

**Solution Manual for Essentials of Strategic Management The Quest for Competitive Advantage
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Chapter 5 The Five Generic Competitive Strategies

Lecture Outline

I. The Importance of Managing Strategically

1. A company's strategy spells out why the company matters in the marketplace by defining its approach to creating superior value for customers and how capabilities and resources will be employed to deliver the desired value to customers.
2. In effect, managers must determine how many and which strategic options to pursue including:
 - a. How to create products or services that attract and please customers.
 - b. How to position the company in the industry.
 - c. How to develop and deploy resources to build valuable competitive capabilities.
 - d. How each functional piece of the business (R&D, supply chain activities, production, sales and marketing, distribution, finance, and human resources) will be operated.
 - e. How to achieve the company's performance targets.

II. The Importance of a Distinctive Strategy and Competitive Approach

1. For a company to matter in the minds of customers, its strategy needs a distinctive element that sets it apart from rivals and produces a competitive edge.
2. Simply trying to mimic the strategies of the industry's successful companies never works.
3. Every company's strategy needs to have some distinctive element that draws in customers and produces a competitive edge.

CORE CONCEPT

A company's **strategy** explains why the company matters in the marketplace by specifying an approach to creating superior value for customers and determining how capabilities and resources will be utilized to deliver the desired value to customers..

III. The Relationship Between a Company's Strategy and Business Model

1. A company's business model is management's blueprint for delivering a valuable product or service to customers in a manner that will yield an attractive profit.
2. The two elements of a company's business model are:
 - a. *Customer value proposition* – The company's approach to satisfying buyer wants and needs at a price customers will consider a good value.
 - b. *Profit formula* – The Company's approach to determining a cost structure that will allow for acceptable profits given the pricing tied to its customer value proposition

CORE CONCEPT

A company's **business model** sets forth how its strategy and operating approaches will create value for customers, while at the same time generate ample revenues to cover costs and realize a profit.. The two elements of a company's business model are its (1) customer value proposition and (2) its profit formula..

Concepts & Connections 1.1

Pandora, Sirius XM, and Over-the-Air Broadcast Radio: Three Contrasting Business Models

Discussion Question: 1. What is the prominent difference between the business models of these three organizations?

Answer: While all three provide essentially the same type of entertainment service, the business models employed by Pandora, Sirius XM, and Over-The-Air Broadcast Radio are completely different.. In the area of value proposition (what the customer sees), Sirius XM provides commercial free entertainment with some local content based upon a monthly fee, while Broadcast Radio provides entertainment with some local content with interruptions for commercials without a fee.. Pandora bridges these two methods.. In one mode it operates more like Over-the-Air Broadcast Radio in that it provides entertainment without a fee that includes targeted advertisements, with the added benefit of allowing the listener to customize the music mix.. In the other mode, listeners can elect to go ad-free for a fee using Pandora One..

For profit, Sirius XM must attract a large enough customer base in order to cover costs and provide profit, while Broadcast Radio must attract a large enough advertiser base to cover costs and provide profit.. Pandora, once again bridging the two, generates profit by either an advertiser base or through ad-free services..

IV. Strategy and the Quest for Competitive Advantage

1. The heart and soul of any strategy is the actions and moves in the market place that managers are taking to gain a competitive edge over rivals. The five most used and dependable approaches are:
 - a. **Low Cost Provider** – Achieving a cost-based advantage over rivals.
 - b. **Broad Differentiation** – Seeking to differentiate the company's product or service from rivals' in ways that will appeal to a broad spectrum of buyers.
 - c. **Focused Low Cost** – Concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by having lower costs than rivals and thus being able to serve niche members at a lower priced.
 - d. **Focused Differentiation** – Concentrating on a narrow buyer segment (or market niche) and outcompeting rivals by offering niche members customized attributes that meet their tastes and requirements better than rivals' products.
 - e. **Best Cost Provider** – Giving customers more value for the money by satisfying buyers' expectations on key quality/features/performance/service attributes, while beating their price expectations.

V. The Importance of Capabilities in Building and Sustaining Competitive Advantage

1. Winning a *sustainable* competitive edge over rivals with any of the five strategies relies on two interrelated efforts:
 - a. Building competitively valuable capabilities that rivals cannot readily match.
 - b. Having a distinctive product offering.

CORE CONCEPT

A company achieves **sustainable competitive advantage** when an attractively large number of buyers develop a durable preference for its products or services over the offerings of competitors, despite the efforts of competitors to overcome or erode its advantage..

