

Chapter Eight:

Strategy Review, Evaluation and Control

8.1 The nature of strategy evaluation

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. Most strategists agree, therefore, 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. Strategy evaluation includes three basic activities: (1) examining the underlying bases of a firm's strategy, (2) comparing expected results with actual results, and (3) taking 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 operates. Too much pressure from top managers may result in lower managers contriving numbers they think will be satisfactory.

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.

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. Strategies often do not affect short-term operating results until it is too late to make needed changes.

Purpose of strategy evaluation

- Strategy evaluation is vital to the organization's well-being
- Alert management to potential or actual problems in a timely fashion
- Erroneous strategic decisions can have severe negative impact on organizations

Basic Activities –

1. Examining the underlying bases of a firms' strategy
2. Comparing expected to actual results
3. Corrective actions to ensure performance conforms to plans

In many organizations, evaluation is an appraisal of performance –

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| Have assets increased? | • Increase in productivity? |
| • Increase in profitability? | • Profit margins, ROI and EPS ratios |
| • Increase in sales? | increased |

Four Criteria (Richard Rumelt): He explains four criteria for strategy valuation. These four criteria are as follow

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| Consistency | • Feasibility |
| • Consonance | • Advantage |

Consistency

Strategy should not present inconsistent goals and policies.

- Conflict and interdepartmental bickering symptomatic of managerial disorder and strategic inconsistency

Consonance

Need for strategies to examine sets of trends

- Adaptive response to external environment
- Trends are results of interactions among other trends

Feasibility

Neither overtaxes resources nor creates unsolvable sub problems

- Organizations must demonstrate the abilities, competencies, skills and talents to carry out a given strategy

Advantage

Creation or maintenance of competitive advantage

- Superiority in resources, skills, or position

Difficulty in strategy evaluation –

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| 1. Increase in environment's complexity | 4. Rate of obsolescence of plans |
| 2. Difficulty predicting future with accuracy | 5. Domestic and global events |
| 3. Increasing number of variables | 6. Decreasing time span for planning |

Advantage

Creation or maintenance of competitive advantage

- Superiority in resources, skills, or position

The process of evaluating Strategies

1. Strategy evaluation is necessary for all sizes and kinds of organization. Strategy evaluation should initiate managerial questioning of expectations and assumptions should trigger a review of objectives and values and should stimulate creativity in generating alternative and formulating criteria of evaluation
2. Evaluating strategies on continuous rather than a periodic basis allows benchmark of progress to established and o\more effectively monitored
3. Managers and employees of the firm should be continually aware of progress being made towards achieving the firm's objectives. As a critical success factors change, organization members should be involved in determining appropriate corrective action.

8.2 A strategy evaluation framework

Strategy-evaluation activities in terms of key questions that should be addressed, alternative answers to those questions, and appropriate actions for an organization to take. Notice that corrective actions are almost always needed except when (1) external and internal factors have not significantly changed and (2) The firm is progressing satisfactorily toward achieving stated objectives.

REVIEWING BASES OF STRATEGY

Reviewing the underlying bases of an organization's strategy could be approached by developing a revised EFE Matrix and IFE Matrix. A *revised IFE Matrix* should focus on changes in the organization's management, marketing, finance/accounting, production/operations, R&D, and computer information systems strengths and weaknesses. A *revised EFE Matrix* should indicate how effective a firm's strategies have been in response to key opportunities and threats. This analysis could also address such questions as the following:

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?

Numerous external and internal factors can prohibit firms from achieving long-term and annual objectives. Externally, actions by competitors, changes in demand, changes in technology, economic changes, demographic shifts, and governmental actions may prohibit objectives from being accomplished.

Internally, ineffective strategies may have been chosen or implementation activities may have been poor. Objectives may have been too optimistic. Thus, failure to achieve objectives may not be the result of unsatisfactory work by managers and employees. All organizational members need to know this to encourage their support for strategy-evaluation activities. Organizations desperately need to know as soon as possible when their strategies are not effective. Sometimes managers and employees on the front line discover this well before strategists.

External opportunities and threats and internal strengths and weaknesses that represent the bases of current strategies should continually be monitored for change. It is not really a question of whether these factors will change, but rather when they will change and in what ways. Some key questions to address in evaluating strategies are given here.

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?

Measuring Organizational Performance

Another important strategy-evaluation activity is *measuring organizational performance*. This activity includes comparing expected results to actual results, investigating deviations from plans, evaluating individual performance, and examining progress being made toward meeting stated objectives.

