategic thinking.

The Delta Model is a management framework that puts bonding at the center of strategy development. We will only cover here a brief overview of the Delta Model. The reader could refer to professor Hax’s recent book for an extensive treatment of this subject.

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The Triangle: Opening the Mindset to a New Set of Strategic Options

Our foremost concern in defining the strategy of the firm or a business is to decide on the relevant strategic positioning. This should capture the essence of how the firm competes and serves customers in its relevant marketplace.

There are three distinct strategic options, which offer very different approaches to achieve customer bonding. They are depicted graphically through a triangle (Figure 5).
Figure 5
Business Model: Three Distinct Strategic Options

Competition Based Upon System Economics:
Complement or lock-in, competitor lock-out, proprietary standard

System Lock-In

Total Customer Solutions

Competition Based Upon Customer Economics:
Reducing customer costs or increasing their profits

Best Product

Competition Based Upon Product Economics:
Low cost or a differentiated position product
Best Product

The *Best Product* (BP) positioning builds upon the classical form of competition. The customer is attracted by the inherent characteristics of the product itself, either due to its Low Cost, which provides a price advantage to the customer, or due to its Differentiation, which introduces unique features that the customers values and for which they are willing to pay a premium. The products tend to be standardized and unbundled. The customers are generic, numerous, and faceless.
The central focus of attention is the competitor, which we are trying to equal or surpass. Competitive advantage rests upon product economics and the internal supply chain, which provide the engine for efficient product production. Innovation is centered in the internal product development process. The liability of this approach is that it generates the minimum amount of customer bonding, hence making the incumbent firms most vulnerable to new entrants.

Its obsessive concern with the competitors often leads to imitation and price war, resulting in rivalry and convergence; the worst of all situations.
In spite of the inherent limitations of this strategic position, it is by far the most widely adopted, and the default position for those businesses that do not deliberately consider other strategic options.
Total Customer Solutions

The *Total Customer Solutions* (TCS) strategy is a complete reversal from the Best Product approach. Instead of commoditizing the customer, we seek a deep customer understanding and relationship that allows us to develop value propositions that bond to each individual customer. Instead of developing and marketing standardized and isolated products, we seek to provide a coherent composition of products and services aimed at enhancing the customer’s ability to create their own economic value.
Instead of concentrating inwardly in our own supply chain, we seek to develop an integrated supply chain that links us with key suppliers and customers. Instead of focusing on competitors and imitating them, we redefine the ways to capture and serve the customer by putting together the overall set of corporate capabilities, also sourcing from proper external parties, that enhance our product offering.

We are outwardly driven; customer economics is our guide. The innovation process is not oriented toward the design of standardized products; it is aimed at initiatives with our key customers for the joint development of distinctive products.
System Lock-In

The *System Lock-In* (SLI) strategic option has the widest scope; it includes the *extended enterprise* – the firm, the customers, the suppliers, and most importantly, the *complementors*. A complementor is a firm that engaged in the delivery of products and services that enhance our own product and service portfolio. The key to this strategic option is to identify, attract, and nurture the complementors.

They are often external, but may also be internal to the corporation, particularly in large and diversified organizations. These complementors are rarely detected and exploited effectively.
That is why a System Lock-In strategy has to start with a full corporate scope – not just for one product or business – and has to continue with the identification and incorporation of all the key external players that can become complementors. The customer continues to be the central focus, but now we extend the enterprise to the fullest. We look at the overall system supply chain, not just the supply chain for our product, and harness the innovation percolating throughout the system as a whole.

The richness and depth of complementors supporting our product or service lock our product into the system and lock-out the competition. Defacto Proprietary Standards are one way to achieve System Lock-In.
Microsoft

Microsoft is the most public example. Personal computer users are compelled to buy Microsoft’s Windows operating system because it has the widest selection of available software applications. Over 100,000 applications are designed to work with Windows, whereas Apple’s Macintosh operating system has one quarter that number. If you want to use the latest or most esoteric software, you had better have Windows on your computer.
Correspondingly, if you are a software company that wants to reach the most customers, you had better write your application to work first (or only) with Windows because it is the operating system on the most computers.

