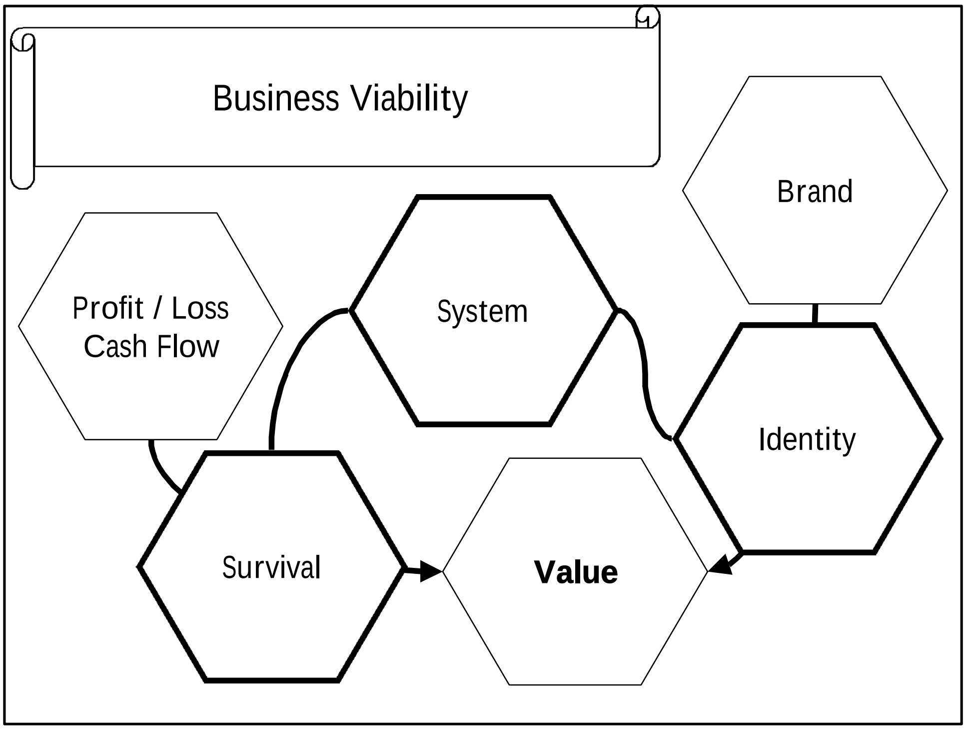


Questions

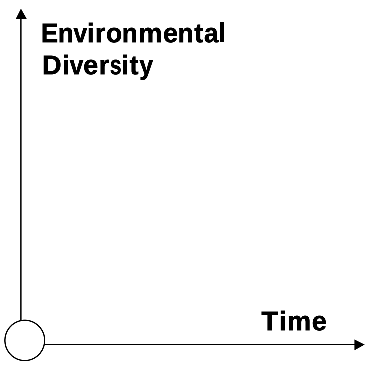
- Why are some companies successful and some not? Why do some companies survive and some not? What does success and survival mean?
- How important is profit? How can a company survive when it isn't making a profit? How can a company fail when it is making a large profit?
- How important is growth? Can a company become non-viable simply because it fails to maintain its year-on-year growth?
- How important is corporate identity and image? Are these factors relevant to business viability?

Core Concepts

- Economic Viability
  - Profit
- Ethical Viability
- Sociological Viability
  - Manageability
- System Viability
  - Relationship between (Open) System and Environment
- Sustainability
  - Resource consumption
  - Social mandate
  - Environmental impact
  - Political support
  - Image

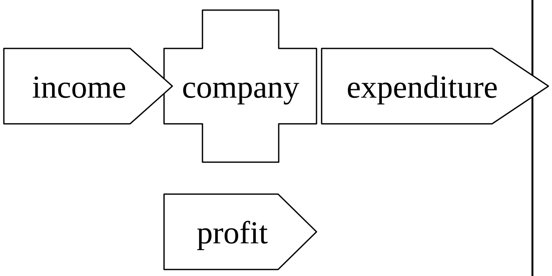
- Viability means: ability to survive.
- For many enterprises, viability is ultimately linked to profit. Even if the business is not currently profitable - perhaps it is in the early stages of development, undergoing a growth spurt, or just going through a bad patch - there is an expectation that it will be profitable at some future date. The expectation of future profit justifies continued investment.
- This economic notion of viability can also be extended to not-for-profit enterprises such as public sector organizations and charities. Such organizations are viable if they are seen to deliver social or other value, sufficient to justify adequate funding and support on an ongoing basis.
- In addition to economic notions of viability, we can also consider the social viability of an organization. An organization is socially viable if it provides enough value to justify any social costs (internal or external).

