

AN INTRODUCTION TO STRATEGIC COST MANAGEMENT



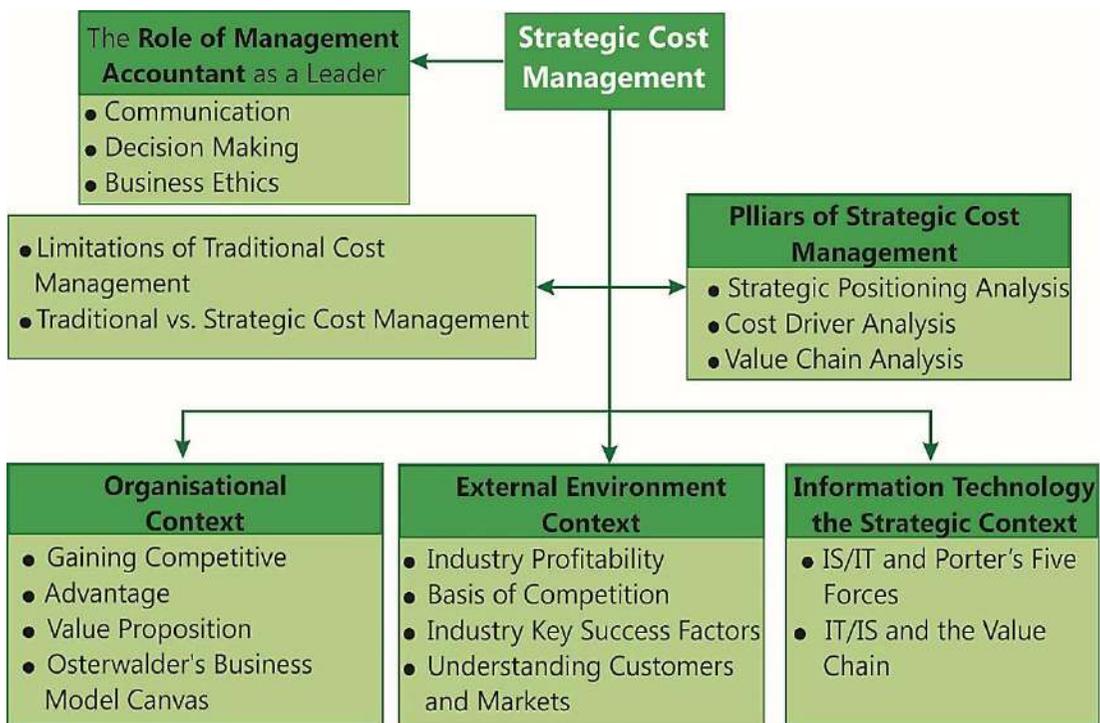
LEARNING OUTCOMES

After studying this chapter, you will be able to:

- UNDERSTAND the need of strategic cost management and ANALYSE its distinction from traditional cost management.
- UNDERSTAND the source of Gaining Competitive Advantage, apart from APPLYING Value Proposition Canvas and Osterwalder's Business Model Canvas.
- ANALYSE the external environment to EVALUATE the Industry Profitability & UNDERSTANDING Customers and Markets, Basis of Competition, and Key Success Factors.
- EVALUATE the role of Information Technology in strategy making with specific application in case of the Porter's Five Forces and the Value Chain.
- EVALUATE the role of Management Accountant as a Leader and UNDERSTANDING the Communication, Decision Making, and Business Ethics aspect of Management Accountant role.



Chapter Overview



This chapter will start by highlighting the limitations of traditional cost management and showcasing how Strategic Cost Management aligns costs with the business strategy while measuring and managing costs. This chapter will provide an overview of the organizational and external environment context of Strategic Cost Management, followed by a discussion of the role of information technology and information systems in the strategic context, as well as shed light on the role of the management accountant as a leader.



A. MANAGING COST STRATEGICALLY

Let's start by acknowledging the fact that *'anything which can be measure, can also be controlled and managed'*¹. Therefore, earlier **cost control** and now **cost management** are applied realities for optimisation as an extension of cost accounting.

¹ V. F. Ridgway published a paper in 1956 criticizing the measurement mantra. Simon Caulkin, a columnist, neatly summarized Ridgway's argument as: "What gets measured gets managed — even when it's pointless to measure and manage it, and even if it harms the purpose of the organisation to do so".

Here students are advised to take note that **cost accounting** deals with only the *ascertaining* and *recording* of costs, not the control or management thereof; it is **management accounting** that empowers the management of organisations with an information and support system to make efforts and attempts to *control* and *manage* the costs.

The emphasis was only on cost *containment* under **cost control** (maintaining the status quo), but with the changing business environment wherein every organization is witnessing cut-through competition, the emphasis has been shifted (better to say widening) from **cost containment** to **cost reduction**. Cost reduction is an emotive term; hence, it shall be better represented through the term '**cost management**'.

Traditionally, cost management focused only on *cutting or reducing cost*, whereas the focus is now widening and aiming for either *reducing cost while maintaining the same quality level (value) or increasing value at the same or reduced cost level*. In a contemporary set-up, **Cost Management is much more than just cost reduction**; it has gained strategic importance in *aligning the cost to business strategies*.

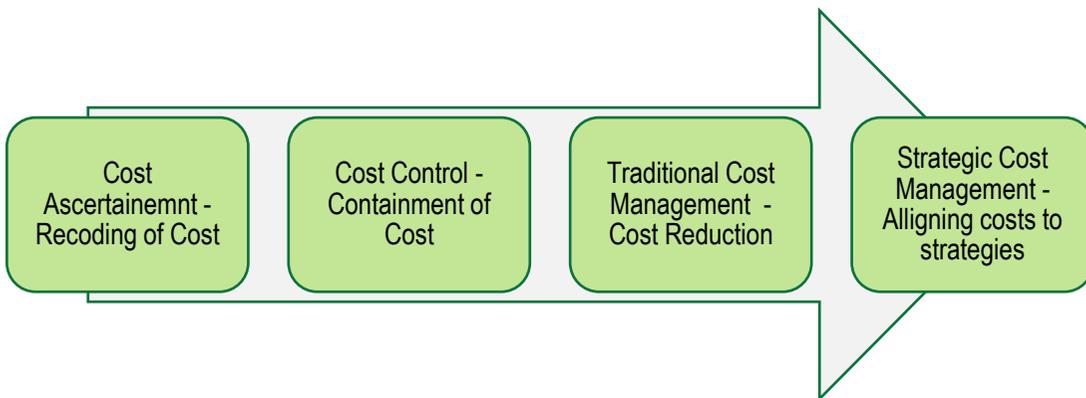


Figure A.1 – Evolution of cost concepts over time horizon

When techniques of cost management are practiced as **strategic driver** in context of organisational objectives and vision, this is termed as **Strategic Cost Management**. In other words, strategic cost management deals with *measuring and managing costs and aligning them to the business strategy*.

Prior to discussing the **underpinning aspects** of **Strategic Cost Management** and highlighting its **differences** from **traditional cost management**, let us consider the **limitations** of traditional cost management, which warrant the evolution of Strategic Cost Management.

1. Traditional Cost Management & Its Limitations

Traditional Cost Management aims at cost reduction. It revolved around the central theme 'that cost cutting always results in enhanced profits'. But a question arises here: Does the theme of traditional cost management always hold truth? The simplest answer to this question is **no, not in every case**.

Let's consolidate the above answer by considering the following *illustrations* –

- Reducing cost by not performing preventive maintenance as and when it becomes due as per the maintenance schedule may lead to major breakdown and therefore results in high corrective maintenance cost and lower profitability.
- In order to reduce cost, if any automobile business decides to close some of the service stations, it may end up losing customers due to poor after-sale services, which in turn leads to a reduction in the top line (i.e., revenue) as well as the bottom line (i.e., profit).



Practical Insight (In continuation to above illustration)

In the automotive sector, service stations or dealers' network act as a touch point to engage the customer and hence carry strategic importance. Vehicle owners in India place a great level of importance on proactive service advisor-led interaction during their service experience, according to the J.D. Power 2022 India Customer Service Index (CSI) Study released on November 24th, 2022.

Do You Know?

According to industry leaders, service (after-sale services) is key in the automotive industry and effectively makes a difference in the car buying decision too. Therefore, most automobile companies in India are striving for expanding their dealers' network which helps them showcase their presence in the market and act as positive decision stimuli for buyers of the class.

The above illustration in the context of stated industry insight highlights the limitations of traditional cost management in considering customer value proposition, aspects of the market, the basis of competition, quality, and many more. The **major limitations** of traditional cost management are listed below –

- Traditional cost management **ignores competition, market growth, and customer requirements**, because it is largely concerned with the quantitative factors inside the organisation.
- Traditional cost management places excessive focus on cost reduction. It ignores the strategic importance of individual cases. **Broad cost reduction** leads to inferior quality.
- Traditional cost management **ignores the dynamics of marketing and economics** because it relies on financial accounting data that is static and historical in nature.
- Traditional cost management has a **limited focus on review and investigation**, only of those variances and deviations that are quantitative in nature.
- Traditional cost management is a **reactive approach**. It can be seen as a corrective function rather than a preventive one.
- Traditional cost management has a **short-term outlook** and may focus on the upcoming year, quarter, or even month.

The above specified limitations of traditional cost management, in themselves emphasise on the **need** for Strategic Cost Management. The need for strategic cost management also observed due to–

- The requirement for **detailed cost analysis** is essential to gain an in-depth understanding of **cost structure**.
- Strategic use of cost data **to gain and sustain a competitive advantage**.
- To **assimilate cost management into strategy** and vice versa.
- To comprehend the **big picture** (a canvas that can showcase the business model), to have a holistic analysis of **cost relations** among the different activities and empower the management in **managing** those relations.

Cooper and Slagmulder² rightly suggested 'it is not sufficient to simply reduce costs; instead, costs must be managed strategically'.

 **Note:** Students are advised to read the need for strategic cost management in reference to the second chapter, i.e., Modern Business Environment.

2. Strategic Cost Management (SCM)

Strategic cost management is the implementation of cost management techniques to sustain and improve the organisation's strategic position as well as reduce costs. It also deals with the collection, processing, analysis and dissemination of cost data with a view to feed information to the system for decision-making to support the organizational strategy as a whole.

Hence, Strategic Cost Management is the **use of cost information** in developing and deploying the **strategy** to practice **superior performance** that leads to **sustainable competitive advantage**.

Strategic Cost Management can be applied in service and manufacturing settings, as well as in not-for-profit environments. Strategic Cost Management deals with the assimilation of both quantitative and qualitative information in decision making.

*Strategic Cost Management is the application of cost management techniques so that they **simultaneously** improve the strategic position of a firm and reduce costs.*

2.1 Underneath Pillars of Strategic Cost Management

Strategic cost management has three important pillars: strategic positioning, cost driver analysis, and value chain analysis.

² Cooper, R., & Slagmulder, R. R. A. (1998). Strategic cost management - What is strategic cost management? *Management Accounting*, January, 14-16.

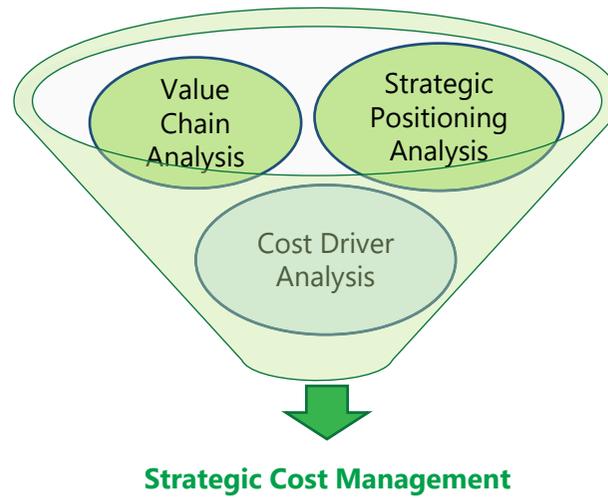


Figure A.2 - Pillars of Strategic Cost Management

Strategic Cost Management is the managerial use of cost information explicitly directed at one or more of the four stages (strategy formulation, communicating the strategy, implementing the strategy, and controlling) of strategic management. Overall recognition of the cost relationships among the activities in the value chain and the process of managing those cost relationships to attain the firm's strategic objectives are the main focal points of Strategic Cost Management.

The relationship among pillars can be viewed as 'understanding the value chain will help in defining the optimal strategic position (positioning strategy), and eventually both will help in identifying relevant cost drivers'.

2.1.1 Value Chain Analysis

Michael E. Porter³ in 1985 advocated using value chain analysis to gain a competitive advantage. The **Value Chain** is the sequential chain of activities that leads to the delivery of the final product to the customer; it also depicts how value (utility) accumulates for the customer.

 **Note** – The use cases of the Value Chain as a model, discussed in detail under heading 2 in the chapter, An Introduction to Strategic Performance Management.

³ Michael E Porter in year 1985 in his book Competitive Advantage: Creating and Sustaining Superior Performance, introduced generic value chain. This book answered the questions he posed; things remain undone in his earlier book, 'Competitive Strategy - Techniques for Analysing Industries and Competitors', written in 1980.

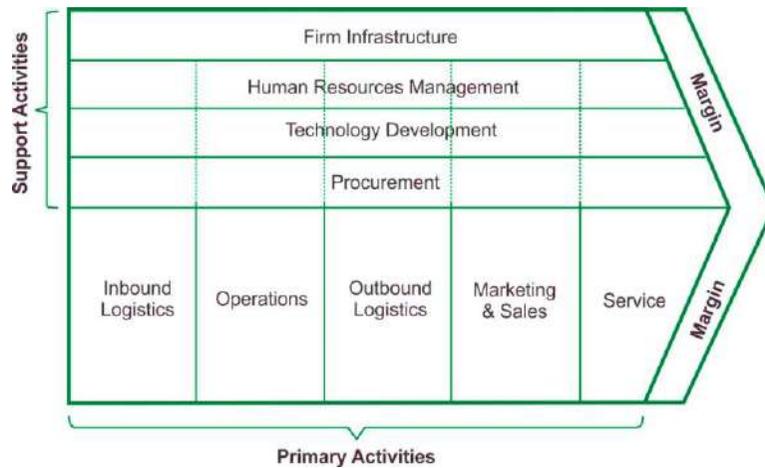


Figure A.3 – The Generic Value Chain⁴

The Value chain comprises the activities in two sets, the first being **primary activities** (vertical), which are directly involved in the transformation of a product or provisioning of a service, whereas the second set is **support activities** (horizontal), which ensure support to perform primary activities. **Margin** is the excess of the value that a customer is willing to pay over the cost incurred by the firm for the product.

Primary Activities comprising of:

- I. **Inbound logistics** cover receiving, storing, and handling raw material inputs. Mind it, inbound logistics don't cover the purchase or procurement. Inbound logistics are deeply impacted by the location of business operations.

Illustration – Most Indian sugar mills are operating in the states of UP, Maharashtra, and Karnataka to generate value through low cost on inbound logistics because these states collectively account for nearly 80% of sugarcane production in India, UP leading the chart with more than 46% of total production⁵.

- II. **Operations** include the transformation of raw materials into finished goods and services; operations must be seen in depth; it may or may not be possible for an organisation to be master of all the activities that are required to render the service or to convert raw material into finished goods; the organisation may take the decision to outsource those activities which are not its core competences.

Illustration – Apple only designs and sells the iPhone; it doesn't manufacture its components. Outsourcing manufacturing to locations with lower resource costs is the main source of value for Apple operations⁶.

⁴ Figure 2-2 at p.37 of Competitive Advantage: Creating and Sustaining Superior Performance (1985) by Michael E Porter

⁵ Para 2.8 on page 21 of the NITI Aayog report titled "Report of the Task Force on Sugarcane and Sugar Industry", <https://niti.gov.in/sites/default/files/2020-08/SugarReport.pdf>

⁶ <https://www.cnbc.com/2018/12/13/inside-apple-iphone-where-parts-and-materials-come-from.html>

- III. **Outbound logistics** covers storing, distributing, and delivering finished goods to customers. This includes how, when, and where for customer reference. Where to deliver, how to deliver, and when to deliver.

Illustration – Many e-retail platforms, such as Amazon, Flipkart, etc., offer delivery at a shipping address that may be different than the billing address; they also offer contactless delivery, and the buyer is free to select the time frame within which delivery shall be attempted.



Practical Insight

The selection of place of business operation is critical to generate value from both inbound and outbound logistics apart from core operation activities as well.

Tata Steels, a Tata Sons group company that is headquartered in Mumbai, had its early operations in Jamshedpur and is still working there. Have you ever thought why J. Tata, in 1908 selected Jamshedpur for Tata Steel? It was close to the iron ore, coal, and manganese deposits as well as to Kolkata, which provided a large market. Therefore, location became the source of value for Tata Steels in both inbound and outbound logistics apart from making operations easy⁷.

- IV. **Marketing and sales** activities comprise conducting market research to determine the marketing mix⁸ that comprises product, price, place, and promotion. McCarthy's concept was further developed by Booms and Bitner⁹ into the 7Ps of the marketing mix by adding three more Ps, i.e. People, Process, and Physical evidence (sometime referred to positioning). The newly added 3Ps have a relatively greater bearing on the provisioning and supply of services than goods. The marketing and selling activities broadly comprise the aspects pertaining to these 7Ps.

It is worth noting that if we keep the customer at the focal point then 4Ps can be replaced by the 4Cs, which are consumer wants and needs (for products); Cost to satisfy (for price); convenience to buy (for place); and communication (for people).

Illustration – A fast-food restaurant chain (with presence in the western part of the globe), decided to enter the Indian market; for that, it had to drastically modify its marketing mix for Indian operations (to be the best fit in the Indian context). Considering this, rather than chicken patties, aloo tikkis were used, prices were kept low, intensive promotional activities and campaigns were launched, and most of their franchises in India offer sitting arrangements as well.



Practical Insight

Marketing and sales effort are truly of significant importance to let the customer, perceive value of the product. Brands often use taglines that create impact. A Noodles brand may choose any of the following taglines or keep changing its tagline from time to time –

- 2 mins noodles ... to focus on **convenience**.
- Taste Bhi Health Bhi ... to emphasis at **health**.
- 2-minute mein Khushiyan (Happiness in 2 minutes) ... to collaborate on **fun and happiness**.

