# Strategic Management

Lecture 12
Strategy Monitoring

# Learning Objectives

- Discuss the strategy-evaluation process, criteria, and methods used
- Discuss three activities that comprise strategy evaluation
- Describe the Balanced Scorecard and appreciate how it is developed
- Identify and describe published sources of strategy-evaluation information
- Identify and describe six characteristics of an effective strategy-evaluation system
- Discuss the nature and role of contingency planning in strategy evaluation
- Explain the role of auditing in strategy evaluation
- Identify and discuss three twenty-first-century challenges in strategic management
- Identify and describe 17 guidelines for effective strategic management

# Topics

- The strategy-evaluation process, Criteria, and methods
- The Three strategy-evaluation activities
- The Balanced scorecard
- Published Sources of Strategy-Evaluation Information
- Characteristics of an Effective Strategy Evaluation System
- Contingency Planning
- Auditing
- Twenty-First-Century Challenges in Strategic Management
- Guidelines for Effective Strategic Management

# The Strategy-Evaluation Process, Criteria, and Methods

- The strategic-management process results in decisions that can have significant, long-lasting consequences
- Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse
- Therefore, most strategists agree that strategy evaluation is vital to an organization’s well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical
- The strategy-evaluation process includes three basic activities:
  1. Examine the underlying bases of a firm’s strategy
  2. Compare expected results with actual results
  3. Take corrective actions to ensure that performance conforms to plans
- Adequate and timely feedback is the cornerstone of effective strategy evaluation
- Strategy evaluation can be no better than the information on which it is based. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory

# The Strategy-Evaluation Process, Criteria, and Methods …

- Strategy evaluation can be a complex and sensitive undertaking. Too much emphasis on evaluating strategies may be expensive and counterproductive. No one likes to be evaluated too closely!
- The more managers attempt to evaluate the behavior of others, the less control they have. Yet too little or no evaluation can create even worse problems
- Strategy evaluation is essential to ensure that stated objectives are being achieved. Strategists need to create an organizational culture where strategy evaluation is viewed as an opportunity to make the firm better, so the firm can compete better, so everyone in the firm can do better, sharing in the firm’s increased profitability
- In many organizations, strategy evaluation is simply an appraisal of how well an organization has performed. Have the firm’s assets increased? Has there been an increase in profitability? Have sales increased? Have productivity levels increased? Have profit margin, return on investment, and earnings-per-share ratios increased?
- Some firms argue that their strategy must have been correct if the answers to these types of questions are affirmative. Well, the strategy or strategies may have been correct, but this type of reasoning can be misleading because strategy evaluation must have both a long-run and short-run focus

# The Strategy-Evaluation Process, Criteria, and Methods …

- Strategies often do not affect short-term operating results until it is too late to make needed changes
- Strategy evaluation is important because organizations face dynamic environments in which key external and internal factors often change quickly and dramatically. Success today is no guarantee of success tomorrow!
- An organization should never be lulled into complacency with success. Countless firms have thrived one year only to struggle for survival the following year
- According to Peter Drucker, "Unless strategy evaluation is performed seriously and systematically, and unless strategists are willing to act on the results, energy will be used up defending yesterday."
- It is impossible to demonstrate conclusively that a particular strategy is optimal or even to guarantee that it will work. One can, however, evaluate it for critical flaws
- Richard Rumelt offered four criteria that could be used to evaluate a strategy: consistency, consonance, feasibility, and advantage

# The Strategy-Evaluation Process, Criteria, and Methods …

- ✓ Consistency
  - It is important to strive for consistency when setting goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency
  - Three guidelines help determine if organizational problems are the result of inconsistencies in strategy:
    - If managerial problems continue despite changes in personnel and if they tend to be issue-based rather than people-based, then strategies may be inconsistent
    - If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent
    - If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent
- ✓ Consonance
  - Consonance refers to the need for strategists to examine sets of trends, as well as individual trends, in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. One difficulty in matching a firm's key internal and external factors in the formulation of strategy is that most trends are the result of interactions among other trends.
  - For example, the day care explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. Although single economic or demographic trends might appear steady for many years, there are waves of change going on at the interaction level.

