Questions Chapter 02
Goals, Values and Performance

True False Questions

Question title	**Question stem**	**Choice**	**Difficulty** 1 Easy 2 Medium 3 Hard	**Page and § references**	**Topic**
TF02.01	Value refers to the estimated monetary worth of a product or asset	T	1	Strategy as quest for value	Value and performance
TF02.02	A firm's Value added is the difference between the value of its outputs sold on a market (sales) and all the costs of the inputs employed by the firm to provide these outputs	T	1	Strategy as quest for value	Value and performance
TF02.03	One of the two ways of creating value from the firm is the so-called "Commerce" activity, which transforms raw material and intermediate products into final products	F	2	Strategy as quest for value	Value and performance
TF02.04	Most of the tools used by top decision-makers in the private-sector corporate world are based upon the central assumption of profit maximization	T	1	Strategy as quest for value *In whose interest? Shareholders vs. stakeholders?*	Value and performance
TF02.05	There are different ways of assessing firms' performance under the central assumption of profit maximization. The very choice of one way instead of another may significantly change the result of firms' performance rankings	T	2	Strategy as quest for value *What is profit?*	Value and performance
TF02.06	Economic profit is a better indicator of firms' performance than accounting profit because economic profit takes into account the normal expected return to capital.	T	3	Strategy as quest for value *From accounting profit to economic profit*	Value and performance
TF02.07	Time is an essential factor in assessing a firm's current performance, and its expected future performance	T	3	Strategy as quest for value *Linking profit to enterprise value*	Value and performance
TF02.08	The maximization of profit in the long-term equates to the maximization of the firm's value, where this value is equal to the Net Present Value of the firm's projected future cash flows	T	3	Strategy as quest for value *Linking profit to enterprise value*	Value and performance

TF02.09	In practice, valuing firms by discounting economic profits leads to the same result as by discounting the firm's net cash flows	T	3	Strategy as quest for value *Linking profit to enterprise value* Enterprise value and shareholder value	Value and performance
TF02.10	The value of a firm less the Net Present Value of its debt equals the stock market value of its equity	T	2	Strategy as quest for value *Linking profit to enterprise value* Enterprise value and shareholder value	Value and performance
TF02.11	Building-in flexibility is a very important and valuable element in the corporate arena because investments can be halted but rarely reversed and strategic behaviors are very hard to alter.	T	2	Strategy and real options	Strategy and real options
TF02.12	The "real option" analysis developed in financial theory has applications in strategic management. The value of an "option" arises from the possibility to halt a project at various stages, while at the same time building on a head-start if you continue with it	T	2	Strategy and real options	Strategy and real options
TF02.13	Estimating a firm's future free cash flows is an easy task	F	1	Strategy as quest for value *Linking profit to enterprise value* Applying DCF to uncertain future cash-flows	Evaluation of performance
TF02.14	The DuPont formula is useful to diagnose reasons for poor performance by disaggregating the return on capital to identify the key "drivers of value"	T	2	Putting performance analysis into practice *Performance diagnosis*	Evaluation of performance
TF02.15	Short term maximization of profit will always lead to long term profit maximization and, therefore, to the maximization of the firm's value	F	2	Putting performance analysis into practice *Balanced scorecards*	Value and performance
TF02.16	The balanced scorecard method developed by Kaplan and Norton attempts to balance short term financial and operational goals against long term financial and strategic goals	T	2	Putting performance analysis into practice *Balanced scorecards*	Balanced Scored Card
TF02.17	Many of the most successful firms were founded on and are driven by core motives other than pure profit	T	1	Beyond profit: values and social responsibilities	Success and profit

TF02.18	The pursuit of profit above all else is likely to inspire all employees from the janitor to the CEO to work in co-operation and achieve the highest level of financial performance and shareholder value	F	2	Beyond profit: values and social responsibilities *Profit and purpose*	Value and performance
TF02.19	The notion that a firm is merely the private property of the shareholders is questioned as outdated by leading contemporary management theorists.	T	1	Beyond profit: values and social responsibilities *The debate over corporate social responsibility*	Debate Corporate Social Responsibility
TF02.20	The inclusion of Corporate Social Responsibility along with the Profit Maximisation motive means that there is little need for further debate on "the role of the firm".	F	2	Beyond profit: values and social responsibilities *The debate over corporate social responsibility*	Debate Corporate Social Responsibility

