Chapter Five:
The Internal Assessment

Chapter outline:

- ✓ *The nature of an internal audit*
- ✓ *Relationship among the functional areas of business*

5.1 The Nature of an Internal Audit

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths/weaknesses, coupled with External opportunities/threats and Clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses.

Internal Audit is Parallels process of external audit. It gathers & assimilates information from:

- Management
- Marketing
- Finance/accounting
- Production/operations
- Research & development
- Management information systems

Involvement in performing an internal strategic-management audit provides vehicle for understanding nature and effect of decisions in other functional business areas of the firm.

Key Internal Forces

It is not possible in a business policy text to review in depth all the material presented in courses such as marketing, finance, accounting, management, computer information systems, and production/operations; there are many sub areas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing.

For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

A firm's strengths that cannot be easily matched or imitated by competitors are called *distinctive competencies.* Building competitive advantages involves taking advantage of distinctive competencies. For example, 3M exploits its distinctive competence in research and development by producing a wide range of innovative products. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths, and maybe even into distinctive competencies.

Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit.

5.2. Relationship among the functional areas of business

Functional relationships refer to the Number and complexity increases relative to organization size. The process of performing an *internal audit* closely parallels the process of performing an external audit. Representative Managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and computer information systems operations.

Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of issues, problems, concerns, and needs in all the functional areas. In organizations that do not use strategic management, marketing, finance, and manufacturing managers often do not interact with each other in significant ways. Performing an internal audit, thus, is an excellent vehicle or forum for improving the process of communication in the organization. *Communication* may be the most important word in management.

Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations.

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and computer information systems managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information.

Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop such good products that marketing managers need to set higher objectives. A key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies.

A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. For example, some state governments, utilities, universities, and hospitals only recently have begun to establish marketing objectives and policies that are consistent with their financial capabilities and limitations. Some firms place too great an emphasis on one function at the expense of others.