Concepts & Connections 1.2

Starbucks' Strategy in the Specialty Coffee Market

Discussion Question: 1. How did Starbucks develop a sustainable competitive advantage in the specialty coffee market?

Answer: Starbucks has developed a unique customer experience through their store ambiance that is difficult and expensive for rivals to match.. This experience which includes the product, the environment it is served in, and the service itself, is intended to create an emotional attachment with their customers.. Their product offerings are broad and include not only coffee and specialty coffee drinks, but also teas, fresh pastries, and other merchandise .. They have carefully nurtured their global brand through strategic expansion, and ensure the consistency of the customer experience through the consistency of their store operations..

VI. Why a Company's Strategy Evolves over Time

1. Every company must be willing and ready to modify its strategy in response to changing market conditions, advancing technology, competitive moves, shifting buyer needs and preferences, emerging market opportunities, new ideas for improving the strategy, and mounting evidence that the strategy is not working well.
2. Most of the time a company's strategy evolves incrementally from management's ongoing efforts to fine tune pieces of the strategy, but, on occasion, major strategy shifts are called for.
3. The evolving nature of a company's strategy means the typical company strategy is a blend of (1) proactive moves to improve the company's financial performance and secure a competitive edge and (2) adaptive reactions to unanticipated developments and fresh market conditions.
4. **Figure 1.1, A Company's Strategy is a Blend of Proactive Initiatives and Reactive Adjustments,** depicts the typical blend found within a company's strategy.
5. A company's realized strategy tends to be a combination of proactive and reactive elements.

VII. The Three Tests of a Winning Strategy

1. Three Questions can be used to distinguish a winning strategy from a so-so or flawed strategy:
 - a. How well does the strategy fit the company's situation?
 - b. Is the strategy helping the company achieve a sustainable competitive advantage?

CORE CONCEPT

A company's **realized strategy** is a combination deliberate planned elements and unplanned emergent elements.. Some components of a company's deliberate strategy will fail in the marketplace and become abandoned strategy elements..

- c. Is the strategy producing good company performance?-
2. Strategies that come up short on one or more of the above tests are plainly less appealing than strategies passing all three tests with flying colors.

VIII. Why Crafting and Executing Strategy Are Important Tasks

1. High-achieving enterprises are nearly always the product of astute, creative, and proactive strategy making.
2. Indeed, good strategy and good strategy execution are the most telling signs of good management.

IX. The Road Ahead

1. Throughout the remaining chapters and the accompanying case collection, the spotlight is trained on the foremost question in running a business enterprise: What must managers do, and do well, to make a company a winner in the marketplace?
2. The mission of this book is to provide a solid overview of what every business student and aspiring manager needs to know about crafting and executing strategy.

Assurance of Learning Exercises

1. Based on your experiences as a coffee consumer, does Starbucks' strategy as described in Concepts & Connections 1.2 seem to set it apart from rivals? Does the strategy seem to be keyed to a cost-based advantage, differentiating features, serving the unique needs of a niche, or some combination of these? What is there about Starbucks' strategy that can lead to sustainable competitive advantage?

Response:

Setting Itself Apart – The student should identify key elements in Starbucks' strategy that set it apart from rivals. These include their unique customer experience. This experience which includes the product, the environment it is served in, and the service itself, is intended to create an emotional attachment with their customers. Their product offerings are broad and include not only coffee and specialty coffee drinks, but also teas, fresh pastries, and other merchandise. They have carefully nurtured their global brand through strategic expansion, and ensure the consistency of the customer experience through the consistency of their store operations.

Elements of Strategy – The student should identify that Starbucks' strategy seems to be keyed on differentiating features as described above as well as targeting some specific niche elements. These include customers who prefer a companies that make a commitment to corporate responsibility including protecting the environment and community where they operate and engaging in 'fair trade' practices with their suppliers.

Sustainable Competitive Advantage – The student should identify that developing a sustainable competitive advantage relies on a) building competitively valuable capabilities that rivals cannot readily match and b) having a distinctive product offering. Further, they should be able to highlight that the two areas described above are both distinctive and difficult to match.

2. Go to investor.siriusxm.com and check whether the SiriusXM's recent financial reports indicate that its business model is working. Are its subscription fees increasing or declining? Is its revenue stream advertising and equipment sales growing or declining? Does its cost structure allow for acceptable profit margins?

