MODULE 2

Competitive advantage depends on the extent to which an organisation creates value for its stakeholders.

Corporate governance is the responsibility of the board and is directed at fulfilling the financial, social and environmental goals of the organisation's stakeholders.

The Management Accountant (MA) plays a key role in generating information for management and other stakeholders about value creating activities and value chain performance.

CREATING ORGANISATIONAL VALUE, PART A: VALUE CREATION

Examples of transaction costs:

- negotiating contracts
- financing investments
- monitoring performance
- gathering information.

Transaction cost analysis is a way to get you thinking about the nature of a business. Why do businesses exist and grow?

" Transaction cost theory "

How to organise production?

Transaction costs

Costs associated with **contracts**.

Costs associated with premises, services, employment, administration.

tour 自由行 a
benefit
cost :

" make or buy "
(produce in house
outsource

A transaction is an economic event in which a good or service is transferred from one economic entity to another.

Where transaction costs are high, business organisations emerge as the most economical way of organising activities.

Professional and trade associations e.g. CPA Australia Ltd reduce transaction costs by providing assurance about the competence of members.

" Outsourcing or contracting for non-core service " is beneficial if it will save the company money. A company should not, however, outsource the resources and competences which give it its competitive advantage.

Organisations: the transaction cost approach | Corporate governance: conformance | Corporate governance: performance | Corporate governance: sustainability | Creating value

Corporate governance (conformance)

is the system by which companies are directed and controlled - historical in orientation, backed up by audit and assurance

Key issues in corporate governance

- Culture and 'tone at the top'.
- The Chief Executive Officer (CEO).
- The board of directors.
- Internal controls.

Corporate governance principles

- Adhere to strategic objectives.
- Minimise risk.
- Promote integrity with codes and standards.
- Fulfil responsibilities to stakeholders.
- Establish accountability.
- Maintain auditor/non-executive independence.
- Report accurately and promptly.
- Encourage shareholder involvement.

Good corporate governance

- Reduces risk.
- Improves performance.
- Improves external perceptions.

Corporate governance controls

- Internal (Audit Committee) vs External (Regulations)
- Formal (accounting systems) vs Informal (culture).

Organisations: the transaction cost approach | Corporate governance: conformance | **Corporate governance: performance** | Corporate governance: sustainability | Creating value

Corporate governance (performance)

is the system which focuses on helping the board of directors make strategic decisions-forward-looking

Performance-related features

- Strategic planning.
- Risk management.
- Performance measurement.

Good corporate governance (performance)

- Choice/clarity of strategy.
- Strategy execution.
- Ability to respond to change.
- Ability to undertake successful mergers and acquisitions.
- Ethics and CSR.

Control organisations to achieve sustainability

Triple bottom line goals:

- financial
- social
- environmental.

Does the business adopt a compliance-based (legal) or integrity-based approach (values and culture)?

Should shareholders' funds be expended for reasons other than:

- competitive advantage; or
- legal compliance; or
- ethical behaviour?

Ethics

- Are the moral principles by which people act or do business.
- The belief systems that people use to judge behaviour.

Ethical problems

- Extortion by officials.
- Bribery.
- Unfair competition.
- Product safety.
- Honesty in advertising.
- Environmental impact.

Corporate social responsibility (CSR)

It is commonly expected that business will provide benefits to society generally, not just by economic activity or to specific stakeholder groups; legislation and social and political pressure now promote this.

- **Employment:** in many countries, equal opportunities and employment protection legislation hampers businesses' ability to adjust the size of their workforce and control labour costs.
- **Environment and externalities:** extensive legislation is designed to protect the natural environment and other forms of amenity such as health and family life.

IFAC Sustainability Framework (2009)

- The purpose of organisations and corporate governance is to achieve sustainability and the triple bottom line: financial, social and environmental goals.
- An organisation must:
  - Promote ethical responsibility and sound corporate governance.
  - Provide a safe working environment.
  - Promote cultural diversity and equity.
  - Minimise adverse environmental impacts.
  - Provide opportunities for social and economic development of communities.

Corporate Social Responsibility (CSR) is an organisation's obligation to maximise positive stakeholder benefits while minimising the negative effects of its actions.

Taking a leadership role in relation to reporting on sustainability and social impacts is one way management accountants can contribute to an organisation's obligations in this area.

Professional accountant leadership role:

Challenge conventional assumptions;

- Redefine success in accordance with sustainability.
- Establish appropriate performance targets.
- Encourage and reward the right behaviours.
- Ensure that information flows to support decisions that go beyond traditional ways of thinking about economic success.

Sustainability

Sustainable activity uses resources no faster than they can be replaced, and waste emissions are held down to a level that the environment can absorb.

Sustainability should be measured by a **'triple bottom line'**:

- **Economic prosperity.**
- **Environmental quality.**
- **Social equity.**

Stakeholders

Value can be created for:

- shareholders (dividends)
- customers (competitive prices)
- employees (wages)
- suppliers (payments)
- managers (remuneration)
- government (taxes)
- community (clean environment).

