

Strategic Management

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Lecture 5

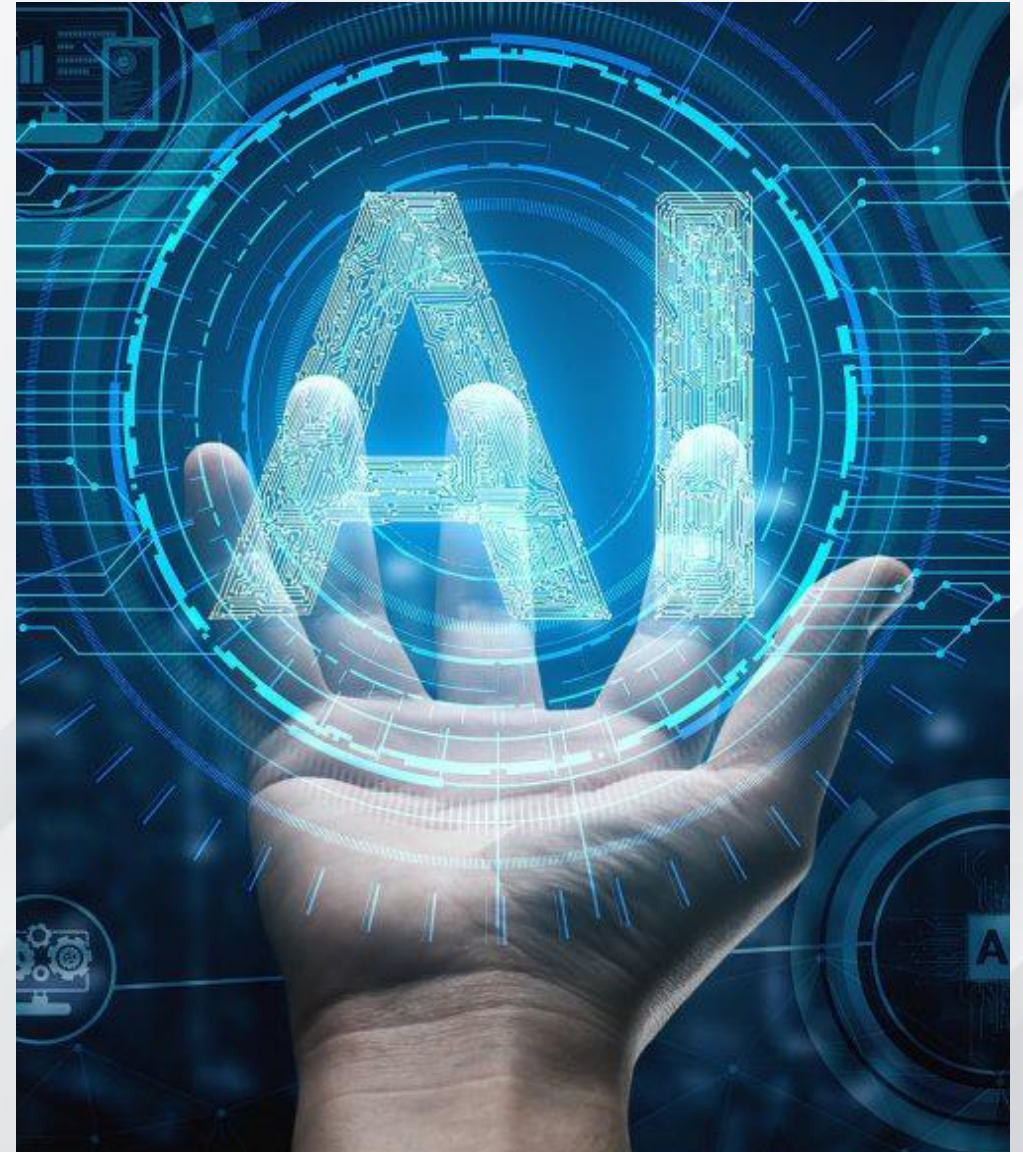
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Part One / Analysis