Multiple Choice Questions

Question title	Question stem	Choices	Correct	Level	Page and § references	Topic
MC02.01	Business is fundamentally about:	a- Making customers satisfied and happy b- Creating value c- Satisfying all stakeholders d- Respecting laws and regulations	**B**	1	Introduction and objectives	Value and performance
MC02.02	The maximization of the value of the firm is primarily determined by:	a- The profits it earns over its lifetime b- The market share it enjoys over its lifetime c- The firm's compliance with state regulations d- Its market capitalisation.	**A**	1	Introduction and objectives	Value and performance
MC02.03	Business strategy is primarily a quest for:	a- Attractive markets b- Profit c- Superior technology d- Motivated and talented personnel	**B**	1	Introduction and objectives	Value and performance
MC02.04	To survive and generate profit over the long run requires a firm to:	a- Focus on revenue maximisation b- Be responsive to evolving customer needs and to relevant changes in the wider political, economic, social and technological environment c- Choose a low cost strategy and a differentiation strategy simultaneously d- Put emphasis on its top managers' behaviors and ethics	**B**	2	Introduction and objectives	Value and performance
MC02.05	In a broad sense, creating value includes two elements:	a- Create value for stakeholders, and then translate this value into low price for customers b- Create strong customer loyalty, and then to progressively increase prices, thereby creating extra value c- Create value for customers, and then extracting some of that customer value as profit d- Create value for customers, and extract some of that customer value through strong motivation of employees	**C**	1	Strategy as a quest for value	Value and performance

MC02.06	Value can be created by:	a- Production b- Acquiring, turning around and selling off divisions or units c- Commerce d- Production and Commerce, or where appropriate by Commerce alone.	**D**	1	Strategy as a quest for value	Value and performance
MC02.07	Commerce creates value by:	a- Transforming physically products b- Repositioning products in space c- Repositioning products in time d- Repositioning products in space and time	**D**	1	Strategy as a quest for value	Value and performance
MC02.08	Value added can be defined as:	a- The difference between sales and expenses b- The difference between the money value of a firm's output and inputs c- The difference between sales and wages d- The retained profits	**B**	1	Strategy as a quest for value	Value and performance
MC02.09	The value added created by a firm is:	a- Nearly all distributed to the most powerful stakeholders, especially to members of the Board of directors b- Completely reinvested into the expansion and improvement of its business activities c- Appropriated exclusively by its owners d- Distributed primarily to employees (wages), lenders (interest), government (taxes), and owners (dividends)	**D**	1	Strategy as a quest for value *In whose interest? Shareholders vs. stakeholders*	Value and performance
MC02.10	The concept of consumer surplus is defined as:	a- The difference between the maximum price the customer would have been prepared to pay and the actual price he pays b- The customer satisfaction generated by the sale c- The difference between the value of the firm's outputs and inputs d- The portion of product a customer doesn't consume when he buys too much	**A**	2	Strategy as a quest for value	Value and performance