Resources

- Raw
- Physical
- Human
- Legal property rights
- Intangible

Organisations: the transaction cost approach | Corporate governance: conformance | Corporate governance: performance | Corporate governance: sustainability | Creating value

Sustainable value created = Value of benefits obtained *less* Direct cost *less* Opportunity cost of resources used

The activities that transform resources into outputs create customer value:

Inputs → Transformation → Outputs → Outcomes

Impediments to value creation

- Lack of understanding of value.
- Self-interested behaviour.
- Negative competition and functional orientation.

Role of MA in value creation

- Identify and measure value drivers.
- Measure inputs and outputs of value-creating activities.
- Plan for, control and maximise value creation (through innovation).
- Eliminate non-value adding activities.

Value drivers

- Something that affects value creation
- Types:
  - Collaboration.
  - Innovation.
  - Efficiency.
  - Market awareness.

Organisation's value drivers affect:

- resource allocation
- measurement and reward of performance
- culture and leadership style.

The various drivers may be in conflict.

The organisation value chain was originally created to describe businesses dealing with physical products.

Does it still work for services organisations or do they create value in other ways?

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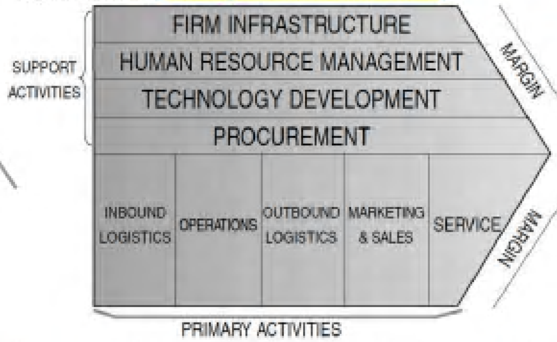
next week

SWOT
PESTEC

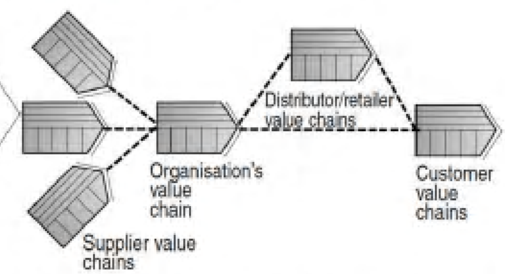
The organisation value chain | The industry value chain | Management accountants and value analysis

Porter grouped the various activities of an organisation into **the organisation value chain.**



The **margin** is the excess the customer is prepared to **pay** over the **cost** to the firm of obtaining resource inputs and providing value activities. It represents the **value created** by the **value activities** themselves and by the **management of the linkages** between them. **Linkages** connect the activities in the value chain. The activities affect one another and therefore must be co-ordinated.

A firm's value chain is connected to what Porter calls a **value system** which includes several organisations' value chains.



Using the organisation value chain. A firm can secure competitive advantage in several ways:

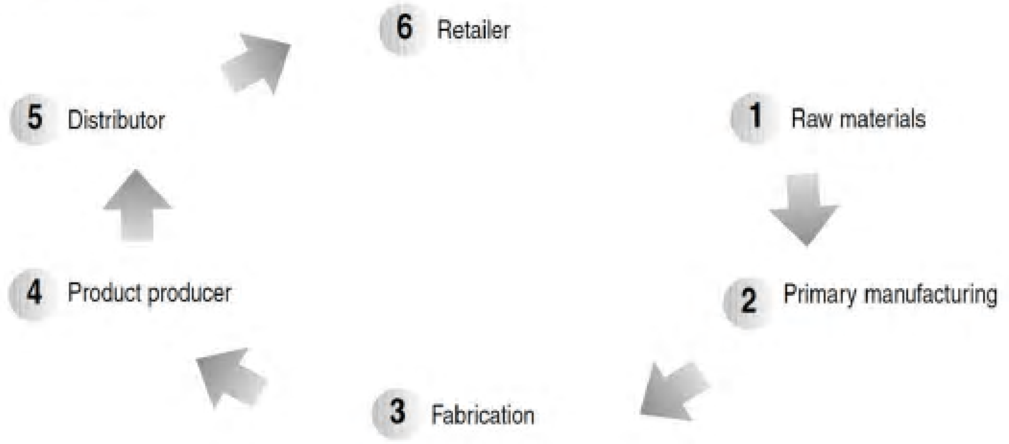
- Invent new or better ways to do activities.
- Combine activities in new or better ways.
- Manage the linkages in its own value chain.
- Manage the linkages in the value system.

Often implemented by strategic alliances:

- service level agreements
- customer affinity programs
- purchaser/supplier collaborations
- joint ventures.

The links between these value chains can represent opportunities for individual organisations to capture more of the value created by the overall system by managing them to their advantage.

The value chain concept can be used to analyse the way an industry delivers value to its participants – the **Industry Value Chain**.



Exploit links in the industry value chain by:

- Direct methods:
  - Vertical integration with others in the chain (upstream with customers or downstream with suppliers).
  - Horizontal integration with other providers of the same goods/services.
- Indirect methods:
  - Using bargaining power over suppliers and customers.
  - Reducing transaction costs by providing co-ordination and by **fostering relationships** that promote innovation eg alliances and joint ventures.