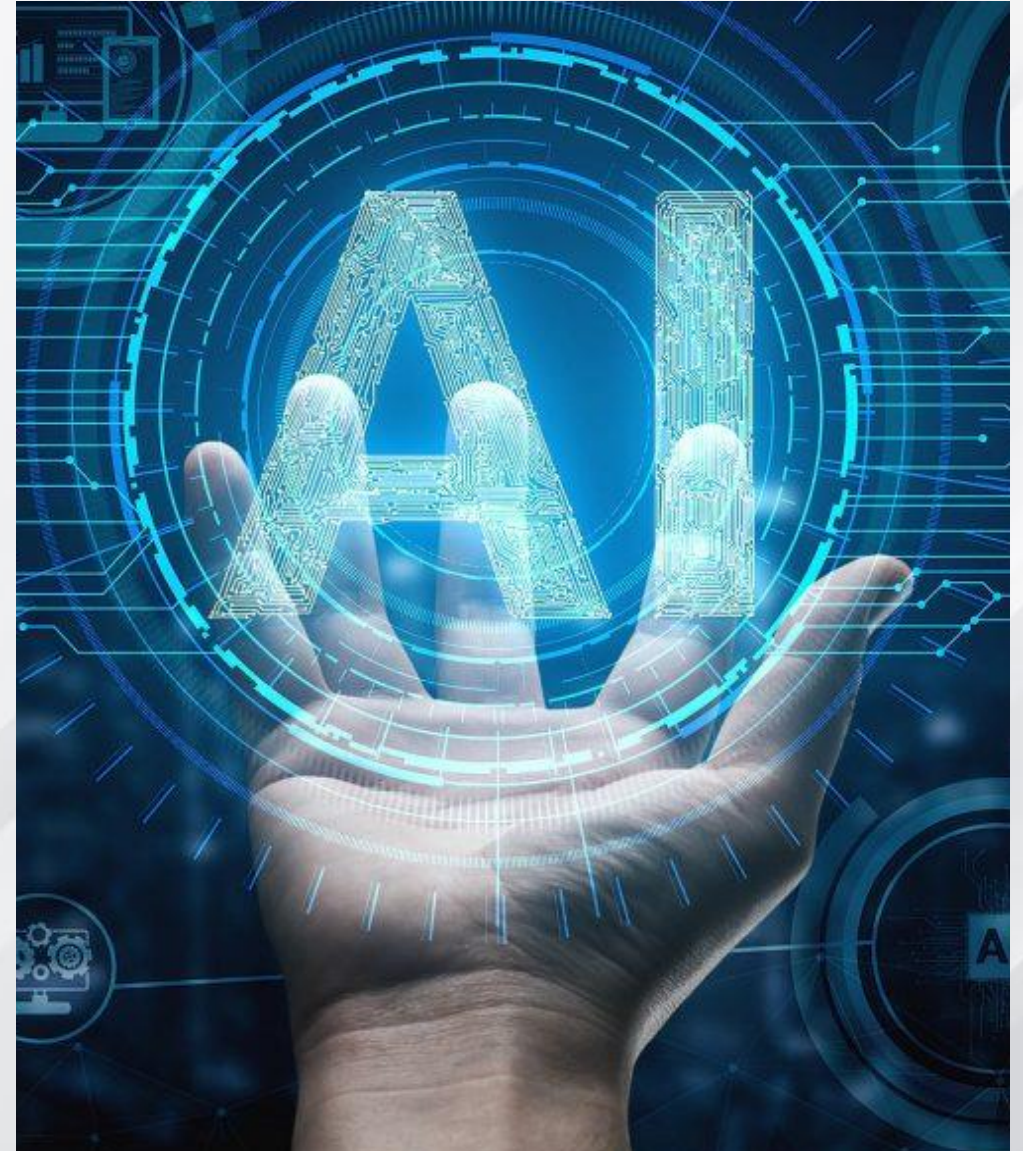
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- **Chapter 2** Strategic Leadership: Managing the Strategy Process
- **Chapter 3** External Analysis: Industry Structure, Competitive Forces, and Strategic Groups
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Strategic Management

Strategic management involves developing and implementing plans to help an organization achieve its goals and objectives. This process can include formulating strategy, planning organizational structure and resource allocation, leading change initiatives, and controlling processes and resources.



