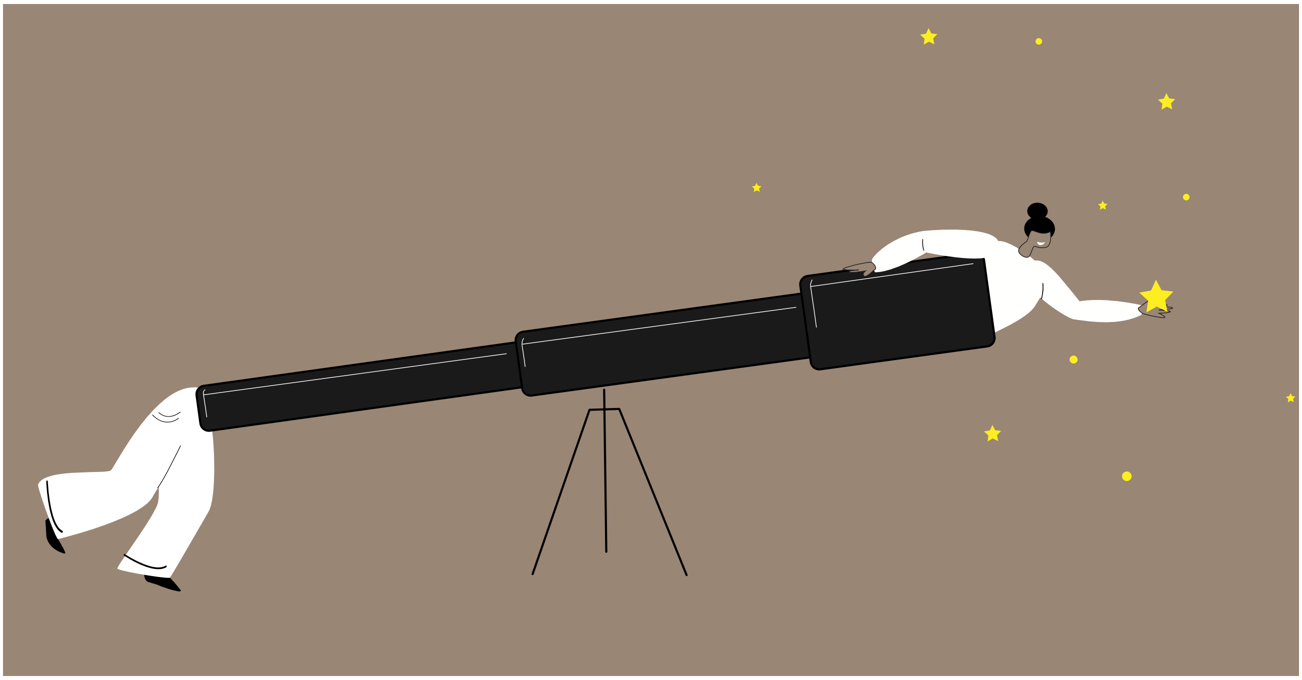

Focusing on Corporate Scope Magnifies Revenue and Investment Opportunities

By Dom Haskett

If designed and executed well, corporate strategy increases competitive advantage.

Analyzing competitive strategies, strategists typically begin by looking at a single business unit operating in a single region and examining its competitive advantages and disadvantages. If designed and executed well, corporate strategy increases competitive advantage.

The corporate scope identifies a company's areas to maintain a competitive presence through proper governance, including a great board. Exemplary boards are robust social systems that know to ferret out the truth and challenge one another. These social systems affect revenue and enterprise growth. Monitoring environmental concerns such as waste discharge and energy consumption and alternative sources of renewable resources are critical factors. Social issues such as company culture and community involvement play a part in retention and whether other institutions will invest in the company. Company values play a role in the intangible brand equity and credit opportunities. An established ESG proposition aids companies in tapping into new markets/opportunities due to trust from governing officials, creating an accessible, flowing pathway for approvals and licensing.