Both long-term and annual objectives are commonly used in this process. Criteria for evaluating strategies should be measurable and easily verifiable. Criteria that predict results may be more important than those that reveal what already has happened. For example, rather than simply being informed that sales last quarter were 20 percent under what was expected, strategists need to know that sales next quarter may be 20 percent below standard unless some action is taken to counter the trend. Really effective control requires accurate forecasting.

Failure to make satisfactory progress toward accomplishing long-term or annual objectives signals a need for corrective actions. Many factors, such as unreasonable policies, unexpected turns in the economy, unreliable suppliers or distributors, or ineffective strategies, can result in unsatisfactory progress toward meeting objectives. Problems can result from ineffectiveness (not doing the right things) or inefficiency (doing the right things poorly).

Quantitative criteria commonly used to evaluate strategies are financial ratios, which strategists use to make three critical comparisons: (1) comparing the firm's performance over different time periods, (2) comparing the firm's performance to competitors', and (3) comparing the firm's performance to industry averages. Some key financial ratios that are particularly useful as criteria for strategy evaluation are as follows:

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| Return on investment | 5. Debt to equity |
| 2. Return on equity | 6. Earnings per share |
| 3. Profit margin | 7. Sales growth |
| 4. Market share | 8. Asset growth |

But there are some potential problems associated with using quantitative criteria for evaluating strategies. First, most quantitative criteria are geared to annual objectives rather than long-term objectives. Also, different accounting methods can provide different results on many quantitative criteria. Third, intuitive judgments are almost always involved in deriving quantitative criteria. For these and other reasons, qualitative criteria are also important in evaluating strategies.

Human factors such as high absenteeism and turnover rates, poor production quality and quantity rates, or low employee satisfaction can be underlying causes of declining performance. Marketing, finance/accounting, R&D, or computer information systems factors can also cause financial problems.

Seymour Tilles identified six qualitative questions that are useful in evaluating strategies:

1. Is the strategy internally consistent?
2. Is the strategy consistent with the environment?
3. Is the strategy appropriate in view of available resources?
4. Does the strategy involve an acceptable degree of risk?
5. Does the strategy have an appropriate time framework?
6. Is the strategy workable?

Some additional key questions that reveal the need for qualitative or intuitive 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?

Taking Corrective Actions

The final strategy-evaluation activity, *taking corrective actions*, requires making changes to reposition a firm competitively for the future. Examples of changes that may be needed are altering an organization's structure, replacing one or more key individuals, selling a division, or revising a business mission. Other changes could include establishing or revising objectives, devising new policies, issuing stock to raise capital, adding additional salespersons, allocating resources differently, or developing new performance incentives. Taking corrective actions does not necessarily mean that existing strategies will be abandoned or even that new strategies must be formulated.

8.4 Characteristics of An effective evaluation system

A Good evaluation system must possess various qualities. It must meet several basic requirements 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 daily. For example, when a firm has diversified by acquiring another firm, evaluative information may be needed frequently. However, 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.

Strategy evaluation 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 portray this type of situation fairly.

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 for informational purposes only; not all managers need to receive all reports. Controls need to be action-oriented rather than information-oriented.

8.5 The contingency model (Contingency Planning)

A basic premise of good strategic management is that firms plan ways to deal with unfavorable and favorable events before they occur. Too many organizations prepare contingency plans just for unfavorable events; this is a mistake, because both minimizing threats and capitalizing on opportunities can improve a firm's competitive position.

Regardless of how carefully strategies are formulated, implemented, and evaluated, unforeseen events such as strikes, boycotts, natural disasters, arrival of foreign competitors, and government actions can make a strategy obsolete. To minimize the impact of potential threats, organizations should develop contingency plans as part of the strategy-evaluation process. *Contingency plans* can be defined as alternative plans that can be put into effect if certain key events do not occur as expected.

Only high-priority areas require the insurance of contingency plans. Strategists cannot and should not try to cover all bases by planning for all possible contingencies. But in any case, contingency plans should be as simple as possible.

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, tornados, 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?

Effective contingency planning involves a seven-step process as follows:

1. Identify both beneficial and unfavorable events that could possibly derail the strategy or strategies.
2. Specify trigger points. Calculate about when contingent events are likely to occur.
3. Assess the impact of each contingent event. Estimate the potential benefit or harm of each contingent event.
4. Develop contingency plans. Be sure that contingency plans are compatible with current strategy and are economically feasible.
5. Assess the counter impact of each contingency plan. That is, estimate how much each contingency plan will capitalize on or cancel out its associated contingent event. Doing this will quantify the potential value of each contingency plan.
6. Determine early warning signals for key contingent events. Monitor the early warning signals.
7. For contingent events with reliable early warning signals, develop advance action plans to take advantage of the available lead time.