This creates a powerfully positive and self-reinforcing feedback loop – people choose Windows to gain access to the most applications, applications providers choose Windows to reach the most people. Once Microsoft achieved a slight edge, it became the clear choice. The system tolerates no meaningful second place.
Distribution Channels

Distribution channels are often a key consideration for System Lock-In positioning. By owning or restricting access to distribution channels, competitors can be locked-out. Brands can be a means to this end. Coca-Cola’s creates higher turnover for retailers than lesser brands, motivating the retailer to give Coca-Cola more shelf-space, which further enhances its brand, further improving its turnover, and so on.

There are several routes to System Lock-In. A company that achieves this position exercises an enormous amount of power.
However, a System Lock-In position is not always possible; there are necessary conditions. Foremost among these is that the value of the product to a customer should significantly increase as the product is used by others. Microsoft is valuable primarily because it is used by the majority of the PC users; the *Yellow Pages* is valuable because it is used by most shoppers; eBay is valuable because it is used by the vast majority of online auction buyers; and the list goes on.
A Self-reinforcing Value Proposition

This leads to a self-reinforcing value proposition. After attaining it, there are additional challenges to a System Lock-In position: how to sustain it and exercise this power in an ethical way that does not create excesses of monopolistic behavior.
The Value Proposition

In a Best Product position the value proposition to the customer is the product and its attributes are independent of the customer. In a Total Customer Solutions position, the value proposition to the customer is enhanced by the interaction between the customer and the product, which leads to bonding with existing customers.

In a System Lock-In position, the value proposition to the customer is enhanced by the interaction with other customers, which leads to bonding with existing and new customers. Bonding reflects externalities beyond the product itself.
Value Creation by Each Strategic Option: Empirical Evidence

Economic returns vary markedly by strategic position. Arnoldo C. Hax and Dean L. Wilde II have collected empirical evidence from over 100 companies occupying a range of strategic positions. Their 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. They use two common, and very popular, measures of performance: market value added (MVA) and market-to-book ratio (M/B).
Market Value Added

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 1.5 times the MVA of Best Product organizations. The results are shown in Table 1.
## Table 1
Value Creation by Each Strategic Option: Empirical Evidence

<table>
<thead>
<tr>
<th></th>
<th>Number of Firms</th>
<th>MVA (Market Value Added)</th>
<th>Market-To-Book Value</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Mean</td>
<td>Standard Deviation</td>
</tr>
<tr>
<td>Best Product</td>
<td>74</td>
<td>14.26</td>
<td>16.57</td>
</tr>
<tr>
<td>Total Customer Solution</td>
<td>67</td>
<td>22.38</td>
<td>28.14</td>
</tr>
<tr>
<td>System Lock-In</td>
<td>16</td>
<td>57.15</td>
<td>48.67</td>
</tr>
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The market-to-book ratio compares the value that shareholders place in the business based upon their assessment of the expected future cashflows 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 is today is valued at $2 million, then the Market-to-Book ratio is 2. Obviously, the strategy and execution of the business has a multiplier effect that creates the additional value.

The empirical data shows that the System Lock-In companies had a 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 (Table 1).
Arnoldo C. Hax and Dean L. Wilde II have found a significant financial premium for companies that can achieve a Total Customer Solutions position, and further enhanced premium for those attaining System Lock-In. However, there are important caveats. This conclusion reflects the performance of companies that have successfully arrived at these positions, it does not account for those that have attempted and failed.