# The Strategy-Evaluation Process, Criteria, and Methods …

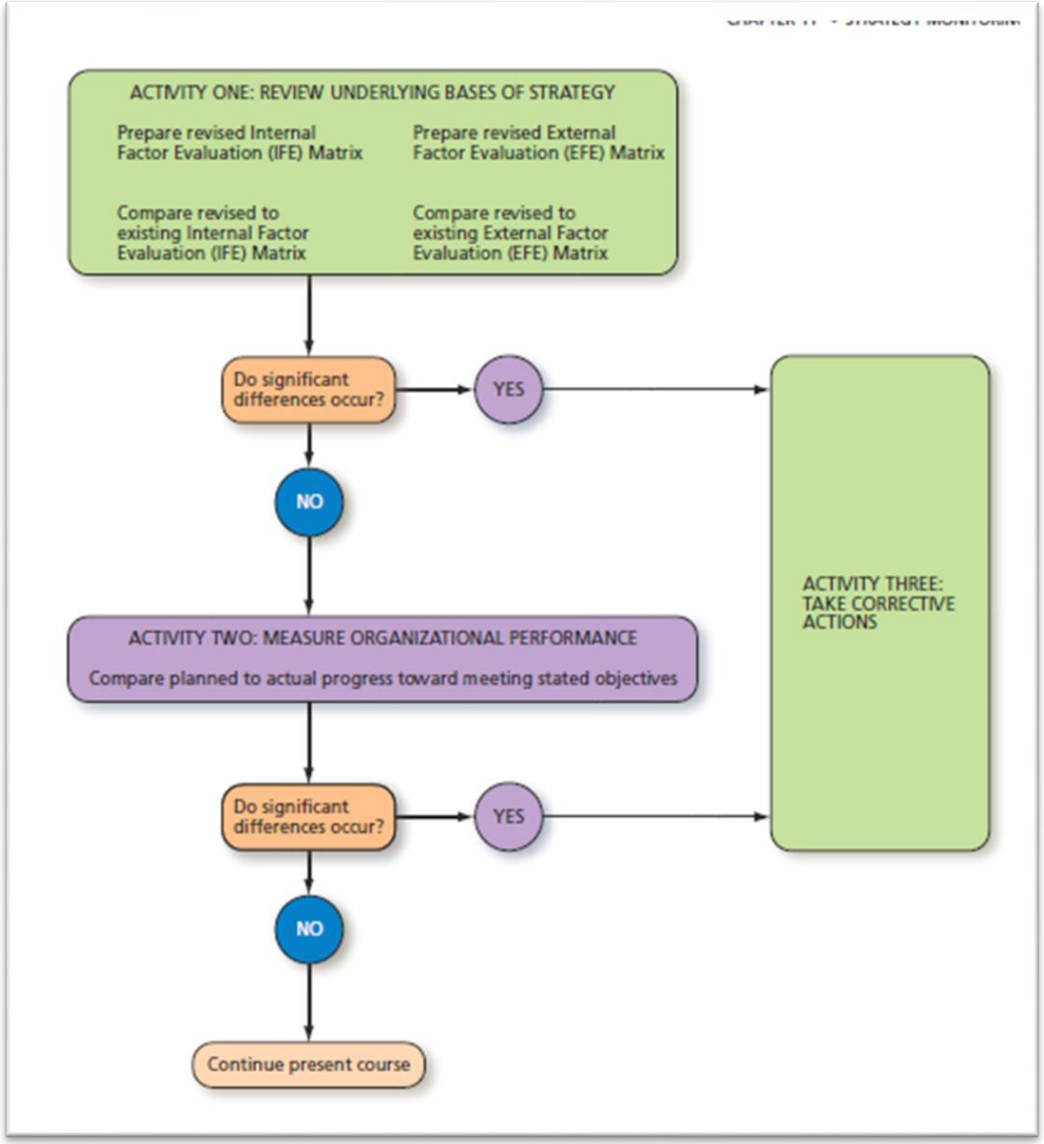
- <u>Feasibility</u>
  - A strategy must neither overtax available resources nor create unsolvable subproblems. The final broad test of strategy is its feasibility; that is, can the strategy be attempted within the physical, human, and financial resources of the enterprise?
  - The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated
  - It is sometimes forgotten, however, that innovative approaches to financing are often possible. Devices, such as captive subsidiaries, sale-leaseback arrangements, and tying plant mortgages to long-term contracts, have all been used effectively to help win key positions in suddenly expanding industries
  - A less quantifiable, but actually more rigid, limitation on strategic choice is that imposed by individual and organizational capabilities
  - In evaluating a strategy, it is important to examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.