⁷ <https://www.tatasteel.com/corporate/our-organisation/heritage/>

⁸ By E. Jerome McCarthy in 1960 in his book Basic Marketing

⁹ Booms, B. & Bitner, M. J. (1981). Marketing Strategies and Organizational Structures for Service Firms. Marketing of Services, James H. Donnelly and William R. George, eds. Chicago: American Marketing Association, 47-51

- V. **After sales service** includes all those activities that occur after the point of sale, such as installation, training, and repair. It is important to note that the importance of after sale services is higher in the case of durable products in comparison to products falling into the FMCG category. In the service industry after sale service depends on the nature of the service.

Illustration – Service station network, time taken to service the vehicle, and quality of service (coverage of what is asked for to check or repair and manner to do so) are key aspects for creating value for its customers in the automobile industry. Even service costs become part of cost ownership and shall be a deciding factor for making purchases in the automobile sector.

Support activities also referred as to secondary activities; it comprises of:

- I. **Firm infrastructure** deals with how the firm is organised. It basically describes the activities pertaining to legal, general management, administrative, accounting, finance, public relations, and quality assurance in the organisation apart from who will perform these and how.
- II. **Technology development** describes how the firm uses technology. Activities such as research and development, IT management, and cybersecurity that build and maintain an organization's use of technology.
- III. **Human resource management** describes how people contribute to competitive advantage. Basically, it deals with the management of human capital. Human resource functions such as hiring, training, building and maintaining an organizational culture, and maintaining positive employee relationships.
- IV. **Procurement** signifies purchasing, but not just limited to materials. Finding new external vendors, maintaining vendor relationships, negotiating prices, and other activities related to bringing in the necessary materials and resources used to build a product or service.

Typically, increasing the performance of one of the four secondary activities can benefit at least one of the primary activities.

Value Chain Analysis is a process of identifying **Key Value Drivers** (can be referred to as equivalent to CSFs) that add substantial value and contribute most towards a firm's competitive advantage by categorising the activities into **value-added** and **non-value-added activities**, with the objective of eliminating non-value-added activities to obtain **cost leadership** and focusing (by further resource deployment) on value-added activities to improve **product differentiation**.

Hence, **Value Chain Analysis** is a means of **evaluating each of the activities** in a firm's value chain to understand **where opportunities for improvement** lie. Conducting a value chain analysis prompts you to consider how each step adds or subtracts value from your final product or service. Value chain analysis can help you realise some form of competitive advantage, such as **cost reduction** (becoming **cost leader**) and **product differentiation**.

Value Chain Analysis requires a framework (**strategic framework**), which can collect a variety of information strategically. Three essential analyses to collect such strategic information are–

- ❑ Industry Structure Analysis – to determine industry profitability and the basis of competition.
- ❑ Core Competencies Analysis – to determine whether organisation possess the desired key success factors.
- ❑ Segmentation Analysis – to understand customers and markets.

📖 **Note** - How to conduct a value chain analysis, the strategic framework thereof and strategies of cost leadership and differentiation, as well as how to attain them, are discussed in detail in upcoming sections of this chapter.

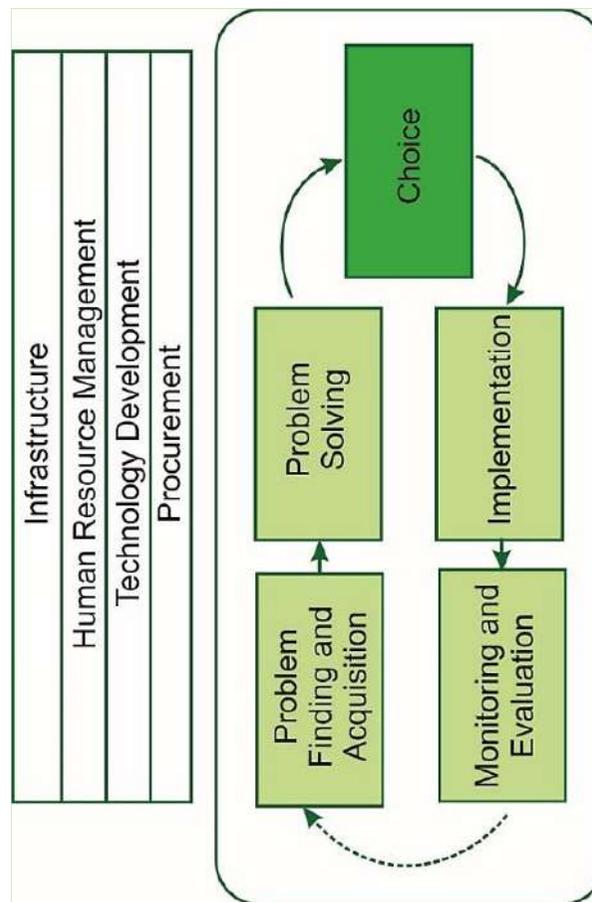


Figure A.4 – The Value Shop Model¹⁰

¹⁰ https://www.researchgate.net/figure/Diagram-of-a-Value-Shop-Stabel-Fjeldstad-1998_fig2_44709027



Concept Insight

Value Shop Model (or Service Value Chain) can resolve the customer's hardship for service providers (Figure A.4).

Value Shop Model (VSM) conceptualised by Mr. James D. Thompson in 1967. It was named and defined by Mr. Charles B. Stabell & Mr. Oystein D. Fjeldstad in 1998. Value Shop Model is oriented to mobilises resources (man, machine, money, and knowledge) to solve the problem by service sector firms. This is similar to the value chain, but with differences in two aspects–

- Rather than focusing on creating value, value shop model focuses on solving problems.
- Primary activities are described as Problem Finding and Acquisition, Problem Solving, Choice, Execution, Control, and Evaluation.

Note- There is no fixed sequence for these activities or resources. Each problem is treated uniquely, and activities and resources are allocated specifically to cater to the problem. These activities are cyclic in nature, and the cycle will run until a solution reached.

Some of the classical examples of value shops include management consultancies such as Boston Consulting Group, Deloitte, and McKinsey. The model can be applied to the BFSI sector, apart from applications in the case of value-based consumption services such as telecom services, services by internet service providers, subscriptions to some software or data processing solutions, etc.

Value is created in the shop by several mechanisms that allow the organization to solve problems better or faster than the client. These are variables such as:

- The organization is in possession of more information about the problem than the client.
- The organization is specialized to deal with the problem at hand with specific methods of analysis.
- Strong expertise from expert professionals is available.

To cut a long story short, for a professional services firm, an alternate representative of a value chain is the value shop, which is essentially a problem resolution model. The primary activities are problem finding and acquisition, problem solving, choosing among solutions, execution, control, and evaluation. Hence, the value shop principle is not concerned with value addition; instead, it deals with the resolution of customer's hardships.

2.1.2 Strategic Position and Strategic Positioning Analysis

Understanding the **strategic position** is concerned with the impact of the **external environment**, **internal resources** and **competences**, and the **expectations and influence of stakeholders** on **strategy**.¹¹ Together, a consideration of the environment, strategic capability, expectations, and purposes within the cultural and political framework of the organisation provides a basis for understanding the strategic position of an organisation.

¹¹ Johnson, G., Scholes, K., Whittington, G. (2008), Exploring Corporate Strategy, 8th Edition: Financial Times Prentice Hall (p. 13)

Strategic Positioning Analysis is the analysis of the **company's relative position** within that strategic segment of **industry that matters** for the purpose of establishing performance targets (while attaining competitive advantage) in addition to determining the means (strategies and plans) of attaining the same and then the measurement of performance as well as the evaluation thereof. Basically, the intent seen in where the firm is positioned in context to its true peer group (which can be referred to competitor) or how it is performing in comparison to others who are operating in the same segment.

To illustrate, Tata Motors' performance or standing shall be analysed in the context of Maruti, Toyota, Honda, and Hyundai, which offer the same products in the same price range with similar features.

Strategic positioning reflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals. Strategic positioning should translate into either one of two things: a premium price (i.e., differentiation) or a lower cost (i.e., cost leadership)

Note- Driving up prices is one way to increase profitability. To command a premium price, a company must deliver distinctive value to customers.... **differentiation**. Driving down costs is another way to increase profitability. To compete on cost, companies must balance price with acceptable quality.... **cost leadership**.

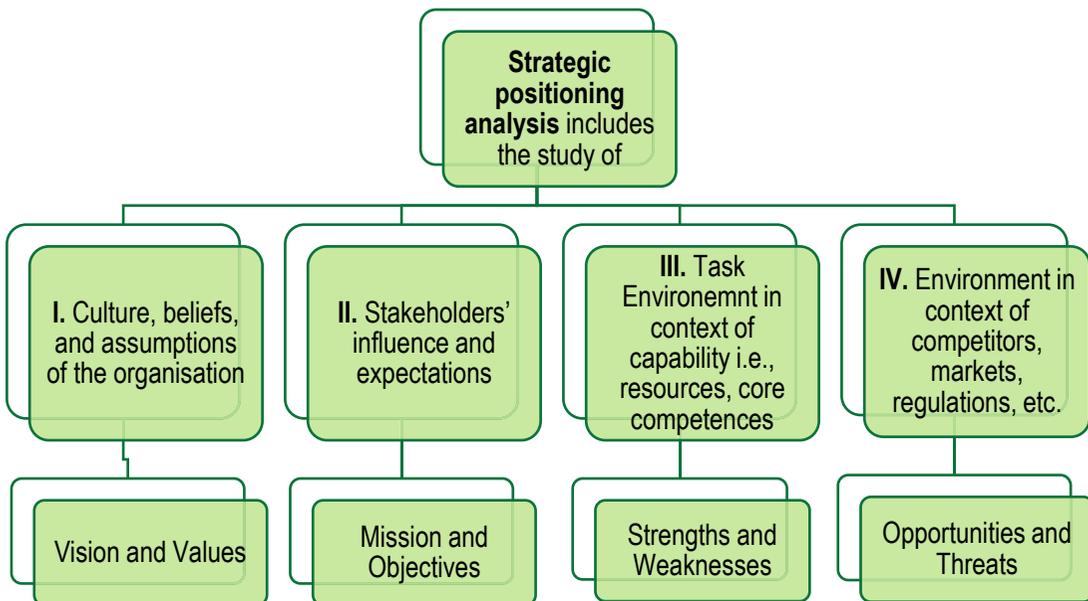


Figure A.5 – Scope of Strategic Positioning analysis

I. Culture, beliefs, and assumptions of the organisation help in appraising the vision and values. Vision is aspiration statement, while values are the guiding principle that will be observed to attain such an aspiration (vision). Culture is the beliefs, values, mindsets, and practices of a specific group of people. It includes behaviour patterns and norms.

Illustration - Google's vision statement is "to provide access to the world's information in one click¹²". The nature of company's business is a direct manifestation of this vision statement. For instance, Google's most popular product is its search engine service. Further, as part of their value system, Google is committed to significantly improving the lives of as many people as possible.



Concept Insight

Denison Organizational Culture Survey (DOCS)¹³- Culture has a strong bearing on Shareholders ROI, Customer Satisfaction, and Business Growth

Denison Organizational Culture Survey (DOCS; a 50-question employee survey) used the Denison Organizational Culture Model, to measure the specific aspects of an organization's culture based on four core critical cultural trait areas: Adaptability, Mission, Involvement, and Consistency.

The survey breaks these four areas down into 3 further sub-categories each, giving a total of 12 areas of cultural assessment. Denison has found an important link between four critical cultural traits and how they can have a significant impact on organizational performance.

Culture and Shareholders' Return on Equity

A Study of 161 publicly traded companies from a broad range of industries was conducted to compare the performance of the 10% of organizations with the best culture scores with the 10% of organization with the worst culture scores.

The average ROE for the organizations with the lowest culture scores is 6%, and the average ROE for organizations with high culture scores is 21%. Highly similar results for return on total investment.

Culture and Customer Satisfaction

Correlations with customer satisfaction were significant for all twelve indices. Average 24 percentile point difference between the top and bottom five performers of a large Fortune 500 construction company in all 12 indices.

Culture and Business Growth

A Study of retail supermarkets in the USA was conducted, comprising 12,000 individuals and 2,500 stores to compare culture profiles with growth rates. 1,305 stores with weak culture records over 5% of sales declined, whereas 424 stores with strong culture records above 5% of sales increased.

II. Stakeholders' influences and expectations shall be considered in order to determine what the shareholders want and how much they will cooperate. So that the same can be reflected in the mission statement and objectives of the organisation. It also needs to be seen whether we are able to meet their expectations or not while appraising strategic position.

Different stakeholder groups have their own set of forces and tactics that have a strong bearing on organisations mission and objectives and, in turn, on its strategic position.

Illustration – Google's key stakeholders are its users, and they will continue using google more and more if it is convenient to use, freely accessible, and user friendly. This is reflected in Google's mission statement. Google's mission is to organize the world's information and make it universally accessible and useful¹⁴. That's why search makes it easy to discover a broad range of information from a wide variety of sources.

¹² <https://www.comparably.com/companies/google/mission>

¹³ <https://www.denisonconsulting.com/culture-surveys/>

¹⁴ https://about.google/intl/ALL_in/



Do You Know?

Do we need to consider all the stakeholders or only those who are significant enough? If only those limited chunk of stakeholders exist, then how do we identify them?

Mendelow's Matrix helps in considering the attitude of stakeholders while setting out strategic objectives. Mendelow's Matrix consists of four boxes representing stakeholders with:

High Interest and High Power – These will be considered key stakeholders, and a business will need to actively engage this group. This group is likely to have a significant influence; they may be the driver behind the change or strategy. They will likely have the power to stop the change or strategy from going ahead if they are unhappy.

This is the group that requires most focus. Keep them both updated on any strategic changes and empowered to steer the direction of change (or at least feel that they have the opportunity to input into the direction of the project).

High Interest and Low Power – This group has an interest in what is happening; however, they are unlikely to have the power to influence change. This group should be kept informed. While, they have little power themselves, they could attempt to join forces with a group with power.

Low Interest and High Power – This group of stakeholders has the potential to move into the 'High Interest and High Power' group, so it is essential that they are kept satisfied. By keeping them satisfied, they are less likely to gain interest and exercise their power of influence.

Low Interest and Low Power – This group is unlikely to have an interest in the organization and its strategic direction. This is often due to their lack of power to influence a situation. They are likely to accept the position and show little, if any, resistance.

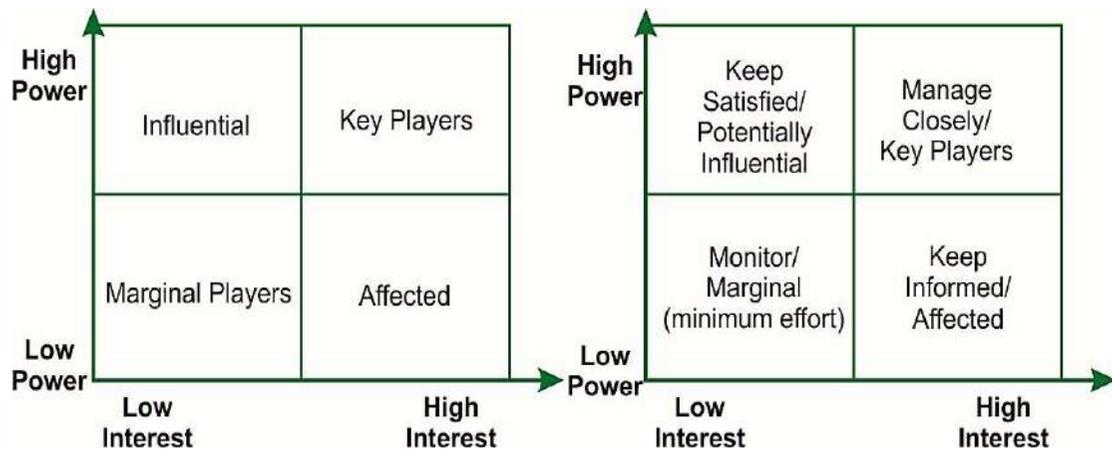


Figure A.6 – Mendelow's Matrix and Response to each class of stakeholders¹⁵

¹⁵ Mendelow, A. L. (1991), 'Environmental Scanning: The Impact of the Stakeholder Concept'. Proceedings from the Second International Conference on Information Systems, 407-418, Cambridge, MA

III. **Strategic capabilities in terms of resources and core competences** shall be analysed in the context of the **task environment** (which may be referred to as the microenvironment) in which organisation is operating to assess the **strengths** and **weaknesses** to appraise the strategic position.

Strengths shall be used aggressively to exploit opportunities to capture competitive advantage, whereas weaknesses need to be analysed at the root-cause level, and those causes shall either be removed or reduced (if they can't be reduced).



Practical Insight

If we have to appraise the position of any automobile company in the context of the automobile industry by identifying its strengths and weaknesses, then we have to consider factors (which may be positive or negative; if positive, then it becomes a strength, and if negative, then it becomes a weakness) like –

- Brand image and STP (segmentation, targeting, and positioning).
- Market value.
- Distribution system.
- Market penetration, product and market development, and diversification.
- Research and development.
- International presence.
- Pattern of production and operational costs and the rate of profits.

Note – Above factors are only illustrative, and the importance of these factors depends upon the influence that it may create.

IV. The **macro environment** (beyond the control of organisation), especially the basis of competition, industry profitability, industry key success factors, customers' behaviour, markets and regulations, etc., shall be analysed to assess **Opportunities** and **Threats** to appraise the strategic position.

Opportunities need to be exploited, whereas a defence mechanism shall be created against threats that can be mitigated. Risk management is of key importance to protect the organisation from threats to sustain its strategic position and make the most of opportunities. This will improve its strategic position, apart from ensuring it realizes the benefits of competitive advantages.



Practical Insight

In line with previous practical insight to identify opportunities and threats to exploit the earlier and residual the later for any automobile company, the relevant facts may include –

- Capabilities in direct and digital marketing.
- Relationship with channel partners.
- Supply chain integrations and after sale services (cost and availability).
- Demand for low cost or innovative products.
- Acquisition, merger, or joint venturing to register un-organic growth.
- Competitors who are aggressive and striking hard to capture market share .
- Stagnation in the economy or industry.
- Price war and innovation war among the players.

Note – Above points are illustrative only.

Mind it, tapped opportunities turned into strengths over time, while unattended or mishandled threats led to weakness.



Do You Know?

