

Strategic Management CB4303

WEEK 4: SHARED VALUE & COMPETITIVE
ADVANTAGE

Haeyoung Koo
Department of Management
City University of Hong Kong

Announcements

- Final group selection due TODAY
 - Please e-mail me with the final list of student names, preferred names, and ID by the end of class if you have not already
- In-class quiz #1 next week
 - To be conducted at the beginning of class (20 mins)
 - Week 1-4 contents
 - Simple multiple choice questions
 - Closed book

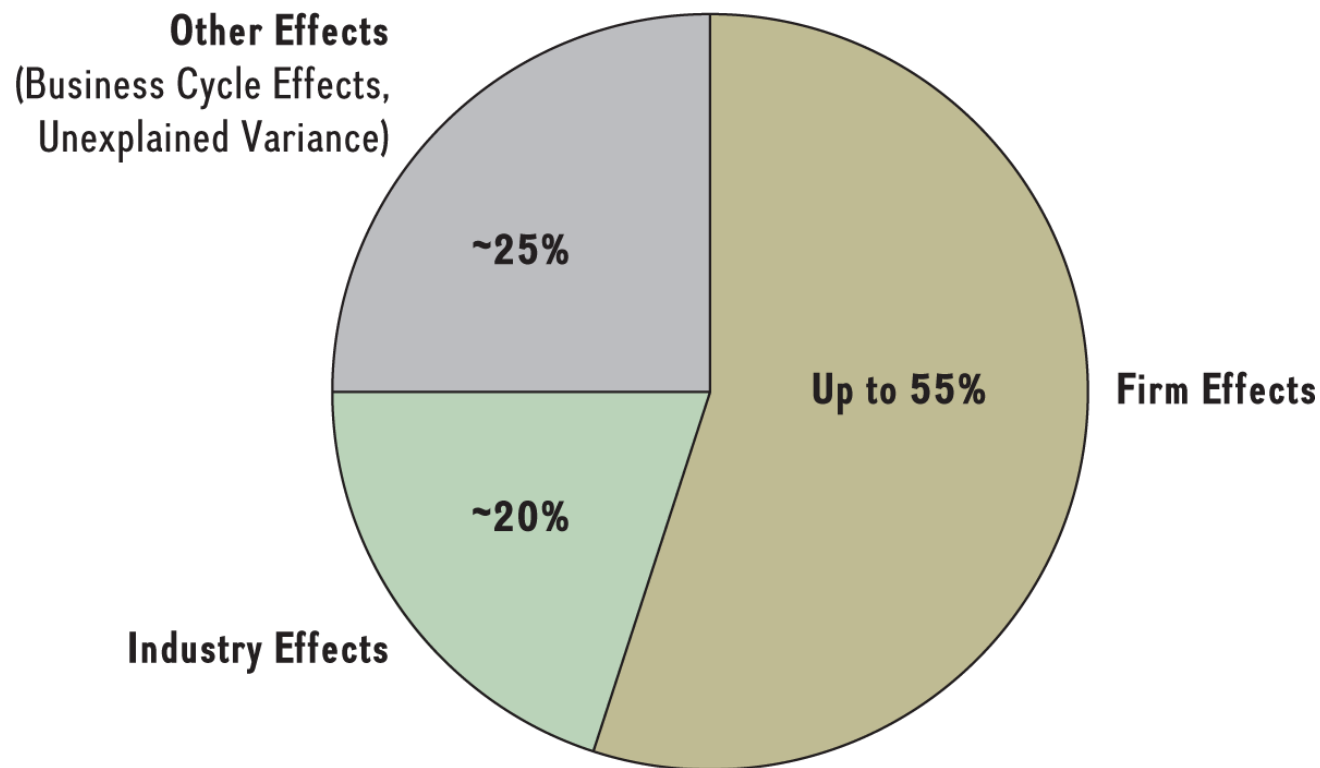
In-Class Quiz

- Please download the LockDown Browser if you have not already
- It is your responsibility to make sure that the LockDown Browser is operating correctly, prior to coming to class
- There will be NO make-up quiz

- Follow the steps below next week:
 1. Open LockDown Browser from the computer
 2. Log in Canvas and then navigate to the quiz
 - Access our course -> Quizzes -> In-class quiz #1
 3. Quiz will start at 12:10PM and end at 12:30PM