There may be added risk and greater difficulty in reaching for the brass ring of System Lock-In or the annuities attached to Total Customer Solutions. Furthermore, while there are striking rewards that can draw you to new strategies, they do not mean to imply that the strategic answer for all companies is the same.
John S. Reed, the past Chairman of CitiGroup, once said; “A CEO has just two jobs, decide what to do and making it happen. And, ninety percent of the job is making it happen. When you are running a company execution becomes everything.”

To guide managers in the “what to do” question, the Triangle dramatically expands the sources of profitability to describe three distinct choices for strategic positioning: Best Product, Total Customer Solutions, and System Lock-In.
“How to make it happen” depends first and foremost on the proper alignment of the core activities of the business with the chosen strategy. Alignment is the operative term. Each strategic position of the Triangle generates a very different set of tasks and activities.

Arnoldo C. Hax and Dean L. Wilde II suggests that the primary obstacle in execution is not working harder, with less error, faster, or smarter, but is failing to align the activities of execution with the specific requirements inherent in the desired strategic position of the business.
To accomplish this goal, they identified the three business processes that capture the essential tasks of execution. The core activities of the firm are embodied in three processes:
The Adaptive Processes: Linking Strategy with Execution

- Business Model
- Innovation
  - The process of new product development
  - Should ensure a continuous stream of new products and services to maintain the future viability of the business
- Customer Targeting
  - The management of the customer interface
  - Identification and selection of attractive customers and enhancement of customers' performance
  - Should establish best revenue infrastructure foundation
- Operational Effectiveness
  - The production and delivery of products and services to the customer
  - Should produce the most effective cost and asset infrastructure to support the chosen strategic position of the business

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1) Operational Effectiveness (OE)

This process is responsible for the delivery of products and services to the customer. In a traditional sense, this includes all the elements of the internal supply chain. Its primary focus is on producing the most effective cost and asset infrastructure to support the desired strategic position of the business.

In a more comprehensive sense, operational effectiveness should expand its external scope to include suppliers, customer, and key complementors, thus establishing an extended supply chain. This process is the heart of a company’s productive engine as well as its source of capacity and efficiency.
2) Customer Targeting (CT)

This process addresses the business-to-customer interface. It encompasses the activities intended to attract, satisfy, and retain customers, and ensures that customer relationships are managed effectively.

Its primary objectives are to identify and select attractive customers and to enhance their financial performance, either by helping to reduce their costs or increase their revenues. The ultimate goal of this process is to establish the best revenue infrastructure for the business.
3) Innovation (I)

This process ensures a continuous stream of new products and services to maintain the future viability of the business. It mobilizes all the creative resources of the firm – including its technical, production, and marketing capabilities – to develop an innovative infrastructure for the business.

It should not limit itself to the pursuit of internal product development, but should extend the sources of Innovation to include suppliers, customers, and key complementors. The heart of this process is the renewal of the business in order to sustain its competitive advantage and its superior financial performance.
Adaptive Processes

Collectively we call them Adaptive Processes, to emphasize the changing nature of the tasks. Figure 6 provides a representation of the interactions that exist between the Triangle which is critical to define the changing role of each Adaptive Process and among the processes themselves, since each one strongly influences the another.
Adaptive Processes

Strategy is not effective if kept at an abstract level. The Adaptive Processes spell out in detail their unique supportive role for each of the three strategic positions in the Triangle. Table 2 summarizes these roles.
Table 2
Role of the Adaptive Processes in Supporting the Strategic Options of the Triangle

<table>
<thead>
<tr>
<th>Adaptive Process</th>
<th>Operational Effectiveness</th>
<th>Strategic Positioning</th>
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<tbody>
<tr>
<td></td>
<td>Best Product Cost</td>
<td>Total Customer Solutions</td>
</tr>
<tr>
<td></td>
<td>• Identify product cost drivers</td>
<td>• Improve customer benefits</td>
</tr>
<tr>
<td></td>
<td>• Improve stand along product cost</td>
<td>• Improve customer economics</td>
</tr>
</tbody>
</table>