Agenda Competitive Advantage, Firm Performance, and Business Models

➤ 5.1 Competitive Advantage and Firm Performance

- Accounting Profitability
- Shareholder Value Creation
- Economic Value Creation
- The Balanced Scorecard
- The Triple Bottom Line

➤ 5.2 Business Models: Putting Strategy into Action

- Popular Business Models

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Gaining and Sustaining competitive advantage

Gaining and Sustaining competitive advantage is the defining goal of strategic management. Competitive advantage leads to superior firm performance.





Gaining and Sustaining competitive advantage

To explain differences in firm performance and to derive strategic implications—including new strategic initiatives—we must understand how to measure and assess competitive advantage. In particular, we introduce three frameworks to capture the multifaceted nature of competitive advantage. The three traditional frameworks to measure and assess firm performance are;

1. **Accounting profitability.**
2. **Shareholder value creation.**
3. **Economic value creation.**



Gaining and Sustaining competitive advantage

We then will introduce two integrative frameworks, combining quantitative data with qualitative assessments:

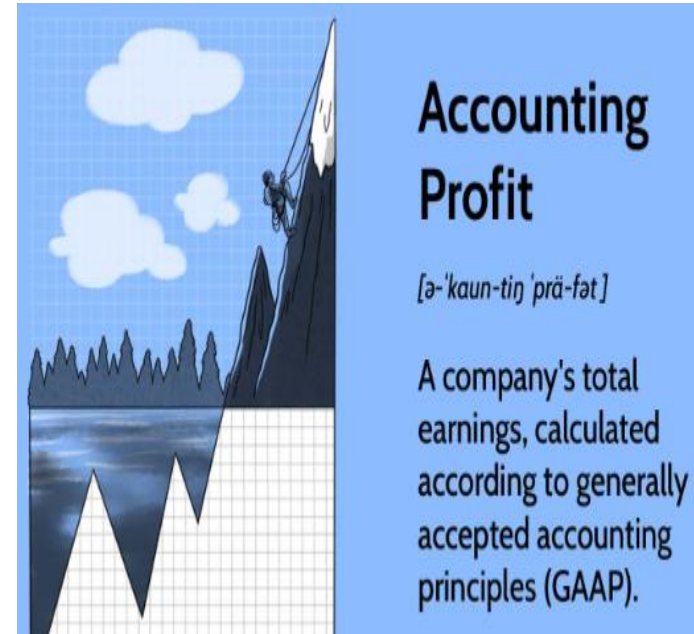
4. **The balanced scorecard.**
5. **The triple bottom line.**

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1- Accounting profitability

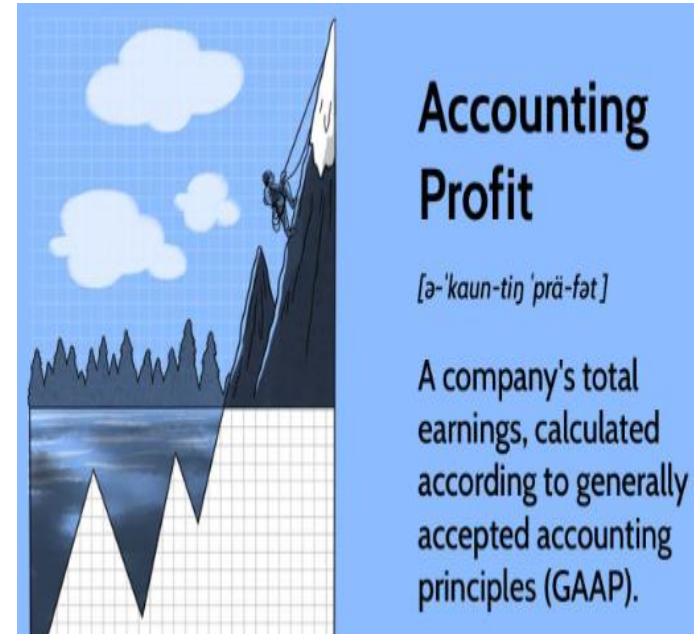
Using accounting data to assess competitive advantage and firm performance is standard managerial practice. When assessing competitive advantage by measuring accounting profitability, we use financial data and ratios derived from publicly available accounting data such as income statements and balance sheets.