Response:

The responses developed by the students may include information such as the following. From the 2014 Annual Report and Proxy Statement, the company is focused on delivering the best possible audio entertainment and in-car services to its customers. Revenue for fiscal year 2013 was \$3.8 Billion which was the highest ever for the company and up 12 percent over the previous year. Subscriptions were up 7 percent over the previous year at a record of 25.6 million users. The company predicts continued growth for fiscal 2014 with projected revenue of \$4 Billion with an adjusted EBITDA of \$1.38 Billion. Sirius radios were installed in nearly 70% or 10.7 million new automobiles in the U.S. market. There are currently 60 million Sirius equipped vehicles in the U.S. and that is projected to reach 100 million by 2017. Advertising revenue was \$89 Million, up from \$82 Million the previous year. Equipment revenue was \$80 Million up from \$73 Million. Finally, income from operations is \$1.04 Billion, up 20% from the previous year.

From the information above, the student should be able to draw the following conclusions:

- The Business Model is working based upon an examination of the Value Proposition and the Profit Formula.
 - Subscription fees are increasing and are projected to continue to increase.
 - The revenue stream from advertising and equipment sales is growing and projected to continue to grow.
 - The company has strong profits and expenses are growing at a lower rate than revenue growth indicating that its cost structure allows for acceptable profit margins.
3. Elements of Google's strategy have evolved in meaningful ways since the company's founding in 1998. After reviewing the company's history at www.google.com/about/company/history and all of the links at the company's investor relations site (investor.google.com), prepare a one-to two page report that discusses how its strategy has evolved. Your report should also assess how well Google's strategy passes the three tests of a winning strategy.

Strategy Evolution – From the information found in the links provided, the student's report should include information similar to the following. The company was founded with the mission of organizing the vast amount of information available on the Internet. The company also undertook methods of information sharing ranging from newsletters and later blogs. By 1998 Google has been featured in PC Magazine highlighting the search engine's ability to return 'extremely relevant results'. In 2000, the company releases its first Google Toolbar allowing other browsers to use Google's search engine and increasing its use. In 2002 Google releases its first Google Search Appliance which allows businesses to use the Google search engine within their own documents. By 2003, Google has released Google AdSense which allows content targeting advertising and by 2004, the company launches Google Mail or Gmail. By 2005 Google is available on mobile platforms followed by a steady roll out of other Google products such as Google Maps, Google Scholar, and Gmail for mobile. By 2009, the company has its Google Android operating system running on T-Mobile phones, and by 2011 it is providing Google Pages allowing users to collaborate and create documents online. Innovation and product expansion continue to today and include internally developed innovations as well as acquisitions to expand into new areas.

The student should conclude that all of these innovations follow a careful underlying strategy of adding products and features to the overall product mix that leverage and take advantage of developments in personal and business technology and devices. The company's strategy has evolved from a simple mission of organizing information on the internet to being the single point solution for creating and finding information across multiple platforms for both personal in business users. One anecdotal indication of the company's success is the use of its name as a verb. If you want to find something out you can 'Google' it.

Strategy Assessment – The student's report should include specific indications that the company's strategy is a winner as follows.

- a. Does the strategy fit the company's situation? Yes, the company's strategy fits the evolving world of technology, information creation, and information sharing.
- b. Does the strategy helping the company achieve a sustainable competitive advantage? Yes, the growing base of customers and revenue streams from various products and platforms is led by continuous innovation which differentiates the company well. The growing profit stream indicates that the strategy is sustainable.
- c. Does the strategy producing good company performance? Yes, the 2014 Annual Report shows that market growth is steady with \$66 Billion for fiscal year 2014 up from \$46 Billion in 2012. Operating profit for fiscal year 2014 was \$16.49 Billion up from \$13.83 Billion in 2012. Taken together, these are significant indicators of strong performance in the market.

article the author discusses the change in management and a stronger focus on overseas sales. Interestingly, the second article discusses that sales have declined despite the management changes and overseas sales efforts. Finally, the third article discusses the sale of the Mexx brand, allowing the firm to focus on their “core portfolio of global lifestyle brands”. These three articles together show how the company’s leadership identified a problem and initiated corrective action, and then when efforts did provide the proper results, took appropriate action and divested the failing brand.

