# Week 2

## Strategic Management

Strategic management is characterised by:

- Cutting across organisational boundaries
- An emphasis on entrepreneurial thinking
- Planning at different levels of the business
- Flexibility and creativity
- Managements' commitment to corporate strategy: reinforced by teamwork, commitment to making things happen, open communication and a shared belief that ambitious goals can be achieved

## Accounting Information in Strategic Management

Varying information needs at different stages of the strategic decision-making process:

- Strategic problem identification stage
- Assessment of strategic alternatives
- Evaluation of strategic actions

Traditional management accounting information is insufficient for strategic decision-making. Strategic management accounting (SMA) is the process of identifying, gathering, and analysing accounting data for helping the management team to make strategic decisions and to assess organisational effectiveness.

## Traditional Versus Strategic Management Accounting

| Traditional Management Accounting | Strategic Management Accounting |
|---|---|
| Historical | Forward-looking |
| Introspective | Outward-looking |
| Narrow scope | Broad scope |
| Internal performance | Performance relative to competitors |
| Single period | Multiple periods |
| Manufacturing focus | Competitive focus |
| Existing activities | Possibilities |
| Reactive | Proactive |
| Programmed (often) | Un-programmed |
| Overlooks linkages | Exploits linkages |
| Based on existing systems | Unconstrained by existing systems |
| Built on convention | Ignores conventions |
| Financial measures | Financial and non-financial measures |
| Exact figures | Approximations |

# Relationship Between Strategic Management and Strategic Management Accounting

Four perspectives with different emphases:

i. Competitor information
ii. Strategic position and management emphasis
iii. The value chain perspective
iv. Market-oriented information

## Competitor Information

- Simmonds (1981) argues that profits arise not from how efficiently he firm operates internally, but from the firm's competitive position over time
- The processes that are important in gaining a competitive position include:
    - Collecting and estimating cost, volume and price data on competitors
    - Determining whether competitors' products are in the build, hold or harvest phase of their lifecycles
    - Calculating market share to assess the strategic position of one's own firm in relation to its competitors
    - Assessing strengths and weaknesses of competitors
- A significant role for management accounting in these processes
- Management accountants can gather relevant information (costs of barriers to entry) from various sources (suppliers and customers of competitors)

## Strategic Position and Management Accounting

Strategic Position: According to Porter (1980, 1985), product differentiation and cost leadership are two main ways in which managers can gain a competitive advantage.

Firms would have different management accounting emphasis depending on which of these strategic positions were taken.

Chenhall & Langfield-Smith (1998) argue that differentiators could emphasise and benefit from certain management accounting techniques/approaches such as balanced performance measures, while low cost firms would focus more on traditional accounting techniques.

## Management Accounting and Strategic Emphasis

| | **Primary strategic emphasis** | |
|---|---|---|
| | Product differentiation | Cost leadership |
| Role of standard costs in assessing performance | Not very important | Very important |
| Importance of such concepts as flexible budgeting for manufacturing cost control | Moderate to low | High to very high |
| Perceived importance of meeting budgets | Moderate to low | High to very high |
| Importance of marketing cost analysis | Critical to success | Often not done at all on a formal basis |
| Importance of product cost as an input to pricing decisions | Low | High |
| Importance of competitor cost analysis | Low | High |

## Value Chain Analysis

"Identifying and exploiting internal and external linkages with the objective of strengthening a firm's strategic position"

A strategic analysis tool used to:

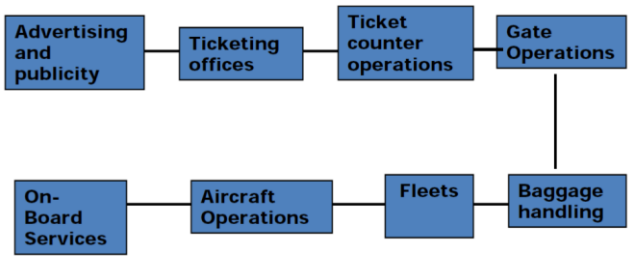
1. Better understand the firm's competitive advantage
2. Identify where value to customers can be increased or cost reduced
3. Better understand the firm's linkages with suppliers, customers, and other firms in the industry