1- Accounting profitability

A firm's managers must be able to accomplish two critical tasks:

1. Accurately assess the performance of their firm.
2. Compare and benchmark their firm's performance to other competitors in the same industry or against the industry average.

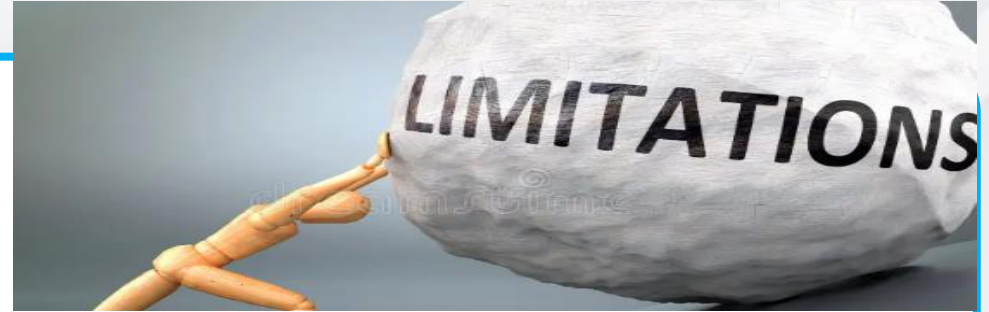


1- Accounting profitability

Limitations on accounting data

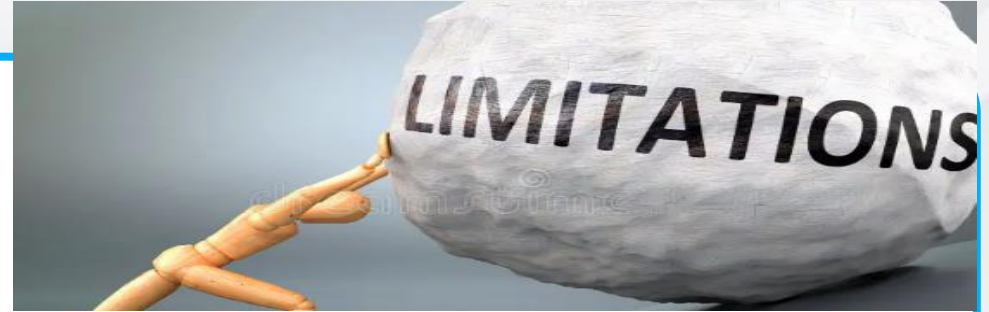
Although accounting data tend to be readily available and we can easily transform them into financial ratios to assess and evaluate competitive performance, they also exhibit some important limitations:

1- All accounting data are historical and thus backward-looking. Accounting profitability ratios show us only the outcomes from past decisions, and the past is no guarantee of future performance.



1- Accounting profitability

Limitations on accounting data



2- Accounting data do not consider off–balance sheet items. Off–balance sheet items, such as pension obligations (quite large in some U.S. companies) or operating leases in the retail industry, can be significant factors.

3- Accounting data focuses mainly on tangible assets, which are no longer the most important. Intangible assets such as the value of intellectual property (patents, trademarks, and so on) and customer goodwill, many key intangible assets are not captured.

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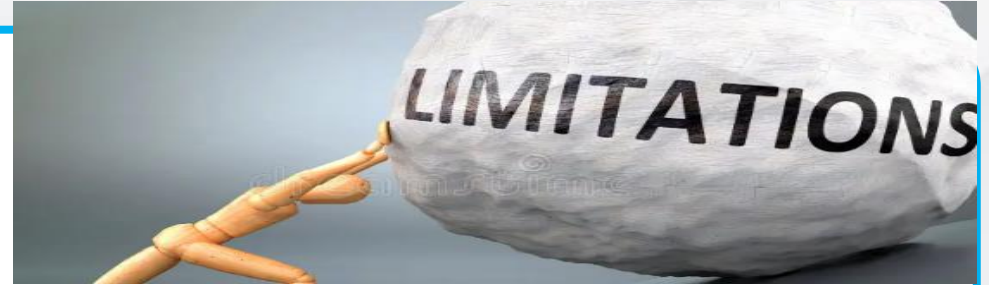
2- Shareholder Value Creation

