# Business Acumen

Murugan Anandarajan, Ph.D.
Professor of MIS

# Value of an Organization

- Value of an organization is shaped by two concepts
  - Business model: Creates and captures value
  - Operating model: Delivers value

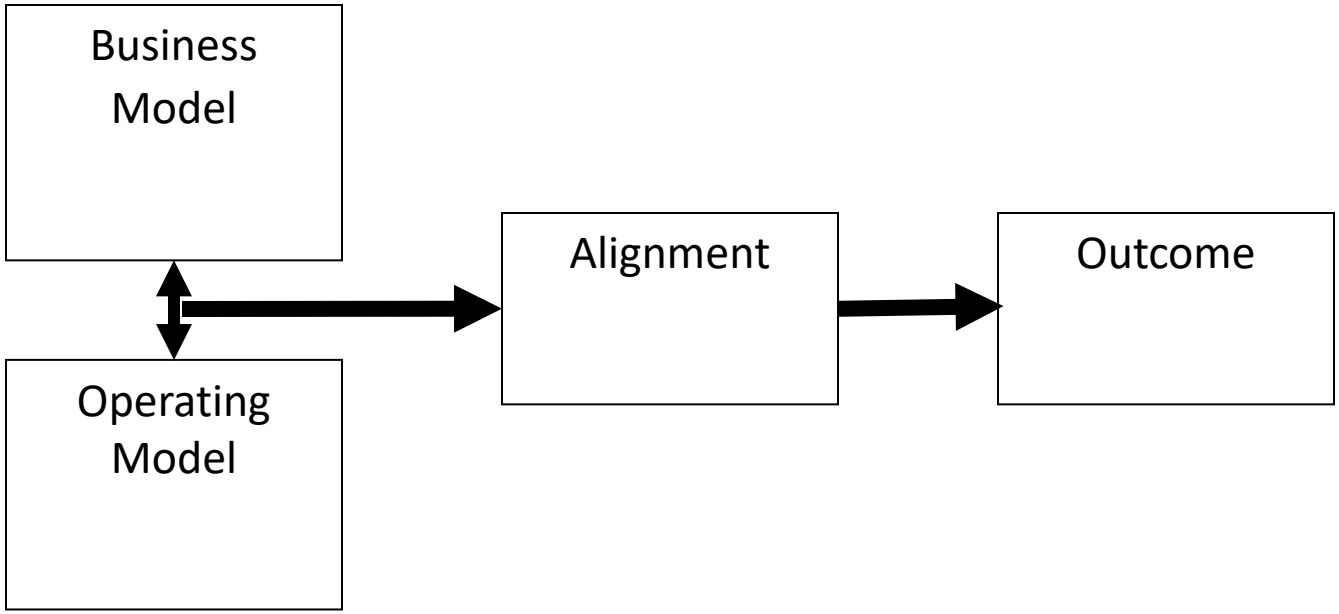
# Business Model

- The organization is all about innovation in the business model, experimenting and recombining various aspects of the value creation and capture.

- Value Creation: Differentiation, Cost, Focus
- Value Capture: Price, License, Promotion

# Operating Model

- Delivers value promised to customer
  - Delivers value at scale: Designing an operating model to deliver as much value to many customers as possible at the lowest possible cost.
  - Achieve sufficient scope: Range of activities
  - Respond to change by engaging in learning: Continuous improvement, improving of performance