Collaboration between participants

- Importance of trust, shared values, aligned goals.
- Management of long-term relationships.
- Measure performance then share risk/reward.
- Helps in planning, reduction of waste, reduction of transaction costs.

Found to be a more effective way of managing industry value chain than each member maximising their own efficiency in isolation.

The organisation value chain | The industry value chain | **Management accountants and value analysis**

Traditional approach	MA	Key factors that create value
■ Short-term profit ■ Internal focus ■ Functions/departments ■ Linkages ignored ■ Focus on cost reduction	■ Sustainable value creation ■ External supplier-customer linkages ■ Value chain ■ Partnership approach ■ Cost improvement by reconfiguring value chain/ improving linkages	■ Strategy ■ Collaboration ■ Satisfaction ■ Quality ■ Innovation ■ Time

Management Accounting Systems (MAS) focus on department budgets, standard costs and variances.

MAS focus on product and market oriented information flowing from supplier to customer.

Performance measurement frameworks need to be more comprehensive.

Value analysis: organisation and industry are complex web of inter-related activities

Management accountant's role in value analysis

Identify:

- Significant activities
- Inputs/outputs in financial/non-financial terms
- Value created by activity
- Value driver of activity
- Linkages between value-creating activities
- Linkages across organisational boundaries

Need to extract maximum value and organise value chains in most effective way:

- reconfigure existing chains
- eliminate non value add activity
- introduce new activities
- enhance existing activities.

Module 2

Unless organisations can sustain competitive advantage, profitability is eroded. Strategic management comprises a set of techniques that enable an organisation to understand its capabilities and ensure best fit with its environment. Strategic management focuses on the long-term direction of the organisation and the implementation of strategies to achieve those goals.

CREATING ORGANISATIONAL VALUE, PART B: STRATEGIC MANAGEMENT

Strategic: avoid becoming so preoccupied with immediate issues that you lose sight of ultimate objectives.

What is strategic management? | Strategic analysis: value analysis | Strategic analysis: SWOT | Internal analysis: capabilities | Internal analysis: products | External analysis: industry analysis/five forces

Managing business strategy

Assumptions of strategic management

- Environment is predictable.
- Organisations/people are controllable.
- Decision-makers act rationally.

Formal strategic plans

- Specific, detailed, quantified.
- Highly detailed.
- Tightly followed.
- Developed through formalised processes.

Strategy: offensive or defensive actions to create a defensible position in an industry, to cope successfully with competitive forces and thereby yield a superior return on investment.

Strategic plan: statement of long term goals, and those policies which will ensure their achievement.

Strategic management: management of the elements involved in planning and controlling a business strategy to achieve sustainable competitive advantage.

Competitive advantage: anything that gives an organisation an edge over industry rivals.

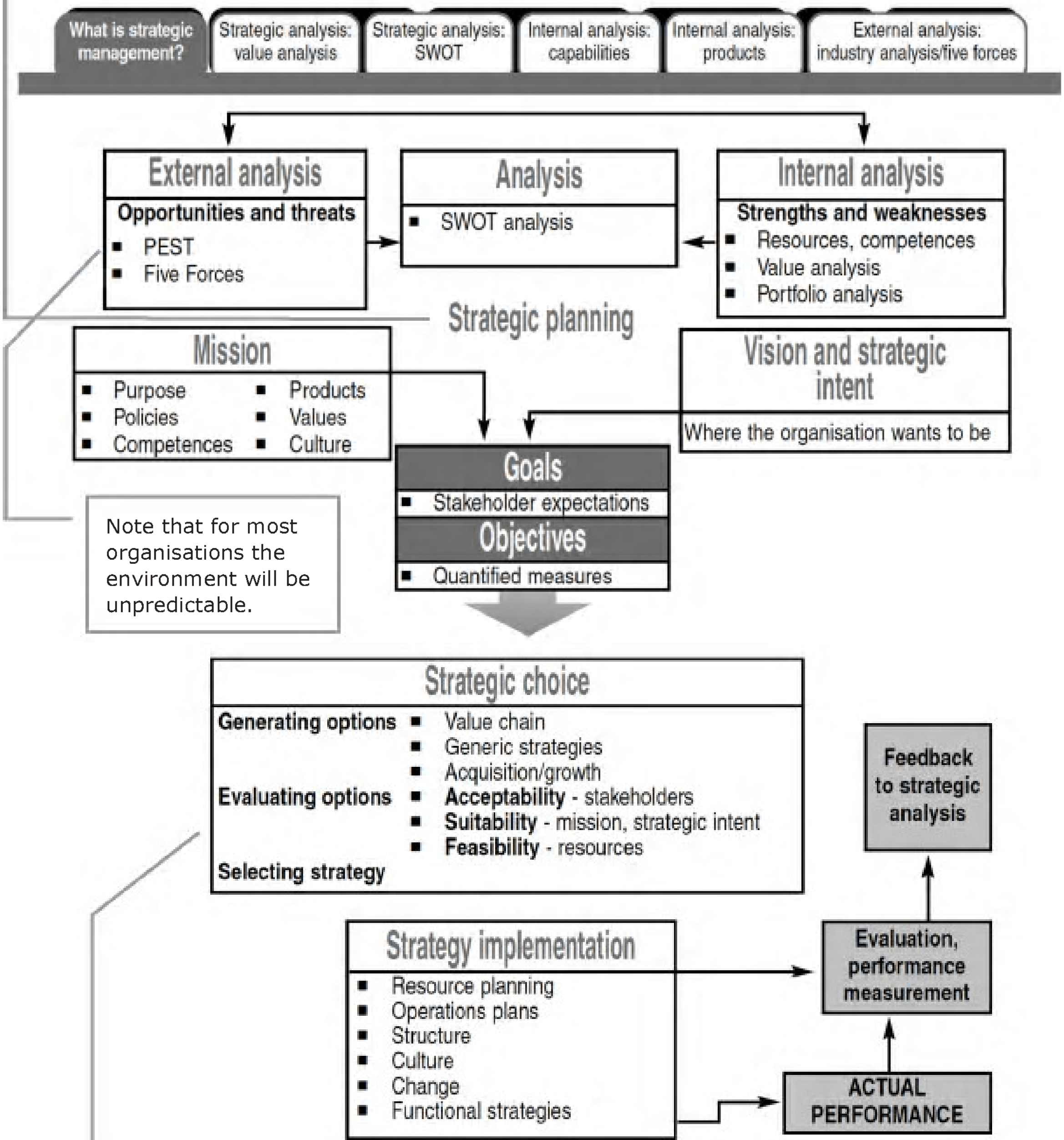
Not particularly real-life.