What tools are handy for conducting strategic position analysis?

SWOT analysis is the focal tool for Strategic Position Analysis supported by PESTEL Analysis (specifically relied on for the analysis of remote environmental factors), Porter's Five Forces (for industry analysis), Porter's Diamond Studies, etc. for external environment analysis.

Porter's Value Chain, Critical Success Factors and Core Competencies, Product Lifecycle, McKinsey 7S, etc. for internal environment analysis.

Note - Lists of tools/ models stated above are illustrative only, not exhaustive.

2.1.3 Cost Driver Analysis

Cost driver is the unit of that activity that causes costs to be incurred. Hence, cost driver is **trigger of change in cost**, meaning thereby more frequency/ runs of cost driver led to more cost.

Cost Driver Analysis includes the examination, quantification, and explanation of the monetary effects of cost drivers associated with an activity.

It is an in-depth review of the cost drivers to make sure that your firm correctly allocates the supporting production and service costs to all goods and services. There are different cost driver analysis methods, including a cost accounting system review, industry analysis, and internal activity analysis.

In traditional costing, the cost driver used to allocate overhead costs (supporting cost) to cost objects only relates to the quantity/ volume of output. But under Strategic Cost Management cost driver for short-term overhead costs (that occur once in a while) may be the volume of output or activity. But for long-term overhead costs, a variety of cost drivers are used.

Based upon the **nature of supporting cost (overhead cost)**, appropriate drivers can be identified and categorised into the following classes–

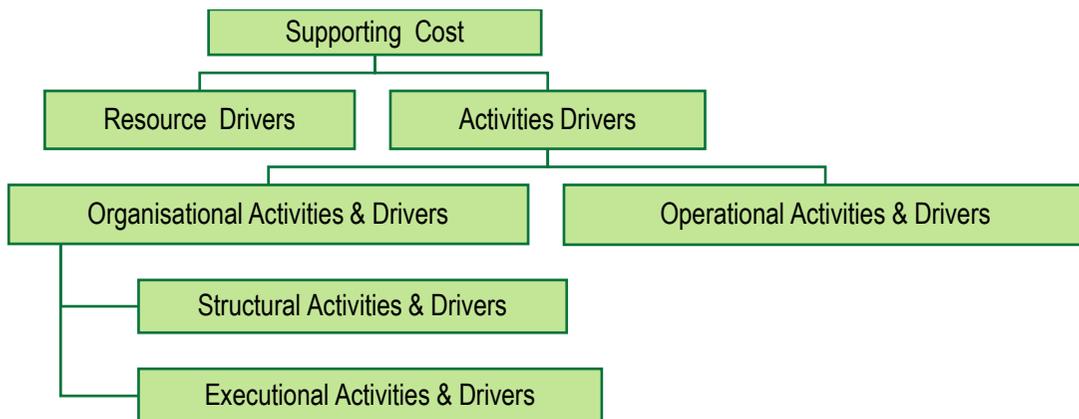


Figure A.7 – Classification of cost drivers

Structural cost drivers relate to business strategic choices about an organization's underlying economic structure, such as scale and scope of operations, use of technology, and complexity of products (it is not necessary that more is better).

Executional cost drivers relate to the execution of the business activities, such as the utilization of employees in terms of involvement, the provision of quality service, product design and manufacturing, and links with suppliers and clients (higher is the better).

 **Note** - Students are advised to refer Annexure 1 at the end of the chapter for a detailed overview of the types of cost drivers.

2.2 Key tools of Strategic Cost Management and their nature

Following are the key tools of strategic cost management; their nature is briefly described here to highlight how they help in aligning costs with business strategies –

| Tool | Description |
|--|---|
| Activity Based Costing | To provide accuracy in allocating indirect costs. |
| Benchmarking | Process performed to determine critical success factors and study the ideal procedures of other organizations in order to improve operations and dominate the market. |
| Competitive Advantage Analysis | Defining strategies that an organization could adopt to excel over rivals. |
| Just-in-Time | A comprehensive system to buy materials (JIT Purchase) or produce commodities (JIT Production) when needed at the appropriate time. |
| Kaizen - Continuous Improvement | Conducting continuous improvements in quality and other critical success factors. |
| Target Costing | Cost that an organization is willing to incur according to a competitive price that could be used to achieve the desired profit. |
| Theory of Constraints | A tool to improve the rate of transferring material into finished goods. |
| Total Quality Management | Adapt the necessary policies and procedures to meet customers' expectations. |
| Value Chain Analysis | Add value to customers, reducing costs and understanding relationship between business organization and customers. |

 **Note** - List of tools specified above is only illustrative, not exhaustive.

3. Traditional vs. Strategic Cost Management

Based upon discussion conducted in the previous headings, Traditional Cost Management & its Limitations and Strategic Cost Management, the following key differences between Traditional and Strategic Cost Management can be considered–

| Basis of Difference | Traditional Cost Management | Strategic Cost Management |
|---------------------------|----------------------------------|---|
| Allocation of cost | Volume (per unit produced). | Allocation will be w.r.t. relevant cost driver – Activity Based Costing. |
| Nature | Reactive (risk averse) approach. | Proactive and dynamic approach. |
| Objective | Cost control and reduction. | Product differentiation (apart from cost containment). |
| Risk Appetite | Risk-averse approach. | Risk taking approach and ability to adapt itself to changing environment. |
| Scope | Internal business environment. | Both internal and external. |
| Term | Short term focus. | Long span or perpetual focus. |

B. ORGANISATIONAL CONTEXT

Strategic Cost Management is the analysis of cost in a broader context (**Organisational** as well as **External Environment Context**), where the strategic elements become more conscious, explicit, and formal. The cost data is used to develop **superior strategies** in route to **gaining a sustainable competitive advantage**. Strategic Cost Management gives a clear understanding of the firm's cost structure in search of sustainable competitive advantage **through cost reduction or differentiation**.

1. Gaining Competitive Advantage

A Competitive advantage is the ability of an organisation to outperform its competitors and make more profits than its competitors do from an equivalent set of activities through superior performance. Gaining and maintaining a competitive advantage over a period of time is challenging for organisations in the global economy with the speed of competition and information exchange possible today.

The role of the strategist (including the management accountant as a cost engineer) is to engineer superior performance within a given industry in which organisation is operating.

A genuine question arises here –

1.1 How can a strategist increase profitability?

The answer lies in having a **competitive advantage**. Companies must search out “white space” in the industry, which usually means competing on **either one of two** fronts–

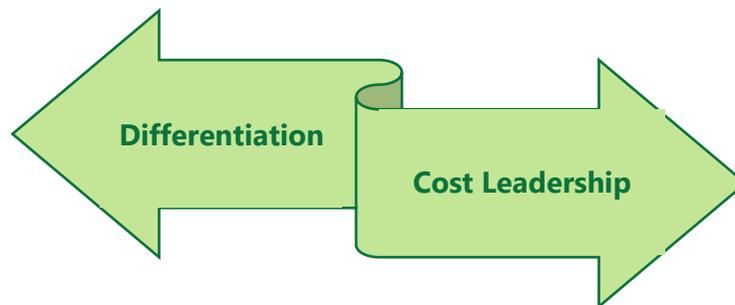


Figure B.1 – Generic strategies to attain competitive advantage (to enhance profitability)



Do You Know?

It's possible to compete at a low cost and be differentiated at the same time, but companies that try to be all things to all customers can wind up getting stuck in the middle, a strategic mistake that Michael Porter calls “the kiss of death”.

1.1.1 Differentiation

Driving up prices is one way to increase profitability. To command a premium price, a company must deliver **distinctive value** to customers. A customer may perceive the high value of any product and be ready to pay a premium due to the differentiation it offers. E.g., Apple. **Product differentiation** is achieved by investing more time and resources into activities like research and development, design, or marketing that can help the organisation's product stand out.

- **Source** - Differentiation can be sourced from quality (design, knowhow or performance), innovation, customer relations/ response (including after sale services), a wide-product range etc.
- **Benefits** - Differentiation helps either earn a huge margin by charging the top price or build market share by charging lesser than premium price.

1.1.2 Cost Leadership

Driving down costs is another way to increase profitability. To compete on cost, firm must balance price with acceptable quality and become the lowest cost producer in an industry. A firm can create a cost advantage in two different ways, by reducing the cost of individual value chain activities and by reconfiguring the value chain as shown below in **figure B.2**

- **Source** - Cost Leadership can be sourced from cost effective inputs, process innovation or re-engineering, low-cost distribution channel, superior operation management, learning curve, and the economics of scale.
- **Benefits** - By producing at the lowest possible cost, the manufacturer can compete on price with every other producer in the industry and earn the highest unit profits, or by charging a lower price than others, it can capture market share.



Figure B.2 – Drivers of Cost Leadership

1.2 Relation between strategies and cost management Emphasis

Strategic emphasis¹⁶ on different aspects under Product Differentiation and Cost Leadership is enumerated below –

| Aspects | Strategic Emphasis | |
|--|-------------------------|---------------------------|
| | Product Differentiation | Cost Leadership |
| Role of standard costs in assessing performance | Not very important | Very important |
| Importance of concepts such 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 | Relatively less important |
| Importance of product cost as an input to pricing decisions | Low | High |
| Importance of competitor cost analysis | Low | High |

The competitive advantage can be sourced from product differentiation or cost leadership, either by reconfiguring the value chain or by reducing the cost of each individual value chain activity; hence, conducting a value chain analysis is essential in both scenarios. So, another question arises here:

1.3 How to conduct a Value Chain Analysis?

There are three steps involved in conducting value chain analysis –



Figure B.3 - Steps involved in value chain analysis

¹⁶ Shank (1989), Strategic Cost Management: New Wine or Just New Bottle? Journal of Management Accounting Research (1): 47-65

1.3.1 Identify Value Chain Activities

The first step in conducting a value chain analysis is to understand all of the primary and secondary activities that go into your product or service creation. If your company sells multiple products or services, it's important to perform this process for each one.

1.3.2 Determine the Cost and Value of Activities

Once the primary and secondary activities have been identified, the next step is to determine the value that each activity adds to the process, along with the costs involved.

When thinking about the value created by activities, an organisation needs to ask itself following questions –

- How does each activity increase the end user's satisfaction?
- How does it create value for the firm?

To be more specific, the organisations need to answer –

- Does constructing the product out of certain materials make it more durable or luxurious for the user?
- Does including a certain feature make it more likely your firm will benefit from network effects and increased business?

Similarly, it's important to understand the costs associated with each step in the process. Depending on the situation, lowering expenses may be an easy way to improve the value each transaction provides.

1.3.3 Assessing and Identify Opportunities for Competitive Advantage

Value Chain analysis can help in identifying points where differentiation can be created or cost leadership can be gained, meaning thereby value chain approach can be used to assess the competitive advantage (because it is better to focus on the process and activities involved in the creation of the product rather than the product alone).

Hence, once you've compiled your value chain and understood the cost and value associated with each step, you can analyse it through the lens of whatever competitive advantage you're trying to achieve.

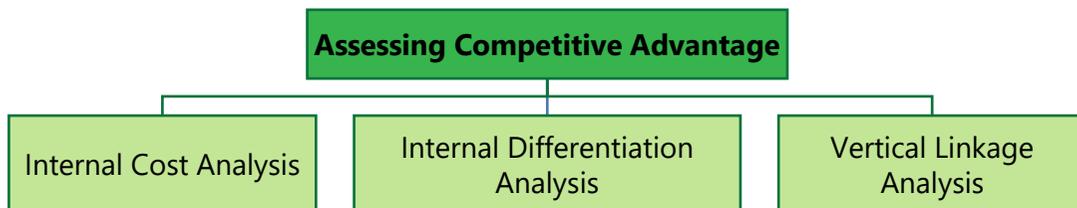


Figure B.4 – Analysis for Assessing Competitive Advantage

Internal Cost Analysis helps in understanding the cost of processes/ activities and identifying the sources of profitability. The steps are as follows –

- Identify the firm's value creating processes.
- Determine the portion of the total cost of the product attributed to each value creating process.
- Identify the cost driver for each process.
- Identify the link between processes.
- Evaluate the opportunities for achieving a relative cost advantage.

To illustrate

If your primary goal is to **reduce your firm's costs**, you should evaluate each piece of your value chain through the lens of reducing expenses.

- Which steps could be more efficient?
- Are there any that don't create significant value and could be outsourced or eliminated to substantially reduce costs?

Internal Differentiation Analysis helps in creating and offering superior differentiation to customers. In order to increase the value perceived by customer, the following steps are to be performed –

- Identify the customer's value creating process.
- Evaluate differentiation strategies for enhancing customer value.
- Determine the best sustainable differentiation strategies.

To illustrate

If primary goal is to **achieve product differentiation**, you should evaluate each piece of your value chain through the lens of–

- Which parts of your value chain offer the best opportunity to realize that goal?
- Would the value created justify the investment of additional resources?

Vertical Linkage Analysis – Creating an extendable organisation by extending the value chain across the firms of suppliers and users.

Using value chain analysis, you can uncover several opportunities for your firm, which can prove difficult to prioritize. It's typically best to begin with improvements that take the least effort but offer the greatest return on investment.

We already discussed in the previous section of this chapter that Value Chain Analysis (three steps explained above) requires a **strategic framework** that can collect a variety of strategic information that will be used while performing the above three steps (especially the third one). Three essential analyses to collect such strategic information are –

- ❑ Industry Structure Analysis – to determine industry profitability and the basis of competition.
- ❑ Core Competencies Analysis – to determine whether organisation possess the desired key success factors.
- ❑ Segmentation Analysis – to understand customers and markets.

📖 **Note** - These three analyses are discussed in detail in an upcoming section of this chapter.

📖 **Note** - Value Chain as a Model, along with how an organisation uses value chain to gain and sustain competitive advantage (desired performance), is discussed in detail under heading 2 in the Chapter, An Introduction to Strategic Performance Management.

For creating a sustainable competitive advantage, in depth analysis of **Value Propositions** is essential, for which **Osterwalder's Business Model Canvas** can be helpful. But prior to move on to **Osterwalder's Business Model Canvas**, it is important to consider what a business model is or what consists of.

2. Business Model

A business model explains how a business works and the economic logic behind it. It is a way of representing and communicating how an organisation creates values for itself while delivering products or services to customers.

Margretta proposed that a business model should include all the activities associated with two key components –

- a. Producing or making something.
- b. Selling something.

But in 2008, Johnson along with Christensen & Kaggerman¹⁷ extended the scope and proposed that a business model also needs a **value proposition**; a business model should contain three components –

- a. Customer value proposition.
- b. Profit formula.
- c. Key resources and processes.

Around 5 years later, in May 2013, Alexander Osterwalder further extended the scope and coverage of business model by suggesting the Business Model Canvas, discussed in detail ahead.

¹⁷ Johnson M, Christensen C, & Kaggerman H, 2008, 'Reinventing your business model', *Harvard Business Review*, December, www.innosight.com/insight/reinventing-your-business-model-form.

3. Osterwalder's Business Model Canvas

Alexander Osterwalder¹⁸ proposed a **nine-element business model canvas** wherein four elements pertaining to cost (key partners, key activities, key resources, and cost structure; on the left side of the canvas) are connected to another four elements pertaining to revenue (customer relationships, channels, customer segments, and revenue streams; on the right side of the canvas) through the ninth element, which is **value proposition**, as shown in figure B.5.

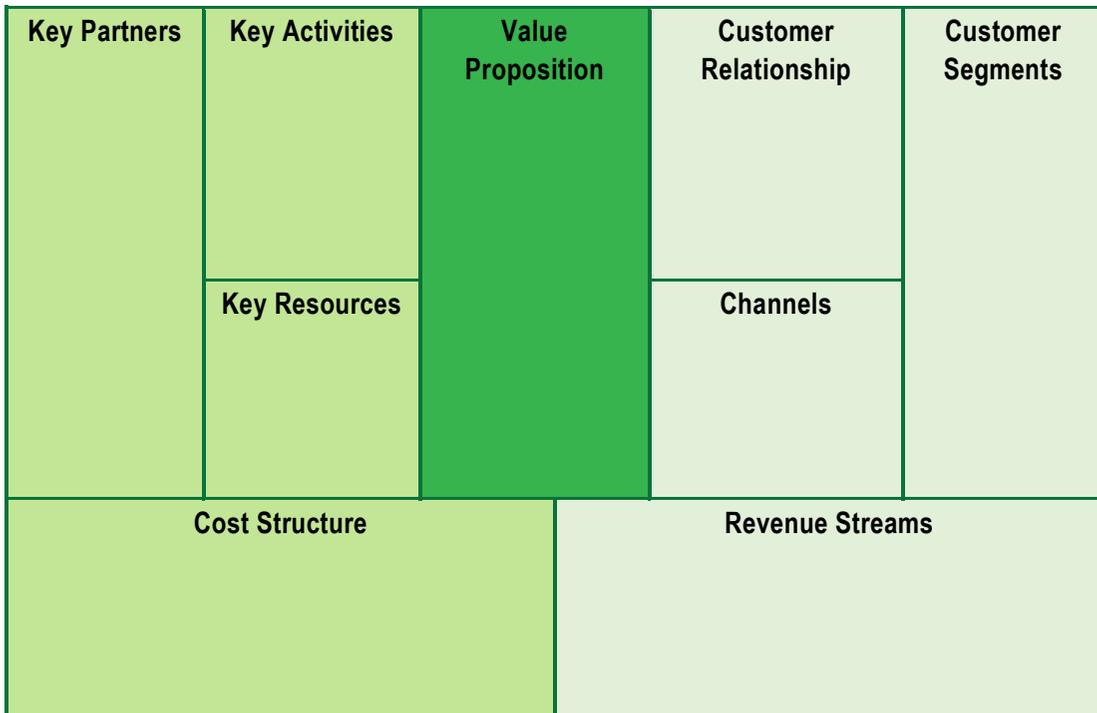


Figure B.5 – Generic Template of Business Model Canvas

Business Model Canvas helps the firm to map, discuss, design, and develop robust business models. Business Model Canvas helps users visualize what is important and forces them to address key areas that are relevant from the point of view of strategy as well as performance.

- a. **Customer Segments** describe who the customers of a business are and why they buy from it. Segmentation is discussed in detail in the next section of this chapter.
- b. **Value Proposition** deals with **products or services** that business offers to target customer segment in order to solve their problems or satisfy their needs.