- The value chain analysis on the product's total value chain, from its design to its manufacture to its service after the sale, includes all steps necessary to provide a competitive product or service.
- Each individual firm occupies a selected part or parts of this entire value chain
- Strategic analysis based on the consideration of the firm's comparative advantage
- Value added and non-value-added activities

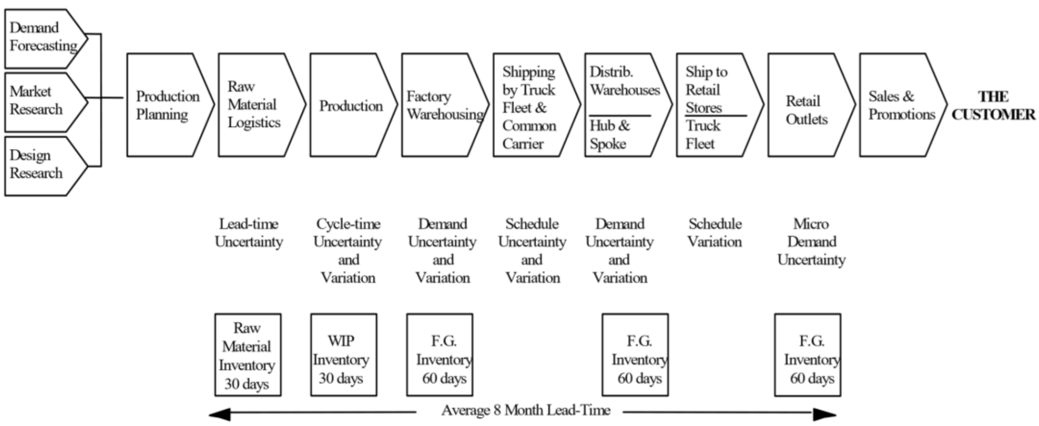
### The Value Chain Recognises Interdependencies

- Recognition that there exist complex linkages between activities, both within and external to a firm
- It recognises interdependencies across activities
- It views the firm in the context of the overall value-creating activities of which it is only a part

*Airline Example*




*Manufacturing Example*



### Exploiting Internal Linkages

Individual activities within a firm are interdependent. These relationships are assessed and used to reduce costs and increase value within the value chain of a business unit.
Example: product design and development activities are linked to production activities and affect the cost of production

### Exploiting External Linkages

- Analyse value chain activities that are performed with suppliers and customers
- Help identify ways to make the buyer-supplier interface more efficient
- Help the firm and its buyers and suppliers find additional ways to reduce manufacturing costs (improvements for all 3 parties)

## Market Oriented Information – Customer Focus

- Customer Profitability Analysis – high-cost low-cost customers
    - Examines how individual customers, or groupings of customers, differ in their profitability
    - Includes calculation of customers' lifetime costs as well as revenue
- Typically, a small percentage of customers contribute to a large percentage of operating income
- 20:80 rule: 20% of customers contribute 80% of profits

### Customer Revenue Analysis

- Consider all activities that affect the net amount received from the customers
- Traces prices and discounts (including sale and cash discounts) to customers and identifies financing costs associated with customer revenues.
- Should include entire lifetime revenues

### Customer Cost Analysis

- Analysis to identify activities and cost drivers to service customers
- Activity Based Costing/Activity Based Management helps to make visible the cost of all activities required to create and maintain a relationship with customers
- Enables managers to identify the characteristics of high cost (hidden-costs) and low costs (hidden profits) customers

# Summary

- SMA is seen as providing information to help in making strategic decisions
- SMA comprises several components that are not common in TMA
- Components of SMA are important in gaining a competitive advantage

# Strategic Process and Strategic Analysis

## Strategic Analysis Undertaken at Corporate and Business Level

What makes an industry attractive?
the potential for profit in the industry.