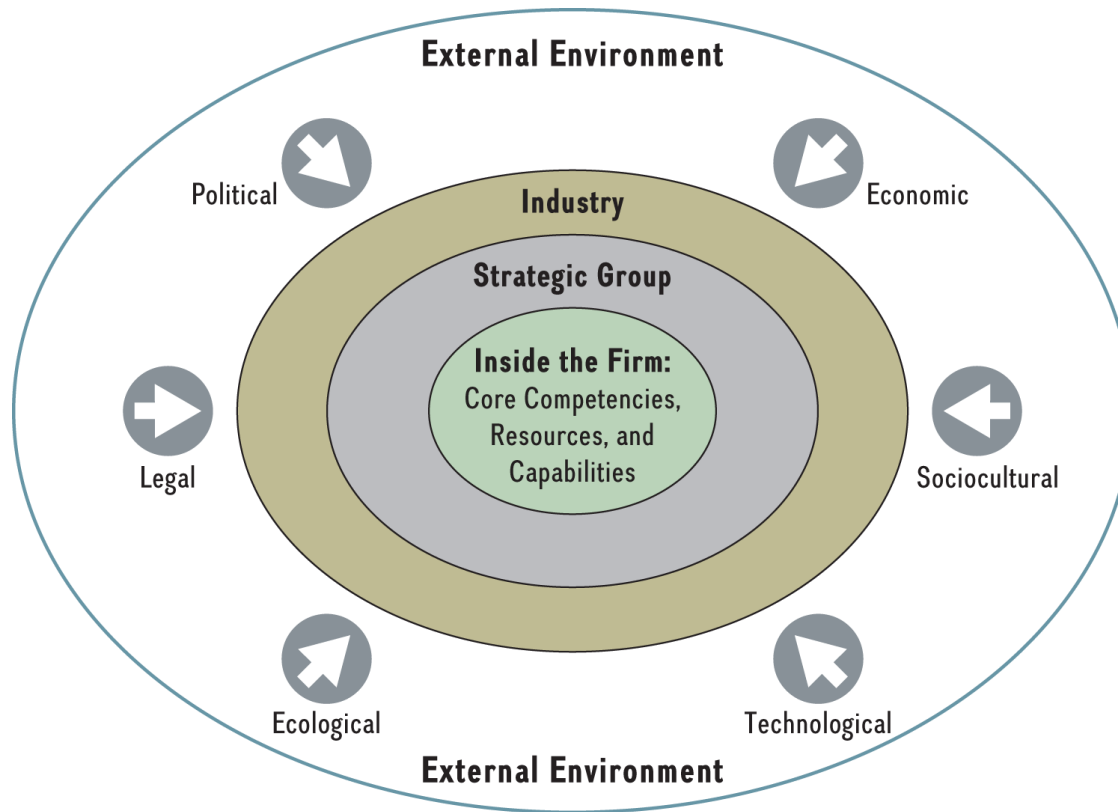
Recap

Industry vs. Firm Effects



Source: Textbook Exhibit 3.3

Inside the Firm: Competitive Advantage

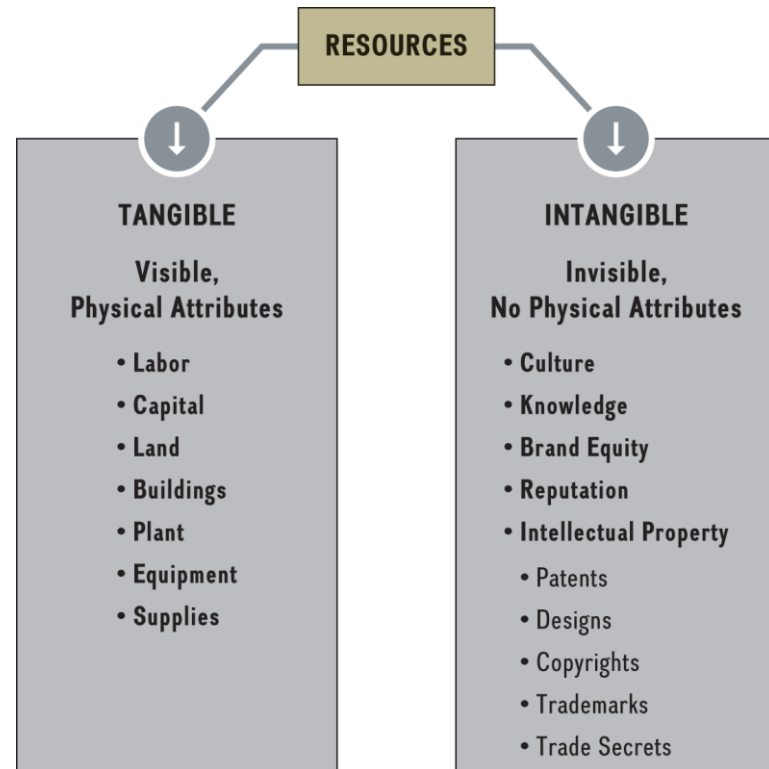


Source: Textbook Exhibit 4.2

Resource-based View

Resource-based View of the Firm

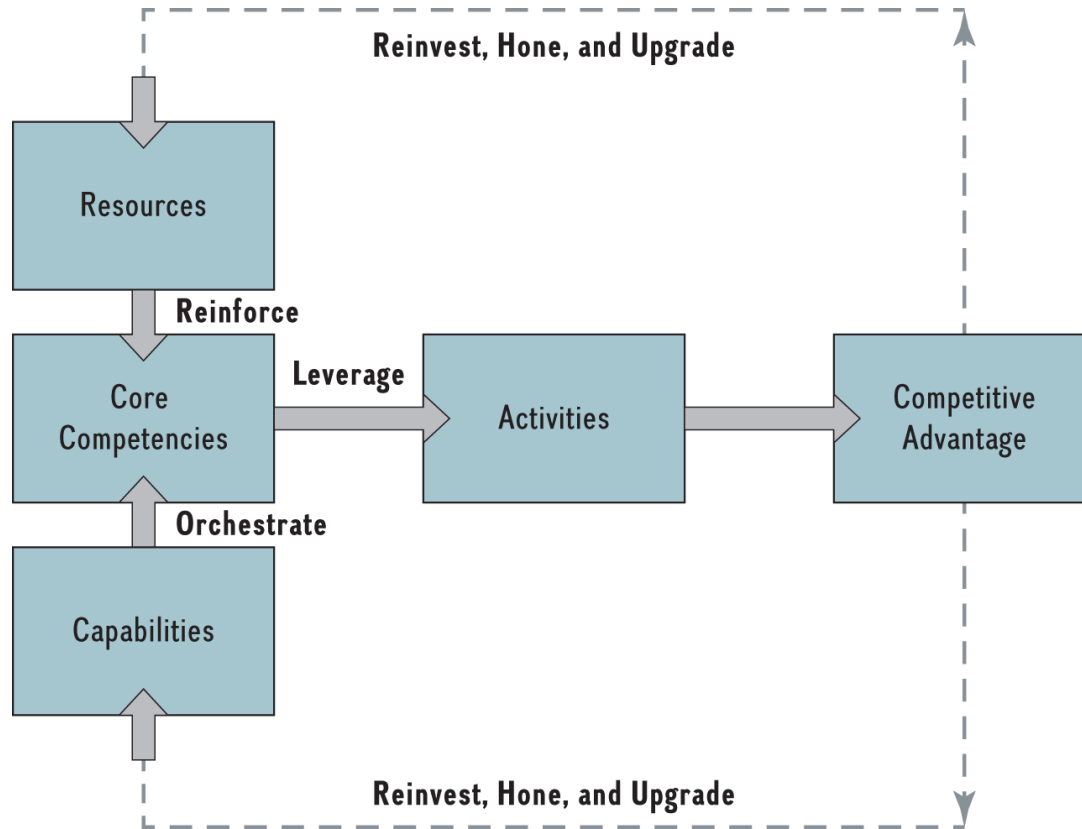
- Firm is made up of a bundle of resources
- Having the “right bundle” allows the firm to enjoy competitive advantage
- Key to superior firm performance



