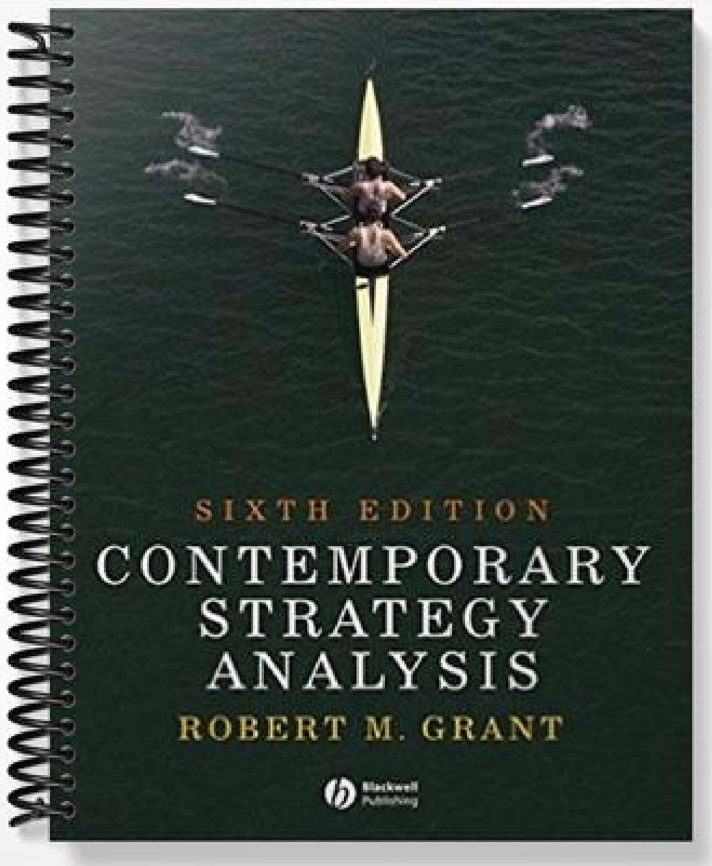
TEST BANK


SIXTH EDITION
CONTEMPORARY STRATEGY ANALYSIS
ROBERT M. GRANT
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Questions Chapter 02

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 amount of money that customers are willing to pay for a good or a service	T	1	p35 §1	Value and performance
TF02.02	A firm's Value Added is the difference between the value of its outputs and the total costs of the inputs purchased by the firm to provide these outputs	T	1	p35 §4	Value and performance
TF02.03	One way of creating value by a firm is its "Commerce" activity, which transforms raw material and intermediate products into final products	F	2	p35 §2	Value and performance
TF02.04	Most of the tools used by top decision-makers in the corporate world are based upon the central assumption of profit maximization	T	1	p36 §5	Value and performance
TF02.05	There are different ways of measuring a firm's profitability. Different measures of profitability are likely to result in very different rankings of firm performance	T	2	p37 §3	Value and performance
TF02.06	Economic profit is a better indicator of a firm's performance than accounting profit because economic profit includes the cost of remunerating of the capital employed by the firm	F	3	p36 §7 (p38)	Value and performance
TF02.07	Time is an important factor in assessing a firm's performance	T	2	p37 §5 p39 §1	Value and performance
TF02.08	Once we consider profits over the long-term , maximization of profit equates to the maximization of a firm's value, where this value is equal to the Net Present Value of the firm's cash flows	T	3	p40 §2	Value and performance
TF02.09	In practice, valuing firms by discounting economic profits leads to the same result as discounting the firm's net cash flows	T	3	p40 §2	Value and performance
TF02.10	The value of a firm, less its debt, does not equal the stock market value of its equity	F	2	p40 §5 p46 §1	Value and performance
TF02.11	Flexibility in the form of the option to delay, amend or abandon a project is an important source of value for a strategic investment project.	T	2	p42 §4	Strategy and real options

