Focus strategy and cost advantage

Telecommunications management & strategy

Ewan Sutherland

GSTIT.edu.et

Graduate School of Telecommunications & Information Technology

Introduction

- Focus strategy and cost advantage:
  - economies of scale
  - economies of learning
  - cost and buyers' willingness to pay
  - dual advantage
- Grant – Chapter 8 "Cost advantage"
- Case study: Wal-Mart

Cost advantage

- Identification of cost drivers
- Assessment of a firm’s cost position relative to its competitors
- Identification of the underlying factors responsible for cost differences
- Development of cost reduction measures

Sources of cost advantage

- Economies of scale
- Economies of learning
- Production techniques
- Product design
- Input costs
- Capacity utilisation
- Residual efficiency
  (elimination of organisational “fat”)

Ghosn at Nissan

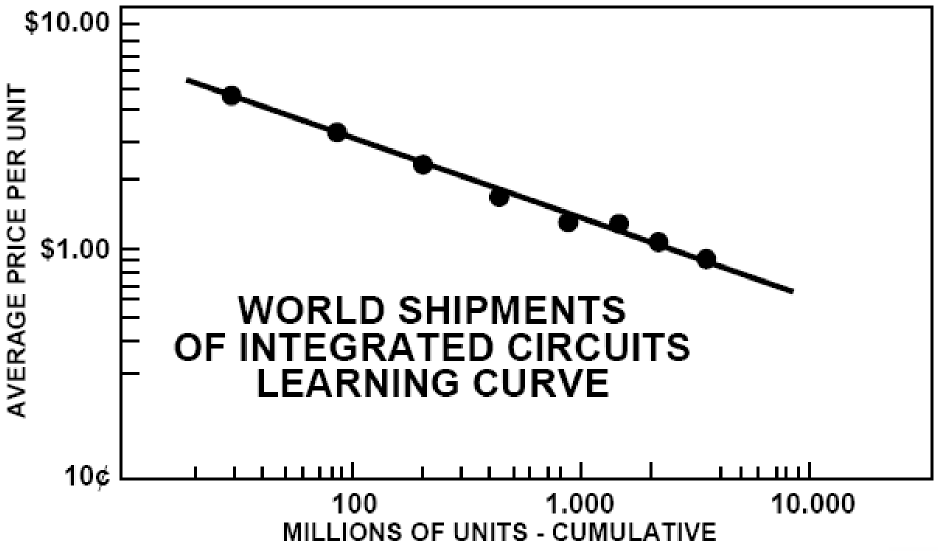
Economies of scale

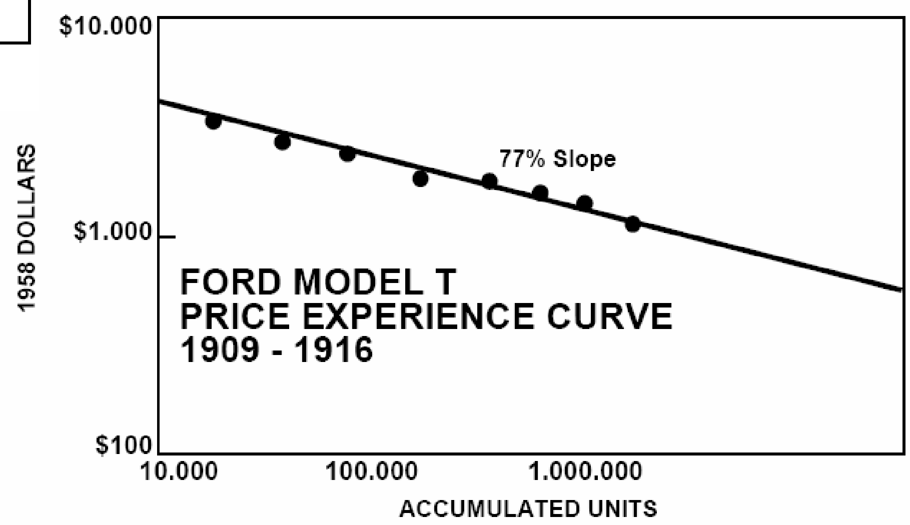
- Where proportionate increases in inputs result in lower unit costs of production
  - development costs
  - advertising costs
- Limits:
  - product differentiation
  - flexibility
  - problems of motivation and coordination
- The pursuit of market share by several players will erode profit margins
- Pricing for market share can be fatal

BCG Experience curve

- Boston Consulting Group "Law of experience"
- The unit cost of value added to a standard product declines by a constant percentage (typically between 20 and 30 percent) each time cumulative output doubles
- Savings are not automatic, but require:
  - management
  - additional investment

> "The experience curve cost effects are an observable fact. They can be confirmed by observation. The principal problems encountered in application are those of defining cost elements and in defining the measuring unit of experience." Bruce Henderson, BCG





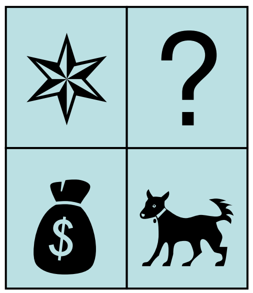
$$C_n = C_1 \times n^{-a}$$

C is the cost of unit of production
n is the cumulative volume of production
a is the elasticity of cost with regard to output

Source: Boston Consulting Group.