Shareholders—individuals or organizations that own one or more shares of stock in a public company—are the legal owners of public companies. From the shareholders' perspective, the measure of competitive advantage that matters most is the return on their risk capital, which is the money they provide in return for an equity share, money that they cannot recover if the firm goes bankrupt.



2- Shareholder Value Creation

Limitations on shareholder value creation

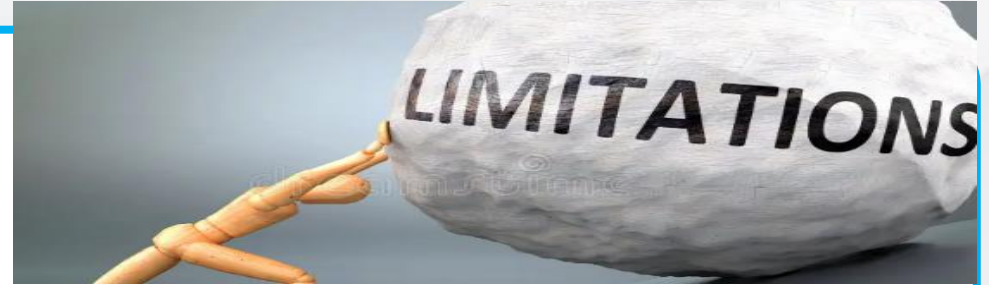


Although measuring firm performance through the total return to shareholders and firm market capitalization has many advantages, just as with accounting profitability, it has its shortcomings:

1- Stock prices can be highly unsteady, making it difficult to assess firm performance, particularly in the short term. This volatility implies that total return to shareholders is a better measure of firm performance and competitive advantage over the long term.

2- Shareholder Value Creation

Limitations on shareholder value creation



2- Overall macroeconomic factors such as economic growth or contraction, the unemployment rate, and interest and exchange rates all have a direct bearing on stock prices.

3- Stock prices frequently reflect the psychological mood of investors, which can at times be irrational.

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3- Creating economic value

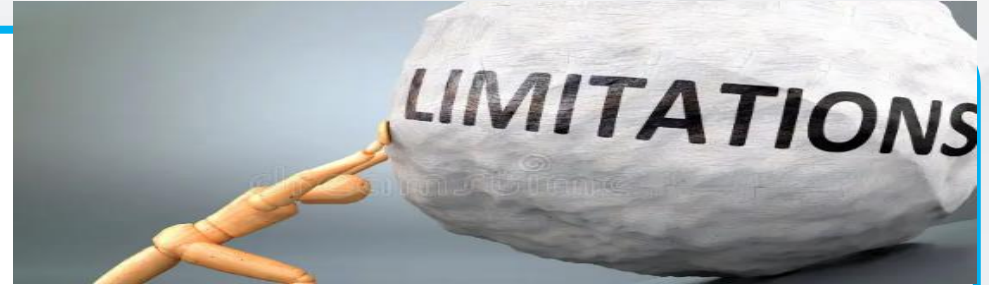
■ The relationship between economic value creation and competitive advantage is fundamental in strategic management. It provides the foundation upon which to formulate a firm's competitive strategy of cost leadership or differentiation.

Economic value created: is the difference between a buyer's willingness to pay for a product or service and the firm's total cost to produce it.