Business Model
Operating Model
Alignment
Outcome

# Creating Value

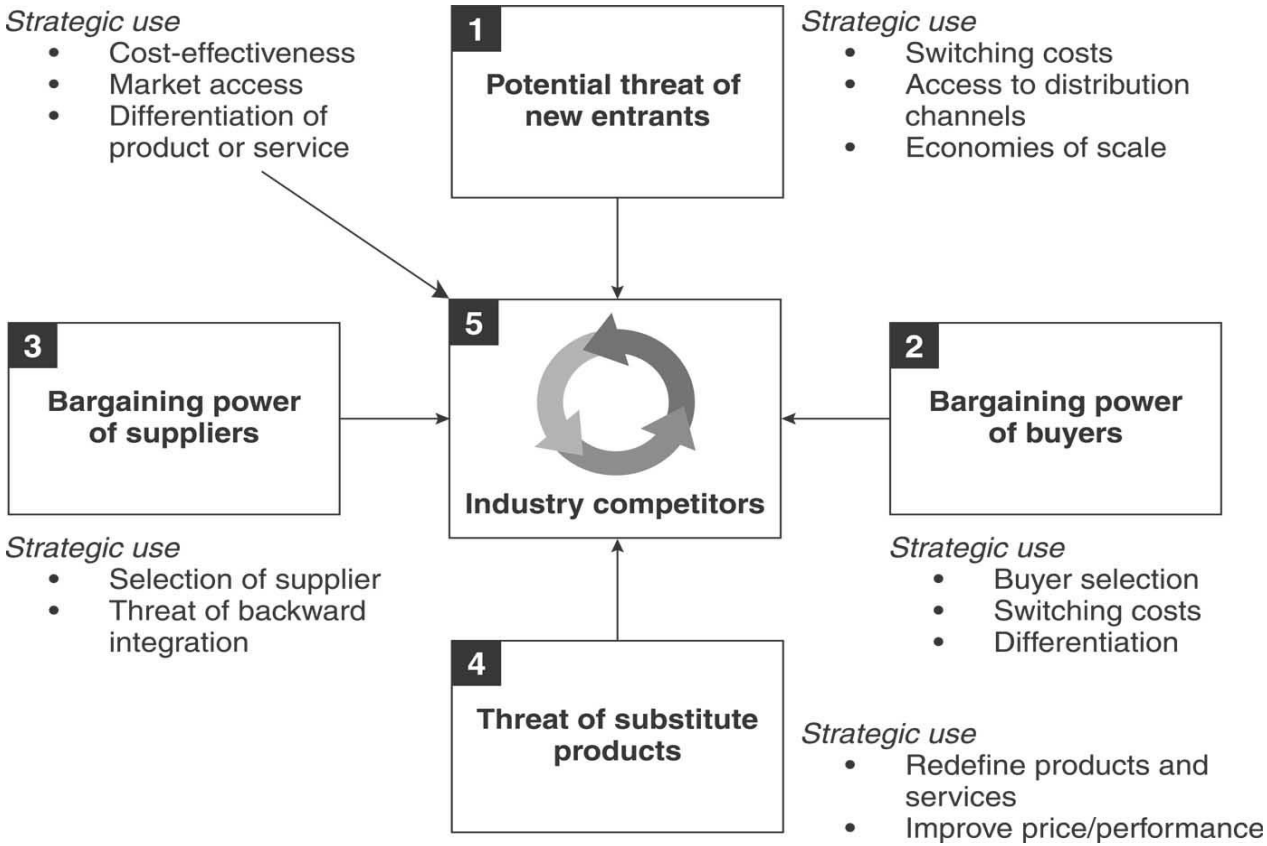
- Value Proposition: Element of strategy that look outwards, reflects choices about the kind of value the company will offer.

- Tailored Value Stream: Best set of activities to deliver the output

# Value Creation

- Evaluating the strategic landscape is helpful in determining strategic opportunities
- Some approaches include:
  - Porter's five forces model
  - D'Aveni's 7 S's framework
  - Porter's value chain model