TF02.12	Real option analysis implies that, under uncertainly, discounted cash flow analysis is likely to undervalue projects and firms	T	2	p42 §4	Strategy and real options
TF02.13	Estimating a firm's future free cash flows is an easy task	F	1	p41 §1	Evaluation of performance
TF02.14	The DuPont formula disaggregates the return on capital to identify the key "drivers of value"	T	2	p46 §6	Evaluation of performance
TF02.15	Short term maximization of profit will lead to long term profit maximization and, therefore, to the maximization of a firm's value	F	2	p51 §2 (p53)	Value and performance
TF02.16	The balanced score card method developed by Norton and Kaplan allows top managers to balance short and long term financial goals by combining the answer to three critical questions	F	3	p51 §2 (p53)	Balanced Scored Card
TF02.17	Most highly successful firms were founded by entrepreneurs who were driven by motivation other than the desire to get rich	T	1	p54 §4	Success and profit
TF02.18	If managers and employees are heralding profit and stakeholder returns as their prime motivator, it will very likely inspire members of the organization and lead to success	F	2	p54 §6	Value and performance
TF02.19	The *property conception* of the firm claims that the firm's sole responsibility to act in the interests of shareholders, whereas the *social entity* approach broadens the scope of this responsibility to include the interests of the community and other stakeholders	T	1	p56 §1-5	Debate Corporate Social Responsibility
TF02.20	In the long run, it seems that the interests of all stakeholder groups tend to converge	T	1	p58 §1	Debate Corporate Social Responsibility

Multiple Choice Questions

Question title	Question stem	Choices	Rationale	Difficulty	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**	2	p35 §1	Value and performance
MC02.02	Value can be created by:	a- Production b- Acquiring, turning around, and selling off divisions or units c- Commerce d- Production and/or Commerce	**d**	1	p35 §2	Value and performance
MC02.03	Commerce creates value by:	a- Physically transforming products b- Repositioning products in space c- Repositioning products in time d- Repositioning products in space and time	**d**	1	p35 §2	Value and performance
MC02.04	Value added is:	a- The difference between the perceived fair price by a customer and the actual price he pays b- The difference between the price actually paid and the value the customer gains from the product c- The difference between the revenue of the firm and its purchases of inputs d- The sum of all the income paid to the suppliers of physical factors of production	**c**	2	p35 §3-4	Value and performance
MC02.05	The conflict between shareholder and stakeholder approaches to the fundamental objectives of a firm:	a- Is a non-issue because shareholder interests always prevail b- Is a real issue but the State's regulatory role provides satisfactory guidelines and answers to the debate c- Is a real issue for corporate governance, but for the purposes of strategic analysis can be avoided by making the simplifying assumption that firms seek to maximize profit over the long term d- Is a real issue that can only be addressed at the ethical level and which is beyond the scope of strategic management	**c**	3	p35 §6-7 p36 §1	Value and performance

MC02.06	How can the assumption of profit maximization be justified?	a- Profit maximization is a useful working assumption because all stakeholders have an interest in the financial viability of the firm and because it simplifies strategy analysis b- Business scandals such as those involving Enron and Ahold prove the wrongness of this assumption; therefore we should not try to justify it c- It cannot be justified and is only an easy and common way to overcoming the difficulty of defining the ultimate goal of a firm d- It does need to be justified because all firms accept that making money is their ultimate goal	**a**	3	p36 §1-5	Profit maximization
MC02.07	The two principal concepts of profit are:	a- Normal return to capital and abnormal return on capital b- Return on capital employed and economic profit c- Accounting profit and the economic profit d- Accounting rent and the economic rent	**c**	3	p37 §6	Profit
MC02.08	EVA stands for:	a- Economic Value of Assets b- Economic Value Approach c- Economic Value Added d- Enhanced Value of Assets	**c**	1	p38 §1	Measure of value
MC02.09	In calculating EVA, the cost of capital is calculated as:	a- Capital invested multiplied by the weighted average cost of capital b- Capital borrowed multiplied by the rate of interest c- The total of interest payments and dividend payments d- None of the above	**a**	2	p38 §1	Measure of value
MC02.10	Profit maximization and value of the firm are two concepts which are:	a- Unrelated because cash flow is only one component of a firm's value b- Closely linked because profit maximization translates into maximizing a firm's value c- Unrelated because the Net Present Value is used to assess the value of a firm d- Closely linked because the value of a firm is the sum of its free cash flows in each year discounted at the firm's cost of dividends	**b**	3	p39 §2	Measure of value