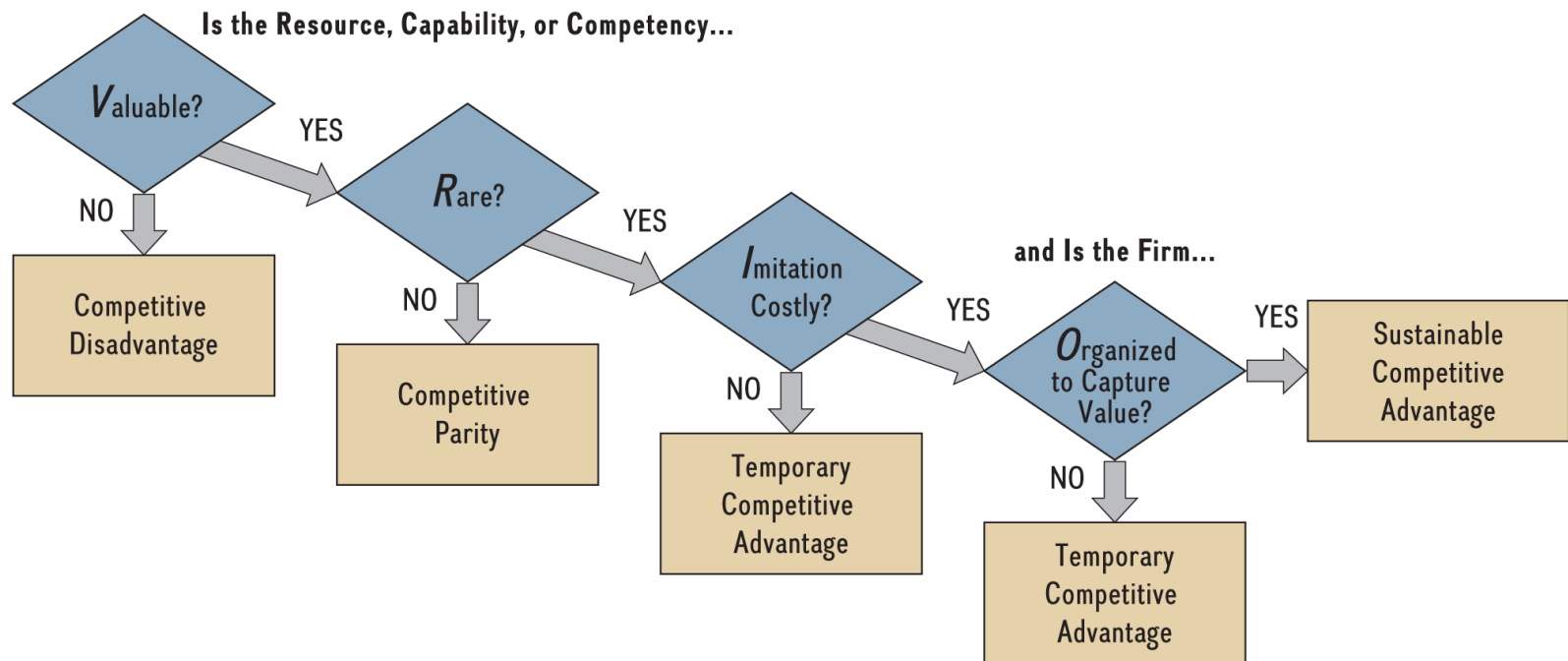
Source: Textbook Exhibit 4.5

Linking Core Competencies, Resources, Capabilities, and Activities to Competitive Advantage

Exhibit 4.4



VRIO Framework



Source: Textbook Exhibit 4.6

Dynamic Capabilities

A firm's ability to:

- Adapt resources over time in its quest for competitive advantage
- Create, deploy, modify, reconfigure, upgrade, leverage

The goal:

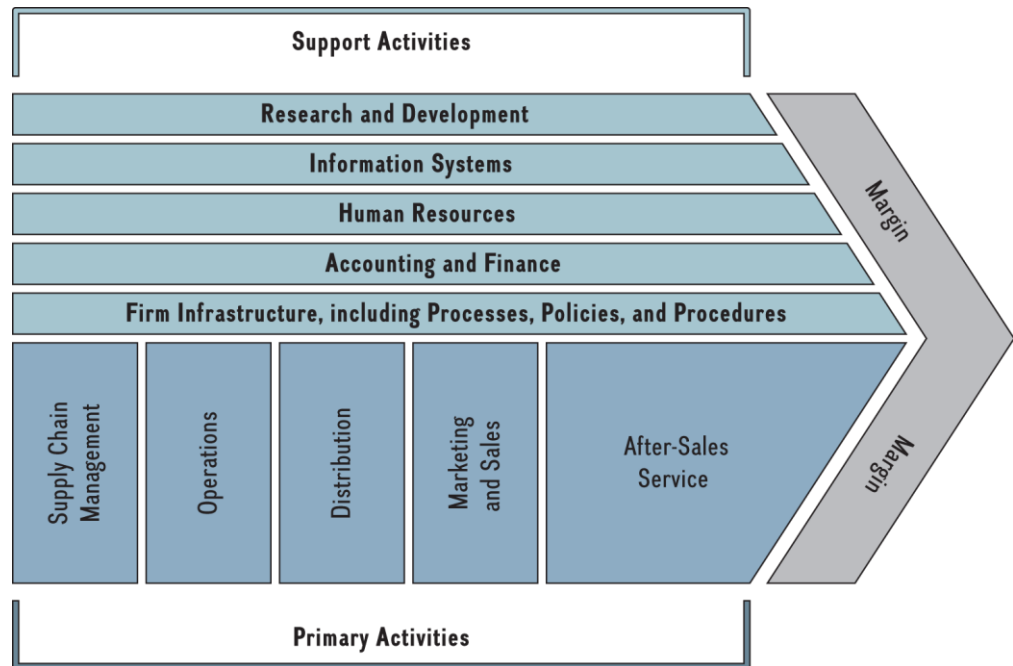
- Create long-term competitive advantage
- Develop resources, capabilities and competencies
- Create a strategic fit with the firm's environment
- Change in a dynamic fashion

Value Chain

Internal activities a firm engages in when transforming inputs into outputs

Each activity adds incremental value

Each activity also adds incremental costs



Agenda for Today

- Topic: Shared Value & Competitive Advantage
 - ✓ Shareholder vs. stakeholder capitalism
 - ✓ Compare traditional frameworks to assess firm performance
 - ✓ Discuss the more integrative frameworks of balanced scorecard vs. triple bottom line to assess and evaluate competitive advantage

An Overview of Frameworks Today

Three traditional frameworks
to measure and assess firm
performance

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

Two integrative frameworks
combining quantitative data with
qualitative assessments

1. Balanced scorecard
2. Triple bottom line

Traditional Frameworks

Performance Assessment Dimensions

Accounting Data

- How much profit does the firm create? (traditional definition of “bottom-line”)

Shareholder Value

- How much value does the firm create for shareholders?