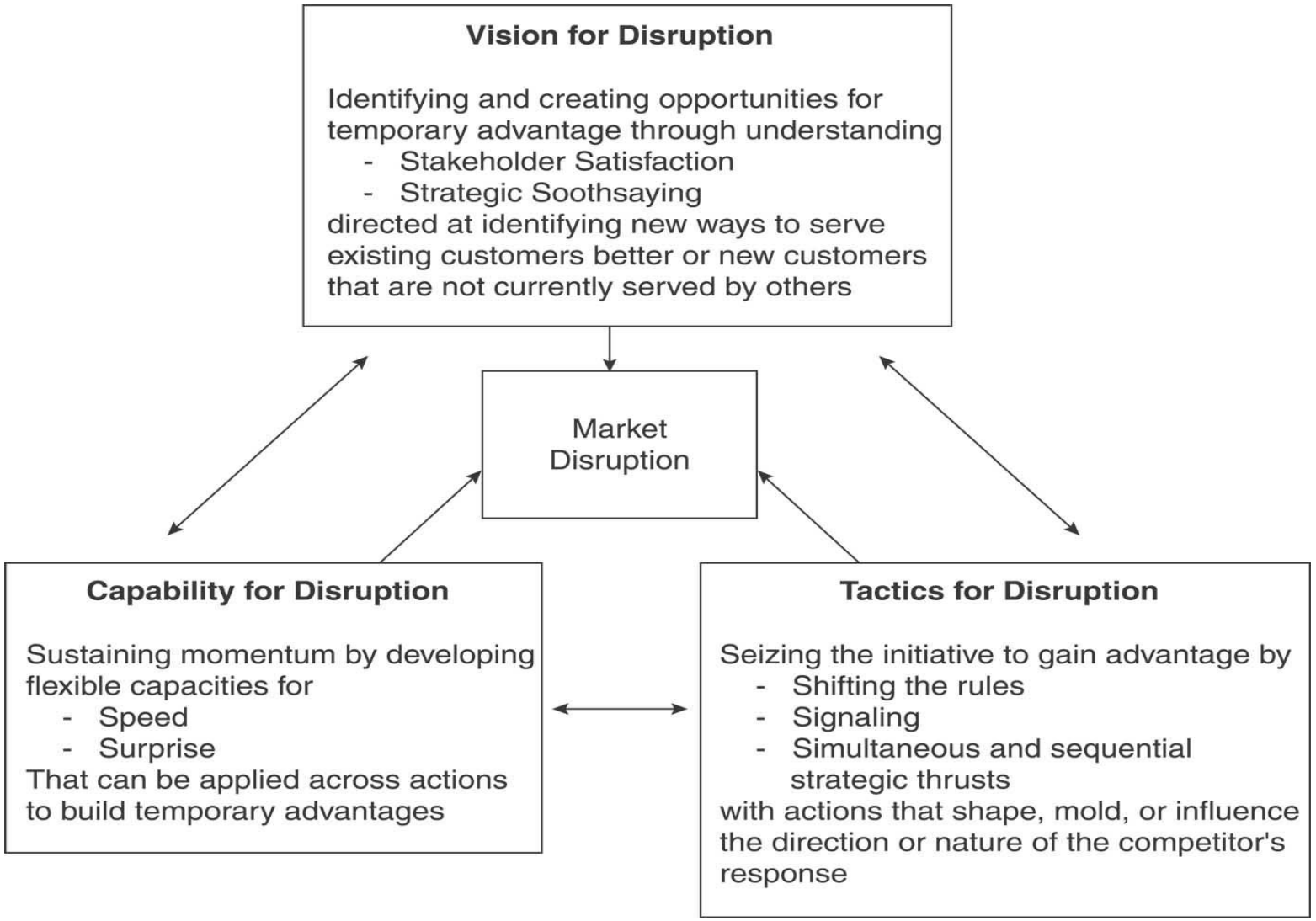
# Industry Analysis



# Five Forces Model

- Using Five Forces Model, managers can:
  - Identify key sources of competition they face
  - Identify uses of information resources to enhance their competitive position against competitive threats
  - Consider likely changes in competitive threats over time