# The Strategy-Evaluation Process, Criteria, and Methods …

- ✓ <u>Advantage</u>
  - A strategy must provide for the creation or maintenance of a competitive advantage in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: (1) resources, (2) skills, or (3) position.
  - The idea that the positioning of one's resources can enhance their combined effectiveness is familiar to military theorists, chess players, and diplomats. Position can also play a crucial role in an organization's strategy. Once gained, a good position is defensible—meaning that it is so costly to capture that rivals are deterred from full-scale attacks.
  - Positional advantage tends to be self-sustaining so long as the key internal and environmental factors that underlie it remain stable. This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average
  - Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, whereas smaller firms seek product or market positions that exploit other types of advantage
  - The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy

# The Three Strategy-Evaluation Activities

- Reviewing Bases of Strategy
- Measuring Organizational Performance
- Taking Corrective Actions



# The Three Strategy-Evaluation Activities …

Reviewing Bases of Strategy

External

1. How have competitors reacted to our strategies?
2. How have competitors' strategies changed?
3. Have major competitors' strengths and weaknesses changed?
4. Why are competitors making certain strategic changes?
5. Why are some competitors' strategies more successful than others?
6. How satisfied are our competitors with their present market positions and profitability?
7. How far can our major competitors be pushed before retaliating?
8. How could we more effectively cooperate with our competitors?

Internal

1. Are our internal strengths still strengths?
2. Have we added other internal strengths? If so, what are they?
3. Are our internal weaknesses still weaknesses?
4. Do we now have other internal weaknesses? If so, what are they?
5. Are our external opportunities still opportunities?
6. Are there now other external opportunities? If so, what are they?
7. Are our external threats still threats?
8. Are there now other external threats? If so, what are they?
9. Are we vulnerable to a hostile takeover?

# The Three Strategy-Evaluation Activities …

Measuring Organizational Performance

<u>Strategists use financial ratios to make three critical comparisons:</u>

1. Compare the firm's performance over different time periods.
2. Compare the firm's performance to competitors.
3. Compare the firm's performance to industry average

Some additional key questions that reveal the need for qualitative judgments in strategy evaluation are as follows:

1. How good is the firm's balance of investments between high-risk and low-risk projects?
2. How good is the firm's balance of investments between long-term and short-term projects?
3. How good is the firm's balance of investments between slow-growing markets and fast-growing markets?
4. How good is the firm's balance of investments among different divisions?
5. To what extent are the firm's alternative strategies socially responsible?
6. What are the relationships among the firm's key internal and external strategic factors?
7. How are major competitors likely to respond to particular strategies?

# The Three Strategy-Evaluation Activities …

## Taking Corrective Actions

**TABLE 11-4 Corrective Actions Possibly Needed to Correct Unfavorable Variances**

1. Alter the firm's structure.
2. Replace one or more key individuals.
3. Divest a division.
4. Alter the firm's vision or mission.
5. Revise objectives.
6. Alter strategies.
7. Devise new policies.
8. Install new performance incentives.
9. Raise capital with stock or debt.
10. Add or terminate salespersons, employees, or managers.
11. Allocate resources differently.
12. Outsource (or rein in) business functions.

# The Balanced Scorecard

- The Balanced Scorecard basic premise is that firms should establish objectives and evaluate strategies on criteria other than financial measures
- Financial measures and ratios are vitally important in strategic planning, but of equal importance are factors such as customer service, employee morale, product quality, pollution abatement, business ethics, social responsibility, community involvement, and other such items
- In conjunction with financial measures, these “softer” factors comprise an integral part of both the objective-setting process and the strategy-evaluation process
- A Balanced Scorecard for a firm is simply a listing of all key objectives to work toward, along with an associated time dimension of when each objective is to be accomplished, as well as a primary responsibility or contact person, department, or division for each objective
- The Balanced Scorecard is an important strategy-evaluation tool that allows firms to evaluate strategies from four perspectives: financial performance, customer knowledge, internal business processes, and learning and growth. Its analysis requires that firms seek answers to the following questions and use that information, in conjunction with financial measures, to adequately and more effectively evaluate strategies being implemented:

    1. Is the firm continually improving and creating value along measures such as innovation, technological leadership, product quality, operational process efficiencies, and so on?
    2. Is the firm sustaining and even improving on its core competencies and competitive advantages?
    3. How satisfied are the firm’s customers?