### Porter's Five Competitive Forces

- Threat of substitutes (price sensitivity)
- Threat of new entrants (barriers to entry)
- Rivalry (intensity of competition)
- Bargaining power of customers
- Bargaining power of suppliers

The stronger the collective impact of these forces, the lower the combined profitability of participating firms.

#### Barriers to Entry

- Supply side economies of scale
    - Any discount received by purchasing a larger amount from supplier
- Demand-side benefits of scale
    - Selling a large amount to minimise selling costs
- Customer switching costs
    - Substitutes
- Capital requirements
- Incumbent advantages
    - Already established office in specific location
- Unequal access to distribution channels
    - Online? Retail stores? Logistics?
- Government regulations
- Expected retaliation
    - Reactions of competition

#### Bargaining Power of Suppliers

- Alternative suppliers
- Number of buyers
- Switching costs
- Differentiation of products
- Substitutes

#### Bargaining Power of Customers

- Number of buyers
- Standardised products
- Low switching costs
- Produce themselves
- Proportion of costs
- Effect of product on quality / other costs

### Threat of Substitutes

- Price/performance trade-off comparable
- Switching costs low

### Rivalry

- Number of competitors is high – can be due to low barriers to entry
- Industry growth is slow
- High exit barriers
- Differentiation of products

# Porters Four Competitive Strategies

## Cost leader

- Broad cost leadership across industry
- Narrow cost leadership focused on industry segment

## Differentiation

- Broad differentiation across industry
- Narrow differentiation focused on industry segment
- Low Cost
- Differentiation

# Competitive Advantage

- Low cost or differentiation (plus focus on a target segment as additional option)
- At the heart of strategy; a firm must choose
- Differentiators do not ignore costs and cost leaders do not ignore differentiation
- Results from a firm's ability to deal with the five forces better than rivals

## Internal Perspective

In addition to gaining insights about opportunities and threats in specific markets, managers must also assess the internal strengths and weaknesses of the business.

Resources and capabilities of the business:

- Current assets
- Productive assets
- Intangible assets
- Distinctive internal capabilities
  - Distinctive competencies
  - Functional skills and market skills
  - Embedded resources
- Market franchise
- Relationships and networks

## What Part of The Industry or Value Chain Is Attractive

- Value chain within the company
- Value chain for the entire industry

## How is Value Created

Porter's generic competitive strategies model focuses on how organisations provide value to the customer.

**Value is created by either:**

- Providing a product or service the customer wants at the lowest cost (**cost leadership strategy**)
- Providing a product or service the customer wants that has unique features that no one else can provide (**product differentiation**)
- A firm can employ cost leadership or differentiated strategy that target the entire market or just a segment of the market (**differentiation focus, cost focus**)

### Avenues for achieving a cost advantage

- Controlling the factors that drive the costs of value chain activities (e.g. economies of scale, managing costs of key inputs, learning-curve effect)
- Revamping the firm's overall value chain (bypass some cost producing activities)

### Avenues for achieving a differentiation

- Better quality, features not included in competitors' products, a unique taste, superior service, prestige and distinctiveness, etc.

Superior performance can only be achieved if costs are kept as low as possible, especially the cost of differentiation.