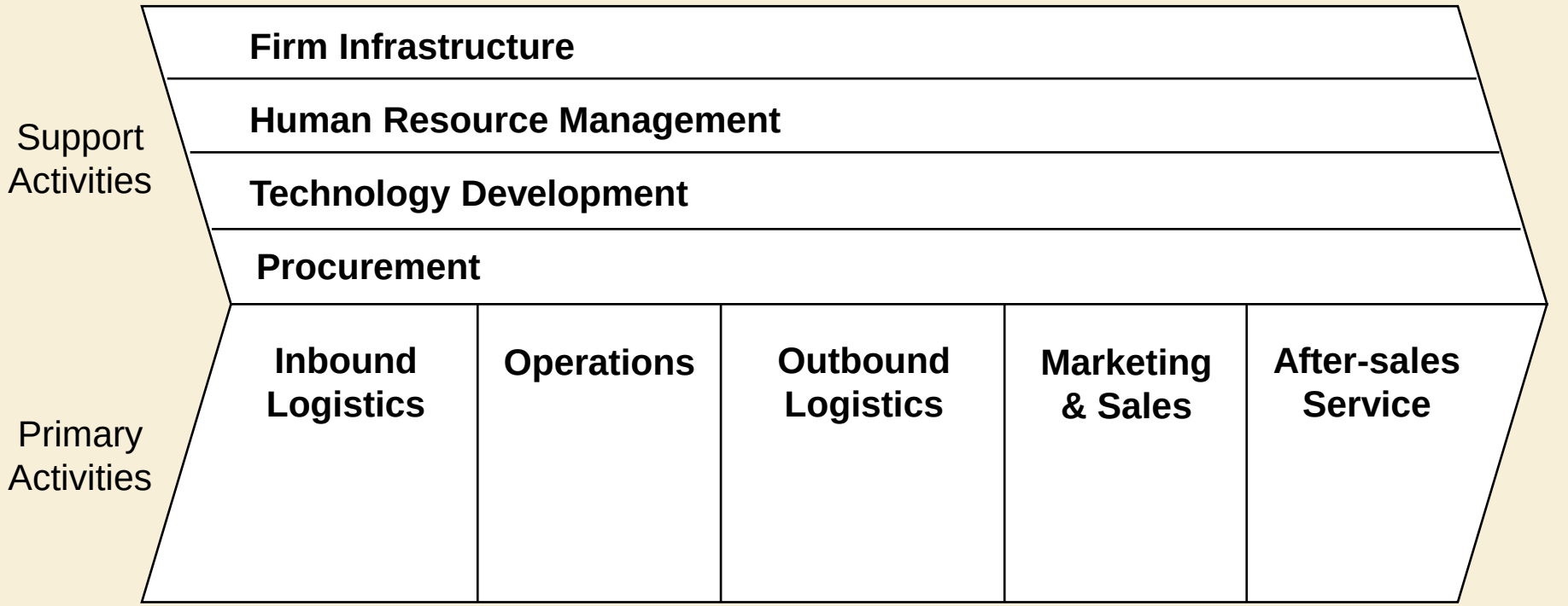
# 7 S's Framework



The break-even point is the point in the volume of activity where the organization's revenues and expenses are equal.

| | |
|---|---|
| Sales | $250,000 |
| Less: variable expenses | 150,000 |
| Contribution margin | 100,000 |
| Less: fixed expenses | 100,000 |
| Net income | $ - |

# Value Analysis




Source: Adapted from Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 2008).

What activity choices did you make
in Round 1 to support your strategy choice?

# Steps in Value Analysis

1. Use the value chain template to break down the firm into its key activities (and if the information is available, competitors' key activities).
2. Analyze each key activity and its drivers to look for ways to reduce the firm's cost and/or increase the buyers' willingness to pay.
3. Decide on a customer value proposition (CVP) and a set of activity choices to efficiently deliver it. *The goal is to drive the largest "wedge" between the buyers' willingness to pay and the total cost to produce.*

# Typical Sub-Activities (italics) in a Manufacturing Firm


Source: Adapted from Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 2008).

# The Warehouse, Round 1

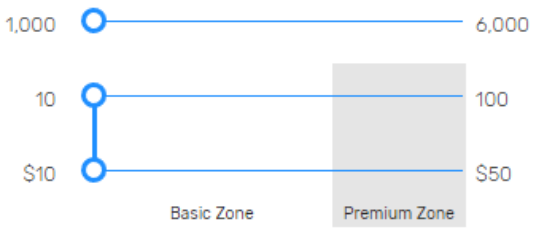
Make inventory and final product delivery decisions.

## Shoe Materials

**Decide how many shoes you would like to produce, and at what level of quality.**

Quantity to Order

Material Quality




1,000 units

Quality rating: 10

$10.00 per unit

## Product Delivery

**Decide which option will be used to deliver final product to the customer.**

Fullfillment Method

- ○ Batches
- ● **Single Shipment**

GO TO INFORMATION

VISIT THE FACTORY

### Order Details

| | |
|---|---|
| Quantity | 1,000 units |
| Quality | Basic |
| Price | $25—$45 |

### Time to Produce

2.4 weeks

### Potential Revenue

$35,000

### Spending Forecast

| | |
|---|---|
| Warehouse | $11,000 |
| Factory | $68,640 |
| Showroom | $2,500 |
| **Total** | $82,140 |

### Potential Profit

-$47,140

PROCEED TO RESULTS

# The Factory, Round 1

Select production method, employees, and station assignments.

Decide your factory's production method

Each employee works: **One Station** | All Stations

| Station Speed | | Stations: Preparation (2–4 mins) | Assembly (4–8 mins) | Completion (3–6 mins) | Inspection (2–4 mins) |
|---|---|---|---|---|---|
| Ashley  | $17/hr, 9.00% defects | ✓ | | | |
| Vu  | $15/hr, 10.00% defects | ✓ | | | |
| Lucy  | $48/hr, 2.00% defects | | | ✓ | |
| Mark  | $50/hr, 1.00% defects | ✓ | | | |
| Ali  | $24/hr, 3.50% defects | | ✓ | | |
| Navid  | $20/hr, 5.00% defects | | | | ✓ |

**Order Details**

| | |
|---|---|
| Quantity | 1,000 units |
| Quality | Basic |
| Price | $25—$45 |

**Time to Produce**

2.4 weeks

**Potential Revenue**

$35,000

**Spending Forecast**

| | |
|---|---|
| Warehouse | $11,000 |
| Factory | $68,640 |
| Showroom | $2,500 |
| **Total** | $82,140 |

**Potential Profit**

-$47,140

# The Showroom, Round 1

Select optional enhancements to the finished shoes. Price increases relating to enhancements are at the discretion of the client, and in general, higher quality shoes will yield a higher price increase per enhancement. Hint: you know from previous experience that the client won't pay more for an over-embellished product, so consider carefully which features would best fit your product strategy.