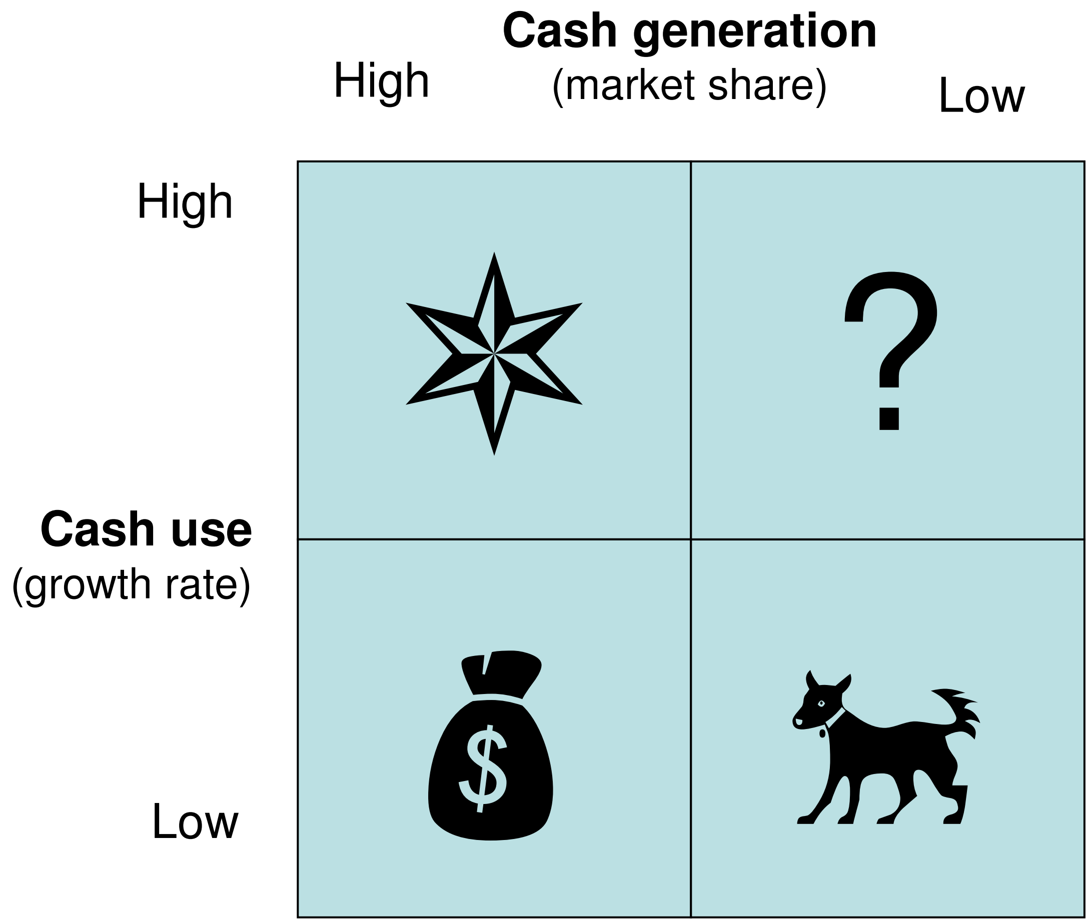
BCG Growth share matrix

- Many "businesses" require far more cash input than they can ever generate [top right]
- A few businesses generate far more cash than they can profitably reinvest [bottom left]
- A few businesses are self-sufficient in cash flow. Over time they will become much larger and also large net generators of cash [top left]
- Most businesses, however, generate very little cash even though they use little. The reported earnings must be reinvested and probably always will. These businesses are "cash traps" [bottom right]



Source: Boston Consulting Group.

BCG Growth share matrix



Source: Boston Consulting Group.

http://www.3wan.net/teaching/strategy2006/notes/bcg.html

Value chain for cost analysis

- Disaggregation into separate activities
- Relative importance in total cost
- Comparison of costs by activity
- Identification of cost drivers
- Linkages
- Identification of opportunities to reduce costs

Ewan Sutherland

- http://.www.3wan.net/teaching/strategy2006/
- 3wan [at] 3wan.net
- Ewan [at] gstit.edu.et
- skype://sutherla

GSTIT.edu.et
Graduate School of Telecommunications & Information Technology