

**Economic Drivers**  
wayne . smi th@csun . edu  
[ updated: Sunday, November 19, 2017 ]

---

**Course:** *MGT 360*  
**Title:** *Management and Organizational Behavior (3 units)*

“Virtue is excellence, something uncommonly great and beautiful, which rises far above what is vulgar and ordinary.”  
---Adam Smith (1723–1790)

“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 economics textbook. Each benefit and cost driver is rooted in core economic principles, such as marginal costs, opportunity costs, transactions costs, diversification, etc. There are other influential competitive and technology factors too.

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

**Benefit Drivers:**

Benefit drivers typically have a key *consumer*-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 profits through *increases in revenues*.

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

“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.”
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 cartridges (at a relatively high margin).”
3. Sale or Delivery Factors  
 (“Marketing is whole company as seen by the customer.”)

“Home Depot can recommend affiliate installers for a newly-purchased water heater. Time-Warner requires the use of prescribed, third-party cable installers. Uber drivers can also deliver packages.”

4. Expectations Enhancing  
(“The customer didn’t know they needed it until we produced it.”)

“I’m going to wait in line at the Apple Store for six hours to be the first to get the latest iPhone. If people see me with a Gucci handbag, then they know that I’m looking to improve my social & economic position in life.”

5. Subjective Features or Image  
(“You don’t know me!”)

“Our firm procures gasoline for our service delivery fleet from this gas vendor because this vendor supports inner-city, youth tennis programs.”

### **Cost Drivers:**

Cost drivers typically 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 profits through *decreases in expenses*.

1. Size  
(The *economy of scale* matters.”)

“For both franchisee- and corporate-owned stores, McDonalds can maintain high quality and lower the overall cost of food materials by bargaining for hamburger meat as a single, large organization.”

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. Their employees are generally more knowledgeable than other firms; therefore, they tend to make fewer errors and omissions.”

3. Location  
(“As everyone knows, in real estate, it’s *location, location, location*.”)

“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; in fact, there is an entire transportation and logistics ecosystem in that region.”

4. Government Factors  
(“It’s the economy, stupid.”)

“The State of New York lured the “Tonight Show” to New York by passing a law that offers tax incentives to major TV shows that relocate there. In general, corn farming is subsidized by the U.S. Government.”

5. Focus

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

“Volvo’s target market is suburban, dual-income, middle-class families with at least one child. Its targeted advertising costs should be well-understood and cost less per each vehicle sold. Southwest Airlines only flies Boeing 737s; therefore, it should have lower marginal costs for maintenance.”

6. Vertical Integration

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

“Starbucks buys coffee beans on the open market, but also owns a few of its own farms in South America to exert more control of coffee bean production process. This should help stabilize bean costs over time. Amazon now makes some its own movies (backward vertical integration) and owns some airplanes and trucks (forward vertical integration).”

7. Efficiency

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

“It is more productive for Exxon to build a slightly larger diameter pipe to transport oil because while the circumference of a cylinder grows *arithmetically* ( $2\pi r$ ), the corresponding volume grows *geometrically* ( $\pi r^2$ ). For the same class section, a university can pay college instructors to teach *four* times as many students for *two* times the amount of pay.”

**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*.

1. Horizontal Integration

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

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

“General Electric manufactures medical imaging devices and jet aircraft engines. GAP, Inc. owns Baby GAP, Banana Republic, and Old Navy. Apple changed personal computing, music delivery, and movie animation.”

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

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

“(First-mover advantage) Toyota had the first, viable hybrid vehicle: Prius. Toyota is now the largest auto manufacturer in the world. (Second-mover advantage) Facebook is much more successful than MySpace.”

3. Make-or-Buy  
 (“Do we need to *own* it—that is, do we need to own the *means of production*?”)  
  
 “U.S.-based Apple contracts with China-based Foxconn and Taiwan-based Pegatron to supply iPhones; Apple also makes a few Macs in the U.S. Nike owns neither shoe factories nor shoe stores; they, for the most part, just manage their brand. In general, Pepsi prefers to own most of their bottlers while Coca-cola prefers to contract with most of their bottlers.”
  
4. Capital-for-Labor Substitution  
 (“Robots will take over the world. Help! I’ve been replaced by a computer!”)  
  
 “The VW plant in Germany and the LEGO plant in Denmark are huge, and nearly entirely automated. I don’t need a bookkeeper all of the time because I use Quickbooks; I just need an accountant some of the time. Turnitin helps instructors check for plagiarism.”
  
5. Commitment  
 (“At what point do I demonstrate that I have *skin in the game*?”)  
 (“When does the *talk* become the *walk*? How will others know that *I am serious*?”)  
 (“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 motivated 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 others *react*?”)  
  
 “Burger King (or “Five Guys”), in general, waits for McDonalds (or “In-and-Out”) to find a suitable restaurant location; Burger King then finds a location very near the McDonalds location. Additionally, one car wash will likely accept a coupon from all other car washes in the area.” When one airline changes a price strategically, other airlines often do similarly.

**Technology Drivers:**

In an industrial and post-industrial economy, the strategic impact of technology can be both wide and deep. There are several other, technological factors that can materially impact the above core benefit and cost drivers. Strategic use of technology drivers leads to increases in profits by *early identification and leverage of state-of-the-art technologies*.

1. Disruptive Technology  
 (“Can an industry be changed by a startup David *slaying* an established Goliath?”)  
  
 “Netflix started with just a small inventory of videos on DVD and a small number of customers. Further, delivery was only via the U.S. Post Office.

Video rental stores such as Blockbuster didn't feel Netflix was a direct competitor...until it was too late to transform themselves to compete."

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. The McDonalds on the corner of Nordhoff and Reseda has an automated, robotic soft drink machine for drive-through operations. When you go to the hospital for an X-ray, you just assume that the resolution of the X-ray image is at least slightly higher than it was 10 years ago. Automobile manufacturers have pledged to make automatic braking standard in all cars by the year 2022."

3. Disintermediation

("Whatever you do, eliminate the 'middle-man'.")

"Redbox and Netflix put video stores out of business. Amazon simultaneously disrupts traditional retail and bolsters package delivery."

4. 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."

5. Diffusion of Innovation

("...innovators, early adopters, early majority, late majority, and laggards...")

"(innovators) The first mass market hybrid car—the Toyota Prius—initially was selling for \$10,000 over the highest sticker price. (laggards) The local phone company still supports the use of rotary dial, landline phones."

6. Innovation Productivity

("It's best to have a 'happy accident'; the best way to have a *good* idea is to have *many* ideas.")

"Post-it notes use a chemical adhesive that was originally designed to be "very sticky"; however, it turns out that an accidental manufacturing prototype with an adhesive "just sticky enough" was just what the market wanted. Viagra was originally intended to be a blood pressure medication; during field trials, however, a significant side-effect was noted in males."

**Source:**

The pithy mnemonics and examples used above are original. However, the categories used above were generally excerpted and adapted from the following text:

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