8.6. Strategic Control: Control Process

Strategic control systems are the formal target-setting, measurement, and feedback systems that allow strategic managers to evaluate whether a company is achieving superior efficiency, quality, innovation, and customer responsiveness and is implementing its strategy successfully. An effective control system should have three characteristics: it should be *flexible* enough to allow managers to respond as necessary to unexpected events; it should provide *accurate information*, giving a true picture of organizational performance; and it should supply managers with the information in a *timely manner*, because making decisions on the basis of outdated information is a recipe for failure.

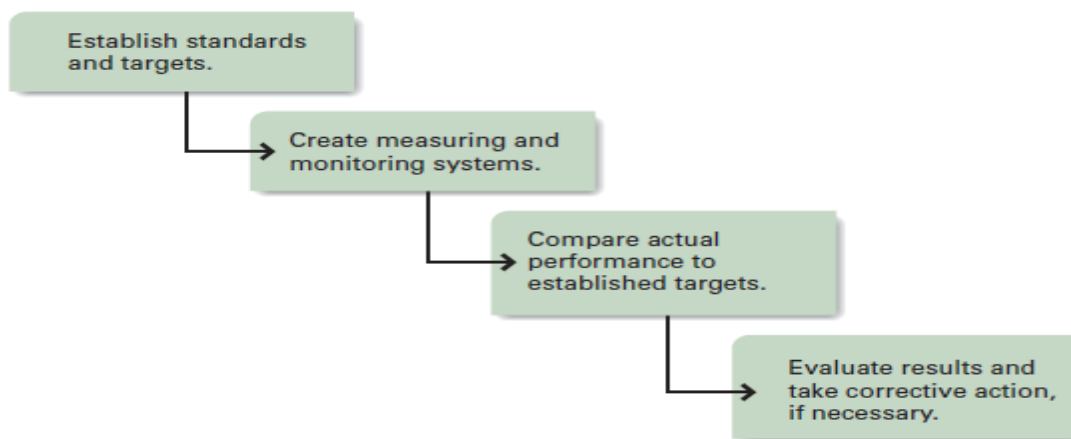


Figure. Steps in Designing an Effective Control System

As Figure shows, designing an effective strategic control system requires four steps.

1. *Establish the standards and targets against which performance is to be evaluated.* The standards and targets that managers select are the ways in which a company chooses to evaluate its performance. General performance standards often derive from the goal of achieving superior efficiency, quality, innovation, or responsiveness to customers. Specific performance targets are derived from the strategy pursued by the company. For example, if a company is pursuing a low-cost strategy, then reducing costs by 7% a year might be a target. If the company is a service organization such as McDonald's, then its standards might include time targets for serving customers or guidelines for food quality.
2. *Create the measuring and monitoring systems that indicate whether the standards and targets are being reached.*

The company establishes procedures for assessing whether work goals at all levels in the organization are being achieved. In some cases, measuring performance is fairly straightforward. For example, managers can measure quite easily how many customers their employees serve by counting the number of receipts from the cash register. In many cases, however, measuring performance is difficult because the organization is engaged in many complex activities. How can managers judge how well their research and development department is doing when it may take five years for products to be developed? How can they measure the company's performance when the company is entering new markets and serving new customers? How can they evaluate how well divisions are integrating their activities? The answer is that managers need to use various types of control systems, which we discuss later in this chapter.

3. *Compare actual performance to established targets.* Managers evaluate whether and to what extent performance deviates from the standards and targets developed in step 1. If performance is higher, management may decide that it has set the standards too low and may raise them for the next time period. The Japanese are renowned for the way they use targets on the production line to control costs; they are continually trying to raise performance, and they raise the standards to provide a goal for managers to work toward. On the other hand, if performance is too low, managers must decide whether to take remedial action. This decision is easy when the reasons for poor performance can be identified—for instance, high labor costs. More often, however, the reasons for poor performance are hard to uncover. They may stem from external factors, such as a recession.

Alternatively, the cause may be internal. For instance, the research and development laboratory may have underestimated the problems it would encounter or the extra costs of doing unforeseen research.

4. *Initiate corrective action when it is determined that the standards and targets are not being achieved.* The final stage in the control process is to take the corrective action that will allow the organization to meet its goals.

For example, managers may invest more resources in improving R&D, diversify, or even decide to change their organization structure. The goal is to continuously enhance the organization's competitive advantage.