3- Creating economic value

Limitations Creating economic value



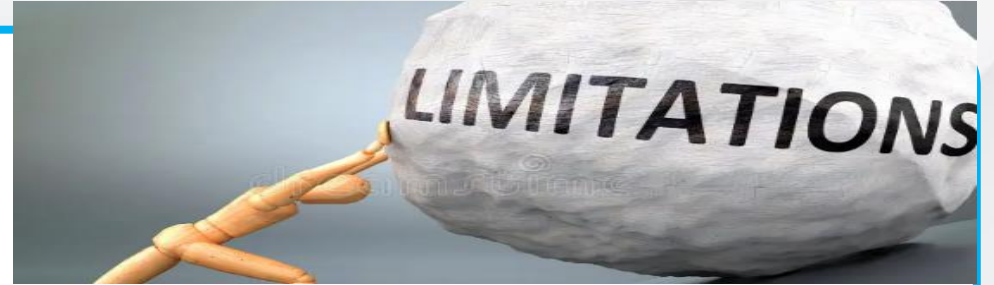
As with any tool to assess competitive advantage, the economic value creation framework also has some limitations:

- 1- Determining the value of a good in the eyes of consumers is not a simple task. One way to tackle this problem is to look at consumers' purchasing habits for their revealed preferences, which indicate how much each consumer is willing to pay for a product or service.

3- Creating economic value

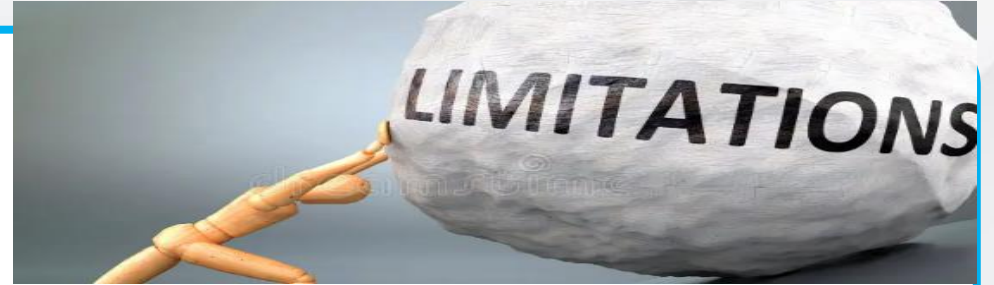
Limitations Creating economic value

2- The value of a good in the eyes of consumers changes based on income, preferences, time, and other factors. If your income is high, you are likely to place a higher value on some goods (e.g., business-class air travel) and a lower value on other goods.



3- Creating economic value

Limitations Creating economic value



3- To measure firm-level competitive advantage, we must estimate the economic value created for all products and services offered by the firm. This estimation may be a relatively easy task if the firm offers only a few products or services. However, it becomes much more complicated for diversified firms such as General Electric or the Tata Group that may offer hundreds or even thousands of different products and services across many industries and geographies.

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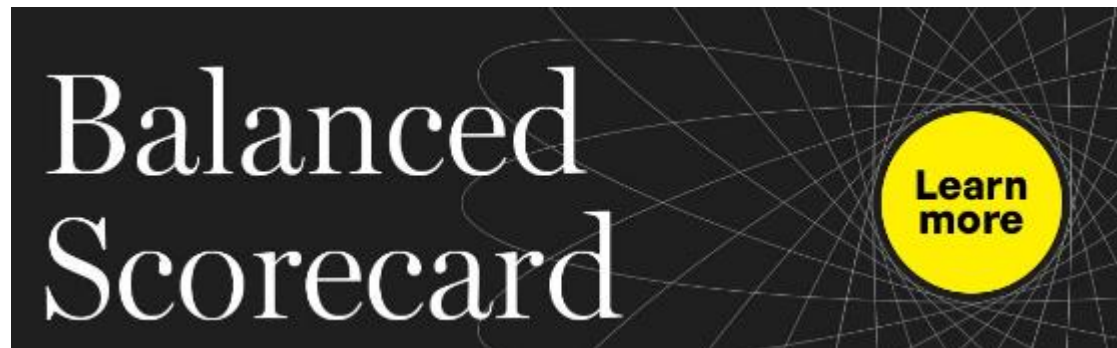
4- The Balanced Scorecard

Just as airplane pilots rely on a number of instruments to provide constant information about key variables—such as Height, airspeed, fuel, position of other aircraft in the Nearby areas, and destination—to ensure a safe flight, so should managers rely on multiple yardsticks to more accurately assess company performance in an integrative way.