Strategic management is inherently uncertain.

Performed by board of directors/senior managers.

Strategic management is focused on the long-term direction of the organisation.

It is forward looking, goal orientated and is about adapting the organisation to its environment.



Note that for most organisations the environment will be unpredictable.

This diagram is a summary; you will deal with these areas later on in this module.

Need to look at whole value chain. Shifting costs to suppliers or customers does not add value.

Strategic position in the industry value chain may be significant. Some parts of the value chain (e.g. food retailing) may create more value than others (e.g. food manufacture).

Value analysis

Identify how an organisation adds value for customers at each stage of the value chain (by improving individual activities in the chain + linkages between them).

Also identify non-value adding activities such as storage and movement to reduce or eliminate them.

Creates/improves competitive advantage

Translates into bigger market share or higher prices

Adds to organisation value

Value propositions

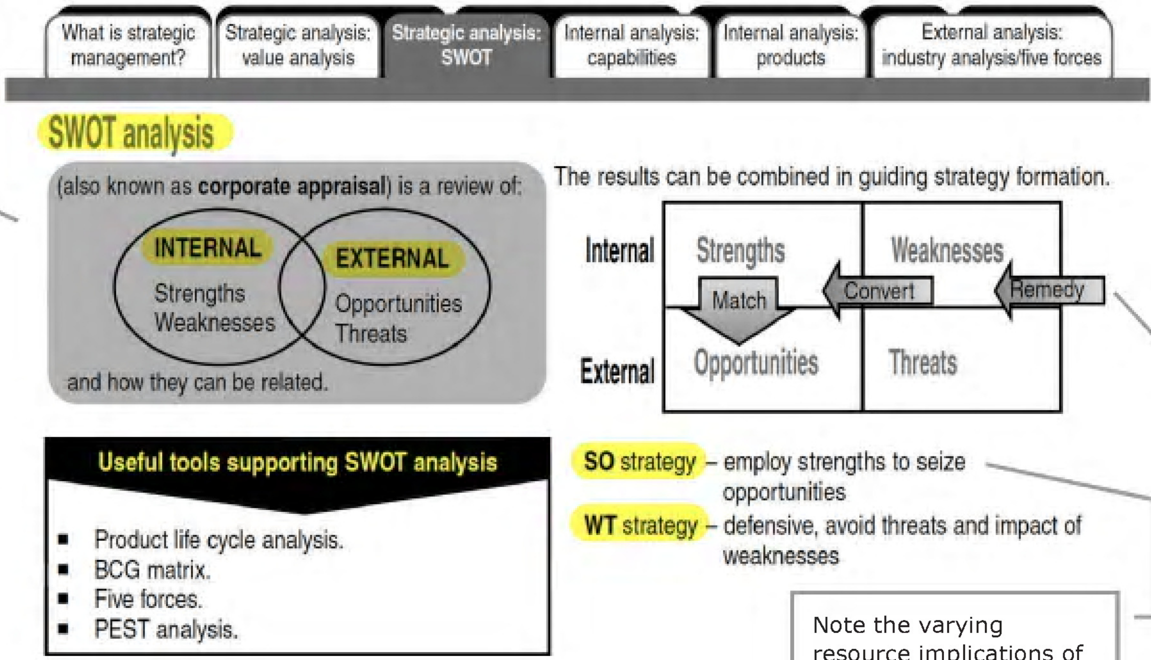
- Identify objectives for each stakeholder group.
- Develop related value proposition for each.
- Customer value is key.