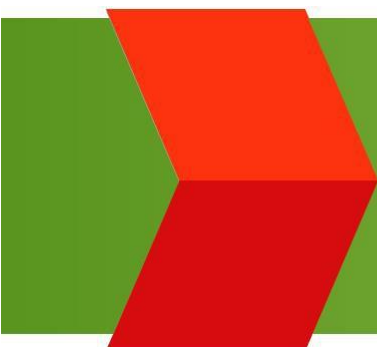
Article 1) LIZ CLAIBORNE INC. TAKES STEPS TO ACCELERATE TURNAROUND AT MEXX
Appoints Tom Fitzgerald as Interim CEO and John Moore as Consulting Vice President, Creative

Source: [http://lizclaiborneinc.com/c/journal/view_article_content?groupid=10123&articleId=73736
&version=1.0](http://lizclaiborneinc.com/c/journal/view_article_content?groupid=10123&articleId=73736&version=1.0)

Article 2) LIZ CLAIBORNE INC. REPORTS 3RD QUARTER AND FIRST NINE MONTHS RESULTS

Source: http://www.liz.com/web/guest/2010news/journal_content/56/10123/80331

Article 3) Liz Claiborne cleans closet with Mexx sale



Overview

Billcutterz.com was a bill negotiation company that attempted to lower rates for customers on their monthly bills for such services as electricity and utilities, Internet, phone, waste management, and cable or satellite television. No fee was charged for BillCutterz.com's services unless savings were negotiated on behalf of its customer. Once savings were obtained and the customer had received revised bills from providers, BillCutterz.com would receive one-half of the savings for the first year.

On January 21, 2014, Billcutterz.com founder and president, Barry Gross, gathered with friends to celebrate his birthday and watch his interview with Dianne Sawyer on ABC World News Tonight that profiled how his four-year-old bill negotiation company was saving its customers hundreds or thousands of dollars each year on their monthly bills. Within days of the ABC World News Tonight segment, Gross also appeared live on Fox Business News to discuss his company's approach to saving money for its customers on their monthly bills. The exposure from the two news segments brought in more than 30,000 new enrollees by February 2014. At the end of its first quarter in 2014, BillCutterz.com was adding 20 to 30 new enrollments every day and had seen its revenues increase by more than 400 percent over the same period in 2013.

There were a number of issues facing the company after the spike in enrollments. The most critical was the backlog of new customers that had signed up for Billcutterz.com. The company did not have the manpower to handle the dramatic increase in customers, which forced Gross to spend the majority of his time on new employee training. In addition, the rapid addition of new employees was creating a cash crunch as the company worked through customers' bills and waited on payment for its services. As a result of exponential growth, the company's business model and strategy have been called into question.

Suggestions for Using the Case

This case was written as a leadoff case and was carefully crafted by the case author to require students to draw upon most all of the concepts discussed in Chapters 1 and 2 to sufficiently prepare for a class discussion of the case. The case involves issues relating to business model development and the evolution of strategy; the need for an action plan is obvious—these are the very things one looks for in a good leadoff case. And the nature of the case virtually guarantees the stimulating kind of class discussion one needs to get the course off on the right foot.

We think **Billcutterz.com** is an excellent leadoff case for the course (other good choices are Whole Foods Market and Robin Hood—which also require that students draw upon the material covered in Chapters 1 and 2). The very close connection between the case and the material in Chapters 1 and 2 make this an especially good leadoff case. You may want to consider covering Chapter 1 in your first day's lecture, Chapter 2 on your second day's lecture, and then assigning **Billcutterz.com** for class discussion on Day 3.

We recommend opening the case discussion with a brief discussion of Barry Gross and his role as the founder and President of Billcutterz.com. A more detailed discussion that focuses on the strategic and operational issues facing the company is next, accompanied by an analysis of the company's financial statements. Finally, the instructor can assist the class in outlining the options that are available to Barry Gross, and to deliberate the recommended course of action for this colorful entrepreneur. We suggest use of a teaching plan that focuses on Billcutterz.com strategy, its business model, and strategic issues resulting from the company's exponential growth.

Video for Use with the Billcutterz.com Case. There is an accompanying 3:10 minute video available at YouTube that you might want to show the class (or have students watch on their own). A 2016 Good Morning America profile of [Billcutterz.com](http://abcnews.go.com/GMA/video/cable-phone-electric-bills-empty-wallet-33429117) can be accessed at <http://abcnews.go.com/GMA/video/cable-phone-electric-bills-empty-wallet-33429117>.

The assignment questions and teaching outline presented in upcoming sections of this TN reflect our thinking about how to conduct the class discussion of the [Billcutterz.com](http://www.billcutterz.com).

It is really very difficult to have an insightful and constructive class discussion of the Billcutterz.com case unless students have not only read the case but also conscientiously worked their way through a set of well-conceived study questions before they come to class. In our classes, we expect students to bring their notes to the study questions to use/refer to in responding to the questions that we pose. Students often find having a set of study questions is useful in helping them prepare oral team presentations and written case assignments—in addition to whatever directive questions you supply for these assignments.