4- The Balanced Scorecard

The balanced scorecard is a framework to help managers achieve their strategic objectives more effectively. This approach harnesses multiple internal and external performance metrics in order to balance both financial and strategic goals.



4- The Balanced Scorecard

Managers using the balanced scorecard develop appropriate metrics to assess strategic objectives by answering four key questions:

1. How do customers view us? The customer's perspective concerning the company's products and services links directly to its revenues and profits. Consumers decide their reservation price for a product or service based on how they view it.
2. How do we create value? Answering this question challenges managers to develop strategic objectives that ensure future competitiveness, innovation, and organizational learning.

4- The Balanced Scorecard

3. What core competencies do we need? This question focuses managers internally, to identify the core competencies needed to achieve their objectives and the accompanying business processes that support, hone, and leverage those competencies.

4. How do shareholders view us? The final perspective in the balanced scorecard is the shareholders' view of financial performance

4- The Balanced Scorecard “The Advantages”



Advantages

The Advantages:

The balanced-scorecard approach is popular in managerial practice because it allows managers to:

1. Communicate and link the strategic vision to responsible parties within the organization.
2. Translate the vision into measurable operational goals.
3. Design and plan business processes.
4. Implement feedback and organizational learning to modify and adapt strategic goals when indicated.

4- The Balanced Scorecard “The Disadvantages”



Dis advantage

The Disadvantages:

1. It is important to note that the balanced scorecard is a tool for strategy implementation, not for strategy formulation.
1. In addition, the balanced-scorecard approach provides only limited guidance about which metrics to choose.
2. When implementing a balanced scorecard, managers need to be aware that a failure to achieve competitive advantage is not so much a reflection of a poor framework but of a strategic failure.

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5- The Triple Bottom Line

- **The triple bottom line** is a sustainability framework that measures a business's success in three key areas: profit, people, and the planet.
- Noneconomic factors can have a significant impact on a firm's financial performance, not to mention its reputation and customer goodwill.
- Managers are frequently asked to maintain and improve not only the firm's economic performance but also its social and ecological performance.



people



planet



profit

5- The Triple Bottom Line

■ **The triple bottom line** is a sustainability framework that measures a business's success in three key areas: profit, people, and the planet.

Profit

In a capitalist economy, a firm's success most heavily depends on its financial performance, or the profit it generates for shareholders. Strategic planning initiatives and key business decisions are generally carefully designed to maximize profits while reducing costs and mitigating risk



people



planet



profit

5- The Triple Bottom Line

■ **The triple bottom line** is a sustainability framework that measures a business's success in three key areas: profit, people, and the planet.

People

The second component of the triple bottom line highlights a business's societal impact, or its commitment to people.

It's important to make the distinction between a firm's shareholders and stakeholders. As firms have increasingly embraced sustainability, they've shifted their focus toward creating value for all stakeholders impacted by business decisions, including customers, employees, and community members.



5- The Triple Bottom Line

■ **The triple bottom line** is a sustainability framework that measures a business's success in three key areas: profit, people, and the planet.

The Planet

The final component of the triple bottom line is concerned with making a positive impact on the planet. Since the birth of the Industrial Revolution, large corporations have contributed a staggering amount of pollution to the environment, which has been a key driver of climate change and environmental concerns. A [report by the International Energy Agency](#) found that the global energy industry released 135 million tonnes of methane into the atmosphere in 2022.



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Business Models: Putting Strategy into Action

Strategy is a set of goal-directed actions a firm takes to gain and sustain superior performance relative to competitors or the industry average.

The translation of strategy into action takes place in the firm's business model, which details the firm's competitive tactics and initiatives. Simply put, the firm's business model explains how the firm intends to make money.



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Popular business models

Given their critical importance to achieving competitive advantage, business models are constantly evolving. Below we will discuss some of the more popular business models:

1. **Razor–razor-blades**
2. **Subscription**
3. **Pay-as-you-go**
4. **Freemium**
5. **Wholesale**
6. **Agency**
7. **Bundling**



Popular business models

1. Razor–razor-blades

Razor–razor-blades. The initial product is often sold at a loss or given away for free to drive demand for complementary goods. The company makes its money on the replacement part needed. As you might guess, it was invented by Gillette, which gave away its razors and sold the replacement cartridges for relatively high prices.