## Shoelace protector

Cost $0.25 per unit

Benefit Buyer may pay up to 2% more

## Technology improvement

Cost $2.50 per unit

Benefit Buyer may pay up to 5% more

## Customized flag add-on

Cost $0.50 per unit

Benefit Buyer may pay up to 3% more

## Upgraded performance insole

Cost $1.50 per unit

Benefit Buyer may pay up to 3% more

### Order Details

| | |
|---|---|
| Quantity | 1,000 units |
| Quality | Basic |
| Price | $25—$45 |

### Time to Produce

2.4 weeks

### Potential Revenue

$35,000

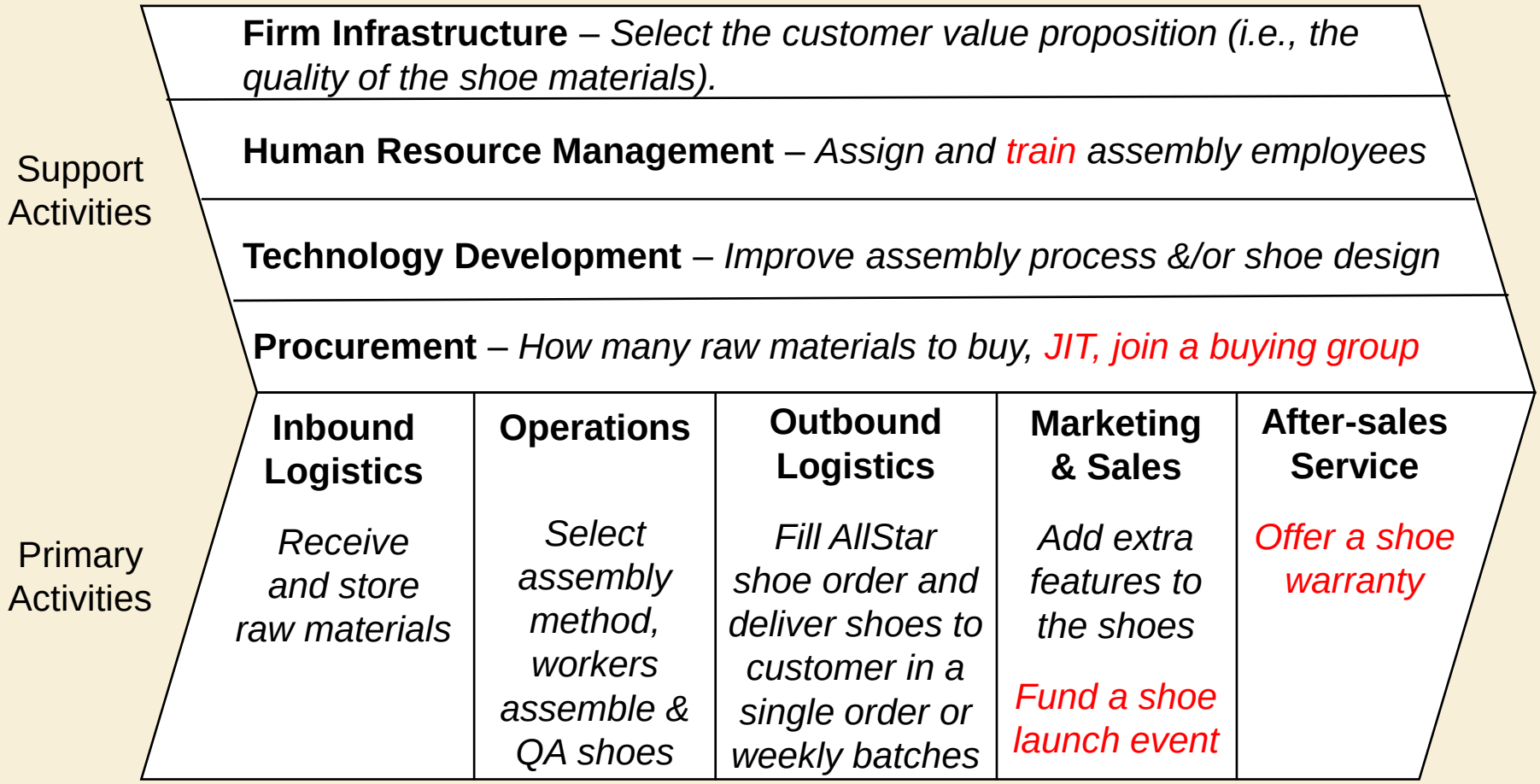
### Spending Forecast

| | |
|---|---|
| Warehouse | $11,000 |
| Factory | $68,640 |
| Showroom | $2,500 |
| **Total** | $82,140 |

### Potential Profit

-$47,140

# Key Sub-Activities in SmartShoe




*Note: Sub-Activities in **red** are activity decisions in Round 2*

Source: Adapted from Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: Free Press, 2008).