Economic Value Creation

- How much economic surplus does the firm generate?

These performance dimensions generally correlate, particularly over time:

- Accounting profitability and economic value creation tend to be reflected in the firm's stock price
- Determines the stock's market valuation

Accounting Profitability

- Assesses firm performance and profitability for a given period
- Ability to compare and benchmark firm performance to competitors and industry average

Available through:

- Standardized accounting metrics (GAAP)
- Form 10-K statements
- Profitability ratios
- Return on equity (ROE), return on assets (ROA)

Limitations of Accounting Data

Historical and backward-looking

Does not consider off-balance sheet items:

- Pension obligations
- Operating leases

Focuses mainly on tangible assets

- May not be the most important: “not everything that counts can be counted”

Intangible assets

- Some are captured in accounting data: IP, goodwill
- Not included but important: innovation, quality, customer experience

Evolution of Strategic Management

1950-1960s: Financial budgeting & economic forecasts

- More about “planning”

1970-1980s: Emergence of strategic management as a field

- Industry analysis and competitive positioning

1990-2000s: Emphasis on the firm

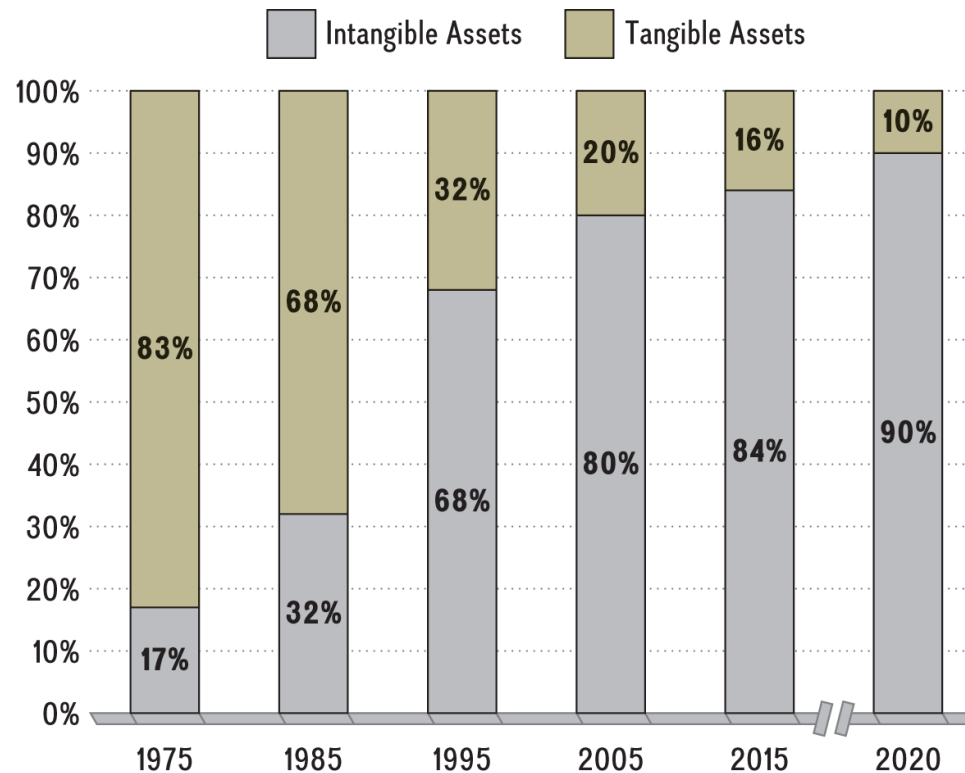
- Resources and capabilities
- **Shareholder value maximization**
- Restructuring, outsourcing, cost cutting

2000-2010s: Emphasis on **innovation and technology**

2020s: Emphasis on **corporate social responsibility**

The Importance of Intangible Assets

% of Intangible Assets to Firms' Stock Market Valuation (1975–2020)



Source: Textbook Exhibit 5.3. Author's analysis and depiction of data from Compustat, 1980–2020

