Business Management & Administration
- Basics -

International Master's program in Information Technology (INFOTECH) of the University of Stuttgart 2015

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Learning Targets

The ecosystem around a successful product: Basic elements of business management that make a company functional

- Leadership: Beyond the mechanics of business management
- Basics: From products all the way to financial management and back
- Process Management: Approaches for continuous improvement to Business Process Reengineering
- Organization: Design and redesign
- Corporate strategy: Purpose, approaches and tools

Closer looks at fashion retail, automotive and software industry
The Marketing mix (Neil Borden)
The Marketing mix (4P’s)
The Marketing mix (7P’s)
The Marketing mix (4C’s)
The Marketing mix (4P’s)
The Marketing mix (4P’s)

**Product**
- Quality
- Features
- Options
- Style
- Brand
- Differentiation
- Sizes
- Services
- Returns
- Warranties
- Packaging

**Price**
- List price
- Discounts
- Allowances
- Rates
- Credit
- Changes
- Communications
- Opportunity Cost
- Payment period

**Place**
- Channels
- Locations
- Transport
- Routes-to-market
- Supply Chain
- Intermediaries
- Coverage
- Inventory
- Partners

**Promotion**
- Message
- Media
- Above/Below-the-line
- Advertising
- Direct
- Publicity
- PR
- Personal Selling
- WOM
- Promotion
- Internet
Products and / or Markets?

- Product features
- Product sales
- Technical excellence
- Product service
- Rational solutions
- Product profitability

The Great Debate:

- Customer needs/wants
- Customer satisfactions
- Customer expectations
- Customer service
- Emotional solutions
- Customer and/or segment profitability

‘PUSH’ Strategy

‘PULL’ Strategy
Levitt on the Product

“A product is what a product does”

What-it-is (features) or What-it-does? (benefits)

Are you selling a 6mm drill

Or a 6mm hole?

A Telephone?

Or Identity?
A service is..

**Government**
- Legal
- Educational
- Health
- Military
- Employment
- Credit
- Communications
- Transportation
- Information services, etc

**Private Non-Profit**
- Art & Music Groups
- Leisure Facilities
- Charities
- Churches
- Foundations
- Colleges, etc

**Business & Professional**
- Airlines
- Banking
- Insurance
- Hotels
- Management consultants
- Solicitors
- Architects
- Advertising Agencies
- Market Research, etc
The Service Product

“A service is any activity or benefit that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product”

[ Kotler ]

Characteristics of services:

1. Intangibility
2. Inseparability
3. Heterogeneity
4. Perishability
5. Ownership
The Augmented Product Concept

- The Support Services component
- The Core component
- The Packaging component

Emotional Benefits

Additional Benefits
- Tangible Benefits or ‘Knowhow’ eg. functions
  - eg. design
- eg. Service, trust, prestige
The Product/Service Life Cycle

**Introduction**
- Supply:
  - Can’t make enough
  - Little formal infrastructure
  - Higher costs
- Demand:
  - Innovators
  - Early adopters
  - Higher Price
  - Higher Risk
  - Little awareness
  - ‘New’

**Growth**
- Push to Maturity
  - Growing availability
  - Growing Competition
- Demand:
  - Growing awareness
  - Reducing Prices
  - Easy majority
  - Emerging standard design

**Maturity**
- Pull!
  - No new buyers
  - Repeat purchase
  - Can get boring
  - Best marketing?
  - Customer focus
  - Market Segmentation (S) critical
  - Consolidation
  - Fewer BIG players
  - More NICHE players
  - Can last a loooong time

**Decline**
- Failing demand
- Falling profits or debts
- Fewer customers
- Death, or
- Rejuvenation
- Possible repositioning

"Consolidation"

The ‘Chasm’
The Marketing mix (4P’s)

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- Services
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- Warranties
- Brand
- Packaging
- Differentiation

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An important word about Price

In any developed market, 90% of customers would prefer to buy on non-price reasons and pay some level of premium price for perceived additional value.

In an undeveloped market, a proportion of customers will prefer to pay premium price for additional value.