MC02.11	How best to express the fundamental objectives of the firm in terms of multiple stakeholders' interests is:	a- Not a real issue because profit maximization is the only fundamental objective b- A real issue but the State's regulation role clarifies what is expected. c- A real issue with much debate; however, profit maximization remains the primary objective d- A real issue to be discussed and decided by politicians and which is beyond the scope of strategic management	**C**	3	Strategy as a quest for value *In whose interest? Shareholders vs. stakeholders*	Value and performance
MC02.12	How could the assumption of profit maximization be justified?	a- The managers of a commercial firm who do not seek profit maximisation are more likely to lose their jobs, so only profit maximisers will survive. b- Business scandals such as those that took place at Enron and Ahold prove the wrongness of this assumption; therefore nobody should try to justify it c- It cannot be justified and is only an easy and common way to overcoming the difficulty to define the ultimate goal of the firm d- It does not need to be justified because it is a basic assumption of business.	**A**	3	Strategy as a quest for value *In whose interest? Shareholders vs. stakeholders*	Profit maximization
MC02.13	The assumption that maximization of shareholder value equates to long-term maximization of profit, is justified partly by "competition" which means that:	a- Strong competition erodes profit, so it is always best to operate from a position of strength (high profits) in order to survive the battle b- Stronger competition emphasizes the need to create more value and more customer loyalty c- Competition plays at the same level across rivals and geographies, and therefore requires profit maximization d- Stronger competition increases pressures to expand into other markets thus leading to higher profits	**A**	3	Strategy as a quest for value *In whose interest? Shareholders vs. stakeholders*	Value and performance
MC02.14	The assumption that the maximization of shareholder value equates to long-term maximization of profit, is justified partly by "simplicity" which means that:	a- The battle between many stakeholders requires common goals b- to attempt to satisfy all multiple stakeholder goals would lead to managerial paralysis c- It allows a firm to have a single objective d- No one will ever be able to fully understand a firm's goals	**B**	3	Strategy as a quest for value *In whose interest? Shareholders vs. stakeholders*	Value and performance

MC02.15	Accounting Profit can be defined as:	a- The ratio represented by accounting profit divided by economic profit b- The difference between accounting profit and economic profit c- The surplus of sales over direct costs available for distribution to the firm's five largest stakeholders d- The surplus of revenues over costs available for distribution to the firm's owners	**D**	1	Strategy as a quest for value *What is profit?*	Profit
MC02.16	The two concepts of profit used in the text are:	a- Normal return to capital and abnormal return of capital b- Return to capital and economic profit c- Accounting profit and economic profit d- Accounting rent and economic rent	**C**	1	Strategy as a quest for value *From accounting profit to economic profit*	Profit
MC02.17	EVA stands for:	a- Economic Value of Assets b- Economic Value Approach c- Economic Value Added d- Enhanced Value of Assets	**C**	1	Strategy as a quest for value *From accounting profit to economic profit*	Measure of value
MC02.18	For working out EVA, the cost of capital is calculated as:	a- Capital Employed multiplied by weighted average cost of capital (WACC) b- Capital borrowed multiplied by the rate of interest c- Capital provided by the firm's owners multiplied by the long term rate of dividends d- The cost of a issuing new shares	**A**	2	Strategy as a quest for value *From accounting profit to economic profit*	Measure of value
MC02.19	To measure performance, economic profit appears superior to accounting profit because:	a- It requires a more demanding performance discipline for managers b- It improves the allocation of capital across businesses c- It increases benchmarking and competition within an industry d- Answers a and b	**D**	1	Strategy as a quest for value *From accounting profit to economic profit*	Measure of value
MC02.20	Profit maximization and value of the firm are two concepts which are:	a- Unrelated because cash flow is only one component of the firm's value b- Closely linked because profit maximization translates into maximizing the firm's value c- Unrelated because Net Present Value is used to assess the value of the firm d- Closely linked because the value of a firm is the sum of its free cash flows in each year discounted at	**B**	1	Strategy as a quest for value *Linking profit to enterprise value*	Measure of value