Shareholder Value Creation

Shareholders

- Own shares of stock
- Legal owners of public companies

Total Return to Shareholders

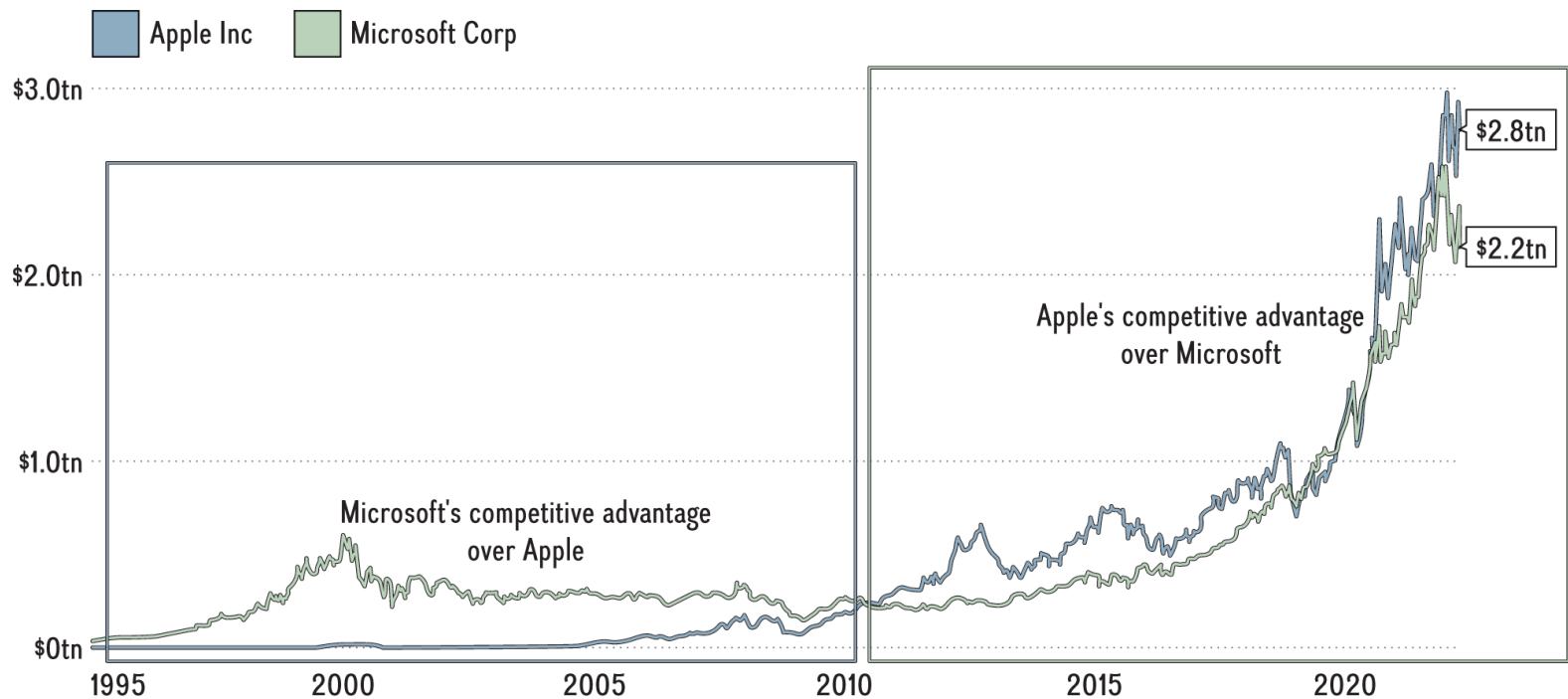
- Stock price appreciation + dividends
- Public firms are required to report total shareholder return in annual filings

Market Capitalization

- Dollar value of total shares outstanding
- Number of outstanding shares x share price

Shareholder Value Creation

Stock Market Valuations of Apple and Microsoft (in USD billion), 1995–2022



Source: Textbook Exhibit 5.4

Limitations of Shareholder Value Creation

Stock prices can be volatile

- Difficult to assess short-term firm performance
- This is due to market volatility, external factors and investor sentiment

Macroeconomic factors affect stock prices

- Economic growth or contraction
- Unemployment, interest and exchange rates

Investor expectations

- Stock prices can reflect the mood of investors
- Constantly adjusted every quarter
- Based on firm performance and industry average
- Investors can be irrational

Economic Value Creation

The difference between:

- Buyer's willingness to pay (value)
- Firm's total cost to produce (cost)

Competitive advantage in terms of economic value creation:

- From superior product differentiation, or
- Relative cost advantage over rivals

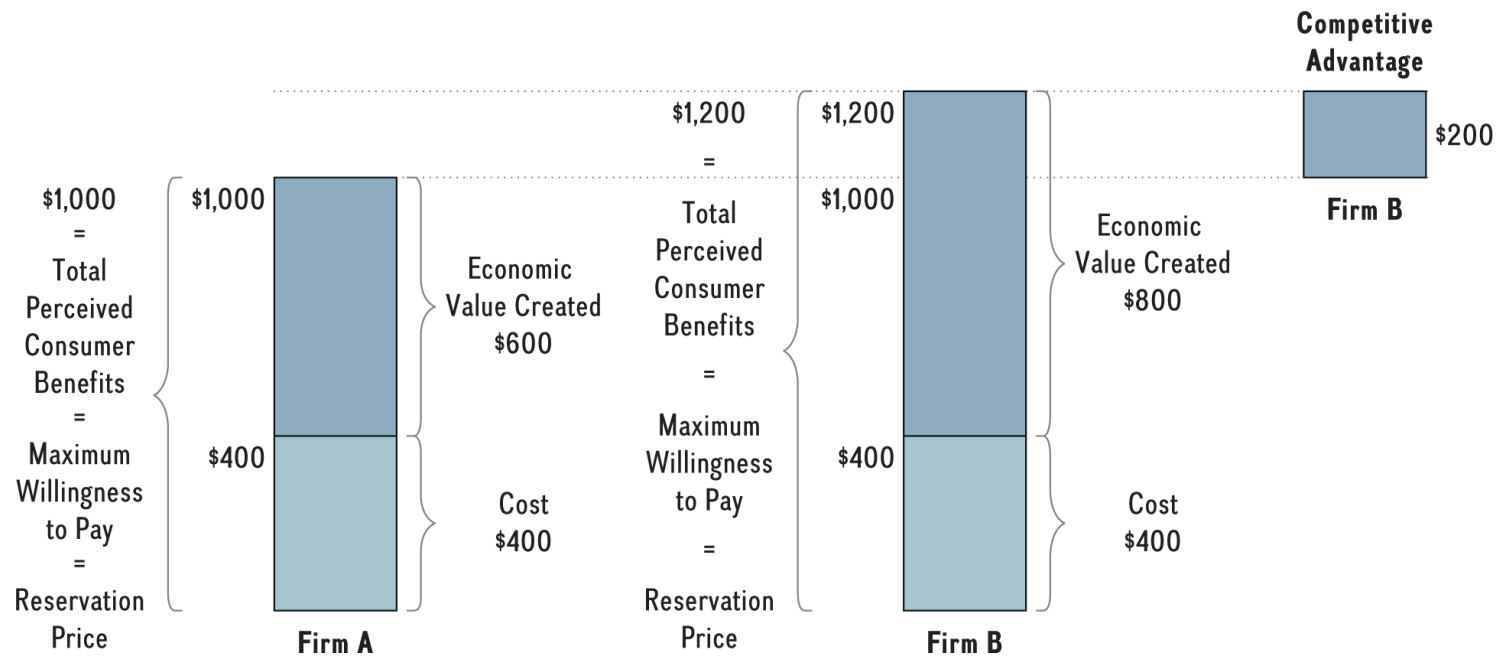
Video explanation:

- [Consumer and Product Surplus](#)