Best Product

Best Customer Benefits

Best System Performance
<table>
<thead>
<tr>
<th>Customer Targeting</th>
<th>Target Distribution Channels</th>
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<tbody>
<tr>
<td></td>
<td>Maximize coverage through multiple channels</td>
</tr>
<tr>
<td></td>
<td>Obtain low cost distribution</td>
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<tr>
<td></td>
<td>Identify and enhance the profitability of each product by channel</td>
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<table>
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<tr>
<th>Target Customer Bundles</th>
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<tbody>
<tr>
<td>Identify and exploit opportunities to add value to key customers by bundling solutions and customization</td>
</tr>
<tr>
<td>Increase customer value and possible alliances to bundle solutions</td>
</tr>
<tr>
<td>Select key vertical markets</td>
</tr>
<tr>
<td>Examine channel ownership options</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Target System Architecture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify leading complementors in the system</td>
</tr>
<tr>
<td>Consolidate a lock-in position with complementors</td>
</tr>
<tr>
<td>Expand number and variety of complementors</td>
</tr>
<tr>
<td>Whenever possible create ownership of direct distribution channels</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Innovation</th>
<th>Product Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Develop family of products based on common platform</td>
</tr>
<tr>
<td></td>
<td>First to market, or follow rapidly — stream of products</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer Service Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify and exploit joint development linked to the customer value chain</td>
</tr>
<tr>
<td>Expand your offer into the customer value chain to improve customer economics</td>
</tr>
<tr>
<td>Integrate and innovate customer care functions</td>
</tr>
<tr>
<td>Increase customer lock-in through customization and learning</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>System Innovation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Create customer and system lock-in, and competitive lock-out</td>
</tr>
<tr>
<td>Design proprietary standard within open architecture</td>
</tr>
<tr>
<td>Complex interfaces</td>
</tr>
<tr>
<td>Rapid evolution</td>
</tr>
<tr>
<td>Backward compatibility</td>
</tr>
</tbody>
</table>
Faulty Identification of Processes

What we find particularly alarming is that most managers implicitly define each process according to a Best Product strategy. Namely, Operational Effectiveness seeks to establish an internally efficient cost infrastructure; Customer Targeting seeks maximum coverage through distribution channels; and Innovation seeks the speedy development of the firm’s products aided by appropriate platforms and first-to-market expectations.

As recognized in Table 2, the situation is starkly different when the Adaptive Processes support the TCS and the SLI strategic options.
Adaptive Processes

In the TCS strategy, the key objective of Operational Effectiveness is the maximization of the customer value, and this can only be achieved through consideration of the combined value chain of the firm and its customers.

Customer Targeting is aimed at developing individual customer bonds, by structurally enhancing the interface with the customer and by creating assets in the customer’s knowledge of your product or services. Innovation aims for the development of a composition of customized products jointly with the customer.
Adaptive Processes

In the SLI strategic position the role of each process again changes. Now Operational Effectiveness is concerned with enhancing the overall system performance, often by consolidating strong partnerships with complementors. Customer Targeting attempts to consolidate a harmonized system architecture through a network of complementors and complementor interfaces. The ultimate goal of Innovation is to develop and appropriate an industry standard, facilitating a broad range of applications.

*Once more, a primary objective is to raise the awareness of the product centric mentality and to expand the alternatives open to managers. Rivalry and competition may not be the winning strategies.*
The Delta Model’s Winning Formula

• Concentrate on the customer. Start with a careful segmentation of your customer base and develop as much knowledge as possible of the customer economics. Remember that the primary objective is to seek customer bonding.

• Select the most appropriate strategic positioning among the three key options – Best Product, Total Customer Solutions, and System Lock-In – that will result in a customer value proposition with the highest possible bonding.
Continue…

• Define the strategic agenda that determines the action program to implement your desired strategic option. Assure the proper alignment with the three adaptive processes – Operational Effectiveness, Customer Targeting, and Innovation.