		the firm's interest rate				
MC02.21	Different profitability measures can lead to different performance ranking of firms. In particular, the following may affect the measure and ranking:	a- Use of strict Accounting Profit, or an adjusted figure such as EBITDA b- The application of accounting standards that vary across countries c- The time period over which performance is measured d- All of the above	**D**	2	Strategy as a quest for value *What is profit?*	Measure of performance
MC02.22	The Discounted Cash Flow method is in general used for:	a- Calculating the long-run return on a specific large asset b- Deciding whether to proceed with a specific investment project c- Valuing an entire company d- All of the above	**D**	2	Strategy as a quest for value *Linking profit to enterprise value*	Measure of performance
MC02.23	The value of a firm is defined as:	a- The sum of its free cash flows in each year, discounted at the firm's weighted average cost of capital (WACC) b- The sum of its cash flows in each year, discounted at the firm's cost of capital c- The sum of its free cash flows in each year, discounted at the average cost of debt d- The sum of its cash flows in each year, discounted at the rate provided by the Federal Bank of each firm's home country on a permanent basis	**A**	2	Strategy as a quest for value *Linking profit to enterprise value*	Measure of value
MC02.24	If Ct is the free-cash flow in each year t, and r is the firm's weighted cost of capital then the formula for the value of the firm V is:	a- $V= \Sigma[Ct/(1+r)^t]$ b- $V= \Sigma[Ct - 1/(1+r)^t]$ c- $V= \sqrt{[Ct - 1/(1+r)^t]}$ d- $V= \sqrt{[\Sigma Ct/(\sum(1+r)^t]}$	**A**	1	Strategy as a quest for value *Linking profit to enterprise value*	Measure of value
MC02.25	Maximizing enterprise value and maximizing shareholder value are linked because:	a- Enterprise value and shareholder value are the same thing b- Shareholder value is calculated by adding debt and other non-equity financial claims to the DCF value of the firm c- Shareholder value is calculated by subtracting debt and other non-equity financial claims from the enterprise value of the firm d- It's obvious that they must be linked.	**C**	3	Strategy as a quest for value *Linking profit to enterprise value* Enterprise value and shareholder value	Measure of value
MC02.26	The text focuses on	a- The text is mainly concerned with generating value	**D**	3	Strategy as a	Measure of value

	enterprise value rather than shareholder value primarily because:	from how a firm is managed, not from how it is financed b- They are theoretically different but in practice they are the same c- The distinction between Debt and Equity is not always easy, and is not the focus of the text. d- Both a and c			quest for value *Linking profit to enterprise value* Enterprise value and shareholder value	
MC02.27	To use the Discounted Cash Flow method, the future cash flows have to be forecasted. To determine these estimates management will :	a- Make justified assumptions about income, expenses, profit and all other significant figures b- Use a benchmarking approach to align the firm's cash flows with its rivals' cash flows c- Use accounting data and directly extrapolate from the past the future cash flows d- Reach consensus by discussion with a group of external experts such as stockbrokers	**A**	2	Strategy as a quest for value *Applying DCF analysis to valuing companies, businesses, and strategies* Applying DCF to uncertain future cash flows	Measure of value
MC02.28	A key merit of long-term profit maximization as a prime goal is its:	a- Simplicity b- Consistency over time c- Tendency to optimise long-term survival d- All of the above	**D**	2	Strategy as a quest for value *Applying DCF analysis to valuing companies, businesses, and strategies* Valuing strategies	DCF
MC02.29	The final step when applying enterprise value analysis to the evaluation of business strategies is:	a- The estimation of cash-flows generated by the business for the next 10 years b- The identification of alternative strategies c- The identification of the influence of each strategy on the firm's cost of capital d- The ranking of the alternative strategies in descending order of NPV value	**D**	2	Strategy as a quest for value *Applying DCF analysis to valuing companies, businesses, and strategies* Valuing strategies	DCF
MC02.30	The field of "real option analysis" emerged in:	a- Industry economics b- Corporate Finance and Investment Banking c- The analysis of systems applied to economics d- Strategic management	**B**	2	Strategy and real options	Strategy and real Options