Example: Superior Product Differentiation

Exhibit 5.5

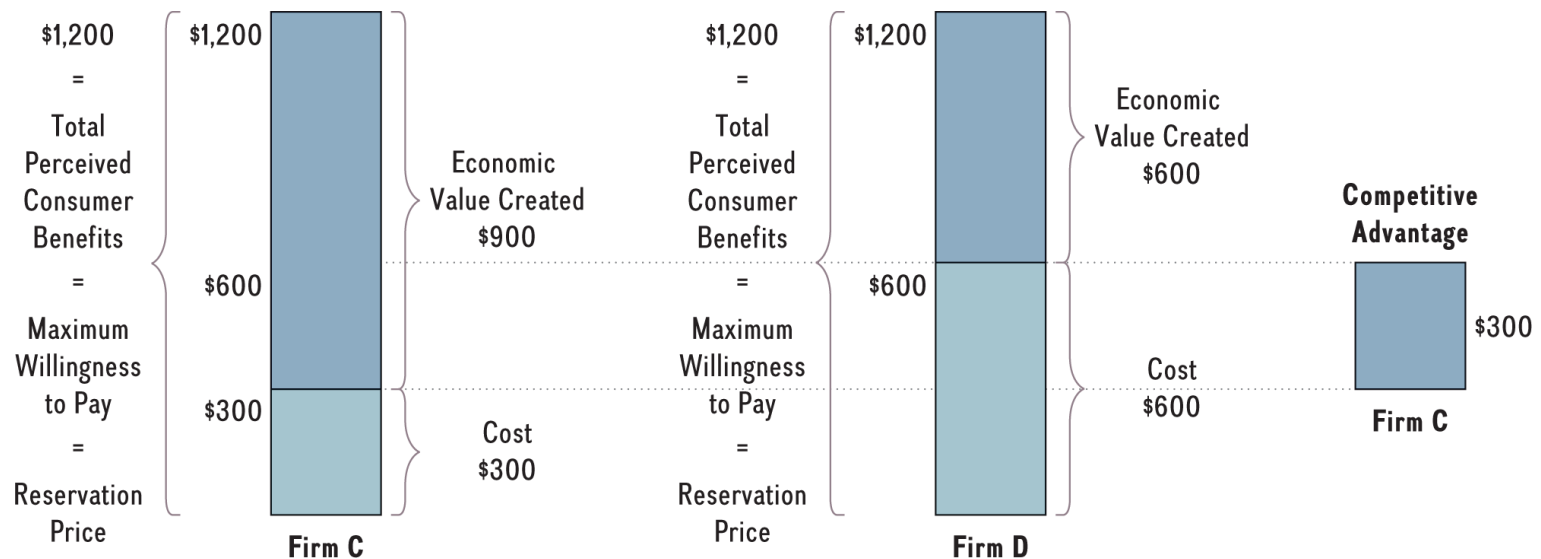
Firm B's Competitive Advantage: Same Cost as Firm A but Firm B Creates More Economic Value



Example: Cost Advantage

Exhibit 5.6

Firm C's Competitive Advantage: Same Perceived Consumer Benefits as Firm D but Firm C Creates More Economic Value from Lower Cost

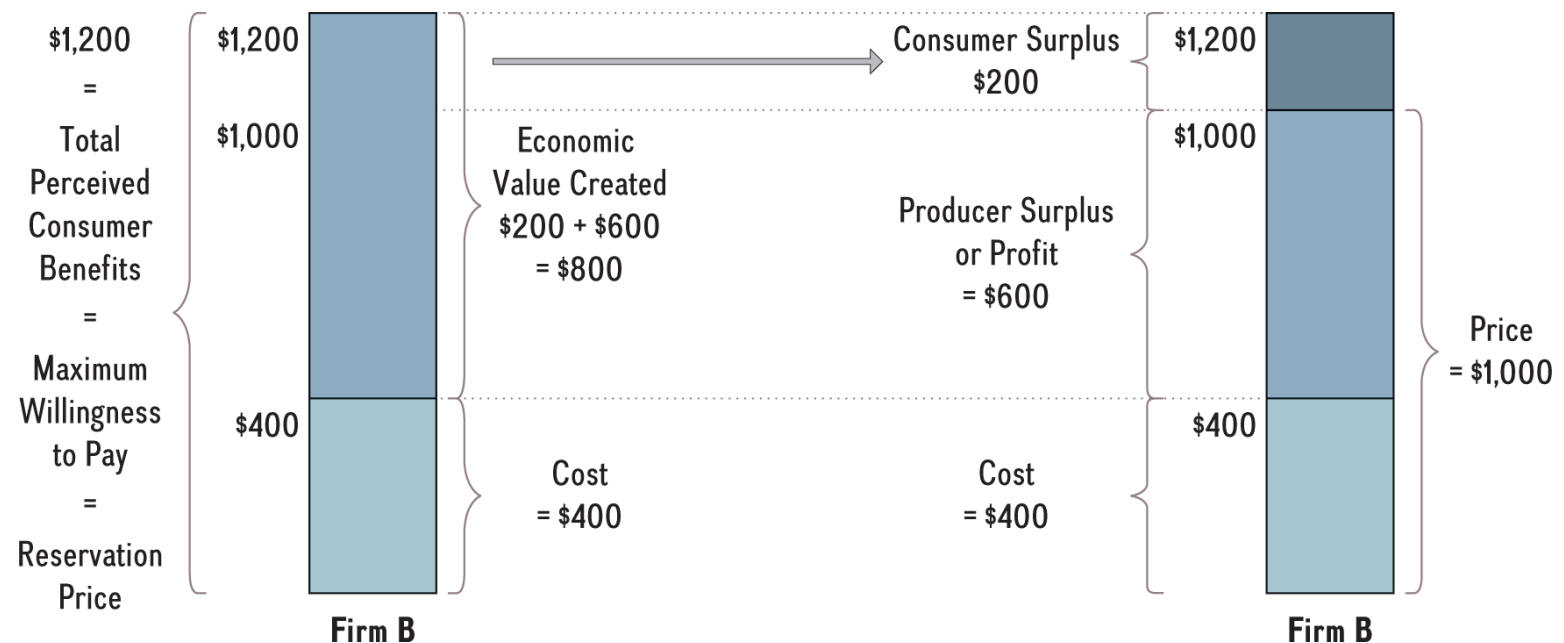


The Role of Consumer Surplus and Producer Surplus

Exhibit 5.7

Consumer and producer surplus is the reason trade happens

Both parties capture some of the overall value created



Competitive Advantage and Economic Value Created: The Role of Value, Cost, and Price