• Design the proper metrics and rewards to facilitate the strategy development.
The Delta Model: An Integrated Framework for Strategy

Table 3 provides a comparison of the critical elements of the three frameworks that we have just reviewed. We will now show that the resulting integrated framework makes the three approaches – Porter’s framework, the Resource-Based View, and the Delta Model – complementary to one another and therefore stronger.

From this perspective, the Delta Model serves as a unifying framework that starts with a vision statement that captures the essence of how the business positions itself and culminates with the tactical means to adapt continuously to an ever-changing environment.
<table>
<thead>
<tr>
<th>Focus of Strategic Attention</th>
<th>Porter’s Framework</th>
<th>Resource-Based View Framework</th>
<th>Delta Model Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>Types of Competitive Advantage</td>
<td>Low cost or Differentiation</td>
<td>Resources, Capabilities, Core Competencies</td>
<td>Best Product, Total Customer Solutions, System Lock-In</td>
</tr>
<tr>
<td>Basic Unit of Competitive Advantage</td>
<td>Activities</td>
<td>Core Products, Strategic Architecture</td>
<td>Adaptive Processes: Operational Effectiveness, Customer Targeting, Innovation</td>
</tr>
<tr>
<td>Strategy As</td>
<td>Rivalry</td>
<td>Real Estate</td>
<td>Bonding</td>
</tr>
</tbody>
</table>
The Delta Model Framework is an integrative process for formulating and executing strategy. The elements of the process are described in Figure 7.
The Triangle: Capturing the Business Vision

The first and most critical task for any business is to capture the essence of its strategic position, in other words, the development of a business vision. The Triangle is an effective tool for describing a meaningful strategic position. Its power resides mainly in its simplicity while capturing the full range of strategic possibilities.

It is a crucial first step because it defines the central purpose of the business, the purpose that will guide the whole process of strategy formulation and implementation. The three distinct strategic alternatives offered by the Triangle – Best Product, Total Customer Solutions, and System Lock-In – present managers with a contrasting set of options through which to reflect on their business strategy.
Figure 7
The Delta Model – an integrative strategic framework

The Triangle
System Lock-in

Total Customer Solutions  Best Product

Mission of the Business
• Business Scope
• Core Competencies

Competitive Positioning
• Activities that drive profitability

Industry Structure
• External factors determining industry attractiveness

Business
The Strategic Agenda

Innovation

Operational Effectiveness

Customer Targeting

Adaptive Processes
Strategic Agenda
The Triangle: Capturing the Business Vision

This greatly influences all the remaining elements of the Delta Model process including the scope, the way to compete, the development of competencies, the Strategic Agenda, and the definition of the processes.

The selection of a strategic position is based on the accumulated experience of management without the benefit of the detailed analysis that follows. Some object to this, arguing that one should collect the data first and then select a strategic option.
But, if so, what data should they collect? This is a chicken and egg problem and managers need a starting point. As the process evolves and new information is generated, it is important for managers to reexamine their assumptions and modify or recalibrate their starting point.

The Delta Model process makes explicit a practice that many companies carry out implicitly.
The mission of the business should make concrete the strategic option that managers have identified using the Triangle. The mission includes two key decisions: defining the business scope, which determines where to compete; and developing the core competencies of the business, which determines the resources and capabilities needed to succeed.
Business Scope and Competencies

Consequently, there are two sets of information in a well-defined and well-articulated mission of the business. First, the business scope must include a view of the competitive domain of the business, both for today and the future, as described by its overall portfolio of products, market coverage, customer focus, complementor focus, and geographic presence.

The business scope is informative not only for what it includes, but for what it leaves out. Second, the core competencies should include the tangible and intangible resources necessary for reaching the desired competitive position.
The Delta Model and the Mission

The selection of the strategic option using the Triangle has a profound impact on the mission. Adopting the Best Product option, for example, makes the product the most critical dimension of business scope; the core competencies are those required to achieve cost leadership or a highly differentiated product offering. The Total Customer Solutions option makes the customer the most critical dimension and requires competencies that focus on customer bonding.