A proportion appears to want the cheapest but have latent needs that have not yet been identified and exploited.

Still, 10% will always buy the cheapest.

10% will always buy the cheapest – because they don’t care about the category.
Approaches to Pricing

1. ‘Cost Plus’ pricing → Cost informs the price
2. ‘Market’ pricing → Customers inform price
   → Cost informs the profit available

Why is this important? 

PRICE IS THE ONLY SOURCE OF REVENUE IN THE MARKETING MIX!
Why industrial (B2B) companies lose customers
Understanding Profit Drivers

Profit

= Revenues - Cost

Revenues

Sales Volume (Units) 1 million
Price €100

Cost

Variable Cost

Variable cost per unit = €60

Fixed Cost €30 million

Sales Volume 1 million

What is the profit impact if each of the 4 levers improves by 10%?
# Understanding Profit Drivers (2)

<table>
<thead>
<tr>
<th>10% improve in:</th>
<th>Profit Driver</th>
<th>Profit</th>
<th>Profit % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Old</td>
<td>New</td>
<td>Old</td>
</tr>
<tr>
<td>Variable cost per item</td>
<td>€60</td>
<td>€54</td>
<td>€10</td>
</tr>
<tr>
<td>Sales Volume</td>
<td>€1m</td>
<td>€1.1m</td>
<td>€10</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>€30m</td>
<td>€27m</td>
<td>€10</td>
</tr>
<tr>
<td>Price</td>
<td>€100</td>
<td>€110</td>
<td>€10</td>
</tr>
</tbody>
</table>
Primary Financial Statements

- Balance Sheet
- Income Statement
- Statement of Retained Earnings
- Statement of Cash Flows
Purpose of Primary Financial Statements

Primary financial statements answer basic questions including:

- What is the company’s current financial status?
- What was the company’s operating results for the period?
- How did the company obtain and use cash during the period?
The Balance Sheet

Summary of the financial position of a company at a particular date

- **Assets**: cash, accounts receivable, inventory, land, buildings, equipment and intangible items
- **Liabilities**: accounts payable, notes payable and mortgages payable
- **Owners’ Equity**: net assets after all obligations have been satisfied
## Generic Balance Sheet

<table>
<thead>
<tr>
<th><strong>Assets</strong></th>
<th><strong>Liabilities and Owner’s Equity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>Wages payable</td>
</tr>
<tr>
<td>Inventory</td>
<td>Short-term debt</td>
</tr>
<tr>
<td>Property, Plant, Equipment</td>
<td>Long-term debt</td>
</tr>
<tr>
<td></td>
<td>Common stock</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>Retained earnings</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Liabilities and Owners Equity</strong></th>
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Purpose of the Balance Sheet

Primary financial statements answer basic questions including:

- What are the resources of the company?
- What are the company’s existing obligations?
- What are the company’s net assets?
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Primary financial statements answer basic questions including:

- What are the resources of the company?
- What are the company’s existing obligations?
- What are the company’s net assets?

- Assets recorded at historical value
- Only recognizes assets that can be expressed in monetary terms
- Owners’ equity is usually less than the company’s market value
The Income Statement

Shows the results of a company’s operations over a period of time:

- What goods were sold or services performed that provided revenue for the company?
- What costs were incurred in normal operations to generate these revenues?
- What are the earnings or company profit?

**Revenues:** Assets (cash or AR) created through business operations

**Expenses:** Assets (cash or AP) consumed through business operations

**Net Income or (Net Loss):** Revenues - Expenses
Generic Income Statement

Sales
- Cost of Goods Sold
- Selling and Administrative Expenses
- Depreciation
- Interest
- Research and Development Expenses
= Earnings before tax (EBT)
- Taxes
= Net Income (NI)
The Statement of Retained Earnings

An additional financial statement that identifies changes in retained earnings from one accounting period to the next.

\[
\text{Beginning retained earnings} + \text{Net income} - \text{Dividends paid} = \text{Ending retained earnings}
\]

Net income results in:
- Increase in net assets
- Increase in retained earnings
- Increase in owners’ equity

Dividends result in:
- Decrease in net assets
- Decrease in retained earnings
- Decrease in owners’ equity
Statement of Cash Flows

Reports the amount of cash collected and paid out by a company in operating, investing and financing activities for a period of time.