Value chain and improving competitive advantage

- Display value-adding capabilities (reputation and branding).
- Eliminate non-value adding activities.
- Use less costly subsititute inputs to activities.
- Conceive new ways to conduct activities.
- More effective linkages than competitors.

A useful way to think about an organisation is as a coalition of stakeholder groups who are simultaneously competing for resources and collaborating to make the organisation successful. In order for the organisation to survive and prosper, each stakeholder must make a contribution to the organisation, and each stakeholder must get something they value in return for their contribution.

SWOT draws all the strategically important threads of capability analysis and environmental analysis together.



Note the varying resource implications of these strategies.

Conversion applies in two ways – remedying weaknesses and managing threats so as to reveal opportunities.

Examination of strategic capability must include an assessment of **quality** – depends on the ability to support the **creation of value for customers**.

Competences are the activities and processes through which an organisation deploys its resources effectively.

What is strategic management?	Strategic analysis: value analysis	Strategic analysis: SWOT	Internal analysis: capabilities	Internal analysis: products	External analysis: industry analysis/five forces

Strategic capability

the adequacy and suitability of an organisation's **resources** and **competences to achieve its strategy**.

Position-based strategy aims to achieve competitive advantage by positioning a market offering to respond to the opportunities and threats present in the environment.

Resource-based strategy is based on the possession of distinctive resources, which may be **physical resources** or **capabilities** (core competences): the activities and processes through which an organisation deploys its resources effectively.

Reproducible capabilities and resources meet customers' minimum requirements and are needed for survival, but other organisations can replicate them quite easily.

Distinctive capabilities and **core competences** underpin competitive advantage and are difficult for competitors to imitate or obtain eg brands, patents.

Categories covered in internal analysis

- Assets - working/fixed capital.
- Resources - external relationships.
- People and management - human capital.
- Systems and processes.

Resources are both physical (e.g. machinery and labour) and intangible (e.g. information and management style).

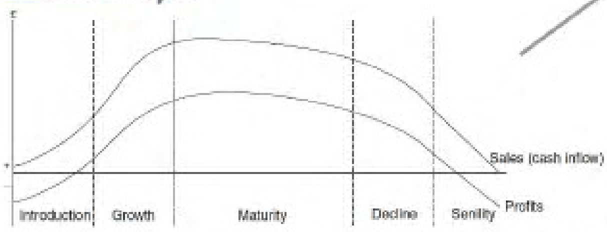
Note the product life cycle is a model, not a law.

Not all products conform to it; stages are different lengths in different industries.

What does each stage imply for the appropriate business strategy in that stage?

The company's offerings to the market are fundamental to its success. They must be kept under review so that there is a suitable mix. The **product life cycle** is an important concept and strategies must be appropriate to stage in life cycle.

Product life cycle



Product class (or **generic product**) – a broad category

Product form – type within the category

Brand – the specific product

Introduction: development, marketing and production costs high; sales volume low; loss maker; negative cash flow.

Growth: sales volumes accelerate, profits rise, but cash flow likely to remain negative; competitors enter the market. High advertising costs. Add additional features to product.

Maturity: longest period; no market growth but profits good, and cash flow positive; reminder promotions only.

Decline: product superseded; sales fall, over-capacity in industry; some players leave market. Those that remain try to find niches.

Portfolio analysis is applicable to products, market segments and Strategic Business Units (SBUs). There are four basic strategies:

Build – Invest for market share growth

Hold – Maintain current position

Harvest – Manage for profit in the short-term

Divest – Release resources for use elsewhere

The BCG Matrix

Market growth rate		High	Low
	High	Star	Question mark
	Low	Cash cow	Dog

Relative market share

Stars – build
Cash cows – hold or harvest
Question marks – build or harvest
Dogs – divest or hold

Problems with the BCG matrix

- Simplistic.
- Strong brand may give competitive strength despite relatively low market share.
- Ignores innovation.
- Dogs and question marks may be needed to complete a range.
- High market growth assumed to be attractive. But will require significant investment which may not be available.
- Ignores competitors other than market leader.
- Does not indicate overall best mix or *how* to build stars and question marks

Importance of having a balanced portfolio:

- stars to assure the future
- cash cows to supply funds to support future growth
- question marks to be converted into stars.