The System Lock-In position introduces complementors as a new dimension of business scope and requires the competencies needed to develop the proper architecture and complementor lock-in.
The Delta Model and the Mission

The mission should highlight the *changes* that the business is seeking to realize. If there are no changes in the mission, there is little chance that the business will succeed in a dynamic world. Strategy is fundamentally about dealing with change which is why the mission must deal with the contrast between the business’ existing scope and its future scope.

These changes ripple through the subsequent process steps and the Strategic Agenda that allows the business to move forward.
Sound analysis of industry structure captures the principal external forces, their future trends, and their impact on a business. Porter’s five forces model helps managers to understand the strategic implications of industry structure. The Delta Model gives rise to a number of critical modifications to the five force framework.

First, the question of rivalry and the focus on the “winner take all” mentality. With two of the Delta Model’s three strategic options (Total Customer Solutions and System Lock-In), rivalry is replaced by bonding as the critical lens through which to observe industry structure, bonding of customers in one instance and of complementors in the other.
Second, is the question of what industry structure managers should analyze. In the conventional Porter model, they are meant to look at the industry in which their business resides. Obviously, that industry always remains relevant to the business; however, managers using the Delta Model do not stop with their own industry.

They extend the analysis to include the industries of their key customers and complementors and seek insights to achieve the desired bonding. As a result, the nature of the industry analysis is greatly affected by the selection of the strategic option.
Competitive Positioning: Building the Activities to Drive Profitability

Having analyzed the external forces that are part of the industry structure, and reached a clear understanding of the opportunities and threats presented by the business environment, we need to establish a strong competitive position that responds to this environment. Again, Porter’s value chain is a useful starting point. The value chain allows us to identify the activities that are most important to achieve competitive advantage, and to develop action programs to enhance the desired capabilities.

However, the Delta Model necessitates a significant expansion to the conventional analysis. Rather than concentrating exclusively on the internal value chain of our own business, we need to include the value chain of all of the external relevant parties.
In the Total Customer Solutions option we look for the proper integration of our value chain with the key suppliers and customers, searching for complementary assets that substantiate and enrich the relationships.
In the System Lock-In option, we look beyond our immediate industry to the system as a whole with all of its relevant complementors. Microsoft needs to look beyond the operating system industry to the industries of the application providers. Coca-Cola needs to look at the industry of the fountains and grocery stores.

The challenge is to create mechanisms where the linkages across those value chains originate the ultimate bond. Once more, the strategic focus is away from rivalry and competition and toward cooperation and bonding.
The Delta Model and Porter’s Framework

As we can see the steps in the Delta Model process involving the industry structure and the competitive positioning map directly to Porter’s framework, but make it more relevant and complete to a wider array of strategic options.

The fundamental methodology proposed by Porter – the five forces and the value chain – are greatly expanded in scope to include the customer and complementor dimensions, and enriched by bonding as an economic force.
The Strategic Agenda: Specifying the Key Business Tasks

The previous steps of the Delta Model – the selection of the preferred strategic options, the mission of the business, the industry structure analysis, and the competitive positioning – provide the relevant background for the development of a compressive Strategic Agenda.

These should include pragmatic, action-driven tasks that in totality will accomplish the strategic objectives of the business.
The Strategic Agenda

The agenda should define each task with sufficient clarity to communicate it across the organization. It makes explicit the role to be played by every manager involved in its execution, including the nature of the Adaptive Process it might generate. It also should identify the necessary indicators and targets associated with each task in order to monitor the business.