To facilitate your use of study questions and making them available to students, we have posted a file of the Assignment Questions contained in this teaching note for the Billcutterz.com case on the instructor resources section of the Connect Library.

You may also find it beneficial to have your class read the Guide to Case Analysis that is available in the instructor resources section of the Connect Library. Students will find the content of this Guide particularly helpful if this is their first experience with cases and they are unsure about the mechanics of how to prepare a case for class discussion, oral presentation, or written analysis.

Auto-Graded Connect Case Exercise. The 5th Edition includes a fully auto-graded Connect case exercise for 12 cases included in the text. The auto-graded exercises closely follow the assignment questions and analysis included in the teaching note for the case. The auto-graded exercise for the Billcutterz.com case requires that students answer a series of multiple choice questions related to Assignment Questions 1-4. Question 5 is left as an open ended question that allows students to fully discuss recommendations concerning improvements to the company's coffee operations, changes in its long-term direction, objectives, strategy, or approach to strategy execution.

Students should be expected to spend about 30-45 minutes to complete the exercise, assuming they have done a conscientious job of reading the case and absorbing the information it contains. All of the questions are automatically graded, and the grades are automatically recorded in your Connect grade book, which makes it easy for you to evaluate each class member's ability to apply many of the concepts discussed in Chapters 1 and 2.

We strongly urge that you consider requiring all class members to complete this particular Connect exercise before coming to class on the day the case has been assigned. Students that do a conscientious job of completing the exercise will be better prepared to make meaningful contributions to the class discussion, as opposed to merely giving off-the-cuff opinions. Insisting that class members bring printouts of their work to use as notes during the class discussion enables them to argue their positions more forcefully and completely

The length of the case makes it ideal for an in-class written case or a final exam case. Our suggested written assignment questions are as follows:

As a prospective intern for Billcutterz.com, Mr. Barry Gross has asked that you evaluate the company's business model, strategy, and internal situation. In addition, he has asked that you recommend an action plan that addresses the company's backlog of customers. Your 4-5 page report should include an assessment of the company's business model, competitive strategy, resources and capabilities, and financial situation. The report should also provide an action plan to allow the company to successfully capitalize on its rapid growth, strengthen its competitive advantage, and improve financial performance.

While participating in an internship with Billcutterz.com, Mr. Barry Gross has noted your skills of analysis and growing business acumen. He has asked that you prepare a report that evaluates Billcutterz.com's business model, strategy and operations. Your report should also make recommendations for contending with the company's exponential growth and improving its overall financial performance. Please provide whatever exhibits related to your analysis that are necessary to present a persuasive argument for your recommended course of action.

Assignment Questions

1. Assess Barry Gross, the founder and President of Billcutterz.com? How has Gross performed as the President of the company as it progressed from new venture into its current growth phase?
2. Regarding Billcutter.com's current operations, what are its strengths and weaknesses? What resources, capabilities and core competencies greatly benefit the company? In what areas is the company potentially weak or require managerial attention? What is your overall conclusion regarding Billcutterz.com's current operations?
3. Conduct an analysis of Billcutterz.com's financial statements. Where is the company strong and/or growing? Where is the company weak? What is your opinion regarding why the company may be weak in this area? What is your overall assessment of the current financial condition of Billcutterz.com?
4. What is Billcutterz.com's stage in the new venture life cycle? Why? What, as a result, is the greatest challenge for Billcutterz.com as a result? What potential steps will Billcutterz.com need to take in order to address this challenge?
5. Briefly summarize the operational and strategic issues faced by Billcutterz.com, and consider the options that Barry Gross has to address these issues. What are your recommendations regarding the course of action that Billcutterz.com and Barry Gross should take to address these key strategic and operational issues?

Teaching Outline and Analysis

- 1. Assess Barry Gross, the founder and President of Billcutterz.com? How has Gross performed as the President of the company as it progressed from new venture into its current growth phase?**

Clearly, Barry Gross is a charismatic entrepreneur. From the opening tableau of his birthday party to the ABC World News Tonight interview, the impression students can draw from the case is that Gross characterizes the personality and characteristics of a model entrepreneur, such as risk taking, driven or determined, confident, and having an opportunity orientation.

Students should also be quick to point to the financial success of Billcutterz.com. As of year-end 2013, Billcutterz.com had reported a net income of \$57,585 on sales of \$89,612. This was an impressive rate of return (see financial analysis below). Further, students will likely also begin to examine the rapid rate of growth reported by the company in the wake of the positive publicity for the firm.