MC02.31	For product development, a "phases and gates" approach means that:	a- A firm's market is divided into specific phases separated by gates, which must be crossed to establish synergies across segments b- A firm's product development relies on time segments that must be linked through gates c- Product development is split into several consecutive phases, at the end of each the product is reassessed to continue (go through the "gate") or discontinue d- For each gate, the value of each product is assessed, and some are abandoned until there is only one left.	**C**	2	Strategy and real options	Strategy and real Options
MC02.32	Viewing strategy as a portfolio of options rather than a portfolio of investments relies upon the central idea that:	a- Strategy needs to reconcile direction and flexibility in an uncertain environment b- "All or nothing" strategic projects can be such costly mistakes as to be fatal to the firm c- The advantage of an option follows from the potential to amend or stop a strategic project during the development process d- All of the above	**D**	3	Strategy as a quest for value *Applying DCF analysis to valuing companies, businesses, and strategies* Valuing strategies	Strategy and real Options
MC02.33	Examples of strategic positioning using the real option approach are:	a- Alliances, organizational capability improvement and ethical culture development b- "Platform" (common underlying technology) investments, alliances and flexible organizational capability e.g. outsourcing c- Just-in-Time and organizational development techniques and alliances d- Development of a culture of cooperation, of information sharing and decentralization	**B**	2	Strategy as a quest for value *Strategy as options management*	Strategy and real Options
MC02.34	Strategic appraisal essentially involves:	a- Bringing in a strategy consultant or "company doctor". b- Assess the cash situation of the firm, then work out how to improve it. c- Assess the current situation; how well is the present strategy doing? Then identify the causes of poor performance. d- Look for obvious problems. If there aren't any, do nothing.	**C**	2	Putting performance analysis into practice *Appraising current and past performance*	Measure of performance in practice
MC02.35	Backward-looking	a- Cash Flows estimation	**B**	1	Putting	Measure of

	performance measures include:	b- Previous years' accounting information c- Accounting data from other firms d- Regulations and rules regarding accounting in the firm's home country			performance analysis into practice *Appraising current and past performance* Backward-looking performance measures: accounting ratios	performance in practice
MC02.36	Proper interpretation of accounting ratios requires:	a- Comparison with competitors b- Analysing trends over 5 years or so c- An understanding of the business and industry d- All of the above	**D**	1	Putting performance analysis into practice *Appraising current and past performance* Backward-looking performance measures: accounting ratios	Measure of performance in practice
MC02.37	To understand poor financial performance, one can identify the "drivers of performance". These drivers are:	a- Elements that emerge from the disaggregation of Return on Capital (for example using the DuPont formula) b- The firm's cost of capital that encompasses the cost of equity and the cost of debt c- Organizational capabilities at the top level management team d- Ability of the firm to satisfy its customers and to grow on a permanent basis its stream of income	**A**	2	Putting performance analysis into practice *Performance diagnosis*	Value and performance
MC02.38	ROIC, ROE and ROA are indicators that share the following important characteristic:	a- They are all ratios. b- They are used in finance c- They are complex to calculate d- They compare a profit-related indicator of the value produced by the firm to the capital invested in the firm	**D**	2	Putting performance analysis into practice *Appraising current and past performance* Backward-looking performance measures: accounting ratios	Measure of performance

MC02.39	Which ratio is closest to the "Return On Invested Capital (ROIC)" ratio?	a- Operating Margin b- Return on Assets (ROA) c- Return on Capital Employed (ROCE) e- Net margin	**C**	2	Putting performance analysis into practice *Appraising current and past performance* Backward-looking performance measures: accounting ratios	Measure of performance
MC02.40	How can a firm set its performance goals?	a- By setting performance targets that are consistent with long term goals b- By setting performance targets which relate to matters over which managers exert significant control c- By setting performance targets that are linked to strategy d- All of the above	**D**	2	Putting performance analysis into practice *Setting performance targets*	Performance targets
MC02.41	What is the fundamental problem of any type of performance management system?	a- It is purely to do with financial ratios b- Middle and junior managers work towards short-term targets, which must always be consistent with long-term goals c- Performance goals are short term, whereas performance targets need to be monitored over the long term d- Managerial, politics, and personal interests need to be taken into account	**B**	2	Putting performance analysis into practice *Setting performance targets* Balanced scorecards	Balanced scorecard
MC02.42	A balanced scorecard is used for:	a- Assessing on a permanent basis the firm's performance b- Evaluating the top managers' performance c- Directing the future evolution of the firm d- Attempting to involve lower management levels in understanding the link between their short-term targets and long-term strategic goals.	**D**	2	Putting performance analysis into practice *Setting performance targets* Balanced scorecards	Balanced scorecard