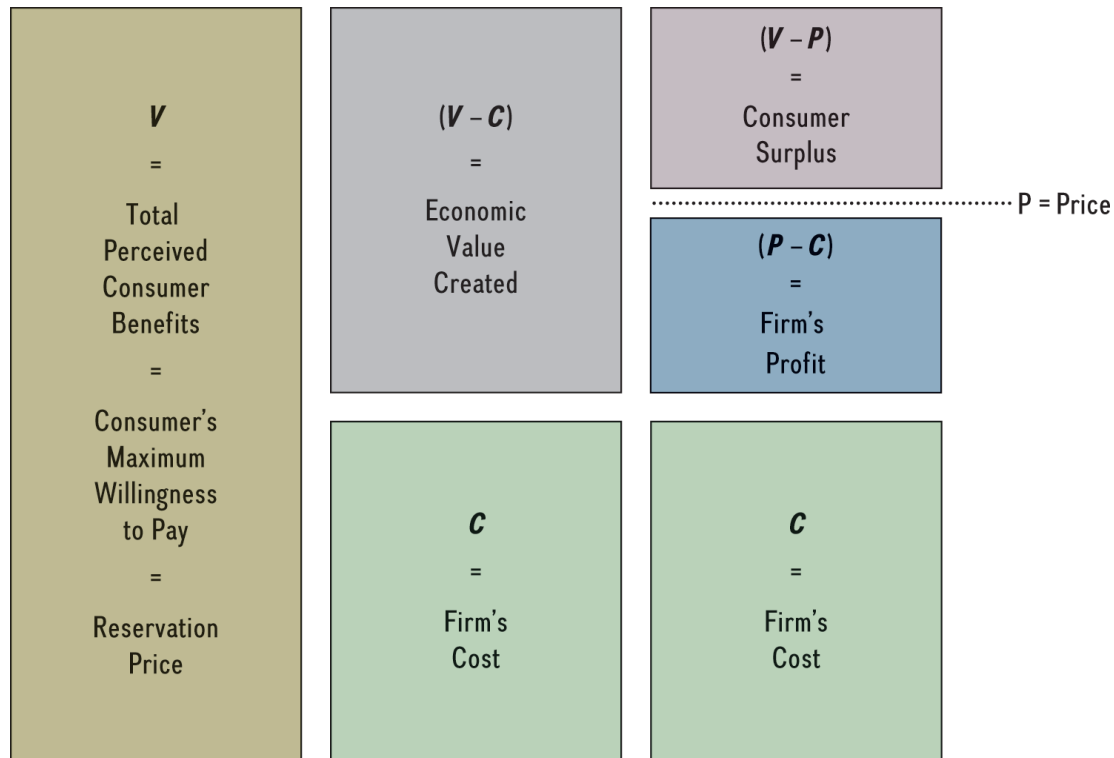


Exhibit 5.8

Limitations of Economic Value Creation

Opportunity costs

- The value of the best forgone alternative
- Example: entrepreneur's forgone wages if employed elsewhere, the cost of capital invested in other resources

Limitations of Economic Value Creation

- Does not consider the opportunity costs
- Not easy to value a consumer good
- Value of a good changes in the eyes of consumer's income, preferences, time, etc.
- Difficulties in measuring firm-level competitive advantage: must estimate economic value for all products and services offered by the firm

Integrative Frameworks

Balanced Scorecard

Framework

- Wholistic measure of competitive advantage
 - Customers
 - Value creation
 - Core competencies
 - Shareholders
- [HBR Video](#)

Example Metrics

- Customers: revenue, profit, customer satisfaction
- Value Creation: competitiveness, innovation, organizational learning
- Core Competencies: key business processes.
- Shareholders: ROIC, ROE, total returns to shareholders

Balanced Scorecard Framework

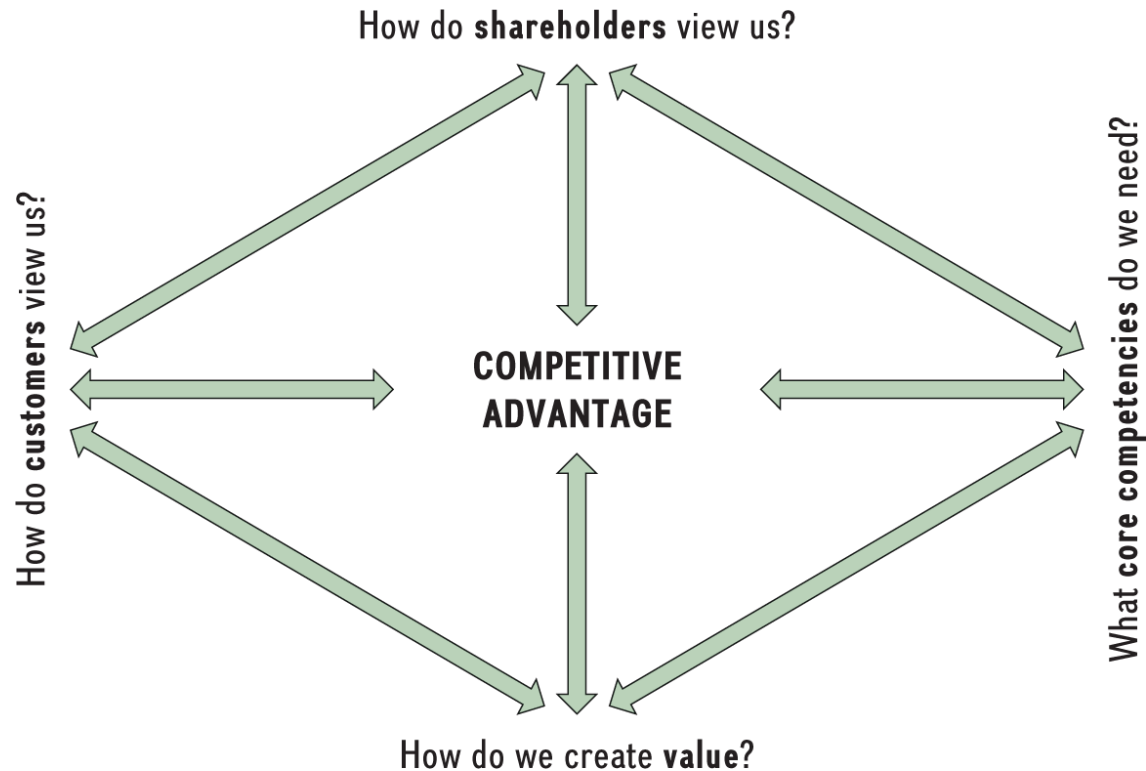


Exhibit 5.9

Balanced Scorecard: Pros & Cons

Pros

- Links strategic vision to responsible parties
- Translates vision into measurable goals
- Designs and plans business processes
- Implements feedback and organizational learning
- Alerts to needed strategic goal adaptation

Cons

- Focused on implementation
- Not formulation
- How to get back on track if deviations occur
- Lacks guidance
- Which metrics to use?
- How to address setbacks?