Dimensions of Viability



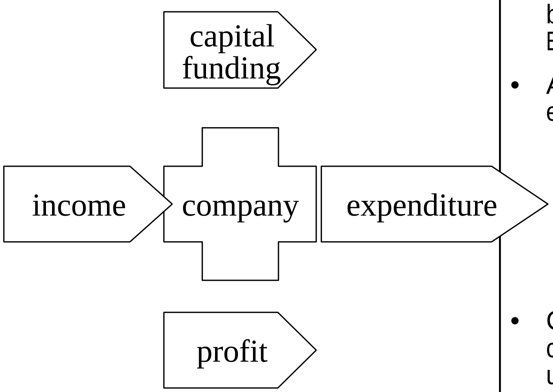
- Viability across a range of environmental conditions is known as **robustness**.
- Viability in a single specialized environment is known as **niche viability**.
- Viability into the future is known as **sustainability**.
- Viability for a defined period, with no requirement for survival after the period has ended, we can call **time-delimited viability**.
  - For example, the plans for a specific event, such as the London Olympics, require time-delimited viability.
  - However, the business case for the investment may reference longer term benefits for the region, and therefore imply some degree of sustainability as well. This affects how we think about the scope of the system.

Viability = Profit?

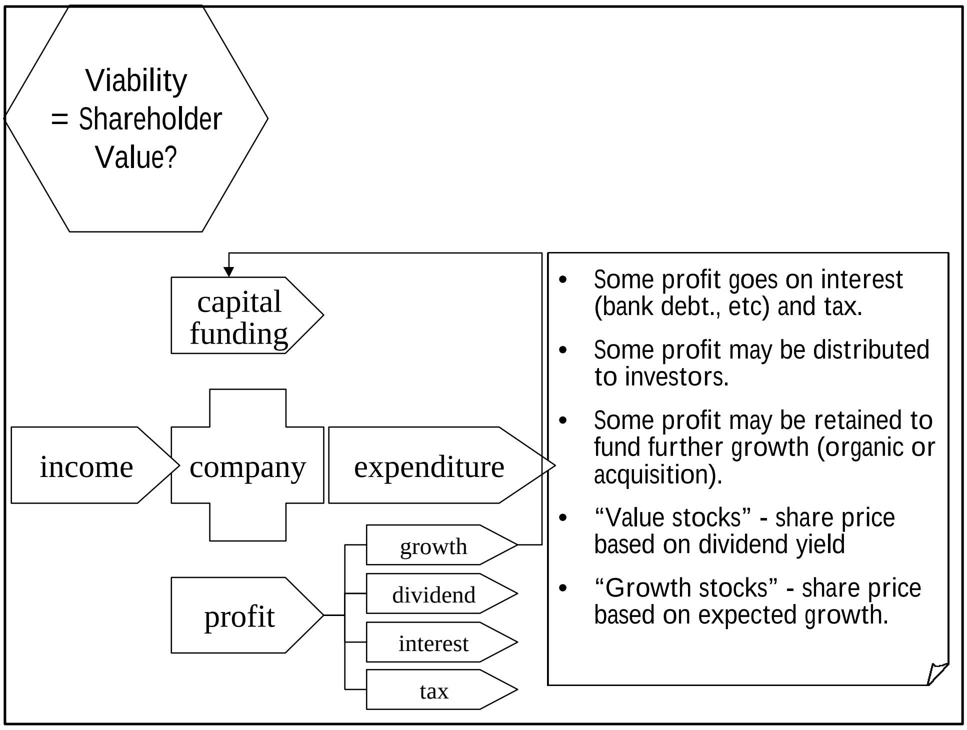


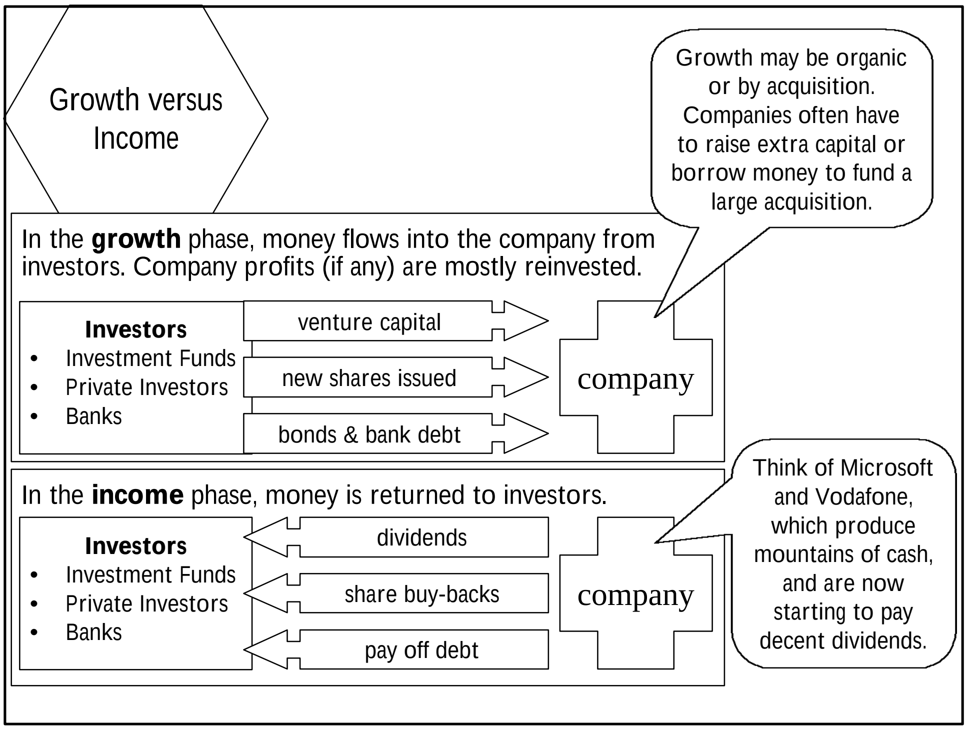
- Profit = Income minus Expenditure
- The simplest notion of viability is that a company is viable if it makes a profit.

Viability = Future Profit?



- But Expenditure generally precedes Income
- Expenditure may exceed Income for several years ("Cash Burn"), before the company reaches Break Even.
- A company is viable if it is expected to make a profit one day.
  - Either it must reach breakeven before funding runs out.
  - Or there must be investors willing to provide further funding.
- Conversely, a company that is currently profitable may have an uncertain future.


Viability = Shareholder Value?
capital funding
income
company
expenditure
growth
dividend
interest
tax
profit
• Some profit goes on interest (bank debt., etc) and tax.
• Some profit may be distributed to investors.
• Some profit may be retained to fund further growth (organic or acquisition).
• "Value stocks" - share price based on dividend yield
• "Growth stocks" - share price based on expected growth.


Growth versus Income
Growth may be organic or by acquisition. Companies often have to raise extra capital or borrow money to fund a large acquisition.