¹⁸ Osterwalder, (May 2013), 'A better way to think about your business model', Harvard Business Review, May, <https://hbr.org/2013/05/a-better-way-to-think-about-yo>.

To illustrate– A camera, printer, photocopier, and scanner manufacturer is selling camera by emphasising on the point that it helps the users to capture beautiful moments, while the range of printers, scanners, and photocopiers that it offers help users experience ease in dematerialisation/ materialisation (conversion of physical content/ data into digital forms and reconversion thereof), digitation, and duplication (replica). Hence, value propositions include creating/ capturing memories, keeping and retrieving records.

Business's value proposition shall be oriented to customers' needs and problems, not its capabilities. In 11th grade your school and teacher taught you bookkeeping, despite the fact that they are capable of teaching analysis of financial statements or even accounting for virtual digital assets, or any other advanced topic on said day.

Certain automobile or e-vehicle manufacturers can manufacture cars that have auto-pilot mode; are there enough customers who really want such a car?

Cars from certain premium brands have top speed ranging from 340-325 kmph; do drivers/ passengers actually require this, especially in the context of road infrastructure?

- c. **Channels** deal with distribution channels using which businesses will deliver the product or render services to their customers. Earlier, there were only physical channels, but now virtual or digital channels such as the web, cellular (mobile), and cloud, etc. have come into existence.

To illustrate– Digital products such as anti-virus software and subscriptions to some websites are delivered digitally rather than through physical mode.

- d. **Customer Relationship** deal with interactions. It basically answers how we get the customers, keep them, and grow them. Customer Relationship Management came into the play here.

To illustrate– some businesses send promotional content (a push mode of communication with customers), other do not (a pull mode of communication with customer). Mobile App based business model using notification as a mean to keep engaging their customer, because engaging customers is important in order to retain them.

- e. **Revenue Streams** describe how business actually make money. It depends on what value the customer is paying for. Here, the strategy to capture the value becomes significant; it may be a direct sale, transaction based price (use and pay, i.e., post-paid telephone bill, electricity), freemium, license, or subscription model.

To illustrate– Online video sharing and social media platforms earn through advertisement and premium services as they follow a freemium as revenue model. Revenue Models will be discussed in detail in the upcoming chapters of this course. E-newspapers use a subscription model.

- f. **Key Resources** describe the most important assets in the business that are nearly indispensable; they can be man, material, machine, method, money, etc. The need is to dig down and identify what is actually driving the business.

Key resources are critical in planning, budgeting, and determining the activity level. In the same case, these may be Key factor (or limiting factor).

- g. Key partners** include suppliers and channel partners who make the business model work. Here, it is important to consider What resources we acquire from them - are those resources key resources? and What activities they are performing for us as business - are these activities key activities or not? This element also defines the need for strategic alliances and partnerships that a company needs to enter.
- h. Key activities** describe the most important things to do in a business or to keep it running or working. Here, the need is to define whether the business is a manufacturing solution (production), supply chain partner (trader or only a logistic partner), or a problem solving (service entity).
- Key activities become the basis for the determination of cost drivers for absorbing the cost of supporting activities.*
- i. Cost includes** the expenses to operate the business and perform **activities**, hosting **partners**, and owning the **resources**. Here the active role of the management accountant comes into play in determining the **cost structure** and evaluating the **scope as well as scale of economics**. What are the most important costs that require management? What are the most expensive resources that require control?

3.1 How to draw Business Model Canvas

By answering the questions written next to each element in figure B.6, a business can draw its business model on a single piece of paper, irrespective of whether it is a mere start-up or a grand old company.

| | | | | |
|---|---|--|---|--|
| 8. Key Partners Who are our partners and key suppliers? Which key resources are we acquiring from our partners? Which key activities do partners perform? | 6. Key Activities What uniquely strategic things does the business do to deliver its proposition? | 2. Value Proposition What's compelling about the proposition? Why do customers buy, use? | 4. Customer Relationship How do you interact with the customer throughout their journey? | 1. Customer Segment Who are the customers? What do they think? See? Feel? Do? |
| | 7. Key Resources What unique strategic assets must the business have to compete? | | 3. Channels How are these propositions promoted, sold, and delivered? Why? Is it working? | |
| 9. Cost Structure What are the business's major cost drivers? How are they linked to revenue? | | 5. Revenue Streams How does the business earn revenue from the value propositions? | | |

Figure B.6 – Questions to answer while drawing a Business Model



Do You Know?

How to use Business Model Canvas?

- Element 1, 2, 3, and 4 in figure B.6 are attributed to customers focus (which can be correlated with the value proposition canvas, i.e., heading 4 of the upcoming topic).
- Element 6, 7, and 8 in figure B.6 are attributed to infrastructure.
- Element 5 and 9 in figure B.6 signify financial viability.

3.2 Industry Insight

Figures B.7 and B.8 shows the generic business model of any entity operating as an Online Meeting Platform or a manufacturer & trader of Razor and Blades, respectively.

| | | | | |
|---|---|--|--|---|
| Key Partners Payment partners Telco partners Distribution partners | Key Activities Software and app development | Value Proposition Free video calling cheaper than a phone (cellular) | Customer Relationship Mass customer base, hence casual | Customer Segment Web users globally |
| | Key Resources Software and developers | | Channels Skype.com | |
| Cost Structure Software development; Resolving complaints and debugging the technical snags | | | Revenue Streams Prepaid or subscription | |

Figure B.7 - Generic Business Model of any Online Meeting Platform

| | | | | |
|--|---|---|--|---|
| Key Partners Manufacturer Retailer | Key Activities Marketing and selling apart from R&D | Value Proposition Razor handle and stainless blades Adjustable, twin blade shaving razors with lubricating Aloe Vera strip | Customer Relationship Lock in (retain) | Customer Segment Mass user base |
| | Key Resources Brand Value Patents and trademark | | Channels Retails store (through stockist and wholesaler) | |
| Cost Structure R&D Manufacturing cost Marketing and selling cost Logistics cost | | | Revenue Streams Blade replacement for the razor Multiple piece value saver pack | |

Figure B.8 - Generic Business Model of any entity operating as a manufacturer & trader of Razor and Blades

4. Value Proposition Canvas

Value Proposition describes the benefits that customers can expect from a product and the bundle of products and services that business offer to specific customer segment to create value.

The value proposition canvas¹⁹ is the tool that will help the organisation **to design, test, build, and manage the great customer value propositions**. It's like a **plugin** for the business model canvas.

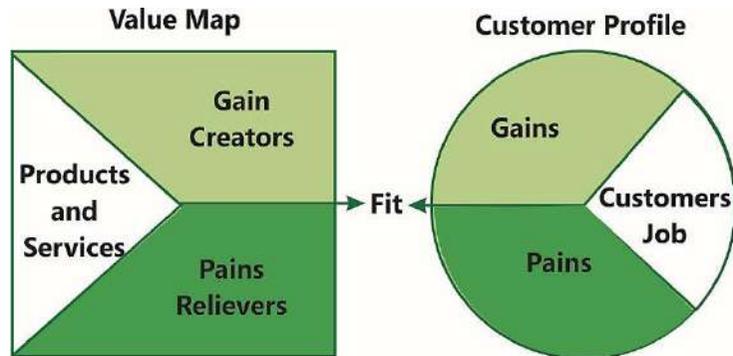


Figure B.9 – Value Proposition Canvas

The tool is based upon two elements of the business model, i.e., the **customer segment** for whom the business firm intends to create the value and the **value proposition** (value proposition map) that will attract customers to the business. With a value proposition canvas, a business firm can **map out** both of these (customer segment and value proposition) with more granularity and **show the fit** between what it offers and what customers want.

4.1 Customer Segment Profile

The customer segment profile describes the characteristics of the business's customers in more detail. The profile is composed of three elements: first, the **jobs** (termed as 'Customer Jobs') that customers are trying to get done in their service or product; second, the related **pains**, i.e., aspects outlining the negative aspects that customers hate or like to avoid; and third, the **gains**, i.e., aspects describing the positive outcomes or benefits that your customers desire to have.

4.1.1 Customer Jobs describes the important issues that business' customers are trying to solve/resolve in their work; it could be their needs that they wish to satisfy or a task that they try to perform and complete in their lives (professional and personal) or at work.

To illustrate, Matrimonial services, legal advice, a specially designed shoe for an internationally recognised player, construction of the house (safety, look, and comfort can be major concerns), ordering food with specifications, face mask/ PPE Kit to protect from specific viruses etc.

¹⁹ By Alexander Osterwalder, Yves Pigneur, Gregory Bernarda, Alan Smith in Value Proposition Design - How to Create Products and Services Customers Want (2014)

Mind it, customers include industrial customers, and jobs can have functional, social, or emotional/personal intent. Some jobs may be crucial to customers, while others may be trivial. To illustrate, an e-vehicle manufacturer seeking specially designed assembly from its vendor for electronic vehicle, message over the birthday cake ordered, and the seasoning and toppings of pizza you just ordered are crucial aspects.

4.1.2 Pains describes anything that annoys the customer before, during, or after getting a job done. This could be unwanted cost, situation, negative emotion, or even risks. Obviously, some of the customer's pains will be severe, while others are mild.

4.1.3 Gains describe the outcome or benefits that the customer requires, expects, or desires, as well as a complementary benefit that he doesn't expect, but will be excited about or surprised by if he gets it. This includes things like functional utilities, social gains, positive emotion, and cost savings. Obviously, some of the benefits will be more relevant to customers than others.

These three elements of the profile describe the customer characteristics that you can observe in the market.



Concept Insight

A clear and concrete description of pains and gains is essential key to offer a better value proposition.

To clearly differentiate jobs, pains, and gains, describe them as concretely as possible. For example, when a customer says, "Waiting in line was a waste of time," ask after how many minutes exactly it began to feel like wasted time. That way, you can note "wasting more than x minutes standing in line." When you understand how exactly customers measure pain severity, you can design better pain relievers in your value proposition.

Ranking jobs, pains, and gains is essential.

Although individual customer preferences vary, you need to get a sense of customer priorities. Investigate which jobs the majority consider important or insignificant. Find out which pains they find extreme versus merely moderate. Learn which gains they find essential, and which are simply nice to have.

Ranking jobs, pains, and gains is essential in order to design value propositions that address things customers really care about. Of course, it's difficult to unearth what really matters to customers, but your understanding will improve with every customer interaction and experiment.

It doesn't matter if you start out with a ranking that is based on what you think is important to your potential customers, as long as you strive to test that ranking until it truly reflects priorities from the customer's perspective.

4.2 Value Proposition Map

A value proposition map describes the features of a business's value proposition that it has designed to address its customers' jobs (through products and services), pains (through pain relievers); and gains (through gain creators). Hence, a value proposition map is composed of the three elements: firstly, the **product and services** around which your value proposition is built; secondly, the **pain relievers** that outlines how the business's products and services alleviate the customers' pains;

thirdly, the **gain creators** describe the positive outcomes and benefits that business's products and services create for your customers.

4.2.1 Products and Services outlines the bundle of products and services that the business is offering to its customers to help them get a functional, social, or emotional / personal job done and to address their pains and gains in the process.

4.2.2 Pain Relievers explicates how your products and services will alleviate specific customer pains before, while, and after the customer tries to get the job done. Pain relievers show or highlight which of all the customers' pains are addressed by the value proposition by either eliminating or reducing them.

4.2.3 Gain Creators describes how products and services offered by business create customer gains. Gain creators show which of all the customers' gains are addressed by the value proposition by creating benefits and outcomes.



Do You Know?

Can you list the elements that can contribute to customer value creation (act as either pain reliever or gain creator)?

- Newness - Some Value Propositions satisfy an entirely new set of needs that customers previously didn't perceive because there was no similar offering. Cell phones, for instance, created a whole new industry around mobile telecommunication.
- Performance - Improving product or service performance has traditionally been a common way to create value.
- Customization - Tailoring products and services to the specific needs of individual customers or customer segments creates value.
- Design - A product may stand out because of superior design. Design is a major element in determining the cost. Design not only of the product but also of the process and service through which that product is manufactured and sold.
- Brand/status - Customers may find value in the simple act of using and displaying a specific brand.
- Price - Offering similar value at a lower price is a common way to satisfy the needs of price-sensitive customer segments.
- Cost reduction - Helping customers reduce costs is an important way to create value.
- Risk reduction - Customers value reducing the risks they incur when purchasing products or services.
- Accessibility - Making products and services available to customers who previously lacked access to them is another way to create value.
- Convenience/ usability - Making things more convenient or easier to use can create substantial value.

Mind it, the above list is non-exhaustive in nature.

Business is said to achieve a **problem-solution fit** when the features of its value proposition map perfectly match the characteristics of customer segment profile. When the market validates this match and the business value proposition gets traction with real customers, the business has achieved the **product-market fit**.

It is worth noting that successful and sustainable businesses have more than just great value propositions; they also have a great business model that makes a great customer value proposition possible.



Do You Know?

What are the key questions that businesses are supposed to ask while defining its value proposition or working on its value proposition canvas?

- What value do we deliver to the customer?
- Which one of our customers' problems are we helping to solve?
- Which job are we helping the customer get done?
- Which customer needs are we satisfying?
- What bundles of products and services are we offering to each customer segment?

To conclude, the Value Proposition Canvas has two sides. With the customer profile, business can have a clear understanding of customer character. With the value map, business describes how it intends to create value for that customer. Business achieve Fit between the two when one meets the other.



C. EXTERNAL ENVIRONMENT CONTEXT

Survival and sustainability are precondition for any business to be successful. The survival of the fittest (fittest to the business environment in which the business operates) is a universal principle; hence, the need for crafting and deploying agile strategies (capable of responding and adapting to the changes that are taking place in and around it) becomes inevitable; therefore, it becomes essential to understand the business environment. Earlier in this chapter, we recognised the need to analyse the business environment for the purpose of developing and implementing the strategy. Here we will consider the requirement in a specific context of the external environment, which has a subset of remote and industry operative environment.

External environment, comprising the factors that are beyond the control of organisation (outside organisation boundary) but have influences on the organisation, its performance, and its strategic positions.

Prior to starting with external environment analysis, it is essential for business firms to define the industry in which they are operating and set out the dimensions of the remote and industry operative environment.

An **industry** is a group of companies that are relatively comparable based on their **primary business activities**, or it can be seen as a group of organisations or business units participating in similar economic or commercial activities and producing similar products or services. Here, it is important to note that there is no single universally acceptable definition of industry. Further, what industry will consist of depends upon the width and depth of the business firm.

To illustrate, when a fast-food retail chain started its operations in the USA, its industry analysis was reserved only up till the customers and fast-food chains (competitors and rivals) operating in the USA. The moment it decides to go beyond borders (continents Asia, Europe, Australia, etc.), the scope of industry has been changed, and now the factors of those continents or countries also become relevant while making decisions or crafting strategies.

Hence, any single economic definition of industry can't be relied on here; business organisations, in light of the competitive market in which they operate need to come up with their own concept of industry.

To illustrate, A two-wheeler riding app-based transport company may not consider a four wheeler riding app-based transport company as its competitors; hence, scope of the industry may be restricted to the other two wheeler ride provider only (where power to substitute (perfect substitute) exists), but reciprocally, it may be possible that a four wheeler riding app based transport company also consider a two-wheeler riding app based transport company as its competitor while performing industry analysis.

Therefore, the scope of industry (definition with narrow or wide inclusions) is a subjective issue. Narrow scope may make analysis more manageable, but exclusion of relevant substitutes or disruptive influences may make it meaningless, whereas a wide scope of industry can ensure more relevance and utility but will be more resource consuming and complex. Cost benefit analysis came into play here.

For further analysis, the external environment is usually broken down into two sub-sets: called the **remote environment** and the **industry operating environment**, including the competitive environment.

The element of **remote environment**, such as **social, technological, economic, environmental, political, legal, and ethical factors (STEEPLE)**, comprises factors that originate beyond (and usually irrespective of) any single firm's operating situation. Remote environment presents firms with opportunities, threats, and constraints, but rarely does a single firm exert any meaningful reciprocal influence.

By working systematically through each of the elements of the remote environment, business should have a comprehensive list of factors that have shaped the historical growth of the industry and are likely to affect the future growth of the industry.

Illustration – Due to technological advancement, the cellular phone changed dramatically from a QWERTY keypad-based handset to a smart phone (touch screen phones with better battery backup and function like internet connectivity, a camera etc.). A cellular phone manufacturer that was once the market leader and held a substantial percentage of market share failed to respond to the changing technology, hence being replaced by an emerging brand that later occupied the position of market leader. Hence, remote environment is beyond the control of single firm operating in the industry. The same factor (technology in this case) brings threat to one and opportunity to the other.



Concept Insight

Industry analysis was conventionally performed using the **PEST** Framework, i.e., Political, Economic, Social, and Technology, but this approach has evolved to reflect the dynamics of the business environment, to **PESTEL** with the addition of environmental and legal issues, and now to **STEEPLE** with the addition of ethical aspects.

Further, as part of the analysis of the **industry's operating environment** (including the competitive environment), it is important to consider all the factors (within the particular industry) that affect **industry profitability** as well as the **competitive position** of business organisations within it. These factors can be grouped into elements such as customers, competitors (as well as potential entrants), suppliers, advocacy groups, regulations, regulatory groups, and many other elements such as the industry life cycle, supplier's suppliers, and buyer's buyers, etc. Basically, it considers the wider picture through factors that are capable of **determining the growth trajectory in addition to future profitability**.

Hence, further in this section, we will consider the forces that determine the profitability of industry, the basis of competition and key success factors that can help business organisations gain a competitive advantage, apart from understanding how customers and markets behave and related aspects thereto in the context of the external environment.