The question posed by the case, however, regards whether Gross has the ability to take the company from startup into its current growth phase. New customers, for example, may have outstripped the ability of the company to adequately service each account. The company may also have reached the limits of its

current facility at the Coastal Bend Business Innovation Center. New employees for the company were also a concern. While Gross was heavily involved in the training of new employees, he was not certain if his time was better spent on that task or if the company was better served by his seeking new business and negotiating large bulk contracts with companies such as Verizon and AT&T.

2. Regarding Billcutterz.com's current operations, what are its strengths and weaknesses? What resources, capabilities and core competencies greatly benefit the company? In what areas is the company potentially weak or require managerial attention? What is your overall conclusion regarding Billcutterz.com's current operations?

Billcutterz.com exhibits a number of strengths in their current operations. Barry Gross and his bill cutting model was clearly a core competence of the company. Further, his ability to train and develop new employees in his bill cutting method was also a core competence. Positive publicity and the resulting spike in new customers suggested a strong revenue potential for the business going forward, and the company's proprietary software system to track customers suggested a capability to manage customer interactions and flow in a professional manner. The company also had positive reputation with customers, resulting in new customer referrals. Finally, the company had developed a social media presence, and was successfully utilizing this channel to increase both brand awareness for Billcutterz.com as well as customer flow.

With regard to weaknesses, the recent spike in new customers posed a significant challenge to the company. The company's Savings Experts had yet to successfully work through the backlog of new employees, and this effort was complicated by the large surge in customers in a short period of time. New customer flow, in other words, was erratic. Gross discusses gaining referrals from existing clients as a marketing strategy to make the new customer flow less erratic, but the recent publicity surge for the company had come largely due to positive publicity through television and possibly social media. Managing the large spike in enrollments, while positive, posed a significant operational challenge for the company.

Commensurate with the spike in enrollments, staffing also posed a challenge. Gross was also heavily involved with employee training, limiting his ability to (a) train more Savings Experts than he alone could handle, and (b) constraining his time to develop new customers and negotiating large discount packages from major service providers. The other issue related to this staffing problem was the difficulty of matching new employees with the surge in customer flow. Anytime a company attempted to staff up to meet demand, it took on the difficulty of matching new hires to new customers. Currently, the company was struggling to meet the new customer base, but care also needed to be taken to not overshoot on hiring. To summarize, current staffing issues revolved around staffing, training and employee/customer optimization.

While a tremendous strength for the company, students should be able to point out that Gross may pose a challenge going forward. Currently, decision making, operations management and training all reside with Gross. As the company grows going forward, Gross will be challenged to relinquish day to day operation and training authority in order to focus on issues more strategic to the company, such as new customer development and large service provider contract negotiations.

While not discussed at length, the case mentions that Billcutterz.com tracked customer communication through a proprietary software system. Care needed to be taken to ensure that this custom system was scalable for future needs of the company. If not, Billcutterz.com may be better served by a larger, scalable customer relationship management software package. A number of corporations offered such software off the shelf, and Billcutterz.com may find that growth necessitates a switch to a more standardized solution.

To summarize, Billcutterz.com demonstrated a number of resources, capabilities and core competencies that should serve the company well going forward. However, the company faced a number of challenges going forward, including customer flow, staffing, leadership and operations.

3. Conduct an analysis of Billcutterz.com's financial statements. Where is the company strong and/or growing? Where is the company weak? What is your opinion regarding why the company may be weak in this area? What is your overall assessment of the current financial condition of Billcutterz.com?

An analysis of Billcutterz.com's financial statements is presented in Exhibit IM-A, below. Annual financial data for the company is available for 2013, and information for January-May 2014 is also presented in the case. Table 1 presents some simple annualized projections for 2014, based on the current rate of sales through May 2014. These projections are likely to be somewhat inaccurate, due to the spike in sales reported in the case. Sales for Billcutterz.com don't appear to be steady or occurring with a predictable pattern. This is typical for new ventures, but it makes sales forecasting problematic.

Revenues for the first five months of 2014 have already outstripped revenues for all of 2013. Sales through May 2014 were \$92,170, compared to \$89,612 for all of 2013. On a forecasted annualized basis, this would put 2014 sales at 146.85% of the 2013 sales pace. This is a very robust growth rate and, as reported in the case, was straining the resources of the company to keep pace. There is discussion in the case regarding the usage of customer referrals in order to generate new sales leads, and it is likely that this discussion was taking place in order to reduce the sudden spikes in new customers and make the growth of the company more steady and manageable.