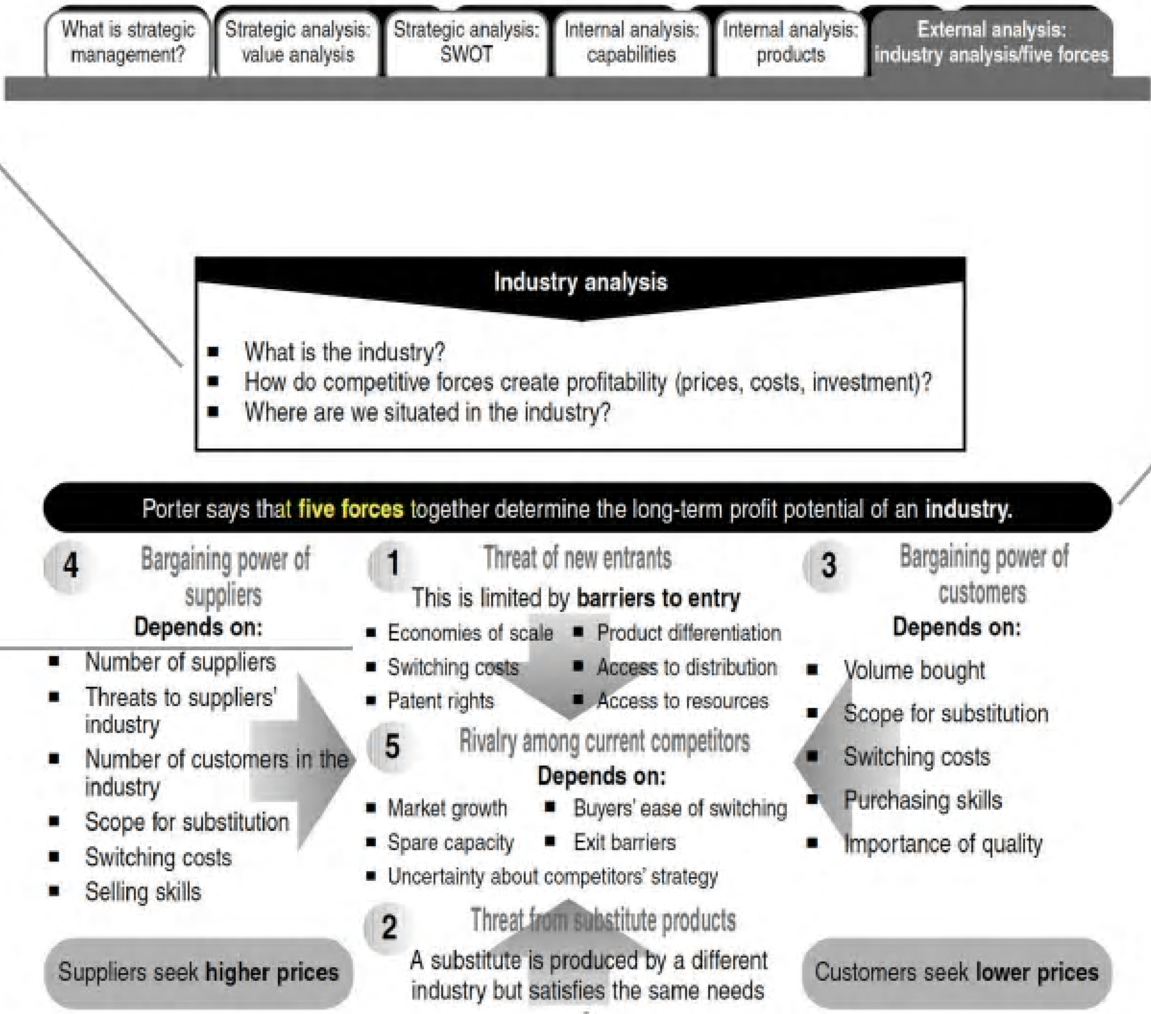
Parallels with product life cycle:

- stars – growth phase
- cash cow – mature phase.

Concentrate on industry's business cycle, not short-term fluctuations.

The reaction of existing competitors will also affect the success a new entrant has.

Note that this is an analysis of the potential for profit in an industry as a whole, not just for individual companies.



This could be an argument for backward vertical integration: bring supply in-house.

Input from a different industry is the test – if the new product comes from the same industry it is an example of competitive rivalry, not a substitute.

Remember, PEST factors are **linked** and **interact** – the way that politics influences economic activity and *vice versa* is an example.

National/international regulations:

- regulatory constraints
- trade barriers.

In addition to the five industry forces identified by Porter (1985), other opportunities and threats must be analysed. The **PEST** framework is based upon six factors: **p**olitical, **e**conomic, **s**ocio-cultural, **t**echnological, **e**nvironmental protection and **l**egal.

Political/legal factors

Governments oversee the framework in which business operates eg physical, social and market infrastructure.

Many aspects of business activity are subject to legal regulation:

- Contracts
- Health and safety
- Employment
- Tax

Other aspects are regulated by supervisory bodies.

Political change and political risks affect the planning activities of many businesses.

Economic factors

These operate in both a national and international context. Relevant factors include:

- Inflation rates
- Employment rates
- Interest rates
- Tax levels
- The business cycle
- Growth/fall of GDP
- Savings levels
- Exchange rates
- International trade
- Capital markets

Government policy

- Fiscal policy (taxes, borrowing, spending).
- Monetary policy (interest rates, exchange rates).
- Size and scope of the public sector.

Business cycles

- Fluctuations in local/national/international economic activity.
- Boom, recession, (depression), recovery.
- Triggering events.

Highlight the importance of globalisation as a key driver of change in the macro-environment (global markets; global production; global competition).

