

**Economic Drivers**  
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“Virtue is excellence, something uncommonly great and beautiful, which rises far above what is vulgar and ordinary.”

“Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer.”  
---Adam Smith (1723–1790)

**Purpose:**

The primary purpose of this document is to augment the strategic formulation and implementation material typically found in a management or strategy textbook. The benefit and cost drivers are rooted in core economic principles, such as fixed costs, variable costs, average costs, marginal costs, opportunity costs, transactions costs, diversification, etc. There are key competition and technology drivers that influence market position and overall success as well.

Rather than presenting the mathematics of the underlying economic principles, aphorisms and pithy quotes are used as helpful learning mnemonics.

**Benefit Drivers:**

Benefit drivers have a key *consumption*-oriented attribute, such as increases in actual or perceived quality. Benefit drivers form the basis on which a firm can *differentiate itself*. Strategic use of benefit drivers leads to increases in net profits through *increases in sales or revenues*.

1. Physical Characteristics

(“You only get one chance to make a first impression.”)

“Within General Motors both the Cadillac and Chevrolet vehicles share similar engine, transmission, and underframe components; however, the Cadillac line will have the upgraded body styles and offer more interior amenities.”  
“Southwest Airlines will offer assigned seating and seats with extra leg room.”

2. Service or Complementary Goods

(“If we give away the *razors*, we can sell them the *blades*.”)

“If we get the ink-jet printers into the hands of more users (at a relatively low margin), we can sell them print cartridges (at a relatively high margin).” “If we get the gaming consoles into the hands of the players (at a *low* margin), we can then sell them the games (at a *medium* margin) and then sell them expansion packs and such (at a *high* margin).” “Walmart bought Vizio (smart) TVs.”

3. Sale or Delivery Factors

(“Marketing is the whole company as seen by the customer.”)

“Home Depot can recommend affiliate installers for a newly-purchased water heater.” “‘In-N-Out’ has a secret menu.” “People often keep their Tiffany & Co. boxes for generations.” “People resell empty Louis Vuitton boxes on eBay.”

4. Expectations Enhancing  
(“The customer didn’t know they needed it until we produced it.”)  
  
“Apple’s view is that it creates products to drive what the consumer will believe she or he needs.” “A BMW isn’t a car.” “Gucci sells handbags to individuals who are looking to signal or improve their social and economic position in life.”

5. Subjective Features or Image  
(“You don’t know me!”)  
  
“Using social media to sell Lip Kits, and in just under three years, Kylie Jenner has become the youngest self-made billionaire in history.” “The sales of *pinot noir* wine went up dramatically after the film ‘Sideways’ was released.”

### **Cost Drivers:**

Cost drivers have a key *production*-oriented attribute, such as decreases in average or marginal costs. Cost drivers explain why *costs vary across firms*. Strategic use of cost drivers leads to increases in net profits through *decreases in expenses or cost of capital*.

1. Size  
(The *economy of scale* matters.”)  
  
“Costco buys half of the world’s supply of cashews annually.” “Many franchises negotiate for goods and supplies as a single, large organization,” “The two advertising giants Omnicron Group and Intergroup Group are merging to leverage AI for buying power in advertising.”
2. Experience  
(“We are further down the *learning curve* than all or nearly all other firms.”)  
  
“Andy Gump pioneered the business of renting portable toilets; therefore, they tend to make fewer errors and omissions.” “Nobody gets fired for buying IBM.”
3. Location  
(“Some regional economies are built with plans for specialized and localized exchange.”)  
  
“Initially, the film industry settled in Los Angeles. They needed plenty of undeveloped land, and they could film and shoot on location (with expensive equipment and personnel) all year around.” “FedEx and UPS planes are at Ontario airport; that region has an entire transportation and logistics ecosystem.”
4. Government Factors  
(“It’s the economy, stupid.”)  
  