Wages for the company grew from \$16,429 in 2013 to \$76,496 as of May 2014. This represented a 1017.48% rate of wage growth for the company, on an annualized basis. The case discusses the addition of new employees, and these new hires represented approximately \$60,000 in new wage expenditure. Despite this expenditure, the backlog in new customer order had not yet been reduced to a manageable size. This was likely due to the time and effort required to train new Savings Experts in the Billcutterz.com methods, and may also reflect the increasing difficulty that Barry Gross was having in remaining deeply involved in new employee training.

The other difficulty posed by the rapid growth in wages for the company was the mismatch between sales growth and wage growth. While sales were growing at approximately 146% on an annualized basis, salaries were growing at a blistering 1017% annualized rate. It is difficult to argue that Billcutterz.com had overstaffed their organization, particularly given the new order backlog, but the pace of new hires would likely need to be attenuated to bring revenues more in line with expenditure, once the sales growth of the company became more predictable. Otherwise, the overshoot in wage growth threatened to erode the company's bottom line and also likely affect cash flow. "A" students should be able to quickly identify the sales/wages mismatch.

All other expenditures on the income statement were growing rapidly, but appeared to be in line with the company's growth rate. Net income through May 2014 was roughly at breakeven, and net income on an annualized basis was projected to also be breakeven, assuming that all of the current sales and expenditures were roughly consistent through the rest of 2014. Profitability had dropped sharply in 2013.

The current ratio for the company had dropped sharply from 2013 to May 2014, but did not appear to be an area of concern. Accounts receivable dropped from \$24,621 to \$4,337 as of May 2014. Students should be able to identify the drop in accounts receivable, and tie this to the large drop in the company's quick ratio. (Bonus Question for Students: What are some of the probable causes for such a rapid drop in accounts receivable?).

Debt to asset and debt to equity ratios for the company have shown a modest increase, with total debt for the company rising to \$22,124. Debt levels were not currently a cause for concern, and did not appear to be growing in excess of the company's ability to handle. Total asset turnover and fixed asset turnover ratios both increased from 2013 to May 2014, suggesting improved operational efficiency, but total asset turnover, in particular, should be interpreted cautiously given the changes on the company's balance sheet.

Retained earnings for the company dropped \$16,248 from year-end 2013 to May 2014, and suggested that the company had likely taken a charge in 2014. Students, particularly accounting majors, should be able to connect this drop in retained earnings with the sudden drop in accounts receivable. Assuming that the accounts receivable write-down was due to uncollectable debts, this would suggest that the company's billing model may be in need of examination. Were customers being served, only to renege on their billing from Billcutterz.com? If so, this may merit some discussion regarding the company's billing practices and business model.

In summary, sales growth for the company had been rapid, and was accompanied by a large spike in company wages. It was too early to determine if the sales/wages mismatch was problematic, but earnings were clearly under pressure due to rapid growth.

TABLE 1

Billcutterz.com Financial Analysis, Annual 2013, Jan–May 2014 and Annualized 2014

	Jan. – May 2014	Annualized 2014	2013	% Change 2013–2014
Revenues	\$92,170	\$221,208	\$89,612	146..85%
Wages	\$76,496	\$183,590	\$16,429	1017..48%
Computer and Internet	\$656	\$1,574	\$685	129..78%
Merchant Processing Fees	\$2,686	\$6,446	\$1,117	477..08%
Office Supplies	\$5,037	\$12,089	\$4,209	187..22%
Rent	\$4,066	\$9,758	\$7,188	35..75%
Telephone	\$1,164	\$2,794	\$1,830	52..68%
Other Expenses	\$2,028	\$4,867	\$568	756..87%
Total Expenses	\$92,133	\$221,119	\$32,027	590..41%
Net Income	\$37	\$89	\$57,585	(99..85%)
Return on Sales	0..04%	0..04%	64..26%	
Return on Assets	0..08%	n..a..	101..21%	n..a..
Return on Equity	0..16%	n..a..	145..81%	n..a..
Accounts Receivable	\$4,337	n..a	\$24,621	n..a
Current Ratio	21..55	n..a	125..78	n..a
Debt/Assets Ratio	48..76%	n..a	30..59%	n..a
Debt/Equity Ratio	95..18%	n..a	44..07%	n..a
Retained Earnings	\$9,569	n..a	\$25,817	n..a
Shareholder Equity	\$23,245	n..a	\$39,493	n..a
Total Asset Turnover	2..03	n..a	1..58	n..a
Fixed Asset Turnover	11..21	n..a	10..90	n..a

n.a. not available

Source: Billcutterz.com internal documents

Note: Financial data has been disguised, but accurately reflect the company's actual financial ratios.