Developments in IT have driven much recent business **change**. (Link to e-business and e-marketing.)

Why are environmental factors important in the business environment?

CSR = Businesses being held more accountable for the social consequences of their actions.

Public opinion drives the impact of environmental protection – scarcity of natural resources and sustainability are both very **practical constraints** on strategic plans.

Social/environmental factors

Demographic changes have clear implications for patterns of demand. They also affect availability of labour. Can also affect recruitment policies.

Culture in society provides a framework for understanding beliefs and values, and creates patterns of human activity. It influences **tastes** and **lifestyles**.

Technological factors

Many strategies are based on exploiting technological change (e.g. the Internet and e-commerce). Others are defences against such change (e.g. emphasising service or quality when a competitor introduces a major technical development).

Technological developments affect all aspects of business (especially IT developments).

- New products and services become available.
- New methods of production and service provision.
- New ways of selling (e-commerce).
- Improved handling of information in sales and finance.
- New organisation structures to exploit technology.
- New media for communication with customers and within the business (e.g. the Internet and email) facilitates business becoming global.

Environmental protection

Pressure coming from many quarters:

- Green pressure groups
- Employees
- Corporate Social Responsibility
- Legislation
- Environmental risk screening
- Shareholders

Possible green issues for businesses to consider:

- Consumer demand for environmentally friendly products.
- Greater regulation by governments and international bodies.
- Businesses may be charged for the external cost of their activities.
- Scarcity of non-renewable resources.
- Sustainability of operations.
- Opportunities to develop new environmentally friendly products and technologies (gain competitive advantage).

How does this vary globally? Regulations and legislation are less rigorous in developing countries.

What opportunities do the increased coverage of sustainability and CSR issues provide businesses?

- Identify risk-based market segments
- Use product analysis e.g. BCG, product life cycle
- Engage with employees
- Re-engineer industry value chain

External analysis: PEST	Strategic planning: developing a good strategy	Strategic planning: business model generation	Strategic planning: generic strategies	Strategy choice	Strategy implementation

Strategic analysis

Strategic planning - review:

- Existing strategic management framework.
- Existing strategic plan.
- Need to revise framework and plan.

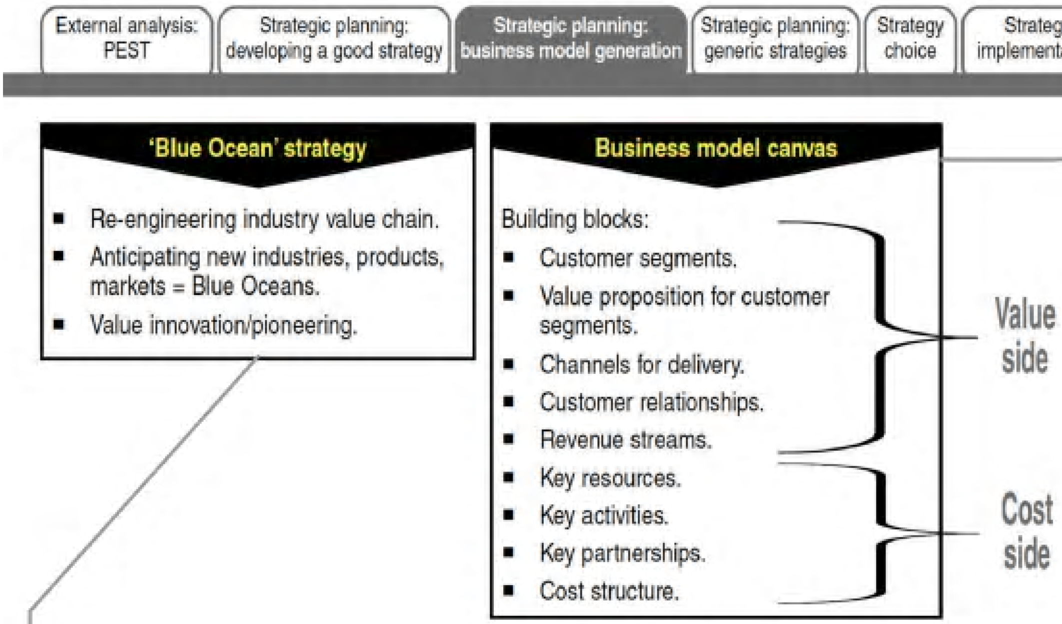
Strategic management framework

- Vision – why is society better off as a result of the organisation?
- Mission – identify stakeholders, commercial rationale, target market.
- Goals – detail of the mission.
- Objectives – quantitative measures of the goals against which performance can be assessed.

A **good strategy** should:

- Use Strengths – exploit organisation's resources/capabilities.
- Address Weaknesses – ensure there are enough resources/capabilities.
- Fit with the Opportunities in the environment.
- Sustain itself against Threats of others replicating it.
- Fit together properly – be internally consistent.
- Survive a reality check – can it be implemented?