MC02.43	What could be called a "paradox of the profit motive"?	a- The fact that highly profitable companies continue to be highly profitable, even though they don't need to be b- The fact that profitable firms might not see threats in their environments which lead to loss of profit in future c- The fact that many successful firms are not driven purely by profit but by broader aims and goals d- The fact that most of the world's largest firms from 50 years ago have since been bought or gone out of business	**C**	3	Beyond profit: values and social responsibility *Profit and purpose*	Paradox of profit
MC02.44	A firm's vision and mission statement should be:	a- To satisfy its customers and be their supplier of choice b- To become the "Best in Class" c- A consistent, long-term sense of purpose which changes relatively little over the life of the firm d- To create a better everyday life for people	**C**	1	Beyond profit: values and social responsibility *Profit and purpose*	Missions and visions
MC02.45	How can "motivation" partially explain the paradox of profit?	a- Sustained profits arise from co-ordinated efforts from a motivated workforce, most of whom, have significant non-monetary motives alone b- Because top managers are not likely to be motivated to increase stockholders' return c- Vision and mission are the most important drivers of success in an organization d- Motivation does not explain at all the "paradox of profit"	**A**	3	Beyond profit: values and social responsibility *Profit and purpose*	Paradox of profit
MC02.46	The set of shared values of the firm:	a- Represent the basic reason for the firm's continued existence as a viable organisation. b- Can be manipulated and transformed easily c- Are part of a qualitative world that is not relevant to strategic management d- Are so difficult to assess and understand that it should not be the main focus of strategy analysts and decision-makers	**A**	2	Beyond profit: values and social responsibility *Profit and purpose*	Culture and values
MC02.47	William Allen's two conceptions of the public corporation entity are:	a- The profit conception and the not-for-profit conception b- The property conception and the social entity	**B**	1	Beyond profit: values and social	Corporate social responsibility

		conception c- The public conception and the state-owned conception d- The service to customer conception and the shareholder conception			responsibility *The Debate over Corporate Social Responsibility*	
MC02.48	Corporate Social Responsibility is:	a- Concerned about the environment and working for it b- About maximising profit and issuing statements saying that the company believes in CSR c- Genuinely recognising that a firm is answerable to all stakeholders, not just the shareholders. e- Being willing to do something "environmentally friendly"	**C**	2	Beyond profit: values and social responsibility *Profit and purpose* Capsule 2.4	Corporate social responsibility
MC02.49	Michael Porter argues that corporate social responsibility should be addressed by a firm:	a- For reasons of reputation, customer expectations and anticipated legislation because it is ultimately in the firm's profit interests b- Because there is a "moral imperative" to do so c- The owners no longer "own" the firm in a meaningful sense. d- Answers a and b	**A**	2	Beyond profit: values and social responsibility *The debate about Corporate social responsibility*	Corporate social responsibility
MC02.50	Influential management theorists such as Friedman, Allen, Handy, Porter and Prahalad:	a- All agree that CSR is necessary according to a "moral imperative" b- Disagree widely about the justification for CSR c- Expect firms to implement CSR according to their theories d- All of the above	**B**	2	Beyond profit: values and social responsibility *The debate about Corporate social responsibility*	Corporate social responsibility

Short Case Multiple Choice Questions

Question title	Question stem	Rationale	Rationale	Difficulty	Page and § references	Topic
SC02.01	Enron and WorldCom are examples of:	a- Corporate scandals that have undermined the confidence into corporations and top managers' behaviors and have contributed to many improvements of firms' corporate governance systems b- Corporate scandals where top managers had self-serving behaviors c- Corporate scandals that are unavoidable in the business world and should not have any impact on corporate governance systems d- a AND b	a	1	Strategy as a quest for value *In Whose Interest? Shareholders versus Stakeholders*	Corporate social responsibility
SC02.02	Ford, Microsoft and Sony are illustrations of:	a- Successful firms whose driving forces are seldom financial b- Successful firms which are present in technically-intensive industries and obsessed with profit c- Not so successful firms which are facing economic and strategic down-turns d- None of the above	a	1	Strategy as a quest for value *In Whose Interest? Shareholders versus Stakeholders*	Firm's goals
SC02.03	EVA has transformed drink giant Diageo:	a- To measure performance b- To allocate capital c- To evaluate its managers d- All of the above	d	1	Strategy as a quest for value *From accounting profit to economic profit*	EVA
SC02.04	To evaluate its strategies, PepsiCo has in the 1990s:	a-Built a very formal strategic planning system b-Built a strong culture of cooperation and information sharing among top managers c-Neglected to improve the strategic process, leading to losses and a degradation of its competitive position d-Integrated value analysis into its strategic management process to assign targets and monitor its divisions performance	d	2	Strategy as a quest for value *Applying DCF analysis to valuing companies, businesses, and strategies* Applying DCF to uncertain future cash flows	Performance measure
SC02.05	Stagecoach, AMP, and Deustche Telecom are partnering in joint ventures with:	a-Ford b-DaimlerChrysler c-Toyota d-Virgin Group	d	2	Strategy and real options *Strategy as options management*	Performance measure