MC02.11	The performance ranking of a firm depends on how profitability is measured. Choosing a measure of financial performance requires us to take account of:	a- The differences between total profit and rate of profit b- Different accounting practices in different countries c- The time period over which profitability is measured d- All of the above	**d**	1	p37 §3-6	Measure of performance
MC02.12	The Discounted Cash Flow methodology is in general used for:	a- Calculating the return on an asset b- Valuating investment projects c- Only a OR only b d- a AND b	**d**	3	p39 §2	Measure of performance
MC02.13	The value of a firm can be calculated as:	a- The sum of its free cash flows in each year, discounted at the firm's cost of capital b- The sum of the firm's operating 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 risk-free rate of interest	**a**	3	p39 §2	Measure of value
MC02.14	The, value of the firm ("enterprise value") and shareholder value:	a- Are in practice the same thing b- Are theoretically different but we can consider that in practice they mean much the same c- Are disconnected and present the same object but from two different perspectives d- Are financial and economic concepts that should not be mixed up	**b**	3	p40 §6 (p41)	Measure of value
MC02.15	To use the Discounting Cash Flow method, the cash flows have to be forecasted. To estimate these future cash flows, the firm's analysts will:	a- Make forecasts of revenues, expenses, and other variables b- Use a benchmarking approach to align the firm's cash flows with its rivals' cash flows c- Use accounting data and directly extract from the past the future cash flows d- Use a Delphi method to generate the data from the discussion of a group of external experts	**a**	2	p41 §1	Measure of value

MC02.16	Viewing strategy as a portfolio of options rather than a portfolio of investments, relies upon the central idea that:	a- Strategy requires us to reconcile direction and flexibility in an uncertain environment b- Strategic decisions, once made, are difficult and costly to modify or reverse c- The value 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	p42 §1, 4	Strategy and real Options
MC02.17	Examples of strategic investments that offer significant option value include:	a- Alliances, organizational capability improvement, and investments in specialized plant and equipment b- Platform investments, alliances, and organizational capability development c- Just-in-Time supply chains and alliances d- Information processing technologies and management training courses	**b**	2	p44 1-3 p45 §4	Strategy and real Options
MC02.18	Backward-looking profitability ratios based on historic accounting data:	a- Are of little value because of the imperfections of accounting data b- Are the only true indicators to firm performance because they are subject to independent audit c- Are useful indicators of a firm's effectiveness in generating profits from its assets d- Are useful only to the extent that they can provide a basis for forecasting future cash flows	**b**	2	p46 §2	Measure of performance
MC02.19	To diagnose the sources of poor performance, analysts can identify the "drivers of performance". These drivers are:	a- Elements that emerge from the disaggregation of Return on Capital (e.g., based on DuPont formula) b- A 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- A firm's ability to satisfy its customers and to grow its stream of income on a permanent basis	**a**	2	p46 §6	Value and performance
MC02.20	ROIC, ROE and ROA are all:	a- Measures of the rate of profit that a firm is generating from its assets b- Differ mainly in terms of the breadth of assets included in the denominator	**d**	2	p47 §1	Measure of performance

		c- Lack standard definitions; hence need to be defined when used d- All of the above				