1. Industry Profitability

Michael E. Porter²⁰ suggests five force model to assess the **intensity of industry competition**. Industry structure (or environment) analysis highlights the profitability potential of any industry using Porter's five forces model. A higher intensity of competition results in lower potential profitability, and vice versa. The five forces that are enumerated by this model are pictured below –

²⁰ In 1980, in his book *Competitive Strategy - Techniques for analysing industries and competitors*

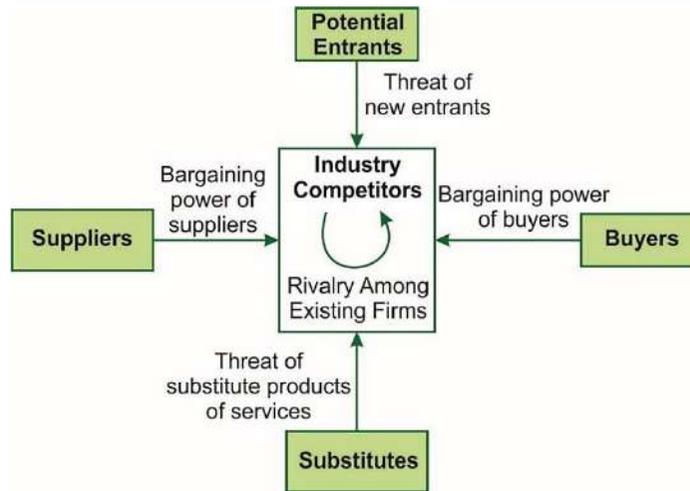


Figure C.1 - Forces Driving Industry Competition²¹

Competition in an industry continually works to drive down the rate of return on invested capital toward the competitive floor rate of return, or the return that would be earned by the economist's "perfectly competitive" industry. This competitive floor, or "free market" return, is approximated by the yield on long-term government securities adjusted upward by the risk of capital loss.

1.1 Bargaining Power of Buyers

Bargaining power of buyers determines their ability to dictate terms, including price. Bargaining power will be high if the cost of switching supplier is low, buyers are few and buyers buy in high volume from small suppliers. High bargaining power may lead to low prices or high costs, hence resulting in a low margin. A buyer group is powerful if the following circumstances hold true:

- It is concentrated or purchases large volumes relative to seller sales.
- The products it purchases from the industry represent a significant fraction of the buyer's costs or purchases.
- The products it purchases from the industry are standard or undifferentiated. Moreover, the industry's product is unimportant to the quality of the buyers' products or services.
- The buyer has full information. It faces few switching costs.

To illustrate - Bargaining power of buyers in the 'airline' industry is high. Customers are able to check the prices of different airline companies quickly through the many online price comparison websites. In addition, there aren't any switching costs involved in the process.

²¹ Figure 1-1 at p.4 of Competitive Strategy - Techniques for analysing industries and competitors (1980) by Michael E Porter

1.2 Bargaining Power of Suppliers

Bargaining power of suppliers determines the cost and quality of input. Bargaining power is higher if a replacement or alternate is not available. A supplier group is powerful if the following apply:

- It is dominated by a few companies and is more concentrated than the industry it sells to.
- It is not obliged to contend with other substitute products for sale to the industry.
- The industry is not an important customer of the supplier group.
- The suppliers' product is an important input to the buyer's business.
- The supplier group's products are differentiated, or it has built up switching costs.

To illustrate - The bargaining power of suppliers in the 'airline' industry can be considered very high. When looking at the major inputs that airline companies need, we see that they are especially dependent on fuel and aircrafts.

1.3 Threat of Substitute Products or Services

Threat of substitute may cause a loss of revenue (top-line) or an increased cost of retention. Threat will be high if the substitute is perfect in nature and cheaper. Substitute can be from different segment and different industry. Switching cost and the perceived level of product differentiation are also relevant here.

To illustrate - In terms of the 'airline' industry, it can be said that the general need of its customers is traveling. It may be clear that there are many alternatives to traveling besides going by airplane. Depending on the urgency and distance, customers could take the train or go by car. People in East Asia (also in Southeast Asia) prefer to use high speed trains, even for long distance.

1.4 Threat of New Entrants

New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources. Hence, the threat of new entrants may damage market share if materialise. The degree of threat depends on the barrier to entry coupled with the reaction from existing competitors that the entrant can expect, apart from perceived profitability. The major sources of barriers to entry are economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, government policy, etc.

To illustrate - The threat of new entrants in the 'airline' industry can be considered low to medium. It takes quite some upfront investment to start an airline company, especially in purchasing aircraft. New entrants also need licenses, insurance, and access to distribution channels, which are not easy to have or get when you are new to the industry.

1.5 Rivalry among Existing Firms

Rivalry occurs because one or more competitors either feel the pressure or see the opportunity to improve their position. Competitive moves by one firm generally have effects on its competitors and thus may incite retaliation or efforts to counter the move; that shows firms are mutually dependent. This pattern of action and reaction may or may not leave the initiating firm and the industry as a whole better off. If moves and countermoves escalate, then all firms in the industry may suffer and be worse off than before. Intensity of competition/ rivalry will determine the effect on profitability or market share. Competition will be stiffer if the number of firms increases, extra capacity exists, products are homogenous, fixed costs are high and exit barriers are also high.

To illustrate – As far as the Indian ‘Airline’ business is concerned, the industry is extremely competitive because of a number of reasons, which include the entry of low-cost carriers, tight regulation leading to high fixed costs, and high barriers to exit. As the same time, the switching cost is low or nil for passenger; hence, rivalry becomes more intensive and stiffer. The passenger market share in the Indian aviation industry in Jan 2015 and Oct 2022 is given below for reference–

| Airline | January 2015 Total 6.2 million passengers carried during Jan 2015 | October 2022 Total 11.4 million passengers carried during Oct 2022 |
|----------------|---|--|
| Air India | 18.7% | 9.1% |
| Vistara | 0.2% | 9.2% |
| Air Asia India | 1.3% | 7.6% |
| IndiGo | 36.4% | 56.7% |
| Spice jet | 9.4% | 7.3% |
| Jet Air | 19.6% | - |
| Go Air | 8.9% | - |
| Jet Lite | 4.5% | - |
| Go First | - | 7% |
| Alliance Air | - | 1.3% |

Source: Indian Express Dated 4th December 2023 p.13 Economy



Concept Insight

Interconnectedness of Barriers (Exit Barriers and Entry Barriers) and Profitability- Although exit barriers and entry barriers are conceptually different, their joint level is an important aspect of the analysis of an industry. Often, exit and entry barriers are related. Substantial economies of scale in production, for example, are usually associated with specialized assets, as is the presence of proprietary technology. Taking the simplified case in which exit and entry barriers can be either high or low, refer to Figure C.2.

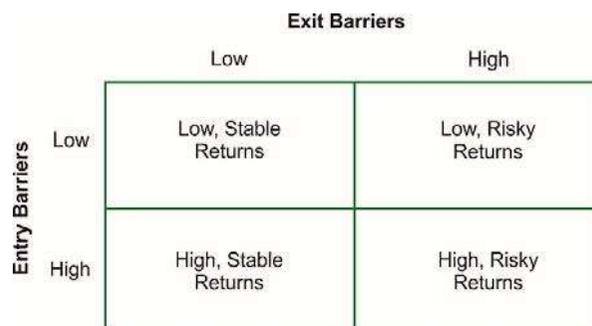


Figure C.2 – Barriers and Profitability

All five competitive forces jointly determine the intensity of industry competition and profitability, and the strongest force or forces govern and become crucial from the point of view of strategy formulation.

To illustrate, even a company with a very strong market position in an industry where potential entrants pose no threat will earn low returns if it faces a superior, lower-cost substitute. Even with no substitutes and blocked entry, intense rivalry among existing competitors will limit potential returns.

The five forces enumerated by Porter's five force model are constantly changing, which makes the model a dynamic analytical tool.

Porter's Five Forces is a good starting point to evaluate an industry but should not be used in isolation. You could, for example, combine it with a Value Chain Analysis or through the VRIO framework in order to get a better sense of where your company's competitive advantage is coming from and to better position your company among rivals. Moreover, Porter's Five Forces is often combined with the STEEPLE analysis to give a good overview of the organization's environment.

 **Note** – Students are advised to refer to the Annexure which contains a list of Porter's Five Forces factors.

2. Understanding Customers and Markets

After assessing the profitability and growth potential of an industry, the industry analysis extends to developing an understanding of customers and markets. The need and importance of understanding customers and markets as well as segments thereof is inevitable because, for a business firm, it is not always beneficial to be operative in all segments of the market. A strategic choice can be made to decide in which segment the firm will operate. Hence, segmentation analysis is relied upon to identify the primary area of operations.

2.1 Market, Market Segment and Market Segmentation Analysis

2.1.1 Market

Market consists of the business firm that is selling the product or rendering the services in addition to the buyer who is buying/ hiring them. Market can be physical (where brick and mortar stores exist) or virtual (based on an e-platform). There may be many sellers and buyers, or only a handful. Market also includes potential buyers.

2.1.2 Segment or Market Segment

A **market segment** is a category of customers who have similar likes and dislikes in an otherwise homogeneous market. In order to be recognised as a segment, the following **criteria** must be satisfied–

- The segment should be **homogeneous internally** in terms of constituents (which may be their demographic character, behaviour, trait, or any other basis of segmentation).

To illustrate, Fabric or readymade clothing firms have kid/ children's ranges in addition to male and female collections. These segments are homogeneous internally; for the first segmentation, age is the basis, whereas for the later two, gender is the basis; all three segments are demographic in nature.

- The segments should be **heterogeneous externally** in terms of other segments. Each segment must be different from the others.

To illustrate, Passenger vehicles and commercial vehicles for automobile companies. Now electronic vehicles are also seen as entirely separate segment. In the given example, all the segments are heterogeneous externally based upon the user (or purpose of use) and source of energy/ power (fuel vs. electricity).

- Segment shall be clearly **identifiable**. A business firm must be able to distinguish between group members and non-group members. The characteristics of group members due to which they fall under a particular segment shall be consistent. The basis of segmentation should be strong enough to make identification easy.
- Segment **size shall be reasonable, if not substantial**, at least of sufficient size so that specific marketing efforts can be made considering potential profitability. Mind it, any size can be considered reasonable, if it can be operated profitably.

To illustrate, most of the companies that adopt the focus strategy or offer limited edition products are still able to operate profitably despite having a small number of target customers.

- A segment must be **responsive** in the sense that it must respond / react to marketing offerings.



Do You Know?

What benefits Market Segmentation provides?

Benefits of market segments includes create stronger marketing messages, identify the most effective marketing tactics, design hyper-targeted ads, attract (and convert) quality leads, differentiate your brand from competitors, build deeper customer affinity, identify niche market opportunities, stay focused.

2.1.3 Segmentation Analysis or Market Segmentation Analysis

Market segmentation is the process of dividing a broad target customer base or business market into small but more defined sub-groups of customers based on some type of shared characteristics, such as demographics, interests, needs, or location.

We already learned in the previous section of this chapter that Value Proposition Canvas is helpful in observing the customer's characteristics, and those characteristics can be used as the basis of segmentation for effective market segmentation.

2.2 Basis of Segmentation

2.2.1 Product segmentation deals with grouping the customer based upon the different products/ assemblies in which the firm deals or features thereof.

To illustrate, automobile industry operates in different **product** segments such as compact, wagon, sedan, and SUVs (product); segmentation can be done based upon the feature of products such as commercial or passenger vehicles; also, based upon fuel-based vehicles or electronic vehicles.

2.2.2 Demographic segmentation relies on the characters such as Age, Gender, Family Situation, Education, and Ethnicity to group the customers.

To illustrate, services that are person oriented and of personal use, such as hair salons and products to be used as personal effects, such as apparel and accessories, usually undergo segmentation based upon demographic characters.

2.2.3 Psychographic segmentation is based on factors such as Personality traits, Values, Attitudes, Interests, Lifestyles, Influences, Subconscious and Conscious Beliefs, Motivations, and Priorities.

To illustrate Airline companies, offer travel in three classes, i.e., economy, business and first class; builders can also do psychographic segmentation based upon **lifestyles** (in addition to income that effects lifestyle, i.e., Low Income Group, Middle Income Group or Higher Income Group to offer LIG or MIG flats, so on and so forth).

2.2.4 Behavioural segmentation using characteristics such as purchasing habits, spending habits, status, and brand interactions for grouping the customer base into segments.

To illustrate, E-commerce platforms such as Flipkart differentiate their plus/ prime members from others (based upon purchasing **habits**, i.e., quantum and frequency); Clubs used to offer silver, gold, prime, premium, and platinum memberships (based upon spending **habits/ slabs**).

2.2.5 Geographic segmentation is based upon the ZIP Code, City, Country, Climate, Urbanity or Rurality of Customers.

Although STP (segmentation, targeting, and positioning) is a marketing approach where business segment, target the best-fit audience segments for their product, and position their product to capture their target segment effectively, it has substantial strategic context and substantial cost implications.

It is commonly observed that non-marketers in business organisation are often stick to what the organisation can produce and are not ready to consider what customers actually want. This attitude becomes a focal shortcoming in planning and executing strategies pertaining to segmentation, targeting, and positioning. All leaders and managers in the organisation need a thorough **understanding of customer needs** and **what drives demand**, as it is critical in designing strategies and developing capabilities to meet those needs. To understand what drives demand, the basis of competition needs to be decoded.

3. Basis of Competition

Competition is a situation where two or more people or organizations are trying to achieve, obtain, etc. the same thing or to be better than somebody else. The competition can be natural or strategic.

Natural competition arises in the process of evolution and refers to the survival of the fittest, as stated at the beginning of this section. Natural competition forced the weaker rivals to exit the market or collapse in search of survival; only those able to sustain themselves either adapt to the change, counter the change, or make the change. Whereas strategic competition deals with the deployment of resources based on a high degree of insight into a business system.

The basis of competition is the **reason why customers of particular business choose it over its competitor**. It can be a product, feature, function, style, availability, or a host of other things. Once a business is done with the industry analysis and has also developed an understanding of the market and customer, it may be able to identify **what exactly drives demand, choice, price, and cost**; assess the current and potential risks that may affect future developments in the industry; and discover what underpins sustainable competitive advantage.



Do You Know?

Determining the basis of competition may involve asking certain questions, such as -

- What drives *demand* for the products and services of the industry?
- How does the customer make a *choice* as to price, feature, and quality of the product?
- How is *price* determined in the industry?
- What are the main drivers of *costs* in the industry?
- What are the *current and potential risks*?

After assessing the competitive forces in a particular industry and determining the basis of competition in the market wherein business operate, it is easy to identify the key success factors (KSFs) to gain a competitive advantage in that industry and also ensure the availability of resources and core competencies involved in KSFs to compete in the market and generate a sustainable competitive advantage.

4. Industry Key Success Factors

There are certain factors in every industry that are critical to the success of any business organisation in **generating** and **sustaining a competitive advantage**. The availability of **resources** and **core-competencies** pertaining to such factors and the strategic use thereof can really help an organisation outperform its peer (or competitor) in its target market. Such factors are called Key Success Factors (sometimes called **Critical Success Factors** i.e., CSFs). In effect, it articulates what the company must do, and do well, to achieve the goals outlined in its strategic plan. Examples would include agility, reliability, diversity, and emotional connection with clients.

Further, with each CSFs, **Key Performance Indicators** (KPIs) are attached to measure the performance of the business organisation regarding said CSF.

To illustrate, cycle time is a critical or key success factor in many businesses, lead time or run time shall be attached as a KPI to the CSF of time.

Key success factors are one of three elements a company's management team must articulate as part of its strategic planning process, with the others being its strategic goals and its strategic scope.

Under a dynamic business environment, with the passage of time, Key Success Factors may change; therefore, the discourse of that market or industry may change, hence, business firms need to be aware of the changes (in assessing them, adapting them, or responding to them) and periodically re-assess the CSFs.

To illustrate, A cellular phone manufacturer that was market leader at onetime (when critical success factors were reliability and an efficient distribution network) lost its leadership position to an emerging brand when smart phones were launched, and the dynamics of the industry changed because users started considering phones as gizmos for receiving and sending emails, playing music, taking photos, and even searching the internet. Resultantly, R&D, Screen Size, Megapixel of the Camera, etc. become new Key Success Factors.

5. Core-Competencies Analysis

Core Competency is a unique preposition that helps a firm stand out in the industry by providing value to its customers. Core Competency leads to either cost leadership or product differentiation, which are the primary sources for a firm to gain a competitive advantage.

Prahalad and Hamel²² suggest that "Core Competences" are some of the most important sources of uniqueness: these are the things that a company can do uniquely well and that no one else can copy quickly enough to affect competition.

Prahalad and Hamel used examples of slow-growing and now-forgotten mega corporations that failed to recognize and capitalize on their strengths. They compared them with star performers of the 1980s (such as Canon and Honda), which had a very clear idea of what they were good at and grew very fast. As they switched efforts away from areas where they were weak and further focused on areas of strength, their products built up more and more of a market lead.



Do You Know?

What can be a source of core competencies?

Core competencies can arise out of-

- Resources – Which firm has, and others don't.
- Capabilities – Ability to coordinate resources and make optimal use of them.

²² C. K. Prahalad and Gary Hamel (1990), "The Core Competence of the Corporation"

5.1 Test of core competency contains three parameters

Relevance – The competence must give your customer something that strongly influences him or her to choose your product or service. If it does not, then it has no effect on your competitive position and is not a core competence.

Difficulty of imitation – The core competence should be difficult to imitate. This allows you to provide products that are better than those of your competition. And because you're continually working to improve these skills, means that you can sustain competitive position.

Breadth of application – It should be something that opens up a good number of potential markets. If it only opens up a few small, niche markets, then success in these markets will not be enough to sustain significant growth.



Do You Know?

How can core competencies be exploited?

- Validate (ensure, establish, and exploit) core competencies in the current business.
- Leverage competencies in the value chains of other existing businesses/ segments.
- Use core competencies to reconfigure the value chains of existing businesses – basically, keep on improving.
- Use core competencies to create new value chains.



D. INFORMATION TECHNOLOGY THE STRATEGIC CONTEXT

The impact of the technology transformation can be seen in pioneering industries such as **music** (digital products are delivered via digital channels), **media** (traditional print news media is already on downward spiral), **retail** (brick and mortar stores are getting replaced with online e-commerce stores, and e-retailer platforms do not own any inventory), and **taxi services** (online ride aggregators are changing the dynamics of traditional taxi services). Signs of similar digital transformation can be seen across most of the industry domains.

Moreover, **data is considered to be new oil**; hence, collecting and processing (in addition to storing and exchanging) data (or **big data**) to **construct useful information** out of it, through **business analytics** or any other means is essential to make **informed decisions** and **strategic choices**; therefore, the use of information technology in a strategic context is inevitable.