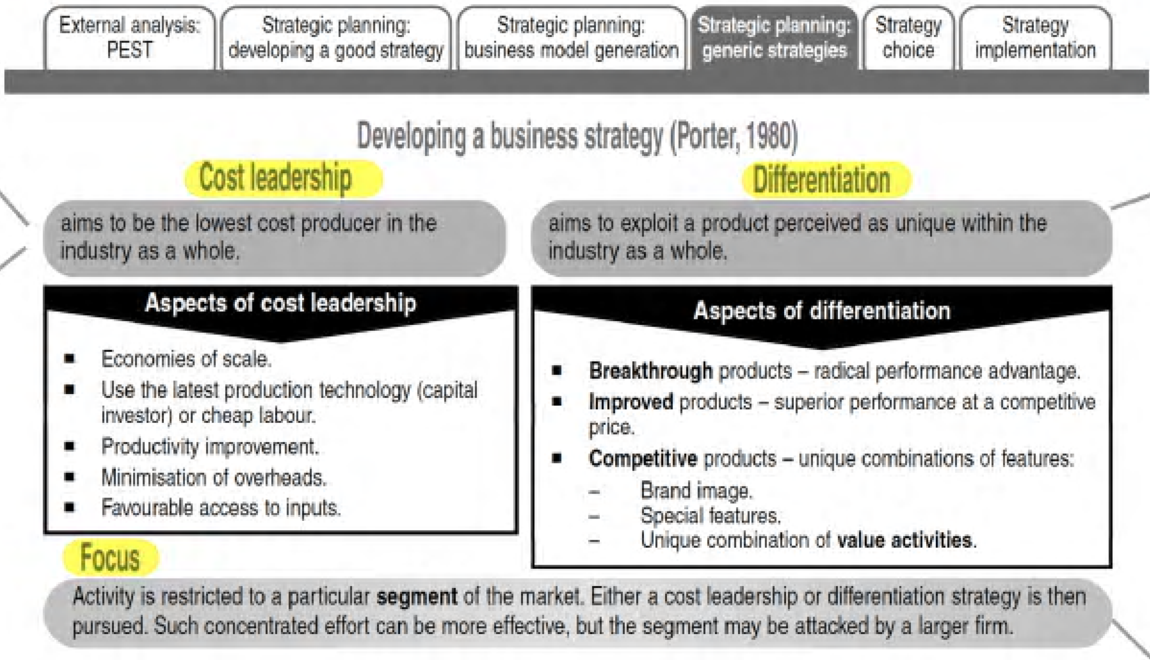
Both approaches together aim to create uncontested market space by simultaneously improving value and reduce cost.



Trying to envisage the totally new is not easy, but just look at the success of Facebook – it is worthwhile!

Cost leadership usually implies a volume of sales and production that will ensure economies of scale: a mass-market marketing mix is therefore essential.

Since there is usually only room for one cost leader in an industry, most large businesses will pursue a differentiation strategy.



Porter talks of cost leadership, not simply low cost.

Is his approach too restrictive in this respect?

Niches can be very secure – mass-market products are likely to fail to meet specific needs (opportunity for differentiation focus) or to be over-specified (opportunity for cost focus).

Culture and overall risk will always be important considerations when assessing suitability.

Iterative process: strategy choice does not simply follow on from (1) strategic analysis and (2) strategic planning.

External analysis: PEST	Strategic planning: developing a good strategy	Strategic planning: business model generation	Strategic planning: generic strategies	**Strategy choice**	Strategy implementation

Strategies are evaluated according to:

1. Their **suitability** to the organisation's strategic situation.

   This might be analysed using organisation and industry value chain analysis.

2. Their **feasibility** in terms of resources and competences.

3. Their **acceptability** to key stakeholder groups.

   Depends upon the view of **each stakeholder!** Financial considerations (return on investment, cash flow, and cost benefit analysis) are generally important, but don't forget issues such as government legislation or corporate social responsibility. Also, **risks** must be carefully assessed.

Criteria for choosing a good strategy:

- Promotes organisation's values.
- Shows how to compete.
- Outlines product/market strategies.
- Creates internal/external linkages.
- Inspires/guides managers.
- Gives discretion for management action.
- Common language.
- Exploits strengths/opportunities.
- Manages weaknesses/threats.
- Complements existing strategies.
- Meets stakeholder expectations.
- → Sustainable competitive advantage.

Consider also competitors' potential response and whether sufficient time is available.

The different attitudes to risk of the various stakeholder groups are the consideration here.

External analysis: PEST	Strategic planning: developing a good strategy	Strategic planning: business model generation	Strategic planning: generic strategies	Strategy choice	**Strategy implementation**

Aim: achieve organisation's objectives by

- Uniting the organisation.
- Organising activities.
- Gaining commitment.
- Ensuring accountability matches reward.
- Feeding back and improving constantly.

Balanced scorecard

Strategy map

Role of Management Accountant

- Analyse competitive environment.
- Evaluate organisation's capabilities.
- Analyse proposed strategies.
- Assist with implementation of strategy.
- Evaluate success/failure through target setting and performance measurement.

MA needs to appreciate that strategic planning/management is:

- forward looking
- long-term
- externally focused
- subjective.

Covered in Module 3.