In the **growth** phase, money flows into the company from investors. Company profits (if any) are mostly reinvested.
Investors
• Investment Funds
• Private Investors
• Banks
venture capital
new shares issued
bonds & bank debt
company
In the **income** phase, money is returned to investors.
Investors
• Investment Funds
• Private Investors
• Banks
dividends
share buy-backs
pay off debt
company
Think of Microsoft and Vodafone, which produce mountains of cash, and are now starting to pay decent dividends.

Viability and Growth

Growth

- Stakeholders benefit from growth. Shareholders get more value, and employees get more job opportunities.
- A company may be obliged to deliver a given level of growth to sustain itself.

Rapid Growth

- Rapid growth may introduce several risks
  - Overextending scarce skills & resources
  - Pressure on cashflow
  - Loss of manageability
  - Reduced margins

Shareholder Perspective: Income or Growth?

- Some investors may prefer income stocks, while others may prefer growth stocks.
- Many investors try to build a portfolio of investments containing a balance of income and growth stocks.
- Some companies may be making the transition from growth to income. Their earnings are already high - can they increase any further?
  - Microsoft
  - Vodafone?

Income Stocks

- For example utilities, such as water company.
- Steady earnings in a steady market. Expected to pay regular dividends to shareholders. Comparatively low risk.
- Possible improvements through cost-cutting and good management.
- Typically have low P/E ratios (because earnings are already high and not expected to increase dramatically)

Growth Stocks

- For example, high tech companies.
- May not be earning much today. Most/all earnings retained for reinvestment.
- Investors hope that the company will grow dramatically. High risk is accepted against a possible high reward.
- Typically have high P/E ratios (because earnings are relatively low but expected to increase).

