

CHAPTER I

RESEARCH PROBLEM PROFILE AND OBJECTIVES

The discipline of strategic management has largely addressed itself to explaining differential performance amongst firms. Fundamentally the field is concerned with identifying whether it is the environment containing the competitive domain, that governs firm behaviour or, is it the nature of competitive activities of participating firms that in turn shapes the environment encompassing them. The conventional framework utilized by the strategy researchers is the 'SWOT' (strengths, weaknesses, opportunities and threats) analysis technique. Firms possessing superior performance are supposedly those that leverage their existing strengths and exploit available environmental opportunities while effectively circumventing threats and building on weaknesses. Such firms are more apt at consistently achieving a good fit between their resources and the relevant environment (Hofer & Schendel 1978, Learned *et. al* 1973). Broadly the analytical framework may be categorised into having the external perspective and the internal perspective. The external perspective represents the environmental opportunities and threats dimension, while the internal perspective is conceived with analysing the strengths and weaknesses inherent in the organisation. The last few decades have seen major progress being made with regards to research in the area of the external perspective. In general, much of this knowledge has evolved out of the work of industrial organisation economists (Bain 1951, Schmalensee 1989) and later on shaped by strategy researchers (Porter 1980, Buzzell & Gale 1987). The advances made in this direction has yielded rich evidences taking the form of models

which specify environmental conditions predominantly, offering varying opportunity/threat levels as determinants of differential firm performance. Although the Efficiency school (Demsetz 1973) argued that it was efficiency which resulted in performance and in turn impacting industry structure, this school of thought did not provide for firm specific characteristics i.e. the strengths and weaknesses internal perspective. An ideal model would synthesise both the dimensions to provide a holistic picture of differential firm performance and relevant behaviour (Porter 1991). Recently, over and above industry conditions, important advances have been made incorporating the critical impact of observable competitive strategies and also provide for the unobservable firm specific factors. Although research emphasising the internal dimension is yet emerging, the field of strategy is far from a grand unified theory of competition.

1.0 Profile Of Research Problem

While the search for an integrated paradigm is experimented with in extant literature, the debate is more along dichotomous lines. One in favour of the external analysis component. The other in favour of the internal aspect, each having to its merit a few credits. Mostly, the effort is to determine where the roots of competitive advantage lie. It is against this backdrop that this study proposes that, the source of differential performance does not entirely ^{lie} with the external environment, nor does it solely exist within the firm. The logic is quite simple. Perfect markets are illusive. Those firms more adept at exploiting imperfections in markets are the ones who will be exhibiting superior

performances and in continuing to do so are the ones who are redefining requisite critical success factors. It is the dynamics of such competition, to seize the competitive initiative, which ensures that market imperfections continue to exist.

Participants in a competitive market domain may broadly be classified as either price-takers or price-makers. Price-takers are the class of firms which seek to optimize profits (assuming profit maximisation as the firm's objective) within given environmental constraints. On the other hand, price-makers are those firms which seek to circumvent and influence the legitimate competitive market forces by deploying profits gained from operational efficiencies in strategic ventures that ensure a sustained comparative advantage in the long run. The former category may be called the firms exhibiting passivity while the latter as proactive firms. That variations in performance exist, is per se evidence enough that such probable postures adopted by firms are a reality. It is the proactivity of firms that generate asymmetries in a market's competitive conditions that perpetuates the existence of disequilibrating markets. The phenomenon in this study, is called 'Competitive Dynamics', and it was proposed that this is the cause of differential performances. A schematic diagram in Fig. 1.0 illustrates the same.