4. What is your assessment of Billcutterz.com's business model? Does the company have a compelling customer value proposition? What is your assessment of its profit formula?

Students are likely to show strong enthusiasm for the company's customer value proposition since Billcutterz.com's bill negotiation service is easy to understand and universally appealing. The company's fee structure of 50 percent of negotiated savings provides no risk to its customers if savings are not achieved. In addition, the company's service allows customers to save hundreds or thousands of dollars in a year for doing nothing more than registering at the company's website and uploading copies of bills. There should be little to debate about the value of the company's services to its customers.

Students will be less enthusiastic about the company's profit formula. Students who have made calculations similar to those in the financial analysis illustrated in Assignment Question 3 will note that the company's delayed billing and collection practice had created a liquidity problem for the company that could jeopardize the viability of the company without some type of cash infusion. The addition of labor and training expense well before the ability to collect payment for services should have students question the capability of the business model to scale with volume. Students may suggest that the current dilemma indicates that the company's profit formula is flawed and will not allow the company to capitalize on its dramatic growth in customer registrations.

5. Briefly summarize the operational and strategic issues faced by Billcutterz.com, and consider the options that Barry Gross has to address these issues. What are your recommendations regarding the course of action that Billcutterz.com and Barry Gross should take to address these key strategic and operational issues?

Billcutterz.com had a number of strategic and operational issues with which to contend. The company had progressed rapidly, and was now struggling with the results of the successful launch of this entrepreneurial venture. Barry Gross had good reason to be proud of his success; now was the time to take Billcutterz.com to the next level of success.

In many ways, the issue for Billcutterz.com revolved around a question of vision: Where did Barry Gross envision this company in two years' time? What changes needed to be made to the company in order to take the company from the start-up phase into the growth phase of evolution? Finally, and most critically, was Gross and Billcutterz.com able to evolve into a maturing company, with all of the processes, procedures and business methods that would accompany such an evolution?

Strategic Issues

Vision – What was Gross' vision for the company in the next two years? Did Gross envision growing Billcutterz.com into a mature company? If so, what were the strategic and operational goals that needed to be set for the company?

Growth – How to manage the large spike in new customer enrollments and grow into a maturing company.

President – Was Barry Gross able to evolve from an entrepreneur into an executive? Further, was he able to release himself from day to day operations and begin to devote increasing levels of time to business development and large service provider negotiations?

Business Model – There was some indication from the balance sheet that the current business model may need examination, especially because of the company's current cash flow predicament. While the company's customer value proposition is strong, there should be considerable debate among students in the class regarding the viability of its cost structure and profit formula.

Operational Issues

Management – Who would manage the day to day operations of the company and begin to systematize the training of new Savings Experts?

New Customers – There was a large backlog of new customer enrollees.

Proprietary Software System – Was the company software system scalable?

Students should be able to formulate this list of strategic and operational issues for the company, and develop recommendations that encompass workable solutions for these issues. In particular, students should be able to articulate a set of recommendations that takes Billcutterz.com from a start-up venture into a small business over the next 24 months. These recommendations should encompass an increasingly administrative focus on the business, with routinized processes and procedures and the beginnings of a hierarchical managerial structure.

Specific recommendations likely to be made by students include:

- Develop employment opportunities for student workers to become Savings Experts to speed the bill negotiation process for Billcutterz.com's backlog of customers.
- Evaluate partnership opportunities with telemarketing firms with idle capacity to negotiate bill reductions.
- The company's customer value proposition is appealing, but the company's profit formula is burdened by labor expense related to Savings Experts' compensation. Students may recommend that the company develop contracts with major service providers such as Verizon, AT&T, and Time Warner Cable that provides automatic non-negotiated discounts to Billcutterz.com customers with satisfactory payment histories.
- Students may also recommend a new compensation plan that provides Savings Experts with incentives that will speed call time and bill negotiation.

Epilogue

As of early 2015, Billcutterz.com continued to struggle with the backlog of new customers. However, Barry Gross was in negotiations with a telemarketing firm with idle large phone banks that could assist the company in negotiating customer bills. An agreement with the company would require that Gross provide training to the telemarketing firm to develop bill negotiation capabilities in its workforce.