Which activity choices in the simulation had the greatest impact on SmartShoe's operating expenses shown on the results page? On its sales?

# Step 2. Analyze each activity and its drivers to look for ways to reduce cost and/or increase willingness to pay

Drivers are factors that impact a key activity's cost or the buyers' willingness to pay.

We focus on the drivers of key firm activities, those activities that generate a significant amount of value and those which incur a significant amount of cost.

Critical drivers in manufacturing firms are typically learning, scale, capacity utilization, linkages, integration, and policy choices.

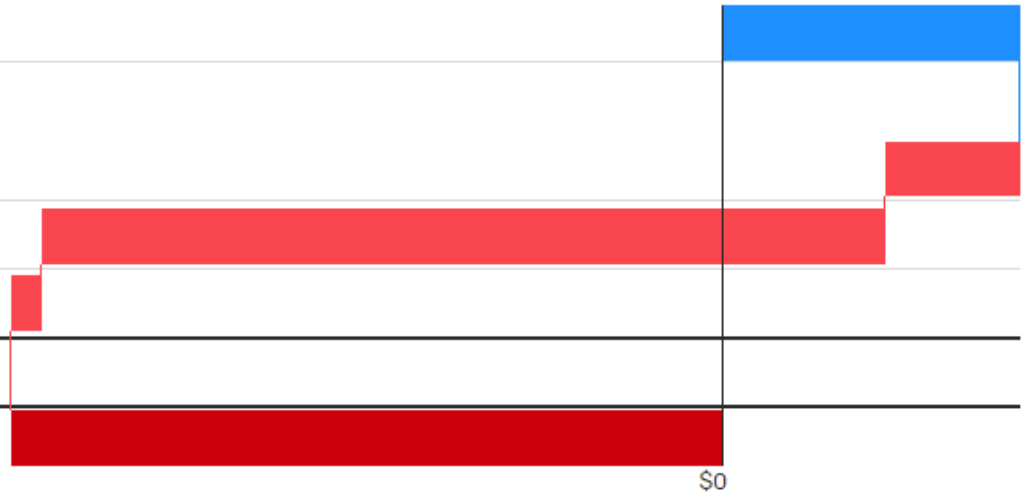
# Simulation Results

Summary Statement

| | |
|---|---|
| Quantity sold | 965 |
| Shoe quality | 7.6 / 100 |
| Price per unit | $25.00 |
| Cost per unit | $84.99 |
| Profit per unit | -$59.99 |