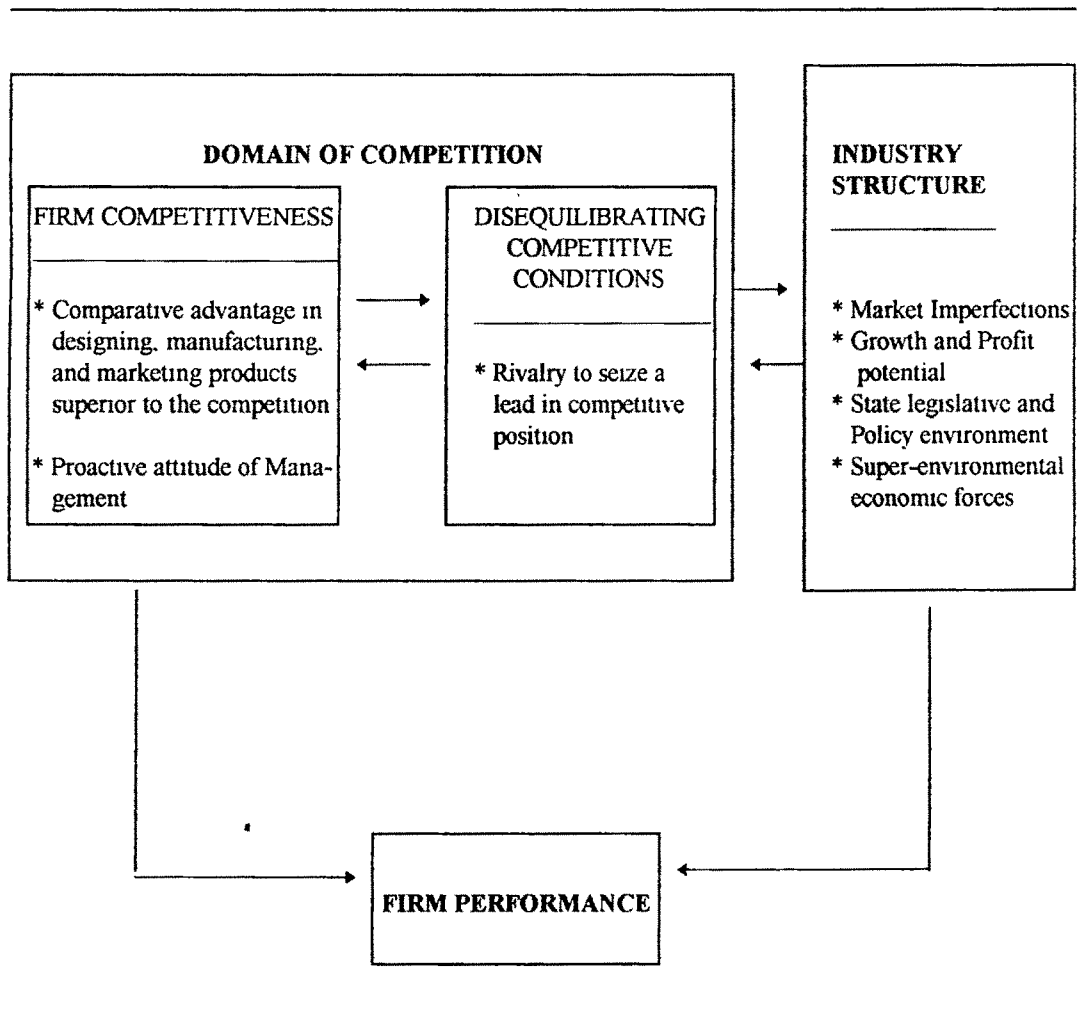
2.0 Objectives Of Study

Given that the nature of this study is to explain the firms competitive behaviour in imperfect markets, the objectives were .

1. To develop an integral model of strategic firm behaviour that aims to make an incremental contribution to the theory of competition

FIGURE 1.0

The Phenomenon Of Competitive Dynamics



- 2 To demonstrate that it is the proactivity of firms, attributable to the dynamics of competition, which determines differential performances and that this phenomenon is a more rational explainer of firms achieving superior performances
- 3 To empirically test this model by analysing the strategic behaviour of large pharmaceutical companies (interchangeably used in this study with the term firm), representing the organised sector of the Indian pharmaceutical industry, vindicating the role of proactive factors as determinants of superior financial performance

The emerging perspective on the resource-based view of the firm provided the inspiration and rationale for the integral model proposed in this study. This study is also based on the premise that all firms participating in a market are not equipped with homogeneous competitive capabilities. This means that the access to and control of the required resources is also not equal amongst a given set of competing firms. Idiosyncratic resources are not easily imitable in the short run and prove to be a major source of comparative advantage.

3.0 Justification For The Study

The researchers in industrial organisation have emphasised the role played by industry factors in explaining differential performance amongst firms. This school of thought, representative of the Structure-Conduct-Performance paradigm (Bain 1951, 1962) forwarded that industry structure influenced conduct (strategy) and impacted on performance. Empirical evidence to support this paradigm is limited and at best mixed.

Recent work done found that industry effects explain about 15 to 20 % of the variance in performance (Schmalensee 1985, Wernerfelt & Montgomery 1988). However, there were industrial organisation economists who broke with traditional SCP thinking and proposed that firms within an industry are not identical exhibiting high variance in performances, implying that they were in turn influencing the structure of the industry in which they operate (Ceccarelli & Clayton 1992). This led to the acceptance of the proposition that conduct (i.e. strategy) does influence performance and is as important as the structure aspect. When market share is taken into account, industry concentration accounts for little, if any, of the variance in firm profitability. It was also posited that the association between concentration and profitability is due to efficiency differences among firms (Ravenscraft 1983, Smirlock, Giligan & Marshall 1984). These indications support the nature of this study.

Branching out from the above mentioned research stream, is the research bank on market share-profitability relationship. More than two decades of research have gone into investigating this relationship largely supporting the view that market share has a decisive influence on profitability (Buzzell & Gale, 1987). Two major meta-analyses have concluded the positive and significant impact of market share on profitability (Capon, Farley & Hoenig 1990; Szymanski, Bharadwaj & Varadarajan 1993). Chiefly the rationale behind this proposition is that market share volumes will materialize in scale economies, and more importantly result in the acquisition of market power making the firm a price-maker.