Shareholder Capitalism

Shareholder Focus

- In the traditional sense, shareholders are the stakeholder group with the most legitimate claim on the firm profits
- Duty of executives is to maximize value for shareholders

Key Assumptions

- Free markets are perfectly efficient
- Individual freedom should be the primary goal of society
- Managers are agents of shareholders

Towards Stakeholder Capitalism

Shift in focus

- Focus on profit maximization ->
- Focus on shareholder value maximization ->
- Corporate social responsibility ->
- Creating shared value (dual focus)

Key Issues

- “Tragedy of the commons” problem, i.e. grand challenge
- Example: climate change
- Economic inequality

“Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society.”

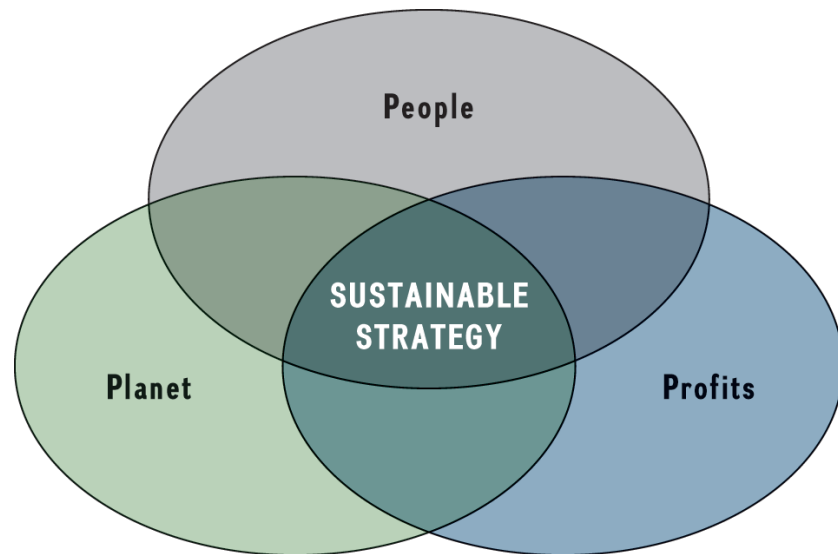
- Larry Fink, CEO of BlackRock, Inc.

The Triple Bottom Line: Sustainable Strategy

Focus: economic, social and ecological performance

Three dimensions

- Profits: economic dimension
- People: social dimension
- Planet: ecological dimension



Source: Textbook Exhibit 5.10

The simultaneous pursuit of performance along social, economic, and ecological dimensions provides a basis for a triple-bottom-line strategy

In-Class Discussion

Patagonia: A Pioneer in Stakeholder Strategy

Patagonia, Inc. is an American retailer of outdoor recreation clothing and gear for the silent sports: climbing, surfing, skiing, fishing, and trail running

It was founded by Yvon Chouinard in 1973 and is based in California



In-Class Discussion Activity: Patagonia

Questions:

1. Describe the influence of Yvon Chouinard, the founder, on Patagonia over decades.
2. Strategy is as much deciding what to do as it is about choosing what not to do. Chouinard decided to keep Patagonia private. Should Patagonia consider going public? Which would you support—remaining private or going public?

Video:

[Patagonia Founder to Shoppers: Don't Buy Clothes You Don't Need \(Even Mine\)](#)

Discussion Format:

- Group into your team
- Discussion timeline
 - Group discussion and preparation among your team (25 mins)
 - Debate as a whole class (10 mins)
 - Debrief (5 min)

Patagonia: The Founder Effect

- Patagonia Mission

- Patagonia's mission: "Fundamentally, businesses are responsible to their resource base. Without a healthy environment, there are no shareholders, no employees, no customers, and no business."
- For 50 years, Patagonia has been a pioneer in pursuing a stakeholder strategy to create shared value

- Yvon Chouinard

- Founder of Patagonia
- Born in 1938
- Key person to set its strategy and culture
- Chouinard is a pioneering leader, and much of Patagonia's identity is defined by the founder
- Never desired to be a businessperson and believed that corporations' ever-increasing desire to maximize profit is harmful to Mother Nature
- Employee empowerment: Chouinard's philosophy of employees' autonomy may weaken the absence of Chouinard

Patagonia: Public vs. Private

- Going public
 - Being a private company limits growth: Nike is some 50 times larger than Patagonia
 - A larger Patagonia may make a more significant difference in achieving its purpose-driven mission
 - A publicly traded Patagonia company may allow more people to buy into and support the company's vision by being shareholders/stakeholders
- Keeping private
 - Going public may jeopardize the very thing that makes Patagonia different from other firms
 - Complexity: while a larger firm may possibly have more power, increased amount of managerial attention are required as firms grow larger
 - Growth may not be sustainable as Patagonia's value chain looks different from other apparel manufacturers
 - Suppliers of organic cotton, sustainable and recycled material, and other eco-friendly supplies may not be scalable

Patagonia: Public vs. Private

- What Happened
 - The Chouinard family decided to donate Patagonia to a purpose-designed trust and non-profit company instead of going public or selling the company
 - Patagonia is continuing with its purpose-driven mission to use business to combat climate change
 - Patagonia continues to implement a variety of ESG (environmental social governance) initiatives such as donating 1 percent of its top-line revenues (“Earth Tax”) to environmental causes

Group Project Preparation

- Discuss potential company for the group project

Next Week

- Week 5: October 5, 2023
- Reminder: final group selection due TODAY
 - Please e-mail me with the final list of student names, preferred names, and ID by the end of class next week
- In-class quiz next week