

“Economic Benefit and Cost Drivers”
(source: CGU Professor Jay Prag...used with permission)
wayne.smith@csun.edu
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Course: *MGT 360*
Title: *Management and Organizational Behavior* (3 units)

“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 handout is to augment the strategic formulation and implementation material in the textbook. The qualitative (“management”) side of strategy principally concerns the many facets of vision, mission, objectives, and goals. The quantitative (“economics”) side of strategy principally concerns “benefit” drivers and “cost” drivers.

Benefit Drivers:

Benefit drivers typically have a key *consumer*-oriented attribute, such as increases in actual or perceived quality.

1. Physical characteristics

“Both the Cadillac and Chevrolet vehicles share similar engine, transmission, and underframe components; however, the Cadillac line will have the upgraded body styles.”

2. Service or Complementary Goods

“If we get the straight razors [ink-jet printers] into the hands of more users (at a relatively low margin), we can sell them replacement blades [cartridges] (at a high margin).”

3. Sale or Delivery Factors

“Home Depot [Time-Warner] can recommend affiliate installers for a new water heater [cable box].”

4. Expectations Enhancing

“Let’s bundle and sell together as one unit the latest Adam Sandler movie from our studio with the latest Anthony Hopkins movie from our studio.”

5. Subjective Features

“Our firm procures gasoline for our service delivery fleet from this 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.

1. Size

“We can lower the overall cost of database and journal subscriptions if all 23 CSU campuses bargain as one unit.”

2. Experience

“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. Our bid contract will go to Andy Gump.”

3. Location

“Our hot dog stand needs to be within walking distance from the University.”

4. Government Factors

“The documentation of the software application must meet the specifications of the U.S. Air Force and the associated World Wide Web pages must be accessible to all individuals, including the disabled.”

5. Focus

“Volvo’s target market is suburban, dual-income, middle-class families with at least one child.”

6. Vertical Integration

“FedEx [UPS] buys Kinkos [Mailboxes Etc.] to get closer to the customer. A high-end steakhouse [coffee shop] owns its own cattle ranch [coffee farms] to better control the quality and supply of beef [coffee beans].”

7. Efficiency

“It is more productive for Exxon to build a slightly larger diameter pipe to transport oil, because while the circumference of a cylinder grows geometrically, the volume grows exponentially.”

Horizontal Integration:

There is one more concept of significant importance from an economic perspective of strategy. “Horizontal Integration” addresses the following question--“How large should our organization be?” For example, “General Electric not only manufactures both light bulbs and jet engines, GE also finances and leases capital equipment.”