Short Essay Questions

Question title	Question stem	Rationale	Diffi-culty	Page and § references	Topic
SE02.01	Although free cash flow is theoretically the best and most appropriate measure of net present value of the firm, in practice economic profit may be a better indicator of performance. Why?	Free cash flow integrates the "consumed" capital by the firm at the time of the expenditure whereas economic profit deducts capital along the life of assets through charging depreciation. For assessing the firm's performance in a single year or a finite number of years, economic profit (such as EVA measure) is usually preferable to free cash flow which depends on managerial choices about capital expenditures, whereas economic surplus represents the surplus being generated by the firm in each year	3	Strategy as a quest for value *Linking profit to enterprise value*	Value and performance
SE02.02	What is economic profit?	Accounting profit takes only into account the cost of capital Economic profit (also referred to as economic rent or rent) represents a better and more reliable measure of profit and therefore, of performance because it is defined as the surplus available once all inputs have been paid for (including capital). A common measure of economic profit is Economic Added value EVA which represents the Net Profit After Tax NOPAT less the firm's weighted cost of capital or WACC	2	Strategy as a quest for value *From accounting profit to economic profit*	Value and performance
SE02.03	The "finance-inspired" theory of Real Options has emerged in strategic management and is used by strategy analysts. Why? What is its contribution?	The ability of preserving flexibility and adaptation in the strategic management process are a huge challenge because investments and actions are almost irreversible and have consequences on the long run. Moreover, determinant information emerges during the process life. Because of these characteristics, viewing strategic orientations as "projects" on which the firm may have an option is valuable since it focuses on this property of flexibility for those projects. This emphasis on flexibility appears critical because it concentrates on the possibility at any time during the process before any final decision is made, to improve, amend, rescale or stop a project	3	Strategy and real options	Value and performance

SE02.04	The Discounted Cash Flow method is function of three variables. Which are these three variables?	The DCF assesses the value of future projects. It uses historical data and relies also on assumptions about the future. The three variables are 1- Return on the firm's invested capital ROIC 2- Weighted average cost of capital 3- Rate of growth of the operating profit	1	Putting performance analysis into practice *Appraising current and past performance* Backward looking performance measures	DCF method
SE02.05	What is the most important for strategic management: preserving stability or flexibility to allow change and adaptation?	Both are important because a firm needs a stable framework for progressing and some stable strategic directions, even if not extremely detailed. However, the ability to alter strategies for adaptation to an ever changing environment is a requirement. The speed and depth of change are key variables and vary with the industry This antagonist necessity represents a huge challenge for top managers that probably grows with the size of the organization	2	Putting performance analysis into practice *Setting performance targets*	Stability vs. flexibility