# Income Statement

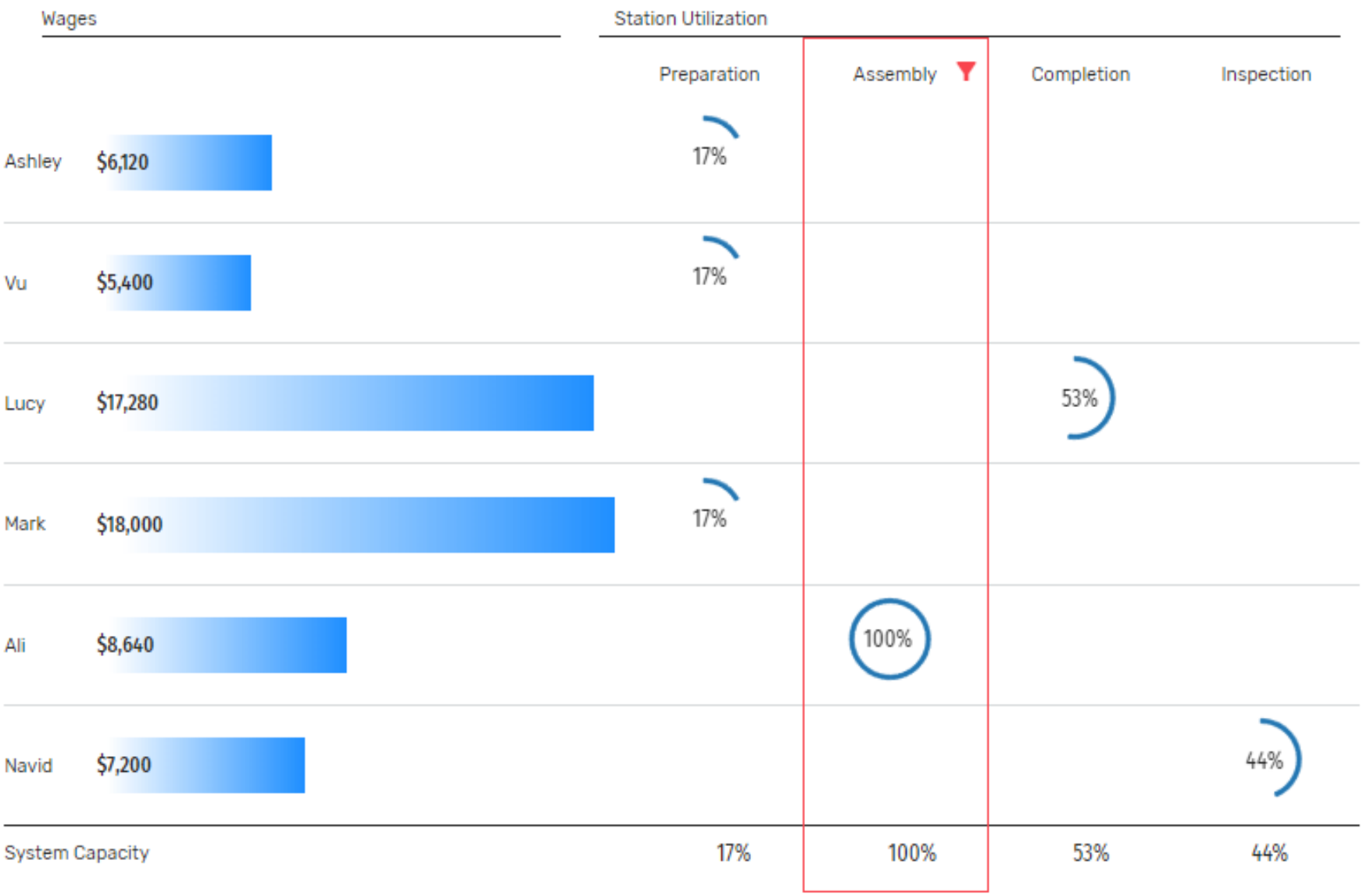
| | |
|---|---|
| **Net Sales** | $24,125 |
| Operating Expenses | |
| Warehouse Expenses | ($10,965) |
| Factory Expenses | ($68,640) |
| Showroom Expenses | ($2,413) |
| **Total Operating Expenses** | ($82,018) |
| **Profit from Special Order** | -$57,893 |



# Expense Detail

| | Expense | Revenue |
|---|---|---|
| **Warehouse** | | |
| **Total Expenses** | ($10,965) | |
| Raw Materials: 1,000 Basic Units at $10 Each | ($10,000) | |
| Units Sold: 965 | ($9,650) | |
| Defective Units: 35 | ($350) | |
| Unused Materials: 0 | ($0) | |
| Product Delivery Selections: | | |
| Single Shipment | ($483) | |
| **Factory** | | |
| **Total Expenses** | ($68,640) | |
| Wages Total | ($62,640) | |
| Base Wages | ($62,640) | |
| Overhead Total | ($6,000) | |
| **Showroom** | | |
| **Total Expenses** | ($2,413) | |
| Embellishments Selected | | |
| Software Improvement | ($2,413) | $0 |

# Factory Output

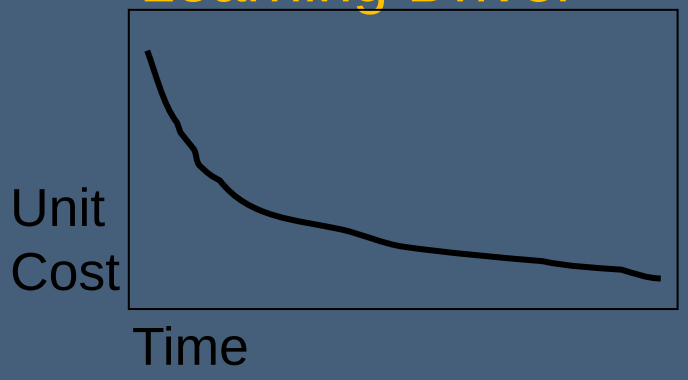


| Driver | Activity Driver Questions & *Decisions* |
|---|---|
| Learning | How long has the key activity been performed? *Can you increase learning in a key activity?* |
| Scale | What is the size of the key activity? *Increase the size advantages of an activity? Spread fixed costs over larger activity volumes?* |
| Capacity Utilization | How much of the activity's capacity is being used? *Can you increase the capacity utilization of the activity?* |
| Linkages | How is the activity aligned with other activities? *Do you improve the coordination between activities or make better trade-offs?* |
| Integration | Is the key activity done in-house or outsourced? *Should you outsource an activity?* |
| Policy Choices | Choice of customers, promotions, assembly, etc.? *Can you make tactical choices to increase willingness to pay or reduce cost?* |
| Inter-relationships | Can you share activity costs with other business units? *Share procurement, infrastructure, or HR costs across business units?* |
| Timing | When was the key activity configured? *Can you purchase assets earlier in the business cycle or build the brand?* |
| Location | What is the physical location of the activity relative to the firm's buyers and suppliers? *Can you move the activity closer to buyer/suppliers?* |
| Institutional Factors | What laws or regulations impact a key activity? *Can we adjust the activity or lobby to change these?* |