- How did the company receive cash?
- How did the company use its cash?

Complementary to the income statement.
Indicates ability of a company to generate income in the future.

<table>
<thead>
<tr>
<th>Cash inflows</th>
<th>Cash outflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sell goods or services</td>
<td>Pay operating expenses</td>
</tr>
<tr>
<td>Sell other assets or by borrowing</td>
<td>Expand operations, repay loans</td>
</tr>
<tr>
<td>Receive cash from investments by owners</td>
<td>Pay owners a return on investment</td>
</tr>
</tbody>
</table>
Relation of statements

Income Statement
- Revenues: $12,443,000
- Expenses: $11,578,400
- Net income: $864,600

Cash Flow Statement
- Cash--Op. Act.: $973,000
- Cash--Inv. Act.: $(1,188,000)
- Cash--Fin. Act.: $245,000
- Net increase: $30,000
- Beg. Cash: $80,000
- End. cash: $110,000

Balance Sheet 12/31/13
- Cash: $80,000
- Other: $4,550,000
- Total: $4,630,000
- Liabilities: $2,970,000
- Cap. Stock: $900,000
- R/E: $760,000
- Total: $4,630,000

Balance Sheet 12/31/14
- Cash: $110,000
- Other: $4,975,000
- Total: $5,085,000
- Liabilities: $2,860,400
- Cap. Stock: $1,000,000
- R/E: $1,224,600
- Total: $5,085,000

Stmt of Retained Earnings
- R/E 12/31/13: $760,000
- Net income: $864,600
- Dividends: $(400,000)
- R/E 12/31/14: $1,224,600
Function of Financial Manager

Operations (plant, equipment, projects) → Financial Manager → Financial Markets (investors)

1a. Raising funds
1b. Obligations (stocks, debt securities)
2. Investments
3. Cash from operational activities
4. Reinvesting
5. Dividends or interest payments

Finance function – managing the cash flow
Financing decisions

Internal corporate financing
- Retained earnings

External sources of funds
- Direct financing (financial markets Instruments)
- Indirect financing (financial Intermediaries)
  - Stocks
  - Debt instruments (bonds, CPs etc.)
  - Loans
Financial markets

- Primary markets
  - Secondary markets
- Money market
  - Capital market
- Organized exchanges
  - Over-the-counter
Primary and secondary markets

**Primary market** – primary issues of securities are sold, allows governments, banks, corporations to raise money by directly selling financial instruments to the public.

**Secondary market** – allows investors to trade financial instruments between themselves. Secondary transactions take place.
Money and capital markets

Money markets – short-term assets (maturity less than 1 year) are traded:
- Certificates of deposits (CDs)
- Commercial papers (CPs)
- Treasury bills

Capital markets – long-term assets (maturity longer than 1 year) are traded:
- Stocks
- Corporate bonds
- Long-term government bonds
Organized exchanges and over-the-counter

**Organized exchange** – most of stocks, bonds and derivatives are traded. Has a trading floor where floor traders execute transactions in the secondary market for their clients.

Stocks not listed on the organized exchanges are traded in the **over-the-counter (OTC)** market. Facilitates secondary market transactions. Unlike the organized exchanges, the OTC market doesn’t have a trading floor. The buy and sell orders are completed through a telecommunications network.
Pro-forma financial statements

Always begin with sales forecast

Project expenses – often a % of sales

Forecast changes in asset and liability accounts
Valuation

*Question:* How much of the company’s equity will the entrepreneur have to give up in order to raise required amount of capital?

- Depends on the value of the stream of uncertain future cash flows
- Requires a technique for valuation
The three primary techniques for valuation

1. Discounted cash flow (DCF)
2. Market multiples
3. Venture capital method
Discounted cash flow

Time value of money

What is the present value of $100 to be received next year?

\[ PV = \frac{CF_t}{(1+r)^t} \]

If \( r = 10\% \),

\[ PV = \frac{100}{(1+0.1)} = 90.91 \]

What is \( r \)? Required rate of return – usually 40-60\% in VC situations
Market Multiples

Apply valuation ratio of comparable firm to firm being valued.