There are three concepts that are involved here: Information Technology (IT), Information System (IS), and Information Management (IM). All three are interconnected; but not the same. Information technology techniques are used as part of an information system to manage information. Organisations develop strategies to ensure alignment among these three and an overall organisational strategy.

Information Systems (IS) are collections of multiple information **resources** (e.g., software, hardware, computer system connections, the system housing, system users, and computer system information) to gather, process, store, and disseminate information. **IS strategy** is concerned with **aligning** IS development with business needs and seeking strategic advantage from information technology. It is usually formulated at the same **level as the product/ market strategy for the SBU**. It deals with resource planning to ensure IT layout is put into practice.

Information Management (IM) concerns a cycle of organizational activity, the acquisition of information from one or more sources, the custodianship (role and responsibilities of those who deal with information), and the **distribution of that information** to those who need it, and its ultimate disposal through archiving or deletion. **IM strategy** tries to 'put management into IT' by defining the **role and structure** of the IT activities in the organisation. It is concerned with the management controls for IT, management responsibilities, performance measurement, and management processes. Here, it is decided who can assess the data and who can't. It is formulated at organisation wide level. It deals with control over the layout of IT uses in organisation.

Information Technology (IT) is the use of computers to create, process, store, retrieve, and exchange all kinds of data and information. IT forms part of information and communications technology. An **IT strategy** (information technology strategy) is a comprehensive plan that outlines how technology should be used to meet IT and business goals. It is usually prepared at the **activity level**. It decides the layout of use cases of IT in the organisation.

Michael J. Earl²³ developed a framework to analyse the linkages and distinctions between three interrelated types of strategy: Information systems, Information management, and Information technology.

The linkage expressed by him is summarised in the following table for reference –

| Basis | IS Strategy | IT Strategy | IM Strategy |
|----------------------|----------------------------------|--------------------|-----------------------|
| Resolve (Scope) | What | How | Where |
| Driven Force | Business Driven | Technology Focused | Management Driven |
| Directional | Top-Down | Bottom-up | Multi-directional |
| Orientation | Demand Oriented | Supply Oriented | Relationship Oriented |
| Organisational Level | Division/ SBU/ Function based | Activity based | Organisation wide |

²³ Management Strategies for Information Technology by Michael J. Earl; Prentice Hall, 1989 (Page 63)



Do You Know?

Why are firms supposed to have an IT/ IS strategy?

Apart from having the ability to impact business at all levels, the need to have an IT/ IS strategy is observed due to the –

- They are capable of creating competitive advantages and sustaining them for a long time. The use of IT can help organisations counter the five forces (identified by Michael E. Porter) in a more appropriate manner.
- IT is a dynamic stream; a lot of new technologies in the wake of industry 4.0, like Big Data, IOT, IOS, and Blockchain, are coming into play; businesses can use them to tap new opportunities. To illustrate, Fintech, with the use of technology, revamps the BFSI sector.
- The cost of Information Technology tools and establishing an Information System is high. Most decisions pertaining to IT/ IS involve not only huge investments but are also irreversible in nature. Even a single error or mistake can be risky.
- For better integration across the value chain and supply chain, IT/ IS are essential. For effective value and supply chain flow, information flow is foremost requirement, which can only be assured through the use of IM, for which appropriate IT/ IS strategies are underlying need.
- The use of IT makes change management easy. For efficient change management, the timely and accurate communications are of great importance; hence the strategic context of IT/IS is multi-fold.

Based upon the points discussed so far, one thing that we can conclude is that IT, together with IS and IM, has the potential to transform the business around the corner. Let's see the impact of IT and IS specifically in the case of Michael E. Porter's Five Forces and Value Chain.

1. IT/ IS and Porter's Five Forces

The concept of Porter's Five Forces Model is explained in detail in earlier sections of this chapter. Here we will consider how IT/ IS impact the five forces of the competitive environment in which an organisation operates–

1.1 The Threat of New Entrants

A new firm/s (competitors) can enter the market, posing a threat to existing players because new entrants who enter the market will bring extra capacity and intensify competition. The degree of the threat from new entrants will depend upon the strength of the barriers to entry and the likely response of existing competition to a new entrant.

Hence, an organisation needs to answer, how best can it take care of the threat of new entrants? Information Technology can have two possible roles in counteracting the threat.

1.1.1 Creating barriers (existing players)

Sophisticated IT applications are expensive, take time to develop (imitate), and are technically challenging to understand for new players. Hence, by using IT (especially computer-controlled production), existing players can increase economies of scale by using methods, therefore requiring an investment of similar value from new entrants.

1.1.2 Breaking down the barriers (new entrants)

Information technology can be used as a tool or weapon by new entrants.

To illustrate, in the banking industry, Internet banking, Mobile banking, and the use of Automated teller machines (ATMs) have reduced banking at branches; hence, the cost of establishing branches can be saved by new entrants. In addition, it will be a new sort of distribution channel that is free from the control of existing players.

1.2 Supplier's Bargaining Power

Suppliers have influence over cost (price charged by them), quality, and availability of input; this influence is referred to as bargaining power. The degree of bargaining power of suppliers will be based upon the number of suppliers, availability of substitutes, switching costs, uniqueness of the brand, technical performance, or design not available elsewhere.

Information Technology can be relied upon to identify the new suppliers, and an e-procurement, or tendering system can be adopted so that prevention of cartelisation of suppliers can be ensured. Now-a-days knowledge management or commercial database companies are providing the paid purchases database that enables organisations to identify potential suppliers with easy scanning of prices from a number of suppliers. Business also uses IT to automatically rotate orders between suppliers and compare prices on the internet.

IT is intensively used to make the concept of an integrated supply chain a reality. Strategic or operational alliances are formed with the vendors, and access to ERP is extended to include them as part of the larger supply chain.

1.3 Buyer's Bargaining Power

Buyers (Customers/ Clients) have an influence on the revenue stream of the business organisation. The degree of bargaining power determines the ability of buyers to dictate terms, including price. The degree of bargain power will be high if the cost of switching suppliers is low, buyers are few or buyers buy in high volume from small suppliers. High bargaining power may lead to low prices or high costs, resulting in a low margin.

Information Technology can be used in many ways by business organisation to reduce or counter the bargaining power of buyers. IT may be used to improve customer service, for example, by allowing online ordering.

1.3.1 Customer Data Warehousing and Mining – The large volume of data regarding customer choice, preference, and buying pattern (habit) is collected and stored in a data warehouse to extract the relevant data (from said warehouse) as the source for direct and target marketing drives.

To illustrate, E-retail Platforms suggest on the items based on your purchase history.

1.3.2 Lock the Customer – Information Technology can be used to lock (retain) the customer either by configuring and adjusting the compatibility of product in such a way that spares must be of the same manufacturer (as main/ principal product) or the cost of switching will be too high.

A scheme of rewards, loyalty bonuses, and cash back, etc. may also be relied on to retain customers.

To illustrate, E-retail platforms or apps, even certain retail stores or service providers, offer premium/ plus status to some of their high value customers, giving them privileges and early access of offers. Some of the stores and businesses offer promo discounts on their first (or few initial) orders from their app.

1.4 Threat of Substitutes

Threat of substitute products or services may cause a loss of revenue (topline) or an increased cost of retention. Threat will be high if the substitute is perfect in nature and cheaper. Substitutes can be from different segments and different industries. Switching cost is also relevant here. IT and IS itself substitute for many products.

To illustrate, laser printers are a fast and perfect substitute for dot-matrix printers; Kindle replaces hard cover or paper bound books; and every other technological innovation.

Note - Threat applies both between industries (e.g., rail travel with bus travel and private car) and within an industry (e.g., long-life milk as a substitute for delivered fresh milk).

But technology can also be used to counter the threat of substitutes. The threat from substitutes can be minimised by ensuring that an organisation develops a product before its rivals and then protects that product for a number of years by means of patents. This approach is widely used in the pharmaceutical and biotech industries, where specialist software is now widely used in the drug discovery process, enabling drugs to be developed that target specific human and animal diseases. Basically, firms can use computer-aided design and manufacturing to develop new products first and remain ahead of their competitors.



Practical Insight

Within a couple of years, Google sold Motorola, the iconic handset maker, to Chinese PC maker Lenovo for \$2.91 billion, which it bought for \$12.5 billion. The reason being that Motorola's IPRs and R&Ds have been transferred in Google's favour. Google used that technology or knowledge as a resource to stay ahead of its rival, therefore counter the threat of substitute²⁴.

²⁴ <https://qz.com/172207/why-google-just-sold-motorola-to-lenovo-for-3-billion>

1.5 Competitive Rivalry

All four forces may come together to produce this force. The intensity of competition (if it is really intense, it is called rivalry) will determine the effect on profitability or market share. Competition will be stiff if the number of firms are increases, extra capacity exists, products are homogenous, high fixed costs are high and exit barriers are high.

The most intense rivalry is where the business is more mature, and the growth has slowed down.

All the resources at a company's disposal may be put to use to maintain market shares and sales, including IT resources. Cost leadership can be exploited by IT using JIT, ERP, and MRP, etc., for example, where IT is used to support just-in-time (JIT) systems. IT can also be used for collaborative ventures that make organisation too big to fail or reduce the competitors' move and effect.

To illustrate, A tour and travel business may enter into strategic partnership with a commercial organisation carrying hotel and inn business. IT can also be used for relationship building with clients and customers so that they remain engaged with organisation; this automatically reduces the threat from rivals.

To conclude, business organisations can use IT/ IS to transform business and its aspects to reduce and counter five forces while outperforming their peers or rivals.

2. IT/ IS and the Value Chain

The concept of a Value Chain is explained in detail in earlier sections of this chapter. Here we will consider how IT/ IS impact the value chain.

Value Chain is the sequential chain of activities that leads to the delivery of the final product to the customer; it also depicts how value (utility) accumulates for the customer. It consists of primary activities and secondary activates, and IT/ IS has bearing on each activity in a number of different ways.

2.1 Primary Activities

2.1.1 Inbound logistics deals with receiving, storing, and handling raw material and other inputs (not related with procurement). A barcoding system can be used to automate the warehousing. The concept of a virtual warehouse is also getting recognition, wherein several outlets or stores of an organisation are connected through an information system that indicates the total inventory levels. RFID (radio-frequency identification uses electromagnetic fields to automatically identify and track tags attached to objects; an RFID system consists of a tiny radio transponder, a radio receiver, and a transmitter) can be used to track items in trading concerns throughout the supply chain. MRP and ERP can be used as information system for resource planning, whereas JIT can be used for stock control.

2.1.2 Operations include the transformation of raw materials into finished goods and the provisioning of services. The first step is designing, wherein CAD (computer aided design) or design thinking is helpful. CAM (computer aided manufacturing) is used to plan for material and capacity apart from production control. Robots can also be used to make processes automated or contactless, and the same CIM (computer integrated manufacturing) to control machine tools and automated guided vehicles can be relied upon. Not only manufacturing but even service entities are using IT in their operations.

To illustrate, Edu-tech portals and platforms offer courses online. Food ordering apps operate through a mobile app or website for booking the food. Banks replace the cash teller with ATMs, and for updating passbooks, there are Kiosks.



Practical Insight

Restaurant and Robots

Robots can also be used for more customer-facing tasks, such as taking orders, collecting payments, or even serving food and drinks. One restaurant that has embraced robotics is YO! Sushi, a Japanese chain with locations in the UK, US, and Australia.

The Wingman joins hamburger-making robots like Flippy from Miso Robotics that White Castle recently bought for 100 of its locations and other kitchen robots that are automating food processing, cooking, and presentation, particularly in fast food settings.

Note – As per robotlab.com, the Robot-as-a-Service (RaaS) program starts at \$1,215 per month and includes shipping, onsite installation, training, and unlimited ongoing support.

2.1.3 Outbound logistics covers storing, distributing, and delivering finished goods to customers. Apart from bar-coding system or RFID, information technology is used for vehicle scheduling and automated warehousing.



Practical Insight (on inbound and outbound logistics)

United Parcel Services (UPS) a logistics company, implemented the wireless network. (Reduce paperwork, improve sorting and tracking, help in resource planning in terms of capacity at the hub, and facilitate timely information)²⁵.

2.1.4 Marketing and sales activities comprise market research and the marketing mix (product, price, place, and promotion). Customer databases are maintained digitally for ease in market segmentation, apart from analysing customer habits and trends therein. Together, these make CRM (Consumer Relations Management) easy.



Do You Know?

Having a website that works seamlessly on all devices helps you outperform.

As per **Sweor.com**

- 75% of consumers admit to making judgements on a company's credibility based on the company's website design.
- 83% of mobile users say that a seamless experience across all devices is very important.
- Mobile e-commerce revenue accounted for above 50% of total U.S. e-commerce revenue.

Digital marketing, social marketing, internet marketing, and viral marketing are gaining importance.

²⁵ <https://www.zdnet.com/article/ups-takes-wireless-to-the-next-level/>



Practical Insight²⁶

Nike started with a more effective use of analytics, focusing on digital consumer data. They also updated their e-commerce strategy with things such as improved UX (user experience) and better-adjusted membership options. Their offline activities corresponded with their online marketing strategy. Nike focused on delivering a unique experience to shoppers who visited their offline stores, especially the flagship stores.

2.1.5 After-sales service includes all those activities that occur after the point of sale, such as installation, training, and repair. Computer system can be relied on for scheduling repairs. Further IoT-enabled remote service software helps manufacturers of equipment, machines, and complex devices monitor their products and provide after-sales product support and maintenance at the customer sites. Such solutions often integrate with a manufacturer's asset management software, ERP, and customer service module, thereby reducing downtime and transportation costs.

2.2 Secondary Activities

2.2.1 Firm infrastructure deals with organisational structure, which can be improved through collaborative workflow using Intranets, Electronic scheduling, Office automation systems and any ERP (Enterprise Resource Planning) for identifying and planning the enterprise-wide resources needed to record, produce, distribute, and account for customer orders.

2.2.2 Technology development describes how the firm uses technology; therefore, this includes IT/IS strategies. For state roadways buses, now online ticket booking is available. This helps in better management, apart from reducing the risk of fraud (involved in using manual tickets). Mind it, here the technological advancement of primary and support services is considered not a product that will be covered under operations.

2.2.3 Human resource management describes how people contribute to competitive advantage. There's a range of technologies that are impacting HR practices; some of the most interesting and disruptive technologies are powered by artificial intelligence and automation.



Do You Know? Human resources technology (popularly known as HR Tech) is a buzz now.

HR tech refers to the software and hardware technology used to automate essential HR functions. HR tech functions as a co-pilot, helping HR professionals streamline time-consuming tasks, including-

- Payroll management.
- Talent management - AI is making recruitment smarter.
- Applicant tracking systems.
- Learning and development.
- Performance management - analytics drive better performance management.
- Employee engagement - better analytics boosts diversity and inclusion.

²⁶ <https://www.forbes.com/sites/forbestechcouncil/2019/10/07/how-nike-is-using-analytics-to-personalize-their-customer-experience/?sh=5e4a5aaf1611>

2.2.4 Procurement means purchasing, but not just materials. Techniques like Electronic Data Interchange for exchanging information with vendors for auto-supply and e-procurement or e-tendering for receiving and appraising Expression of Interest (Eoi) from vendors have proven handy.



Practical Insight

Ford Motor Company has set up the Computer Aided Design module in association with its suppliers, with the intent of providing them clarity on design specifications so that the costs (time and monetary resources) of design and changes can be reduced.



Do You Know?

Not only private enterprises, which are working solely/ substantially for-profit motives, but even public enterprises, which have the twin objective of economic growth and social welfare, are using technology to be cost efficient. This is evident from the launch and use of the Central Public Procurement Portal (<https://etenders.gov.in/eprocure/app>) for e-procurement by the Government of India. The e-Procurement System enables the tenderers to download the tender schedule free of charge and then submit the bids online through this portal.

In the end, it can be concluded that IT/IS has the capabilities to revamp the value chain and empower the organisation to tap the opportunities for creating greater values.



E. THE ROLE OF MANAGEMENT ACCOUNTANT AS A LEADER

As business environments changed, new organizational structures and management styles emerged, and as a result, the roles and responsibilities of business managers changed dramatically. The role of management accountant has also undergone a substantial transformation. Now the Management Accountant assumes the role of business leader.

Management accountants lead from the core of business, working within organizations to identify opportunities, reveal insights, and make the big strategic decisions that shape a business' future. Hence, aspects like **communication**, **decision-making**, and **business ethics** that are part of the Management Accountant's behaviour become critical to the success of his or her organisation. In this section, after considering the transformation of the role of a Management Accountant, the behavioural aspects specified above will be discussed.

Since business organizations face various complicated challenges in a dynamic business environment, the capabilities of their managers should be at a level so that can take up the challenge.

1. The Transforming Role of the Management Accountant

Traditionally, the roles of a Management Accountant prominently include –

Role # 1. Stewardship Accounting

Role # 2. Long-term and Short-Term Planning

Role # 3. Developing Management Information System (MIS)

Role # 4. Maintaining an Optimum Capital Structure

Role # 5. Participating in the Management Process

Role # 6. Providing Ease in Control

Today businesses require a management accountant who reports the key figures with in-depth analysis and provides fresh perspectives by "telling a story" about the reported data to propel the business ahead; hence, the role of management now also includes –

Role # 7. Analysis

Role # 8. Planning

Role # 9. Innovation

Role # 10. Leadership

Therefore, Management Accountant is a position that holistically addresses the various aspects that affect the sustainability of a business's performance. Along with budgeting, forecasting, management of performance, and control of internal processes, the management accountant impacts decisions related to strategies, operations, and technology as a business leader.

If accounting is truly a language of business, then management accountant is indeed poet, who appreciate value and numbers.

The management accountant is at the crossroads of technology, financial analysis and strategy, and leadership, helping to identify what is driving the company's profits and losses rather than simply reporting them.

The management accountant goes an additional step beyond reporting and assists the C-Suite (the group of officers of a business organization who have the word "chief" in their titles) to figure out the most effective route to growth and stability and to develop strategies for growth in the long run by translating the lofty "big picture" goals into tangible operational and financial actions.