“The State of North Carolina has given \$845 million in tax incentives over 39 years to Apple for building a “Second HQ” in the Raleigh-Durham area.”  
“Georgia subsidizes Data Centers.” “Australia partly subsidized the filming of ‘Pirates of the Caribbean’; New Zealand did the same for ‘Lord of the Rings’.”
5. Focus

(“Which *segment* of which vertical industry sector can we best succeed in?”)

“Private-label (‘house’) brands for specific consumer products (e.g., Costco’s Kirkland brand) spend little or no advertising.” “130 year old General Electric has split into three separate companies: Healthcare, Energy, and Flight.” “220 year old DuPont recently split: Electronics, Water, and Industrial,” “120 year old Honeywell recently split: Aerospace, Automation, and Materials” “Ford has two main, internal divisions; Gas (‘Ford Blue’) and EV (‘Ford-E’).”

6. Vertical Integration (*forward* and *backward*)

(“How can we control more of the value-chain, supply-chain, or service-chain?”)

“Starbucks buys coffee beans on the open market but also owns a few of its own farms in South America.” (backward integration) Walmart is part-owner of a meat processing facility in Nebraska.” (backward integration) “Amazon makes some its own movies (backward integration), and also, leases some freight airplanes (forward integration).” “Dominoes delivers.” (forward integration)

7. Efficiency

(“How can we best leverage the net marginal change in our favor?”)

“It is better for Exxon to build a slightly larger diameter pipe to transport oil because while the circumference of a circle grows *linearly* ( $2\pi r$ ), the corresponding area grows *quadratically* ( $\pi r^2$ ).” “For the same class section, a university can pay a college instructor to teach *four* times as many students for *two* times the amount of pay.” “A firm can change the value of ‘dues’, ‘miles’, ‘rewards’, or ‘points’ at its own discretion.” “Chipotle doesn’t pay dividends.”

**Competition Drivers:**

There are several other, general factors that can materially impact the above core benefit and cost drivers. Strategic use of competitive drivers leads to increases in profits by *creating* and *maintaining a dynamic market position* within one or more industries.

1. Horizontal Integration

(“In how many markets do we wish our organization to be successful in?”)

(“Should we plan to *stick to our knitting*?”)

“3M manufactures approximately 60,000 products across hundreds of business lines.” “Apple changed computing, phones, music, and movie animation.” “The [Boy] Scouts now accepts girls.” “KPMG, a ‘Big 4’ accounting firm, practices law in Arizona.” “The Auto Club sells Hawaiian vacations.”

2. First-mover Advantage (“*bleeding edge*”) (“the early bird catches the worm”)

Second-mover Advantage (“*cutting edge*”) (“the second mouse gets the cheese”)

“Tesla started producing EVs. (First-mover advantage)” “Facebook (TicTok) has been more successful than MySpace (Snap) (Second-mover advantage)”

3. Make-or-Buy

(“Do we need to *own* it—that is, do we need to own the *means of production*?”)

(“*Data is the new oil*; every successful business is now, partly, in the data business.”)

“Nike owns neither shoe factories nor shoe stores; for the most part they just manage their brand.” “ViacomCBS has sold its three famous studio lots.” “Emirates Airlines wants to do more than just flying customers as a part of a trip. In the future, they want to capture as much *data* about a passenger and the passenger’s trip, and then do extensive *analytics* themselves.” “Of the 88 cities in L.A. County, about half manage their own Police Departments while the other half contract with the County Sheriff.”

4. Capital-for-Labor Substitution

(“Robots will take over the world. Help! I’ve been replaced by a computer!”)

“Maria’s Italian Kitchen at Reseda and Nordhoff has a robot named Romeo that transports food and busses dishes.” “Turnitin helps instructors check for plagiarism which is a very time-consuming task.” “As the required minimum wage increases, McDonald’s is using fewer human order-takers and using more touchscreens/kiosks to take orders.” “AI systems can make some decisions.”

5. Commitment

(“At what point do I demonstrate that I have *skin in the game*?”...“Walk the Talk?”)  
 (“How do I ensure—including legally—that a *relationship will be successful*?”)