Viability and Size: Is Bigger Better?

Four Routes to Economies of Scale …

Cost = Fixed Cost + Variable Cost.

– As volume increases, the fixed cost is shared across a larger number of units, so the average cost goes down.

Variable cost is not linear

– As volume increases, the unit price of certain input commodities can be reduced.

Costs change over time - productivity increases

– The more you do something, the more efficient you get (learning by doing).

Resource smoothing

– Where resources come in large units, larger volumes should produce less wasted resource.

… and Diseconomies of Scale

Scarce Resources

– Demand for a scarce resource increases its price or reduces its quality/reliability.

Step Costs

– As volume increases, new fixed costs are incurred. For example, a larger factory or an additional layer of management.

Complexity Costs

– Loss of efficiency, reliability or performance.

Viability and Competition

Competition

- Does competition for business provide an incentive to innovate?

Monopoly

- If there is no competition for business, does this remove the incentive to innovate?

Regulation

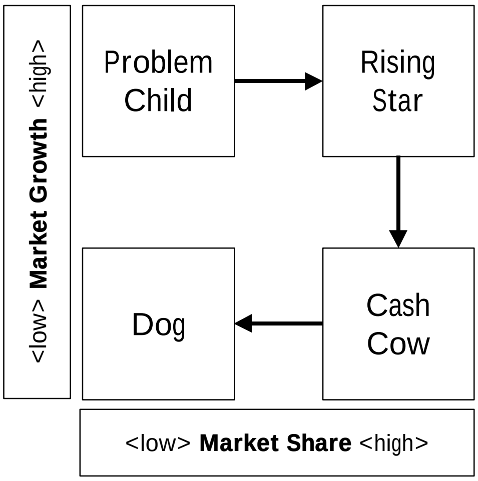
- Stimulate competition?
- Compensate for lack of competition?

Market Scope

- Monopoly and Competition are relative to a given way of **scoping** the market.
- A company that has a monopoly (or dominant market share) in one market system may have many competitors when viewed as part of a larger market system.
- Example: a company with a large share of the office software market may have a much smaller share of the overall software market or office equipment market.

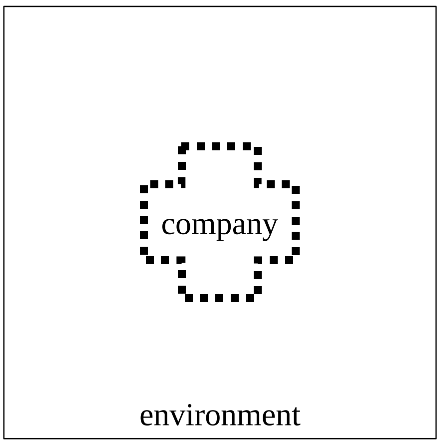
Product Life Cycle

- *What is the relationship between a business and its products?*
- *How do life cycle decisions affect business viability?*



- Income Stocks are based on “Cash Cow” products.
- For example, most successful utility companies have a high market share in a stable market (low growth).
- But think of Microsoft and Vodafone generating huge amounts of revenue from their main products.
- In order for these companies to remain Growth Stocks rather than Income Stocks, they need to find a constant stream of new “Rising Star” products.

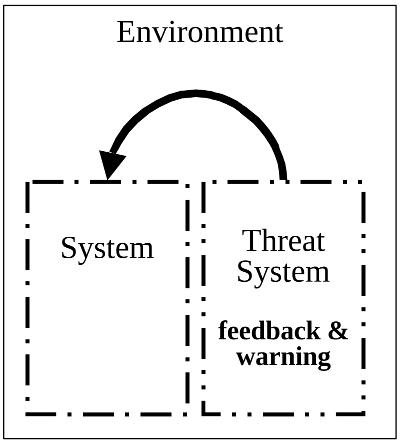
Company as Container for Value



- A company wishes to maximize its assets and minimize its liabilities.
- Assets can leak outwards.
  - Lost revenue / opportunities
  - Leaking knowledge
  - Loss of identity, reputation & trust
- Liabilities can leak inwards.
  - Excess costs & risks
- Among other things, security involves maintaining the integrity of the company boundaries.

- So can we protect a company by building an IT firewall?
  - Assume the main threats are outside the organization?
  - Assume the main threats are inside the IT systems?