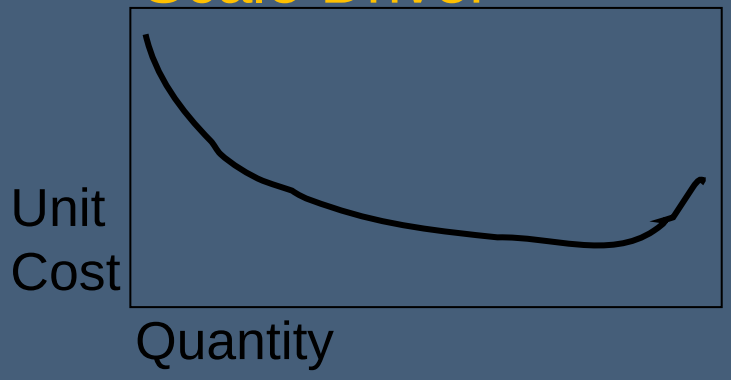
| Driver | Activity Driver *Decisions* in the Sim |
|---|---|
| Learning | *Can you increase learning in a key activity?* |
| Scale | *Can you increase the size advantage of an activity? Spread the fixed assembly line costs over larger activity volumes?* |
| Capacity Utilization | *Can you increase the capacity utilization of the activity?* |
| Linkages | *Can you improve the coordination between activities or make better trade-offs?* |
| Integration | *Should you outsource an activity?* |
| Policy Choices | *Can you make tactical choices that increase the buyers' willingness to pay or reduce cost?* |

# Visual Representation of Four Key Cost Drivers in Value Chains

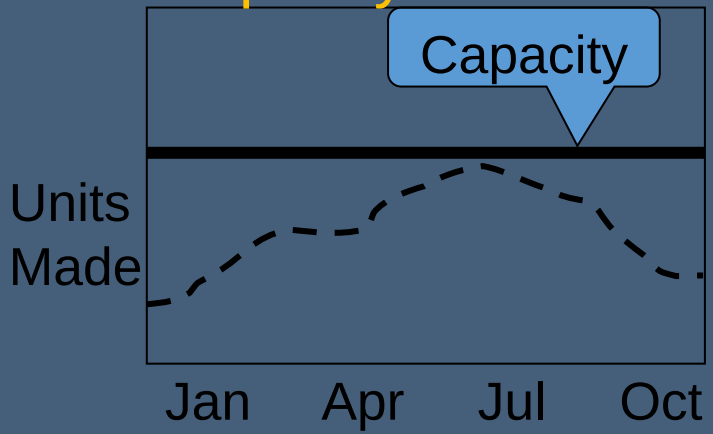
## Learning Driver



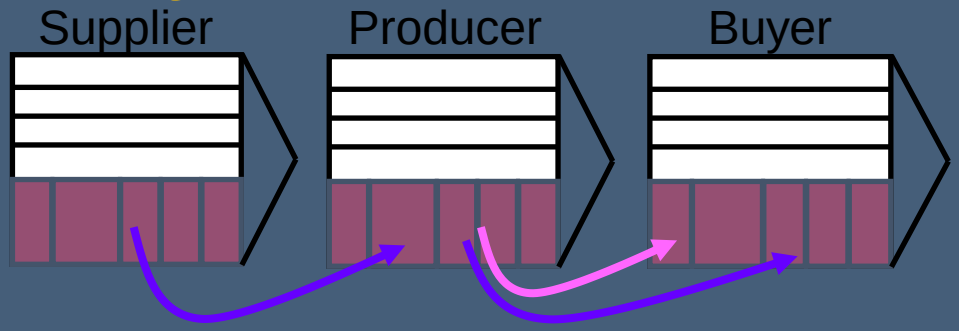

## Scale Driver




## Capacity Utilization




## Linkages Driver



# Step 3. Decide on a CVP and a set of activity choices

Select a customer value proposition and then make a coordinated set of activity and driver choices to profitably deliver this CVP.

Your goal in Round 2 is to drive the largest wedge between Allstar Sports' willingness to pay and the cost to produce the shoes.