MC02.21	A balanced scorecard is a tool used for:	a- Avoiding the problems of accounting data in assessing a firm's past performance b- Allowing manager's to choose the performance criteria against which they will be evaluated c- Linking a firm's long-term strategic goals to specific performance measures against which individual business units and departments can be evaluated d- All of the above	**c**	2	p53	Measure of performance
MC02.22	What is the "paradox of profit"?	a- Rich people increase on a permanent basis their wealth because of the "working capital" phenomenon b- Successful firms might not see threats in their environments and can actually die from them c- The firms that are most successful at generating profit over the long term are typically driven by motives other than profit maximization d- Nearly all of the firms present at the foundation of the S&P Index have now disappeared	**c**	2	p53 §4	Paradox of profit
MC02.23	The set of shared values of a firm:	a- Form the firm's core ideology and are critical for "holding the organization together" b- Need to be manipulated and transformed by every new CEO c- Are part of a qualitative world that is not relevant to strategic management d- Is so difficult to assess and understand that it should not be the main focus of strategy analysts and decision-makers	**a**	1	p56 §1	Culture and values
MC02.24	The two dominant conceptions of public corporations that are key influences on the responsibilities of management are:	a- The profit conception and the not-for-profit conception b- The property conception and the social entity conception c- The public conception and the state-owned conception d- The customer service conception and the	**b**	2	p57 §1	Corporate social responsibility

		shareholder conception				
MC02.25	According to the Chicago economist, Milton Freidman, the social responsibility of business is:	a- To maximize profits over the long run subject to avoiding harm to other stakeholders or to the natural environment b- To maximize profits over the long run subject to engaging in open and free competition without deception or fraud c- To maximize shareholder returns even if this means manipulating reported financial data d- To contribute to social welfare by maximizing the total of producer and consumer surplus	**a**	1	p58-59	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 confidence in corporate managers' behaviors and have contributed to improvements in 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 impact corporate governance systems d- a AND b	**d**	1	p35 §7 (p36)	Corporate social responsibility
SC02.02	Ford, Microsoft, and Sony are illustrations of:	a- Leading enterprises whose success was based upon vision and strategic intent rather than the desire for huge profits b- Successful firms which are present in technically-intensive industries and obsessed with profit c- Previously successful firms whose short-term greed has led to loss of corporate reputation d- None of the above	**a**	1	p37 §1	Firm's goals
SC02.03	AT&T's CFO James Meenan stated that the adoption of EVA lead to:	a- Increased competition across AT&T's divisions b- Increased competition with industry rivals c- Increased managerial efficiency and performance d- Increased tension within the top management team	**c**	1	p38 §2-3	Performance measure
SC02.04	To evaluate its management strategies, in the 1990s PepsiCo:	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 performance	**d**	2	p41 §3	Performance measure
SC02.05	The key lesson to be drawn from BP's sustainability initiatives during 2000-6 is:	a- Corporate responsibility initiatives are only for public relations purposes b- CEOs have limit influence outside the executive suite c- CSR can be compatible with shareholder interests, but	**c**	2	pp58-59	Corporate Social Responsibility

		words must be supported by deeds d- CSR can only be aligned with shareholder interests but only when CSR is limited to works and token actions				

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 by charging depreciation. For assessing the firm’s performance in a single year or a finite number of years, economic profit (such as the EVA measure) is usually preferable to free cash flow, which depends on managerial choices about capital expenditures. In comparison, economic surplus represents the surplus being generated by the firm in each year	3	p40 §2	Value and performance
SE02.02	What is economic profit?	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 Average Cost of Capital (WACC)	2	p37 §7 p38 §1	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 is a huge challenge because investments and actions are almost irreversible and have consequences in 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	p42 §1-4 p44 §1-4 p45 §1	Value and performance
SE02.04	The Discounted Cash Flow method is function of three variables. What 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	p46 §3	DCF method

SE02.05	What is the most important for strategic management: preserving stability, or maintaining 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 These conflicting requirements represent a huge challenge for top managers	2	p50 §2	Stability vs. flexibility

Questions Chapter 02

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	p35 §1-2 p36 §1	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 (Sarbanes Oxley 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	p36 §4 p55 §1-2 p57 §5 p58 §1	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	p57 §1-5 p58 §1 p63 Note23	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	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	2	p57 §1-5	Value and ethics

	their mission, and balance them with human values?	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.			
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	p47-52	Performance evaluation