“Doing business in Myanmar (formerly Burma) is difficult; they have little infrastructure, including a legal system to enforce contracts.” “R. R. Donnelly and Sons was the sole printer of the Sears catalog for more than 125 years.” “The CSU System got serious about graduation rates when the state offered additional monies to improve student success and academic performance.”

6. Game Theory

(“If my firm implements a particular strategy, how will other firms *react*?”)

“When Uber introduced ride subscriptions, Lyft quickly responded with its own ride subscription service.” “When one airline changes a price, other airlines also change prices, often within minutes.” “Five Guys is next to In-N-Out.” “One car wash will likely accept a coupon from all other car washes in the area.”

**Technology Drivers:**

There are several technology drivers that can materially impact the above benefit, cost, and competition drivers. These technology drivers can help in areas such a security, safety, quality, reliability, productivity, and integration, among others. Strategic use of technology drivers leads to increases in profits by *early identification and leverage of state-of-the-art technologies*.

1. Innovation Productivity

(“The best way to have a *good* idea is to have *many* ideas—i.e., have ‘happy accidents’.”)

“Post-it notes use a chemical adhesive that was originally designed to be ‘very sticky’; however, it turned out that an accidental manufacturing prototype resulted in an adhesive that was ‘just sticky enough’”. “Viagra was originally intended to be a blood pressure medication; during field trials, however, a significant side-effect was noted in males.” “WD-40 was the 40<sup>th</sup> variation.”

2. Incremental Improvements  
("The world is made up of visible things but is held together by invisible things.")  
  
"Spanx are essentially 'girdles' but with a better fabric; also sell them to men."  
"The McDonalds on the corner of Nordhoff/Reseda has an automated, robotic soft drink machine for the drive-thru." "Each new X-ray, Cat-Scan, or MRI machine produces higher resolution with less radiation." "Recently, titanium has replaced steel in many hammers used by both professionals and hobbyists."
3. Disruptive Technology  
("Can an industry be changed by a *startup David* slaying an *established Goliath*?")  
  
"Netflix first changed movie delivery (twice) and eventually how a small studio can become a large studio." "Space-X has demonstrated that a rocket can be used more than once." "IT Cloud providers eliminate much of the need for small, individually-managed file and computing servers." Zillow and Redfin are changing residential real estate sales/commissions. Nearly every automobile manufacturer has presented tangible plans to move all vehicles to electric power.
4. Disintermediation  
("Whatever you do, eliminate the 'middle-man'.")  
  
"A For Sale By Owner (FSBO) transaction eliminates a real estate agent."  
"Bitcoin can be used without any reference to fiat (U.S. central control) currency." "The use of open source software may not involve any company."
5. Commoditization  
("PCs are ubiquitous; everyone now lives a digital life.")  
  
"IBM invented the modern, desktop PC for widespread use in business, but IBM eventually sold their entire PC business to Lenovo." "Harrah's pioneered the use of tracking in-house casino habits by gamblers electronically with individual electronic cards; now, all casinos do it." "Index funds changed investing."
6. Network Effects  
("In a knowledge economy, it is *increasing returns to scale* that matters most.")  
("Building a *network* matters, especially when the network makes it hard to *switch*.")  
  
"Microsoft Windows (an operating system) not only directly serves users but forms a platform for other companies to build applications." Amazon lost money for many years but slowly gained market share. Also, in addition to products, Amazon sells its own infrastructure: AWS." "Starting Facebook (LinkedIn, Indeed, etc.) was difficult, but because the company knows about the network for each user, each additional user contributes more value to the company. That is, the network itself has value, even if there is no direct sale to the individual user."

**Source:**

The quotes are from a variety of sources, and many of the examples came from my students. However, the categories used above were excerpted and adapted from the following text:

Besanko, D., et al. (2016) *Economics of Strategy*, (7<sup>th</sup> ed.), Wiley.