Viable in Hostile Environment



Theory 1

- Threats are random

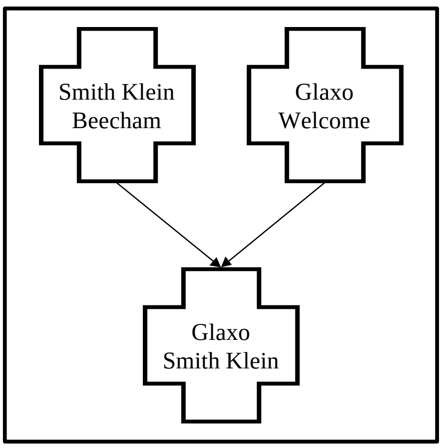
Theory 2

- Threats are clustered

Theory 3

- Threats are intelligent

Company as Predator



- Some companies grow by acquisition.
  - A history of mergers can sometimes be read in the company name.
- Some corporate identity is lost in the merger.
  - This is sometimes symbolized by shortening the company name.
- Some industries appear to demand regular consolidation.
  - Only the predators are viable.
  - Organic growth is not regarded as viable (says who?)

Protecting company from predators

- Occupy niche - too small to be of interest to larger competitors.
- Bind expertise and resources
- Obsessive about company secrets.
- “Poison pill” - create problems for companies attempting hostile takeover.

- However, protection from predators may undermine the business model.
  - Niche may be restrictive
  - Uneconomic price for key resources.
  - Poison pill is uneconomic for investors.
- Sometimes directors may put too much energy and resources into maintaining the independence of a company, conflicting with the best interests of the shareholders.

Viability in the Not-For-Profit Sector

What makes an operation viable, if there is no profit?

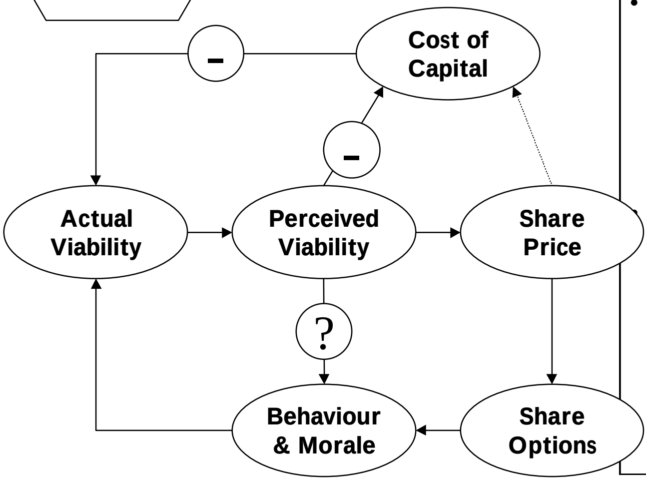
Does value always have to be reckoned financially?

Possible definitions

- Public Sector
  - An operation is viable if it can maintain a decent level of service while retaining political support.
- Charity
  - An operation is viable if it can maintain a decent level of service while retaining voluntary support and funding.

- We may also want to consider the viability of operations within a larger company, where profit and loss cannot be separately accounted for.
- Viability refers to a reliable supply of whatever sustains the operation - both financially and non-financially.
- Long-term viability means that an operation should not represent a permanent drain on resources, without giving something of value in return.

True Viability and Perceived Viability



- While real viability can affect perceived viability, there are other (possibly irrational) influences on perceived viability that have nothing to do with real viability.
- Conversely, the effect of perceived viability on real viability is at best indirect (perhaps by affecting morale or the cost of capital) - but any causal link in this direction cannot be taken for granted and should be explained.

Discussion

Questions

- Does viability imply stability, or is permanent instability compatible with viability?
  - Metaphor of European Fighter Aircraft - “fly-by-wire”
- What is the difference between viability and sustainability? What connotations does each term have?
- What are the possible threats to the viability of a monopoly?
- What are the implications of conflict between long-term viability and short-term share price?

Case Examples

- BSkyB
- Invensys
- Marks and Spencer
- Nuclear Energy

Reading

Suggested Reading

- E.F. Schumacher, Small is Beautiful: A study of economics as if People Mattered (first published 1973)
- This is a highly partisan analysis of global economics, with a strong basis of ethics and systems theory.
- When studying at university level, you are not expected to agree with everything you read. But you are expected to master the arguments and arrive at your own opinion.

Other Reading

- Maturana & Varela The Tree of Knowledge