The razor–razorblade model is found in many business applications today. For example, HP charges little for its laser printers but imposes high prices for its replacement toner cartridges.



Popular business models

2. Subscription

The subscription model has been traditionally used for print magazines and newspapers. Users pay for access to a product or service whether they use the product or service during the payment term or not. Microsoft uses a subscription-based model for its new Office 365 suite of application software. Satellite radio, internet service providers, and health clubs. Netflix also uses a subscription model.



Popular business models

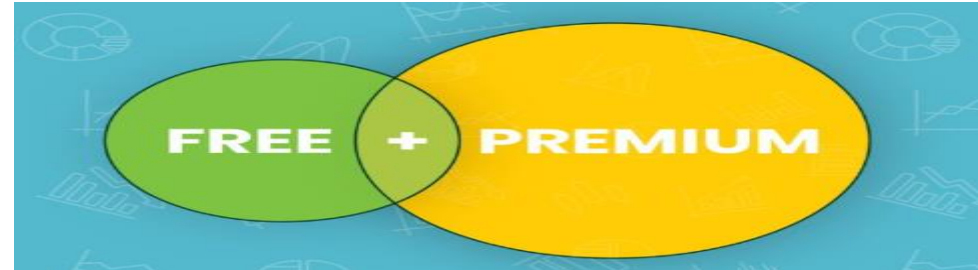
3. Pay-as-you-go

Pay-as-you-go. In the pay-as-you-go business model, users pay for only the services they consume. The pay-as-you-go model is most widely used by utilities providing power and water and cell phone service plans, but it is gaining momentum in other areas such as rental cars and cloud computing such as Microsoft's Azure. News providers such as The New York Times and The Wall Street Journal have created "pay walls" as a pay-as-you-go option.



Popular business models

4. Freemium



The freemium (free + premium) business model provides the basic features of a product or service free of charge, but charges the user for premium services such as advanced features or add-ons. For example, companies may provide a minimally supported version of their software as a trial (e.g., business application or video game) to give users the chance to try the product. Users later have the option of purchasing a supported version of software, which includes a full set of product features and product support.

Popular business models

5. Wholesale

Wholesale. The traditional model in retail is called a wholesale model. Let's look at the book publishing industry as an example. Under the wholesale model, book publishers would sell books to retailers at a fixed price.



Popular business models

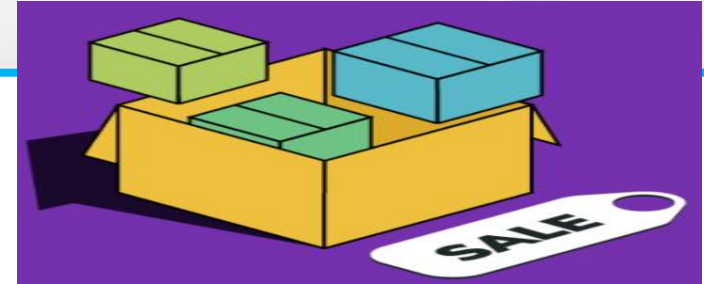
6. Agency

In this model the producer relies on an agent or retailer to sell the product, at a predetermined percentage commission. Sometimes the producer will also control the retail price. The agency model was long used in the entertainment industry, where agents place artists or artistic properties and then take their commission.



Popular business models

7. Bundling



Bundling. التجميع The bundling business model sells products or services for which demand is negatively correlated at a discount. Demand for two products is negatively correlated if a user values one product more than another. In the Microsoft Office Suite, a user might value Word more than Excel and vice versa. Instead of selling both products for \$120 each, Microsoft bundles them in a suite and sells them combined at a discount, say \$150. This bundling strategy allowed Microsoft to become the number-one provider of all major application software packages such as word processing, spreadsheets, slide show presentation, and so on.



Thank You