Chapter Eight
Strategy Review, Evaluation and Control

8.1The Nature of Strategy Evaluation

Evaluation is the systematic determination of merit, worth, and significance of something or someone. Evaluation often is used to characterize and apprise subjects of interest in a wide range of human enterprises, including the Arts, business, computer science, criminal justice, education, engineering, foundations and non-profit organizations, government, health care, and other human services.

"Strategy evaluation alerts management to potential or actual problems in a timely fashion."

- It is complex and sensitive undertaking
- Overemphasis can be costly and counterproductive

Systematic Review, Evaluation & Control

1. Strategies become obsolete
2. Internal environments are dynamic
3. External environments are dynamic

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 –

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

Four Criteria (Richard Rummelt): He explains four criteria for strategy valuation. They are:

1. **Consistency**

Strategy should not present inconsistent goals and policies.

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

2. **Consonance**

Need for strategies to examine sets of trends

• Adaptive response to external environment

• Trends are results of interactions among other trends

3. **Feasibility**

Neither over tax resources nor creates unsolvable sub problems

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

4. **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.

8.2A 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?

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.

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:

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

Apart from quantitative criteria, 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?

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.

8.3 Published Sources of Strategy-Evaluation Information

A number of publications are helpful in evaluating a firm's strategies. Although published sources of strategy-evaluation information focus primarily on large, publicly held businesses, the comparative ratios and related information are widely used to evaluate small businesses and privately owned firms as well.

8.4 Characteristics of an Effective Evaluation System

A Good evaluation system must possess various qualities. 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.

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.

Large organizations require a more elaborate and detailed strategy-evaluation system because it is more difficult to coordinate efforts among different divisions and functional areas. Managers in small companies often communicate with each other and their employees daily and do not need extensive evaluative reporting systems. Familiarity with local environments usually makes gathering and evaluating information much easier for small organizations than for large businesses. But the key to an effective strategy evaluation system may be the ability to convince participants that failure to accomplish certain objectives within a prescribed time is not necessarily a reflection of their performance.

There is no one ideal strategy-evaluation system. The unique characteristics of an organization, including its size, management style, purpose, problems, and strengths, can determine a strategy-evaluation and control system's final design. Robert Waterman offered the following observation about successful organizations' strategy-evaluation and control systems:

Successful companies treat facts as friends and controls as liberating. Morgan Guaranty and Wells Fargo not only survive but thrive in the troubled waters of bank deregulation, because their strategy evaluation and control systems are sound, their risk is contained, and they know themselves and the competitive situation so well. Successful companies have a voracious hunger for facts. They see information where others see only data. They love comparisons, rankings, anything that removes decision-making from the realm of mere opinion. Successful companies maintain tight, accurate financial controls. Their people don't regard controls as an imposition of autocracy, but as the benign checks and balances that allow them to be creative and free.

8.5 The contingency Model

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.

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 those assertions and established criteria, and communicating the results to interested users." People who perform audits can be divided into three groups: independent auditors, government auditors, and internal auditors. Independent auditors basically are certified public accountants (CPAs) who provide their services to organizations for a fee; they examine the financial statements of an organization 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.

Two government agencies—the General Accounting Office (GAO) and the Internal Revenue Service (IRS)—employ government auditors responsible for making sure that organizations comply with federal laws, statutes, and policies. GAO and IRS auditors can audit any public or private organization. The third group of auditors is employees within an organization who are responsible for safeguarding company assets, for assessing the efficiency of company operations, and for ensuring that generally accepted business procedures are practiced.

The Environmental Audit

For an increasing number of firms, overseeing environmental affairs is no longer a technical function performed by specialists; it rather has become an important strategic-management concern. Product design, manufacturing, transportation, customer use, packaging, product disposal, and corporate rewards and sanctions should reflect environmental considerations. Firms that effectively manage environmental affairs are benefiting from constructive relations with employees, consumers, suppliers, and distributors.

Instituting an environmental audit can include moving environmental affairs from the staff side of the organization to the line side. Some firms are also introducing environmental criteria and objectives in their performance appraisal instruments and systems. Conoco, for example, ties compensation of all its top managers to environmental action plans. Occidental Chemical includes environmental responsibilities in all its job descriptions for positions.

Using Computers to Evaluate Strategies

When properly designed, installed, and operated, a computer network can efficiently acquire information promptly and accurately. Networks can allow diverse strategy-evaluation reports to be generated for—and responded to by—different levels and types of managers.

8.6 Strategic Control: Control Process

The process of evaluation basically deals with four steps:

1. Setting standards of performance
2. Measurement of performance
3. Analyzing variance
4. Taking corrective action

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