Short Reflective Questions

Question title	Question stem	Rationale	Diffi-culty	Page and § references	Topic
SR02.01	To what extent is a firm's value approach helpful in assessing performance from an external point of view?	This approach provides managers with a guide to understanding the complexity of this topic. Value, in a broad sense, refers to the money customers are willing to pay for a product or service. Then, the challenge for business is to create value for customers and to extract some of that value in the form of profit for the firm. This profit can be measured in different ways but the overall profit maximization translates into maximization of the value of the firm. From an external point of view, assessing performance is a daunting task because of the complexity of the organization, of emergent strategies, and of pressures from the environment. Using profit is convenient, because this proxy can be easily quantified, proves to be reliable in measuring performance, and has fiscal and financial implications. Profit is at the root of the fundamental and simplifying assumption that firms operate in the interests of their owners to maximize long term profits.	3	Strategy as a quest for value	Performance evaluation
SR02.02	Is it possible for managers to manipulate their firm's value for stakeholders' interests or for self-serving reasons?	It is likely that this type of endeavor takes place. We can make a distinction between illegal behavior and "only" unethical behavior, although the line between the two is becoming blurred. Illegal behaviors can be punished by law enforcement authorities and send the perpetrators behind bars. "Cooking the books" or lying in official business documents or hearings belongs in this category. Unethical behavior refers to actions that are legally, financially and technically possible; however, they may not be ethical because they induce a biased evaluation of the firm. Accounting offers possibilities in that field. Just hiding important information or presenting that information differently may fit into that category, for example when a manager reports to the higher managerial level. The trend in the business world is to increase control and accountability for top managers and accounting firms (Sarbarnes Oaxley Act, 2002) and to punish violators severely. Many studies show that ethical behavior, respect for stakeholders, and excellent "corporate citizenship" pays-off for the firm in the long term.	2	Strategy as a quest for value *In Whose Interest? Shareholders versus Stakeholders*	Value and ethics

SR02.03	Theory explains that corporate strategy and corporate social responsibility must be aligned for better performance and long term success within all the firm's constituencies. Do situations exist where they absolutely conflict in a win-loose game?	The social entity conception of the firm looks at the organization as a community of individuals that is sustained and supported by its relationship with its social, political, economic, and natural environment. In this approach, there is a double relationship between the survival and prosperity of the firm and the coexistence with the external environment. In other words, the prosperity of the owners of the firm cannot in the long term take place in an environment characterized by poverty and misery. The firm and its context should rely on each other to increase the quality of life, in general, on both levels. In the short term, there are situations where the value of internal prosperity and external sharing may conflict (e.g. Body Shop looking for natural products; Patagonia and its environmentally friendly raw materials; and state agencies providing more benefits than the average in their industry, then increasing costs and shrinking returns). However, in the long term, firms are "condemned" to find a "strategic compromise".	2	Beyond profit: values and social responsibility	Value and performance
SR02.04	If a corporation is a living organization with social responsibilities, how would the players in the defense or tobacco industries justify their corporate goals, and their mission, and balance them with human values?	These industries experience difficulties in justifying some aspects of their mission and values. Justifying the contribution to their shareholders seems to be easy because they generate profits. However, their role in the community at large may be more questionable. For the tobacco industry, products are clearly harming health and do not provide any benefit. One contribution they may claim is that the use of tobacco may avoid the use of worse substances and drugs; this argument is hardly convincing. The only solution for these firms is diversification to other non-harmless products and to educate people to quit smoking before quitting that industry themselves. The defense industry is a more complex question. Its role is not directly to make profit but to build and maintain the country's resources and capabilities to protect itself against any aggression, and to act abroad to protect the outside interests of the country. Morally, the use of force and violence is reprehensible but can be justified in certain cases. Justifying their mission is easier and can be positively complemented by the humanitarian role that armed forces may have in some countries.	2	Beyond profit: values and social responsibility	Value and ethics
SR02.05	What happens if the Key success factors of an industry are misunderstood? Does the disaggregation of the profit into components allow analysts to capture the causes of the misunderstanding and to fix it?	If KSF are misunderstood, bad consequences can occur because the strategic process may start on an incorrect basis. If the requirements to be successful are misunderstood the firm will probably not be able to satisfy them. If the firm uses a strong analytical capability, it may be able, afterwards, to identify the right KSF and fix the problem. The disaggregation of profit into components provides analysts with a useful tool to identify the antecedents and determinants of profit. However, a qualitative analysis often proves to be necessary to capture the entirety of the phenomenon. Another approach, such as the Resource-based view or the Balanced score card can be extremely valuable as well.	2	Strategy as a quest for value	Performance evaluation