Examples: P-E, market value/book value, Market value/ Sales

Problems:

- What is the appropriate multiplier?

- Start-ups frequently do not have positive earnings, may not yet be generating sales, and have few assets.
Venture Capital Method

Effectively combines the previous two methods. Commonly used in the private equity industry.

- Project value at some point in the future using some sort of multiple
- Discount that value to the present
- Discount rate is more ad hoc – but usually high (40-75%)
Role of price


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<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>1</td>
<td>Employees are knowledgeable &amp; experienced in our industry</td>
</tr>
<tr>
<td>2</td>
<td>Provide quality engineering appropriate to our needs</td>
</tr>
<tr>
<td>3</td>
<td>Meeting schedule commitments</td>
</tr>
<tr>
<td>4</td>
<td>Meeting cost expectations &amp; commitments</td>
</tr>
<tr>
<td>5</td>
<td>Deliver value for the money</td>
</tr>
<tr>
<td>6</td>
<td>Providing schedules that meet our needs</td>
</tr>
<tr>
<td>7</td>
<td>Provide quality fabrication and construction that meets our needs</td>
</tr>
<tr>
<td>8</td>
<td>Being able to perform the work wherever we need it done</td>
</tr>
<tr>
<td>9</td>
<td>Pricing for services &amp; technologies</td>
</tr>
<tr>
<td>10</td>
<td>Having local employees with knowledge of local customs/regulations</td>
</tr>
</tbody>
</table>
The race to the bottom

Marketing should NOT be about:

- Selling as much as possible
- Building market share – at any cost
- Chasing any sales revenue available
- Cutting the price to stay in the “race”

- Unless you want to kill the company!
The Marketing mix (4P’s)
The distribution channel is ...

"The route along which a product and its title (ie the rights of ownership) flow from production to consumption"
Channel Configurations

Originating manufacturer/Service provider

Direct

Post Phone Online F2F

Direct Mail

Distributor

VAR

OEM

Wholesaler

Prime Contractor

Sub Contractor

Agent

Retailer

Specialist

End Buyer/User
Why use intermediaries?

- Specialisation
- Division of labour
- Provide assortment by gathering supplies together from number of manufacturers - “honest broking”
- Breaking bulk so as to meet scale of need of customers - and buying in bulk on behalf of customers
- Reduce “contractual costs”
- Geographical proximity and local knowledge
- Adding value (eg customisation, service, installation)
- Theoretically cash received quicker up the chain
- Running “interference” - for their customers and their suppliers
Reducing “contactual” costs or channel geometry

4 Manufacturers contact 4 retailers directly

No. of contacts = 4 x 4 = 16

4 Manufacturers distribute through a wholesaler

No. of contacts = 4 + 4 = 8
Increasing Retailer concentration
Battle for control

"Let's say I have a new product. Sainsbury and Tesco have over 50% of the London market: London is so important that, if they won't accept my product, it simply isn't worth launching."

- Major Food Manufacturer

"I account for 25% of your business. You account for less that 5% of mine. Let's talk terms."

- Retail Buyer to Major Household Products Manufacturer
Who ‘owns’ the customer owns the margins

[Diagram showing the flow of communication and information between producer, intermediary, consumer/end user, and the concept of brand franchise leading to margin.]
Your choice
The Marketing mix (4P’s)
Which half?

"I know that half my advertising budget is wasted, but I'm not sure which half."

William Hesketh Lever, 1st Viscount Leverhulme (1851–1925) was an English Industrialist, philanthropist and colonialist. He established a soap manufacturing company called Lever Brothers (now part of Unilever) with his brother James.
The fundamental proposition

1. Who is the one person you want to talk to?
2. What is the one thing you want to say to them?
3. Why should they believe you?
4. How do you want them to feel as a result?
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