We have two additional observations. First, the agenda is dynamic, which means that it is the subject of continuous revisions.
Second, it must be communicated throughout the organization. We have encountered endless situations where management is hesitant to share the strategy broadly because it either raises competitively confidential issues, or it can contain bad news for some business segments. Both are usually bogus concerns.
The Strategic Agenda

The competitively sensitive information is typically in the tactical elements of execution and the bad news for individuals is better addressed head on.

Communications is essential to energize the organization and to assure the congruence between the business purpose and the individual actions of all the participants.
The strategic agenda integrates all the necessary tasks that are required to set the overall direction of the business. The Adaptive Processes go further. They go deeper into the organization and into the details of execution. This guarantees the alignment of strategy and execution in an explicit and direct way.

Every Adaptive Process in turn produces its own Strategic Agenda that has the same format characteristics as the business agenda but more localized and detailed. With these steps finished, the strategy formulation is complete.
Continue…

The Resource-Based View of the firm calls for the nurturing and appropriation of key resources and capabilities as the source of competitive advantage. We complained that the vagueness of this statement impairs the usefulness of this framework in the pragmatic world of management. There are, however, two steps within the Delta Model where the Resource-Based View concepts are a natural fit.
In the mission statement we call for the specification of the required core competencies that the business needs to achieve its desired strategic positioning. These core competencies might not be exclusive to a given business unit within the overall corporation. Indeed, the most desirable situation exists when the competencies reside at the corporate level - as the Resource-Based View insists - and are also distributed throughout the entire business portfolio.

In this manner the corporation creates additional value through the businesses, which legitimizes the corporate structure as an added-value entity. In that sense, core competencies are the critical focus of the corporate strategy.
The Strategic Agenda and the Adapative Process

The definition of the Strategic Agenda of the Adaptive Processes is the second step in the Delta Model where issues of capabilities are confronted. Now we go from the broad statement of core competencies that are part of the business mission to the skills that are needed in the Operational Effectiveness, Customer Targeting, and Innovation processes.
Continue…

This sharper focus of requirements breaks the ambiguity inherent in the abstract Resource-Based View. From this perspective core competencies support the development of the strategic positioning of the business; and resources and capabilities are the skills required in the Adaptive Process that are needed in the implementation.
The intersection of the Resource-Based View and the Delta Model occur in the mission and now in the Adaptive Processes. The Adaptive Processes link strategy with execution and link the broad competencies at the corporate level with the specific activities required at the business level.

A schematic of the full Delta Model process is shown in Table 4.
### Table 4

**The Delta Model and the three strategic options**

<table>
<thead>
<tr>
<th>The Elements of the Delta Model</th>
<th>The Three Strategic Options</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Triangle: The Source of Strategic Options</strong></td>
<td>Best Product</td>
</tr>
<tr>
<td><strong>Business Mission:</strong></td>
<td></td>
</tr>
<tr>
<td>Product Scope</td>
<td>Driver</td>
</tr>
<tr>
<td>Market Scope (customer, consumer channel)</td>
<td>(Either Local–Regional–Global)</td>
</tr>
<tr>
<td>Complementor Scope</td>
<td>Align with Strategic Option</td>
</tr>
<tr>
<td>Geographic Scope</td>
<td></td>
</tr>
<tr>
<td>Core Competencies</td>
<td></td>
</tr>
<tr>
<td><strong>Industry Structure:</strong></td>
<td>Business Industry</td>
</tr>
<tr>
<td>Relevant Industry Focus</td>
<td></td>
</tr>
<tr>
<td><strong>Competitive Positioning:</strong></td>
<td>Internal Value Chain: Business</td>
</tr>
<tr>
<td>Relevant Value Chain Focus</td>
<td></td>
</tr>
<tr>
<td><strong>Business Strategic Agenda</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Adaptive Process Priorities:</strong></td>
<td>1st</td>
</tr>
<tr>
<td>Operational Effectiveness</td>
<td>Customer Targeting</td>
</tr>
<tr>
<td>3rd</td>
<td>2nd</td>
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</tbody>
</table>