Some customers are willing to pay a premium for green companies with competitive alternatives. Creating products that require fewer resources can open cash flow for other investment opportunities.

Corporate Strategy and Scope Determine the Upside for Return on Invested Capital

A company can be the top performer in a failing market, resulting in that company losing profits. The sources are as follows for price premium: product innovation, quality, brand, consumer lock-in, and rational product discipline. The references are cost and capital efficiency: innovative business method/model, unique resources, economies of scale, and scalable product/process. The source that combines both price premium and capital cost efficiency is increasing returns to scale. The capital and time-intensive pharmaceutical and biotechnology industries have high returns on invested capital because they are scalable and protected by brands and patents. Following exclusivity expiration, generic manufacturers enter the market, increasing supply and driving down price and revenue.

Brand loyalty plays a part in customer retention due to patients' needs, ability to pay, and product quality. Customers are willing to pay a premium based on the market and affordability. ROIC excluding goodwill is a better measure of its performance than its peers. It allows us to focus on the underlying economics without the distortion of premiums paid for acquisitions. ROIC (including goodwill) measures the company's ability to create value over and above premiums paid for investments. The difference has increased due to better operating performance and higher margins, which are precisely observable related to long-lasting brands.

Capital

Changing a company's capital structure would affect its value due to trade-offs. The relative equity and debt levels affect risk and cash flow and, therefore, the company valuation. Financial engineering relates to optimal leverage with taxes, financial distress, and agency costs. A company creates value by selecting the appropriate capital structure applicable to its industry and specific situation. In a perfect capital market, levered equity returns 35 percent higher than unlevered equity. Companies have little control over the effective market rates related to the cost of capital. Controllable aspects are capital structure, borrowing costs, tax rates, dividends, etc. Theoretically, managers should take on all projects with positive expected values even if there is a high likelihood of failure. There are considerations around the costs of bankruptcy and financial distress that are often difficult to measure accurately. Managers sometimes fall victim to overweighting impact losses from smaller projects and missing value creation opportunities.

For example, if you could purchase a new data center, that would help scale business processes that cost $5 billion. Considering that the company has $10 billion in equity and $10 billion in debt. If the company successfully develops the new data center, there is a 75 percent chance that it will be worth $25 billion, with a net profit of $15 billion. Some managers will choose against this development because of the 25 percent chance of failure that could result in a $5 billion loss. This investment will not tank the company in the case of failure and should be considered.

Behind the Curtain

Companies that correctly match their strategy-making processes to their competitive circumstances perform better than those that don't. For example, the shareholders sometimes only focus on quarterly earnings and ROI vs. well-rounded value creation. When increasing margins with this short-term focus, managers tend to make trade-offs. Trade-offs include, but are not limited to, poor product development for customers, not paying employees good wages, and providing employees with poor working conditions. This behavior creates a natural conflict; managers should make the best decisions for the company, focusing on sustainable long-term earnings, not short-term quarterly metrics. Maximizing the current share price is not equivalent to maximizing long-term value because those short-term inflationary strategies eventually dilute actual value.

Due diligence and R&D are vital to connecting all the parts of an enterprise when looking to ensure product line innovation and next-level productivity. Implement more flexibility into projects for stepwise investments to scale the proven technologies and scale down the unproven technology. The advantage of using a scenario-expected cash flow approach over an ad-hoc risk

premium approach when evaluating risk projects is giving companies different perspectives versus single-point estimates. Companies could create multiple strategies to mitigate risk and take advantage of opportunities that require heavy investments. It gives enterprises realistic and optimistic measures, fully disclosing all factors.

Tying It Together

Creating an environment where long-term strategies are accepted is essential. The company's culture must focus on excellent product development, significant investments into R&D initiatives, investment in human capital, and understanding that quality must be at the company's foundation to be recognized by its products in the market. ☆

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