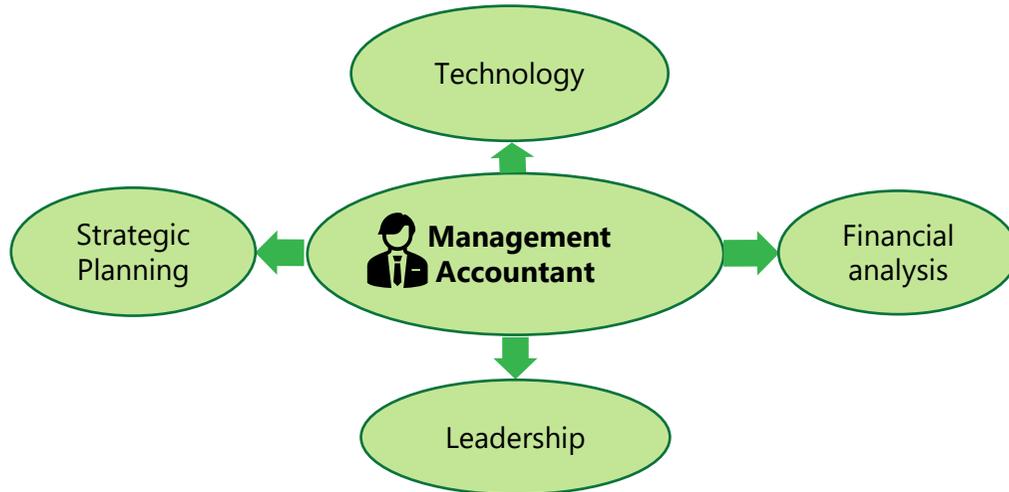


Figure E.1 - Management accountant is at the crossroads of technology, financial analysis and strategy, and leadership

1.1 Analysis - To offer new insights and vision

Management accountants, through analysis of financials (and non-financial information as well), can uncover the meaning of numbers for the company. He constantly looks for discoveries within the data to offer new **insights and vision** to craft apt strategies. The insights they provide should pertain to TQM, Supply Chain, Innovations, Customers' Profitability, etc.

1.2 Planning - Building Informed Strategies

Management accountants apply their **forecasting and budgeting** skills to aid senior leaders in making the most effective business and financial decisions or to develop strategies. Working closely with executives, CEOs, and other leaders Management accountants are essential in defining and implementing a long-term plan. In essence, a management accountant is expected to provide the technical depth of accounting while also providing broad business operations coverage.

1.3 Innovation - Technological Advancement and Breakthrough

In business, infusing technology can do miracles. Being innovative is essential for businesses to sustain or improve their performance. The Management Accountant should assume the **role of initiator** or **change advocate** for technological innovation to practice i4.0 (i.e., Industry 4.0), even now i5.0.

1.4 Leadership - From Planning to Execution

Management accountant, being a leader, needs to be proficient in **decision-making** as well as making **communications** in process of crafting plans and ensuring precise execution, usually across several divisions and departments of a company. He should observe **professional and business ethics** to lead by example.

Mind it, being a leader is way different from just being a manager in many ways, such as –

- Leaders create a vision; managers create goals; manager don't.
- Leaders are change agents; managers maintain the status quo.
- Leaders are unique; managers do copy.
- Leaders take risks; managers control risk.
- Leaders are in it for the long haul; managers think short-term.
- Leaders grow personally, and managers rely on existing, proven skills.
- Leaders build relationships, and managers build systems and processes.
- Leaders coach; managers direct.
- Leaders create followers; managers have employees (subordinates).

2. Management Accountant - In the Role of a Leader Who Drives the Strategy

Leadership is required to develop an organisational strategy, drive change, and align the organisation's structure, resources, and culture with the strategy.

In the previous section (especially in point 1.4, i.e. Leadership - From Planning to Execution, stated above on this page), we acknowledge that Management Accountant assume the role of leader, who need to make or assist in **decision-making** in wake of organisational strategy, make **communications** (of strategy, plans, vision, and values) while getting such decisions executed either himself or through others; and remain **ethical** throughout. Let's consider each of these three highlighted dimensions of the role of the management accountant as a leader in detail.



Figure E.2 – Dimensions of the role of management accountant as leader

2.1 Communication

Communication is a two-way process that involves the transfer of information or messages from one person or group to another. Considering the organisational structures and level thereof, it can be classified as vertical (upward and downward), horizontal, and diagonal.

From the perspective of a management accountant in a strategic context, communication includes all formal and informal exchanges of ideas, beliefs, imaginations, emotions, or thoughts. The Management Accountant who is considered an agent of change (to align the organisation's structure, resources, cost structure, and culture with the strategy), while communicating the change and the need for it, also needs to communicate the vision and strategy; this will reduce resistance and make the process of change smoother. The new strategy needs to be communicated with actions as well as words.



Concept Insight

The message in full, and then process the message to construe the real intent.

Communication is more than just sending messages

Communication is something more than just sending a message; it includes feedback from the receiver; only then, it become dialogue else monologue. Receiving and analysing the feedback is important because it signifies what is actually conveyed. The importance of this aspect has increased in the case of communication done by management accountant in strategic contexts because feedback will help to understand the resistance, if any, and the nature thereof.

Listening is more than just hearing

The receiver should listen carefully (both sender and listener should try to reduce the noise, i.e., barriers to communication) to receive.

Management Accountant, apart from reporting to the C-suite, used to talk to workers and staff either in **quality circle** meetings, or **corner meetings** or on the **production floor** (some time on the shop floor also) to communicate informally but effectively.

Techniques such as **management by wandering/ walking around** (MBWA)²⁷ are helpful. MBWA refers to a style of business management that involves managers wandering around, in an unstructured manner, through the workplace(s) at random (rather than a plan where employees expect a visit from managers at more systematic, pre-approved, or scheduled times), to check with employees, equipment, or the status of ongoing work. The expected benefit is that a manager, by random sampling of events or employee discussions, is more likely to facilitate improvements to the morale, sense of organizational purpose, productivity, and total quality management of the organization as compared to remaining in a specific office area and waiting for employees.

²⁷ Management consultants Tom Peters and Robert H. Waterman had used the term in their 1982 book *In Search of Excellence: Lessons from America's Best-Run Companies*.



Practical Insight²⁸

“Management by wandering around” is very similar to the Japanese *Gemba walk* method developed at **Toyota**.

The origin of the MBWA has been traced to executives at the company **Hewlett-Packard** for management practices in the 1970s.

In the end we need to recognise that **technological advancement** has changed the mode and style of communication drastically. In order to have effective communication, management accountants also need to consider the mode of communication very consciously; the choice shall be based upon the criteria of intellectual level of the receiver, cost budget, availability of time resources, and nature of information (highly sensitive or operational), among others.

2.2 Decision-Making

Decision-making is the process of **making choices** by identifying a decision, gathering information, and assessing alternative resolutions. Decision-making process is substantially impacted by the type of organisation structure adopted in addition to its size, industry, level of maturity, vision, mission, and goals. The impact may be either positive or negative. If the aspects specified in the immediate previous sentence are clearly defined and communicated to stakeholders, then the process of decision-making will be smooth or else complicated. Where it is complicated, a stronger leader is required who has a transformational leadership style.

Decision-making is required at every step of the **strategy development process**. Being part of the strategy development process, management accountant required to either make decisions or assist the C-suite in making decisions. Since decisions taken (or assisted) by management accountant are deciding factors in **organisation’s direction and growth**, hence, **criteria** for making decisions shall be **rational**. A decision is said to be rational if it is **objective, fully informed, conscious, explicit, deliberate, consistent (but considering the need for an hour or warrant of situations), logical, and aiming for end goals**.



Do You Know?

Why do business managers or leaders make irrational decisions?

- Enthusiasm to quickly get to the end of the analysis process, i.e., jump straight from analysis to recommendation without considering any other alternatives.
- Not listing to others (and their perspective).
- Error in forecasting and determining the affecting factors.
- Readily agree with the leader’s proposal.
- Superficial understanding of facts.
- Judgement error or lack of expertise.
- Carrying pre-notions - having prior views about the ‘best’ solution.

²⁸ Management by Walking Around by Hassan, p.20 (2020)

Management Accountant has to make decisions regarding the benchmarks, standards, budgetary allocations, quality limits, and many more in association with others in the organisation; hence, must have **strong rapport** and **communication** with his counterparts in other departments of functional expertise.

In the end, we must acknowledge that **leadership style** has a strong bearing on the decisions that management accountant make and the effectiveness thereof.

2.3 Business Ethics

Ethics deals with moral philosophy that involves systematizing, defending, and recommending concepts of **right and wrong behaviour**, whereas business ethics is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that can arise in a **business environment**. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations.

Business ethics are closely related to the values of organisation; hence, **ethics should reflect values**. Undoubtedly relying upon **Milton Friedman's** arguments, the **classical approach** to ethics suggests that business leaders are responsible for the **wealth maximisation** of fund providers only, but business has changed its orientation from **shareholder to stakeholder**. Hence, rather than leveraging the classical approach of ethics, the **socio-economic approach** shall be observed, which suggests that in order to be **sustainable**, every business organisation needs to **balance** the **economic motive and social costs** of their actions. Competitive and profit-maximising organisations may well be efficient in the eyes of shareholders or fund providers, but an overriding focus on efficiency and profit can lead to ethical issues and dilemmas such as unequal income distribution or damage to the environment.

Therefore, in determining how the organisation will achieve its goals, leaders establish or shape the ethics and values that guide the activities of the organisation and set the limits or the extent to which the **'means justifies the ends'**. Therefore, the management accountant while making decisions and communicating the same, shall observe business ethics.

To illustrate, for performance evaluation, he/ she may use the triple bottom line as a framework. In lifecycle cost, he/ she may consider site cleaning costs at the end of the project as well as displacement costs incurred to run the project.



SUMMARY

- ❑ Traditional Cost Management aims at cost reduction. It revolved around the central theme 'that cost cutting always results in enhanced profits', whereas Strategic Cost Management deals with measuring and managing costs and aligning them to the business strategy.
- ❑ Strategic Cost Management is the application of cost management techniques so that they simultaneously improve the strategic position of a firm and reduce costs.

- ❑ Strategic cost management has three important pillars, viz., strategic positioning, cost driver analysis and value chain analysis.
- ❑ Value Chain is the sequential chain of activities which leads to delivery of final product to the customer, it also depicts how value (utility) accumulates to customer. Typically, increasing the performance of one of the four secondary activities can benefit at least one of the primary activities.
- ❑ Value Chain Analysis is a process of categorising the activities into value added and non-value-added activities, with objective of eliminating non-value added activities to obtain cost leadership and focus (by further resource deployment) on value added activities to improve product differentiation.
- ❑ An alternate representative of a value chain is the value shop, which is essentially a problem resolution model. The primary activities are problem finding and acquisition, problem solving, choosing among solutions, execution, and control/ evaluation.
- ❑ Strategic positioning reflects choices a company makes about the kind of value it will create and how that value will be created differently than rivals. Strategic positioning should translate into either one of two things: a premium price (i.e., Differentiation) or a lower cost (i.e., Cost Leadership)
- ❑ Cost Driver Analysis includes the examination, quantification, and explanation of the monetary effects of cost drivers associated with an activity.
- ❑ Companies must search out “white space” in the industry, which usually means competing on either one of two fronts; a premium price (i.e., Differentiation) or a lower cost (i.e. Cost Leadership). It’s possible to compete on low cost and be differentiated at the same time—but companies that try to be all things to all customers can wind up getting stuck in the middle, a strategic mistake that Michael Porter calls “the kiss of death.”
- ❑ To command a premium price, a company must deliver distinctive value to customers. To compete on cost, companies must balance price with acceptable quality and become lowest cost producer in an industry.
- ❑ A business model explains how a business works and the economic logic behind it. It is a way of representing and communicating how an organisation creates values for itself while delivering products or services for customers.
- ❑ Alexander Osterwalder proposed a nine-element business model canvas wherein four elements pertaining to cost (key partners, key activities, key resources, and cost structure; on left side of canvas) are connected to another four elements pertaining to revenue (customer relationships, channels, customer segments and revenue streams; on right side of canvas) through ninth element that is value proposition.

- ❑ The Value Proposition Canvas has two sides. With the Customer Profile business can have clear understanding of customer character. With the Value Map business describe how it intend to create value for that customer. Business achieve Fit between the two when one meets the other.
- ❑ Business is said to achieve a problem-solution fit when the features of business's value proposition map perfectly match the characteristics of your customer segment profile. When the market validates this match and business value proposition gets traction with real customers, business achieved the product-market fit.
- ❑ External environment comprising the factors that are beyond the control of organisation (outside organisation boundary) but having influences on organisation, its performance, and strategic positions. The external environment is then broken down into two categories for further analysis, called the remote environment and the industry operating environment including the competitive environment.
- ❑ An industry is a group of companies that are relatively comparable based on their primary business activities. There are segments inside the industry. Industry classifications are typically grouped into larger categories called sectors.
- ❑ Industry analysis was conventionally performed using the PEST Framework i.e., Political, Economic, Social and Technology, but this approach has been evolved to reflect dynamics of the business environment, to PESTEL with add-on of environment and legal issues and now to STEEPLE with add-on of ethical aspects.
- ❑ All five competitive forces jointly determine the intensity of industry competition and profitability, and the strongest force or forces are governing and become crucial from the point of view of strategy formulation. The five forces enumerated by Porter's five force model are keep-on changing, this makes model a dynamic analytical tool.
- ❑ Market consists of business firm that is selling the product or rendering the services in addition to buyer who is buying/hiring them. A market segment is a category of customers who have similar likes and dislikes in an otherwise homogeneous market.
- ❑ Market segmentation is the process of dividing a broad target customer base or business market, into small but more defined sub-groups of customers based on some type of shared characteristics such as demographics, interests, needs, or location. Basis of Segmentation can be Product, Demographic, Psychographic, Behavioural, and Geographic characteristics.
- ❑ Basis of competition is that reason why your customer chooses you over your competitor.
- ❑ There are certain factors (Called Critical Success Factors) in every industry that are critical to success of any business organisation in generating and sustaining competitive advantage. Further with each CSFs, Key Performance Indicators (KPIs) are attached to measure the performance of business organisation regarding said CSF.

- ❑ Core Competences are some of the most important sources of uniqueness: these are the things that a company can do uniquely well, and that no-one else can copy quickly enough to affect competition.
- ❑ Information Technology (IT), Information System (IS) and Information Management (IM), all three are inter-connected; but not same. Information technology techniques are used as part of information system to manage information. Organisations develop strategies to ensure alignment among these three and overall organisational strategy in place.
- ❑ IT collectively with IS and IM has potential to transform the business around the corners. It has strong influence on Michael E Porter's Five Force, Moreover IT/IS has capabilities to revamp the value chain and empower the organisation to tap the opportunities for creating greater values.
- ❑ Management Accountant is a position that holistically addresses the various aspects, which affect the sustainability of a business's performance. The management accountant is at the crossroads of technology, financial analysis and strategy, and leadership, helping to identify what is driving the company's profits and losses, rather than simply reporting them.
- ❑ Management Accountant assume the role of leader, who need to make or assist in decision making in wake of organisational strategy, make communications (of strategy, plans, vision and values) while getting such decisions executed either himself or through others; and remain ethical throughout.



TEST YOUR KNOWLEDGE- MCQS

MCQ 1

Mr. Anirban, Chief Management Accountant and advisor to CEO of Avantha Holdings considering the value proposition canvas as tool to respond to aspects highlighted by customer profile analysis. You (cost trainee) recently join Avantha Holding, Mr. Anirban asked to appraise the following statement to pick the correct statement regarding value proposition map

Options

- a. Pain relievers and gain creators counter each other's effects
- b. Pain relievers and gain creators are the one and same thing
- c. Pain relievers are different from Gain creators
- d. Either one of Pain relievers or Gain creator can be part of value proposition map

Key - c

Reason – Pain relievers and gain creators both create value for the customer in different ways. The difference is that the former specifically addresses pains in the customer profile, while the latter specifically addresses gains. It is okay if either of them addresses pains and gains at the same time, The main goal of these two areas is to make the customer value creation of your products and services explicit.

MCQ 2**In continuation to previous MCQ**

Mr. Nilanjan is hired by Avantha holding as independent consultant for drafting of value proposition map. He suggests that ranking of customer's jobs, pains, and gains is essential to respond them. Mr. Anirban is not convinced with need of rank said three elements of customers' profile; hence he seeks your help in evaluating following two statements regarding the customer's jobs, pains, and gains.

- I. Pains and Gains are controlled by Business.
- II. All the pains and gains need not be responded or addressed.

Options

- a. Both the statements are correct
- b. Both the statements are incorrect
- c. Only statement 1 is correct
- d. Only statement 2 is correct

Key - d

Reason – Pain relievers and gain creators are distinctly different from pains and gains. Business have control over the former, whereas it doesn't have control over the latter. Business decides (i.e., design) how it intend to create value by addressing specific jobs, pains, and gains. Business don't decide over which jobs, pains, and gains the customer has and no value proposition addresses all of a customer's jobs, pains, and gains. The best ones address those that matter most to customers and do so extremely well.

MCQ 3

The technique of "Management by wandering around" is concerned with which of following leadership aspects of management accountant.

- I. Communication
- II. Decisions Making

Options

- a. Both of I and II
- b. Only with I
- c. Only with II
- d. None of I and II

Key - b

Reason – Management by wandering/walking around (MBWA)²⁹ is helpful in making communications and supporting TQM. MBWA refers to a style of business management which involves managers wandering around, in an unstructured manner, through the workplace(s), at random (rather than a plan where employees expect a visit from managers at more systematic, pre-approved or scheduled times), to check with employees, equipment, or on the status of ongoing work. The expected benefit is that a manager, by random sampling of events or employee discussions, is more likely to facilitate improvements to the morale, sense of organizational purpose, productivity and total quality management of the organization, as compared to remaining in a specific office area and waiting for employees.

MCQ 4

Technology is dynamic in nature and has significant bearing on activities that create value for customers. Your organisation is considering introducing RFID, as technological breakthrough. RFID is capable to revamp which of following primary activities (to generate scope of value);

- I. Inbound logistic
- II. Outbound logistic
- III. Sales and Marketing
- IV. After-Sale Services

Options

- a. III and IV only
- b. II and III only
- c. I and III only
- d. I and II only

Key - d

Reason – RFID (Radio-frequency identification uses electromagnetic fields to automatically identify and track tags attached to objects. An RFID system consists of a tiny radio transponder, a radio receiver and transmitter) can be used to track items in trading concerns throughout the supply chain. It is calibre to positively influence inbound and outbound logistic.