# Published Sources of Strategy-Evaluation Information

- A number of publications are helpful in evaluating a firm's strategies. For example, Fortune annually identifies and evaluates the Fortune 1000 (the largest manufacturers) and the Fortune 50 (the largest retailers, transportation companies, utilities, banks, insurance companies, and diversified financial corporations in the United States)
- Fortune ranks the best and worst performers on various factors, such as return on investment, sales volume, and profitability
- Annually, the publication publishes its strategy-evaluation research in an article titled "World's Most Admired Companies."
- Nine key attributes serve as evaluative criteria:
    1. people management
    2. Innovativeness
    3. products quality
    4. financial soundness
    5. social responsibility
    6. use of assets
    7. long-term investment
    8. global competitiveness
    9. quality of management

# Characteristics of an Effective Strategy Evaluation System

- The strategy-evaluation process must exhibit several characteristics to be effective. First, strategy-evaluation activities must be economical; too much information can be just as bad as too little information, and too many controls can do more harm than good
- Strategy-evaluation activities also should be meaningful; they should specifically relate to a firm's objectives. They should provide managers with useful information about tasks over which they have control and influence
- Strategy-evaluation activities should provide timely information; on occasion and in some areas, managers may need information on a daily or even continuous basis. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently
- In contrast, in an R&D department, daily or even weekly evaluative information could be dysfunctional
- Approximate information that is timely is generally more desirable as a basis for strategy evaluation than accurate information that does not depict the present
- Frequent measurement and rapid reporting may frustrate control rather than give better control. The time dimension of control must coincide with the time span of the event being measured

# Characteristics of an Effective Strategy Evaluation System ...

- Strategy-evaluation processes should be designed to provide a true picture of what is happening
- For example, in a severe economic downturn, productivity and profitability ratios may drop alarmingly, although employees and managers are actually working harder. Strategy evaluations should fairly portray this type of situation
- Information derived from the strategy-evaluation process should facilitate action and should be directed to those individuals in the organization who need to take action based on it
- Managers commonly ignore evaluative reports that are provided only for informational purposes; not all managers need to receive all reports
- Controls need to be action-oriented rather than information-oriented. The strategy-evaluation process should not dominate decisions; it should foster mutual understanding, trust, and common sense. No department should fail to cooperate with another in evaluating strategies
- Strategy evaluations should be simple, not too cumbersome, and not too restrictive
- Complex strategy-evaluation systems often confuse people and accomplish little
- The test of an effective evaluation system is its usefulness, not its complexity

# Contingency Planning

- Some contingency plans commonly established by firms include the following:
  1. If a major competitor withdraws from particular markets as intelligence reports indicate, what actions should our firm take?
  2. If our sales objectives are not reached, what actions should our firm take to avoid profit losses?
  3. If demand for our new product exceeds plans, what actions should our firm take to meet the higher demand?
  4. If certain disasters occur—such as loss of computer capabilities; a hostile takeover attempt; loss of patent protection; or destruction of manufacturing facilities because of earthquakes, tornadoes, or hurricanes—what actions should our firm take?
  5. If a new technological advancement makes our new product obsolete sooner than expected, what actions should our firm take?
- Too many organizations discard alternative strategies not selected for implementation although the work devoted to analyzing these options would render valuable information
- Alternative strategies not selected for implementation can serve as contingency plans in case the strategy or strategies selected do not work

# Auditing

- A frequently used tool in strategy evaluation is the audit. Auditing is defined by the American Accounting Association (AAA) as “a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria, and communicating the results to interested users.”
- Auditors examine the financial statements of firms to determine whether they have been prepared according to generally accepted accounting principles (GAAP) and whether they fairly represent the activities of the firm. Independent auditors use a set of standards called generally accepted auditing standards (GAAS)
- Public accounting firms often have a consulting arm that provides strategy-evaluation services
- The new era of international financial reporting standards (IFRS) is approaching in the United States, and businesses need to go ahead and get ready to use IFRS

# Twenty-First-Century Challenges in Strategic Management

- The Art or Science Issue
- The Visible or Hidden Issue
- The Top-Down or Bottom-Up Approach

# Guidelines for Effective Strategic Management

**TABLE 11-7 Seventeen Guidelines for the Strategic-Planning Process to Be Effective**

1. It should be a people process more than a paper process.
2. It should be a learning process for all managers and employees.
3. It should be words supported by numbers rather than numbers supported by words.
4. It should be simple and nonroutine.
5. It should vary assignments, team memberships, meeting formats, and even the planning calendar.
6. It should challenge the assumptions underlying the current corporate strategy.
7. It should welcome bad news.
8. It should welcome open-mindedness and a spirit of inquiry and learning.
9. It should not be a bureaucratic mechanism.
10. It should not become ritualistic, stilted, or orchestrated.
11. It should not be too formal, predictable, or rigid.
12. It should not contain jargon or arcane planning language.
13. It should not be a formal system for control.
14. It should not disregard qualitative information.
15. It should not be controlled by "technicians."
16. Do not pursue too many strategies at once.
17. Continually strengthen the "good ethics is good business" policy.

# THANK YOU