Strategic factors supporting improved profitability

- A summary of the master thesis with the above title, by Nils Axiö and Jonas Lidén

Whereas a company’s long time survival and performance can be measured in several ways, perhaps the most common metric would be its profitability. Milton Friedman has, although disputably so, been attributed the quote “the business of business is business”. Even though a company today might have pressure from various stakeholders for other pursuits, it is certain that it will not be sustainable without long-term profitability. No wonder then that the question What leads to profitability? has been asked as long as modern firms have existed.

The above discussion was the starting point of a master thesis case performed during spring and summer 2012. During the authors of this article’s studies, issues of strategy and profitability had been present. Hence, it was natural to pursue a deeper knowledge and understanding of these areas.

A common indicator of company’s long time survival and performance is its profitability. What then lies behind profit is a popular field of study, although more prescriptive than inquisitive literature has been published. One of the main reasons is that identification of what has led to an increase in profitability is extremely complex, as companies work in different micro and macro environments and that these change over time. Studies are usually performed in retrospective, and what was applicable to one company at one time, might not be so to a different company at a different time and in a different environment. Few studies have been conducted summing up the current knowledge base within the field of Strategic Management in an accessible manner. Books trying to summarise are often found within management or business literature, and this was considered a good starting point for the study.

One of the most sold business books is Good to Great by Jim Collins. Collins and a team of co-workers evaluated past stock performance data and identified 11 “great” companies, which were then dissected to see what made them tick. The idea for the thesis was using Good to Great as a starting point, setting out to investigate what had been done in the study of the reasons behind profitability, both in business books, but also more academic literature. The idea was to see what different conclusions had been made and how they changed over time. Perhaps it was possible to conclude what had been done in a common framework and find a set of factors important to profitability?

The purpose thus became To identify strategic factors in companies that improved their profitability.

To delimit the above-mentioned problems and identify important factors, choices in selection and scope were made. The main idea was to use the resulting increased profitability as a fixed factor, and the “changing” factors with a possible influence as variable. The following areas delimit the work:

- Possibility to affect and potential impact
  - Management needs to be able to affect a factor relevant for the study as well as for profitability
  - The impact of said factor is of importance – management needs to know what impact an influence on one factor can have
- External and internal factors
  - Factors needs to be considered on a scale as to what degree they are internal or external keeping potential for being able to influence them in mind as well as their effects
- Improved and sustained profitability
Considered factors needs to be something sustainable and not temporary, and should affect profitability on a higher level than business cycles or financial “tricks”

Results
The thesis starts out by a presentation of the relevant theoretical area, Strategic Management. From this area several factors are identified and lifted. The factors are grouped based on their respective chronological appearance as a management theory or tool, as well as their perceived operational level. Table 1 presents these.

Table 1 - Groups of concepts

<table>
<thead>
<tr>
<th>Group</th>
<th>Time for appearance as management theory/tool</th>
<th>Operational level</th>
<th>Concepts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current operations</td>
<td>-1960</td>
<td>Operational, day-to-day, internal</td>
<td>• Control measures&lt;br&gt;• Evaluation,&lt;br&gt;• Rewards&lt;br&gt;• Motivation</td>
</tr>
<tr>
<td>Organisation</td>
<td>1950-1970</td>
<td>Organisational, organisation compared to external world</td>
<td>• Focus on competencies&lt;br&gt;• Strategic organisation</td>
</tr>
<tr>
<td>Foundation</td>
<td>1960~1990</td>
<td>Abstract, underlyng, internal</td>
<td>• Culture&lt;br&gt;• Purpose&lt;br&gt;• Communication&lt;br&gt;• Leadership</td>
</tr>
<tr>
<td>Forward operations</td>
<td>1980-</td>
<td>Operational, forward looking, hybrid between internal and external views</td>
<td>• Flexibility&lt;br&gt;• Creativity&lt;br&gt;• Learning</td>
</tr>
</tbody>
</table>

Furthermore, the concepts were analysed in terms of difficulty in evaluating, changing and their potential impact on profitability. For the summary of the analysis as well as the table presenting these findings, see the discussed master thesis.

Lastly, some conclusions based on the findings of the thesis are drawn.

First, different perspectives were found within the different types of literature (i.e. more academic or more practitioner based); they all brought valuable insight into the field. The academic literature provided research-oriented proved facts and methods. Arguably these could be negatively affected by the very rigorous yet necessary academic methods due to the rapidly changing nature of a globalised market. The more practitioner based view brought more gut-feeling and experience-based insight into the harder-to-prove concepts, such as culture. Arguably, the practitioner-based literature lacks in rigidity and research thoroughness.

Second, although there were many different views on the weighing of the different concepts, their presentation and nomenclature, no major contradictory ideas were found. Thus, no important ambiguity should be affecting the results.

Third, the strategic concepts found could be ordered into different levels according to their level of abstractness, i.e. from more operational (e.g. Control) to more general and underlying (e.g. Culture).
Fourth, the concepts were generally found to be hard to measure, often needing an indirect metric.

Fifth, most of the concepts had parts that were deeply rooted in the organisation and its culture, and the differences in how easily they could be affected were considerable.

Although there are several models for analysing certain aspects of a company's profitability, research done found none that was used to look at the company from a broad strategic view, and in which parts could be the focus of further attention. The framework built and presented in the thesis is by no means a grand model for analysing a firm’s entire profitability structure, nor does it give proper advice on the weighting of the factors or which models or methods to use for continued improvement efforts. However, it serves as an attempt to summarise and give a broad picture of factors considered important by practitioners and academics throughout the history of Strategic management. As far as the study could find, there was no good summary of current research, especially one considering both an academic and practitioner viewpoint.