MCQ 5

A Business model should contain which three components out of those stated below;

- I. Customer value proposition
- II. Profit formula
- III. Impact factor
- IV. Key resources and processes

²⁹ Management consultants Tom Peters and Robert H. Waterman had used the term in their 1982 book In Search of Excellence: Lessons from America's Best-Run Companies

Options

- a. I, II and III only
- b. I, II and IV only
- c. I, III and IV only
- d. II, III and IV only

Key - b

Reason – In 2008, Johnson along with Christensen & Kaggerman³⁰ extended the scope of business model to what was earlier proposed by Margretta and proposed that a business model also needs a **value proposition**, therefore business model should contain three components–

1. Customer value proposition.
2. Profit formula.
3. Key resources and processes.

MCQ 6

Shakti Bearing Ball Trading Limited is considering the proposal to enter into trading of casting iron as well. Mr. Madhu Sudan, chief strategic enumerate the entry exist barriers of proposed business line and called a review meeting at request of CEO to consider final advice of C-suite. You (Chief Cost Advisor) also attended the meeting and suggested that barriers have influence on profitability (rate as well as nature). Mr. Sudan told SBBTL expected that there will be high entry and exit barriers you are advised to tell nature and margin rate in context of five force model.

Options

- a. Low margin with stable return
- b. Low margin with Risky return
- c. High margin with stable return
- d. High margin with Risky return

Key - d

Reason – Impact of exit and entry barriers on profitability (margin) are depicted below-

| | | Exit Barriers | |
|----------------|------|----------------------|---------------------|
| | | Low | High |
| Entry Barriers | Low | Low, Stable Returns | Low, Risky Returns |
| | High | High, Stable Returns | High, Risky Returns |

³⁰ Johnson M, Christensen C & Kaggerman H, 2008, 'Reinventing your business model', *Harvard Business Review*, December, www.innosight.com/insight/reinventing-your-business-model-form.

MCQ 7

The board of Modern Furniture Limited considering the need of strategies for Information related aspects. Chief Information and Technology officer made a statement “Information Technology (IT), Information System (IS) and Information Management (IM), all three are inter-connected; but not same. Information technology techniques are used as part of information system to manage information”. He further highlights the nature of IT/IS/IM strategies and suggests–

- I. IT strategy is supply-oriented
- II. IS strategy is demand-oriented
- III. IM Strategy is dimension-oriented

Which of the above specified statements are incorrect

Options

- a. I only
- b. III only
- c. I and II only
- d. I and III only

Key - b

Reason – IM strategy trying to 'put management into IT' by defining the **role and structure** of the IT activities in the organisation. It is concerned with the management controls for IT, management responsibilities, performance measurement and management processes. Here it is decided who can assess the data and who can't. It formulated at organisation wide level. It deals with control over the layout of IT uses in organisation. Hence IM strategy is **relationship oriented**.

MCQ 8

Ali Fabrics Limited (AFL) has recently decided to invest in an Electronic Data Interchange system that will enable the AFL to automatically place orders with its major suppliers. Currently, AFL purchasing department staff have to place orders using postal mails and telephone to the company's suppliers, which is slow and inefficient.

Which activity within AFL's value chain will the new EDI system improve?

Options

- a. Infrastructure
- b. Inbound Logistic
- c. Procurement
- d. Outbound Logistic

Key - c

Reason – The EDI system will improve the system for sourcing and purchasing materials. This is procurement. Note that inbound logistics refers to inventory management - not the purchasing of inventory itself.

MCQ 9

Management Accountant assume the role of leader, who need to make or assist in **decision making** in wake of organisational strategy, make **communications** (of strategy, plans, vision and values) while getting such decisions executed either himself or through others; and remain **ethical** throughout. Which of the following statements are incorrect?

- I. An increasing number of organizations are segregating management accountants in separate managerial-accounting departments.
- II. Management accountants often are part of cross-functional teams.
- III. Management accountants make significant business decisions and resolve operating problems while support in strategic decision making.
- IV. The role of management accountants has changed considerably over the past decade.

Options

- a. Only I
- b. Only III
- c. Both I and III
- d. Both I and II

Key - a

Reason – Management Accountant is a position that holistically addresses the various aspects, which affect the sustainability of a business's performance. The management accountant is at the crossroads of technology, financial analysis and strategy, and leadership, helping to identify what is driving the company's profits and losses, rather than simply reporting them.

MCQ 10

Tara Fabrics considering the decisions regarding segmentation. Management Accountant raised and said it was acknowledged that managerial discretion and judgment determine which markets are selected and targeted and which others are ignored. In order for market segmentation to be effective, all segments must be –

Options

- a. Distinct, Artistic, Measurable and Profitable.
- b. Distinct, Accessible, Measurable and Popular.
- c. Desperate, Accessible, Many, and Profitable.
- d. Distinct, Accessible, Measurable and Profitable.

Key - d

Reason – In order to be recognised as segment, the following criteria shall be satisfied the segment should be homogeneous internally, heterogeneous externally (distinct), identifiable (measurable), shall be reasonable if not substantial (profitable), and must be responsive (accessible).



TEST YOUR KNOWLEDGE- CASELET BASED MCQS

Case-let on Strategic Fit - Value Propositions of a multinational automotive company that is engaged in designs and manufactures electric vehicles

In electronic-vehicle segment (four-wheelers), there are many players, who are trying to meet different requirements of their customers including personal mobility, regular long-distance trips, and be different from others with their offerings but an emerging multinational automotive company that is engaged in designs and manufactures electric vehicles is leading the chart.

In 2008, such multinational automotive company released its first electric car, the Speed. The Speed was the first car to use lithium-ion battery cells, and the first electric car to travel more than 320 km (200 miles) per charge. Such multinational automotive company aims to create more affordable electric car options to attract a broader customer base. Such multinational automotive company expanded its geographic footprint, with production facilities in Country C (country with cheap resources) and the Country U (a developed country), as well as 438 stores and 100 service centres in various countries.

The M10EV (e-vehicle) was launched in July 2009, and The Leaf, another e-vehicle from another rival company was introduced in December 2010. But such multinational automotive company counter them strongly with the Model S on 22 June 2012 and the first delivery to a retail customer in Europe took place on 7 August 2013, while deliveries in Country C began on 22 April 2014. The next model was the Model X launched in 2015. Then such multinational automotive company launched Model 3 in mid-2017. The sale of such Model 3 surpassed the sale of The Leaf in early 2020 to become the world's best-selling electric car ever, with more than 5,00,000 total units sold by March 2020. However, the Model Y of such multinational automotive company is the bestselling electric vehicle in terms of yearly units. Such multinational automotive company also became the first auto manufacturer to produce 1 million electric cars in March 2020. Global sales of the Model 3 passed the 1 million milestone in June 2021, the first electric car model to do so.

While the Leaf achieved the milestone of 5,00,000 units sold globally in early December 2020, 10 years after its inception.

Country C is larger consumer of e-vehicles with total of 78,42,668 light-duty plug-in electric vehicle on road at end of 2021 and nearly 15% of new vehicle sold during 2021 were electric vehicle there.

There is a clear division between the opinions of industry experts. Larger chunk of experts feels a strategic fit between value map and customer profile is the reason of superior performance by such multinational automotive company, while some other feels first mover advantage is the reason.

You after qualifying chartered accountancy, recently join a consulting firm that has undertaken the task to study the value proposition of such multinational automotive company. Team of consultants, list the pains, gains, pain relievers and gain creators. List was then given to computer operator for digitisation and circulation among all consultants, who are working on this. But operator jumbled the list as–

1. *Growing network of charging points*
2. *Brand recognition*
3. *Slow charging*
4. *8 years battery warranty*
5. *Durable battery lifetime*
6. *Insufficient number of charging points*
7. *Reputable brand*
8. *Developed interior ergonomics*
9. *Self-driving option*
10. *Lack of luggage space*
11. *Interior ergonomics*
12. *75 minutes to charge 100% with supercharging stations*

Requirements**MCQ 1**

Which of following is correct combination of Pains?

Options

- a. Item No. 3, 6 and 10
- b. Item No. 3, 5 and 10
- c. Item No. 3, 5 and 11
- d. Item No. 2, 5 and 11

Key – a i.e., Item No. 3, 6 and 10

Reason – Refer answer to first descriptive question of this case-let

MCQ 2

Which of following is correct combination of Gains?

- a. Item No. 3, 6 and 10
- b. Item No. 2, 5 and 11
- c. Item No. 3, 5 and 11
- d. Item No. 3, 5 and 10

Key – b i.e., Item No. 2, 5 and 11

Reason – Refer answer to first descriptive question of this case-let

MCQ 3

Which of following is correct combination of Pain Relievers?

- a. Item No. 1, 7 and 9
- b. Item No. 4, 7 and 9
- c. Item No. 1, 8 and 12
- d. Item No. 4, 8 and 12

Key – c i.e., Item No. 1, 8 and 12

Reason – Refer answer to first descriptive question of this case-let

MCQ 4

Which of following is correct combination of Gain Creators?

- a. Item No. 1, 7 and 9
- b. Item No. 4, 7 and 9
- c. Item No. 1, 8 and 12
- d. Item No. 4, 8 and 12

Key – b i.e., Item No. 4, 7 and 9

Reason – Refer answer to first descriptive question of this case-let

Descriptive Question 1

Do you agree to the opinion of larger chunk of industry experts or not? Justify your answer.

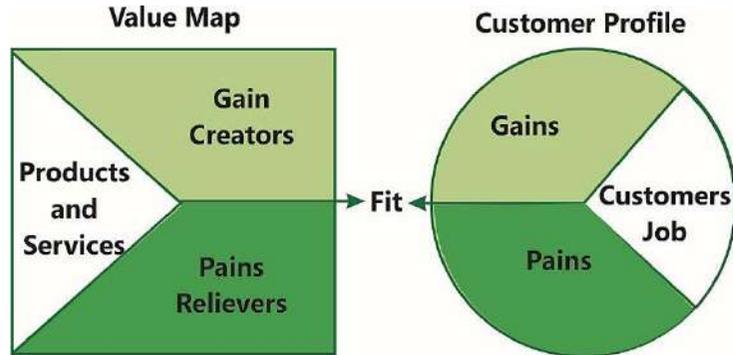
Answer - The opinion of larger chunk of industry expert is correct considering value proposition canvas.

Value Proposition describes the benefits that customers can expect from product and the bundle of products and services that business offer to specific customer segment to create value. Therefore, value proposition canvas³¹ is the tool that will help the organisation **to design, test, build and manage the great customer value propositions**.

The **Value Proposition Canvas** has two sides. With the Customer Profile business can have clear understanding of customer character. With the Value Map business describe how it intend to create value for that customer. Business achieve Fit between the two when one meets the other.

³¹ By Alexander Osterwalder, Yves Pigneur, Gregory Bernarda, Alan Smith in Value Proposition Design - How to Create Products and Services Customers Want (2014)

Value Proposition Canvas



Value Proposition Canvas of multinational automotive company that is engaged in designs and manufactures electric vehicles

| Value Map | | Customer Profile |
|---|------------|--|
| Products & services Model S Model X Model 3 | FIT | Customer Jobs Personal mobility Regular long-distance trips Be different from others |
| Pain relievers Growing network of charging points Developed interior ergonomics 75 minutes to charge 100% with supercharging stations | | Pains Insufficient number of charging points Lack of luggage space Slow charging |
| Gain creators 8 years battery warranty Reputable brand Self-driving option | | Gains Durable battery lifetime Brand recognition Interior ergonomics |

Business is said to achieve a **problem-solution fit**, when the features of business's value proposition map perfectly match the characteristics of your customer segment profile. When the market validates this match and business value proposition gets traction with real customers, business achieved the **product-market fit**.

The value proposition canvas drawn above shows fit (problem-solution as well as product-market) exist, hence options of larger chunk of expert is factually correct.

Descriptive Question 2

How establishing manufacturing in Country C help such multinational automotive to do better in primary activities of their value chain?

Answer – Primary activities of value chain consist of the inbound logistics, operations, outbound logistics, marketing & sale, and after sale services. Automobile industry use assemblies, which are usually procured from countries with low-cost model (because such countries are capable to produce these assemblies cheaply, substantially due to cheap labour rates). Such multinational automotive company is not an exception to this. Country C is one such country. Therefore, by establishing their operations in Country C such multinational automotive company is able to reduce inbound cost, also reduce the cost of operation due to cheap labour rate.

Moreover, Country C is largest market for E-Vehicle. This not only reduce outbound logistic cost as well as easy and large market hence marketing and sale also become easy; further the fact Country C is growing market create a great source of value.

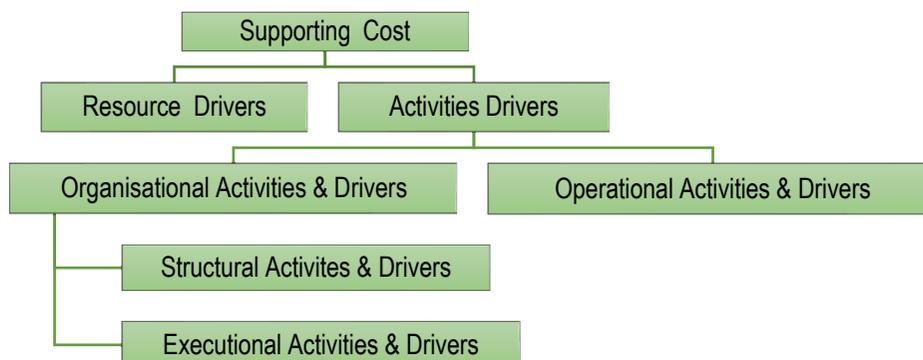
Hence, establishing operation in Country C is beneficial to such multinational automotive company in generating same or higher value (perceived value by customer) for its customer at lower cost level (than earlier); therefore, increasing margin.

Note – Alternate answers are possible to this particular descriptive question.

ANNEXURE 1

Based upon two **distinct nature of supporting cost (overhead cost)**, drivers can also be categories into two classes

- 1. Resource drivers** – Concerned with contribution of specific quantum of resources, which caused cost → electricity costs to produce products and the number of machine hours spent (machine hour is resource).
- 2. Activity driver** – Concerned with cost incurred on the activities required to complete a specific task → inspection costs and the number of inspections or the hours of inspection (Inspection is required activity to ensure quality).



2.1 Organizational activities and cost drivers

2.1.1 Structural cost drivers relate to business strategic choices about an organization's underlying economic structure, such as scale and scope of operations, use of technology and complexity of products.

- Scale – What are the investment amounts for research and development, product design, production and other operations?
- Scope – What is the area of operation, front-line or back-end?
- Experience – How many years has the company already operated this?
- Technology – What technical processes are involved in each process of the company's value chain?
- Complexity – How sophisticated are the products or services to provide to customers?

Note – Not necessary that more is better.

2.1.2 Executional cost drivers relate to the execution of the business activities, such as utilization of employees, provision of quality service, and product design and manufacturing.

- Workforce involvement – Do the employees take part in decision-making and performance improvements?
- Total quality management – Are the managers and employees devoted to total quality in processes and products?
- Capacity utilization - What are the operational scales for matching utilization of plant capacity?
- Plant layout efficiency – How efficient is the production plant's layout?
- Product configuration – Is the product design or service formulation effective?
- Linkage with suppliers and customers – Is the linkage with vendors and customers based on the company's value chain?

Examples

| Structural activities | Structural cost drivers |
|--------------------------------|---|
| Plant construction | Number of plants, scale, degree of work centralization |
| Employee grouping | Number and type of work units |
| Complexity | Number of product lines, number of unique processes, number of unique parts, degree of complexity |
| Process selection and use | Types of process, experience of usage |
| Executional activities | Executional cost drivers |
| Employee utilization | Degree of involvement |
| Quality service provision | Quality management approach |
| Operation of plant layout | Plant layout efficiency |
| Product design & manufacturing | Product configuration |

2.2 Operational activities and cost drivers

Operational activities are daily work activities done as a result of the structure and process adopted by the company. Operational cost drivers refer to factors that drive the costs of operational activities. Can be categories at Unit, Batch and Product level.

Examples

| Unit-level activities | Unit-level cost drivers |
|---|------------------------------|
| Grinding materials | Grinding machine hours |
| Component assembly | Labour assembly hours |
| Drilling holes | Drilling machine hours |
| Materials use | Material weight |
| Electricity use (Power) | Number of kilowatt-hours |
| Batch-level activities | Batch-level cost drivers |
| Equipment set up | Number of setups |
| Finished products moved in batch | Number of moves |
| Manufacturing products inspected in batches | Inspection hours |
| Reworking products | Number of defective units |
| Product-level activities | Product-level cost drivers |
| Product design and/or redesign | Number of change orders |
| Product line scheduling | Number of different products |
| Product testing | Number of procedures |

ANNEXURE 2

List of Porter's Five Forces factors

Threat of new entrants

- Economies of scale
- Product differentiation
- Brand identity/loyalty
- Access to distribution channels
- Capital requirements
- Access to latest technology
- Access to necessary inputs

- Absolute cost advantages
- Experience and learning effects
- Government policies
- Switching costs
- Expected retaliation from existing players

Bargaining power of suppliers

- Number of suppliers
- Size of suppliers
- Supplier concentration
- Availability of substitutes for the supplier's products
- Uniqueness of supplier's products or services (differentiation)
- Switching cost for supplier's products
- Supplier's threat of forward integration
- Industry threat of backward integration
- Supplier's contribution to quality or service of the industry products
- Total industry cost contributed by suppliers
- Importance of the industry to supplier's profit

Bargaining power of buyers

- Buyer volume (number of customers)
- Size of each buyer's order
- Buyer concentration
- Buyer's ability to substitute
- Buyer's switching costs
- Buyer's information availability
- Buyer's threat of backward integration
- Industry threat of forward integration
- Price sensitivity

Threat of substitute products or services

- Number of substitute products available
- Buyer's propensity to substitute
- Relative price performance of substitutes
- Perceived level of product differentiation

- Switching costs
- Substitute producer's profitability & aggressiveness

Rivalry among existing competitors

- Number of competitors
 - Diversity of competitors
 - Industry concentration and balance
 - Industry growth
 - Industry life cycle
 - Quality differences
 - Product differentiation
 - Brand identity/loyalty
 - Switching costs
 - Intermittent overcapacity
 - Informational complexity
 - Barriers to exit
-