## How to Sustain a Competitive Advantage

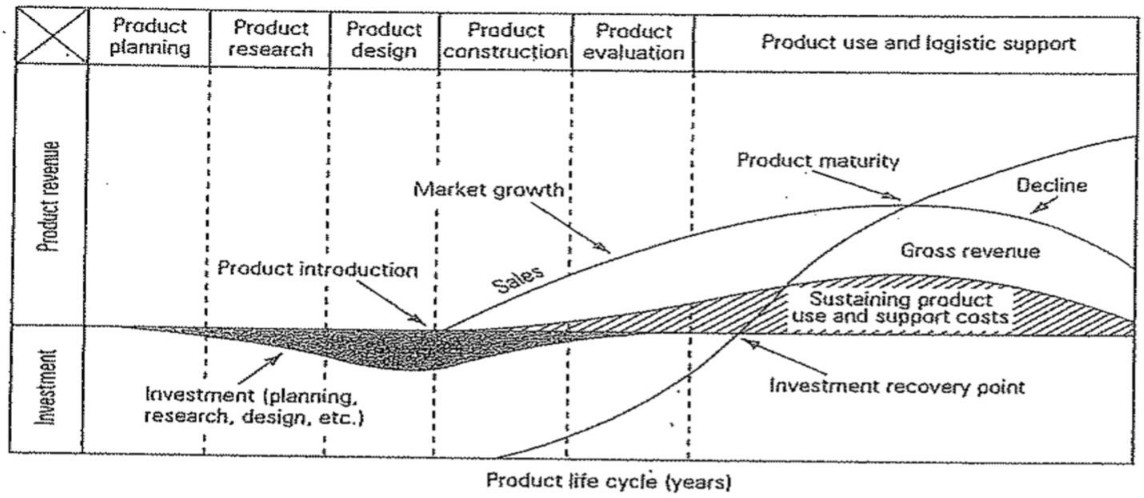
- Competitive advantage through product differentiation will be sustainable until the competition catches up and price is the only difference
- Cost leaders can also lose their competitive advantage over time, for instance due to competition
- New strategies are likely to emerge to deal with changed circumstances
- Understanding how strategies change over time synthesises the Boston Consulting Group (BCG Matrix) and the product life cycle

## Product Life Cycle (PLC)

- The PLC starts with the introduction of the product into the market, progresses through growth and maturity stages, and ends with the decline of demand
- Each stage has distinct customer, price, profit, productions and investment characteristics
- The PLC helps to understand how products and markets change overtime. Understanding such changes is important as it affects how a product is managed and controlled
- Different business strategies are appropriate for each stage of the PLC

**Figure 3.12**

Life-cycle costs and revenues




## The BCG Matrix

- Growth – product must be in high demand and depends on the function of the market
- Market share – relative popularity in the market and depends on the function of the company

### The learning curve the learning curve reduces the cost per unit over time by:

- Learning to be more efficient
- Economies of scale

## Frameworks for Strategy Analysis

- Porter's Generic Strategies
    - Cost leadership, differentiation, focus
- Strategy based on the PLC
    - Introduction, growth, maturity, decline/ build, hold, harvest, divest
- BCG
    - Star, cash cow, question mark, dog
- Miles and Snow Typology
    - Prospector, analyser, defender, reactor

### Similarities

- Question mark and stars – differentiation – build/hold strategies – prospector
- Cash cows – cost leadership – harvest strategies – defender

### Miles and Snow Typology

**Prospector**: highly innovative, constantly seek for new products and new opportunities; oriented towards growth and risk taking (Apple, 3M)

**Analyser**: maintains market share, improve the performance of current products, and seeks to be innovative (but not as much as Prospector) (Rolex, Rolls-Royce)

**Defender**: concentrates on protecting its current markets; maintaining stable growth and serving current customers; less aggressive and less entrepreneurial style of management (Microsoft, Sony)

**Reactor**: no consistent strategic approach and drifts with events in the environment; reacting to, but fail to anticipate or influence environmental events (Nokia, Blackberry)

## Summary

Strategic questions need to be addressed at corporate level and business level

- What industries are attractive?
- What part of the industry or value chain is attractive?
- How is value created?
- How to sustain competitive advantage

Explored the frameworks available to analyse positioning of firms and products

- Porter's generic strategies
- Strategy based on the Product Life Cycle
- BCG
- Miles and Snow Typology