However, critics have pointed out that the role of third factors, mainly firm-specific factors, have not been adjusted for in the requisite models. When these firm-specific factors are included in a profit model the market share coefficient turns insignificant. But when they are dropped the market share coefficient is biased upwards by 0.36 (Szymanski, Bharadwaj & Varadarajan 1993). This also supports the argument forwarded by some researchers (Jacobson & Aaker 1985) that market share per se has no intrinsic value. What matters are the factors that led to securing a significant market share, in the first place. In this sense it is per se a determined, output, variable. Rumelt (1991) in a major study found that 46 % of variance in performance was due to firm specific factors. Capon, Farley & Hoenig (1990) in a meta-analysis of 320 published studies with firm performance as the dependent variable, could find only one solitary study using a firm-specific variable, demonstrating deficient research in the area of modelling firm specific characteristics indicating that the concerned models were underspecified. This study had opted to exclude market share from the model and solely include firm proactivity constructs to capture effects of the same. The findings of the market share-profitability relationship, in this study, support the same.

This study largely aims to extend work in the direction of the resource-based theory of the firm the genesis of which lie in the work prompted by Penrose (1963). This perspective argues that superior performance firms are those that have a comparative advantage in resources and make effective and efficient use of the same. It is this feature that drives strategy and leads to the achievement of a better competitive position (Hunt & Morgan 1995, 1996, 1997). Contemporary emerging perspectives, like the core

competence theory (Prahalad & Hamel 1990) are also illustrative of the need not to treat the firm as a 'black box'

Finally, little empirical work in the context of the Indian pharmaceutical industry, to the best of the knowledge of this researcher has been attempted to operationalize the dimension of firm specific unobservables in a profit model.

4.0 Pragmatic Relevance And Chapter Scheme

Interestingly, the pharma industry is an ideal illustration of a case for competitive dynamics. A unique feature of the pharma industry, specifically in the case of ethical life saving drugs, is the almost complete absence of consumer sovereignty. Demand for pharmaceuticals is contingent on a physician's prescription for the drug, which ensures no possibility of substitution. This implies the demand function for drugs is expected to be highly inelastic for either price reductions or price increases. The same also holds true with respect to the influence of consumer income upon quantity demanded. Standard economic theory suggests that demand for drugs is essentially independent of price and income.

Given the above, it then follows that large pharma firms should possess tremendous market power, earning above par profits consistently. To check such and other monopolistic forces, the state is compelled to impose a good measure of regulation, not only on prices, but also on manufacturing practices, which to some extent is responsible for a uniform cost structure. Trade channel members (central in pharma

marketing) are also unionized impinging on margins which are already controlled. In spite of these constraints, the large pharma firms do exhibit ample tendencies of pursuing a proactive policy.

The Indian Pharma Industry, too, is no exception to the above observed phenomena. It is characterised by . seemingly ever increasing governmental regulations and policy changes, shifting price controls, eroding profitability and consequently a vanishing bottomline, rigorous controls on formulations and an absence of international patent protection resulting in a maze of me-too products; increasing clout of trade associations and their constant demand for an increase in the trade margins, a staggering 23,790 large, medium and small units jostling for a place in the markets making this industry the most competitive one in the Indian economy. While such a competitive market structure enforces similar cost and demand considerations, large firms are yet found to be behaving differently. A few of them have, on the contrary, achieved a transnational status. Finally, in the light of emerging post GATT-IPR challenges, this study stands more than validated.

Chapter Two, presents a profile of the industry structure offering relevant vital statistics and descriptions on the nature of demand for ethical drugs, historical evolution since Independence, the state of technological self-reliance, investments, export performance, the regulatory framework, and landmark profitability studies conducted, among other features.

Chapter Three, presents an overview of literature for research undertaken in the discipline of strategic management. Theoretical rationale, empirical findings, contributions

and limitations of the following were covered the Classical Industrial Organisation (IO) school, the Efficiency/Revisionist school, the New IO school, the Business Policy/PIMS Paradigm school, the Austrian economics school and the Resource-based theory of the firm school.

Chapter Four, lays out the theoretical rationale for the phenomenon of Competitive Dynamics, it's relevance with the Resource-Advantage theory of competition; the role of proactive behaviour within the consolidated model of the firm; the study's integral conceptual and empirical model of strategic firm behaviour is spelled out highlighting the omitted variable bias of excluding the firm proactivity aspect, finally the research propositions to be explored and tested are offered.

Chapter Five, spells out the methodology undertaken, covering the universe criteria, sample selection and justification, a defense of the time frame used, data sources, operational definitions and descriptions of the constructs employed to represent proactivity, and finally, the functional forms and statistical techniques selected for empirically testing the model.

Chapter Six, reports the results, interpretations, limitations and policy recommendations of the study's empirical findings for the model proposed

Chapter Seven concludes with a general overview of the study, summary of findings, theoretical and methodological limitations uncovered, value for practicing managers, future research directions, and lastly, offers a brief emerging scenario for the industry with available strategic options for countering environmental challenges in the light of this study's empirical inferences.