Strategic Management

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Strategy Review, Evaluation, and Control
A note from David

The best formulated and best implemented strategies become obsolete as a firm's external and internal environments change. It is essential, therefore, that strategists systematically review, evaluate, and control the execution of strategies. This chapter presents a framework that can guide managers' efforts to evaluate strategic-management activities, to make sure they are working, and to make timely changes. Management information systems being used to evaluate strategies are discussed. Guidelines are presented for formulating, implementing, and evaluating strategies. Family Dollar Stores evaluates strategies well.

The Nature of Strategy Evaluation The strategic-management process results in decisions that can have significant, longlasting 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. The strategy-evaluation stage of the strategic-management process is illustrated in Figure 9-1.

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 pres sure 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.

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. Described in Table 9-1, consonance and advantage are mostly based on a firm's external assessment, whereas consistency and feasibility are largely based on an internal assessment. 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. Organizational trouble can come swiftly, as further evidenced by the examples described in Table 9-2.

TABLE 9-1 Rumelt's Criteria for Evaluating Strategies

Consistency

A strategy should not present inconsistent 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 due to 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.

Feasibility

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.

Advantage

A strategy must provide for the creation and/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 as 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, while smaller firms seek product/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.

Source: Adapted from Richard Rumelt, "The Evaluation of Business Strategy," in W. F. Glueck (ed.), ***Business Policy and Strategic Management*** (New York: McGraw-Hill, 1980): 359–367. Used with permission.

TABLE 9-2 Examples of Organizational Demise

A. Some Large Companies That Experienced a Large Drop in Revenues in 2008 vs. 2007		B. Some Large Companies That Experienced a Large Drop in Profits in 2008 vs. 2007	
Molson Coors Brewing	−23%	UAL	−1,427%
Citigroup	−29%	Sonic Automotive	−818%
Morgan Stanley	−29%	Citigroup	−865%
Goldman Sachs Group	−39%	CBS	−1,036%
Fannie Mae	−48%	Rite Aid	−4,122%
Freddie Mac	−71%	Pilgrim's Pride	−2,224%
Weyerhaeuser	−32%	Centex	−1,090%
Centex	−41%	Harrah's Entertainment	−939%
Pulte Homes	−32%	American International Group	−1,701%
Massachusetts Mutual Life	−26%	Gannett	−730%
Allstate	−20%	OfficeMax	−899%
American International Group	−90%	Brunswick	−806%
Hartford Financial	−64%	Brightpoint	−822%
Atria Group	−58%	Owens Corning	−974%

Strategy evaluation is becoming increasingly difficult with the passage of time, for many reasons. Domestic and world economies were more stable in years past, product life cycles were longer, product development cycles were longer, technological advancement was slower, change occurred less

frequently, there were fewer competitors, foreign companies were weak, and there were more regulated industries. Other reasons why strategy evaluation is more difficult today include the following trends:

1. A dramatic increase in the environment's complexity
2. The increasing difficulty of predicting the future with accuracy
3. The increasing number of variables
4. The rapid rate of obsolescence of even the best plans
5. The increase in the number of both domestic and world events affecting organizations
6. The decreasing time span for which planning can be done with any degree of certainty1

A fundamental problem facing managers today is how to control employees effectively in light of modern organizational demands for greater flexibility, innovation, creativity, and initiative from employees.2 How can managers today ensure that empowered employees acting in an entrepreneurial manner do not put the well-being of the business at risk? Recall that Kidder, Peabody & Company lost $350 million when one of its traders allegedly booked fictitious profits; Sears, Roebuck and Company took a $60 million charge against earnings after admitting that its automobile service businesses were performing unnecessary repairs. The costs to companies such as these in terms of damaged reputations, fines, missed opportunities, and diversion of management's attention are enormous.

When empowered employees are held accountable for and pressured to achieve specific goals and are given wide latitude in their actions to achieve them, there can be dysfunctional behavior. For example, Nordstrom, the upscale fashion retailer known for outstanding customer service, was subjected to lawsuits and fines when employees underreported hours worked in order to increase their sales per hour—the company's primary performance criterion. Nordstrom's customer service and earnings were enhanced until the misconduct was reported, at which time severe penalties were levied against the firm.

The Process of Evaluating Strategies

Strategy evaluation is necessary for all sizes and kinds of organizations. Strategy evaluation should initiate managerial questioning of expectations and assumptions, should trigger a review of objectives and values, and should stimulate creativity in generating alternatives and formulating criteria of evaluation.3 Regardless of the size of the organization, a certain amount of management by wandering around at all levels is essential to effective strategy evaluation. Strategy-evaluation activities should be performed on a continuing basis, rather than at the end of specified periods of time or just after problems occur. Waiting until the end of the year, for example, could result in a firm closing the barn door after the horses have already escaped.

Evaluating strategies on a continuous rather than on a periodic basis allows benchmarks of progress to be established and more effectively monitored. Some strategies take years to implement; consequently, associated results may not become apparent for years. Successful strategies combine patience with a willingness to promptly take corrective actions when necessary. There always comes a time when corrective actions are needed in an organization! Centuries ago, a writer (perhaps Solomon) made the following observations about change:

There is a time for everything, A time to be born and a time to die, A time to plant and a time to uproot, A time to kill and a time to heal, A time to tear down and a time to build, A time to weep and a time to laugh, A time to mourn and a time to dance, A time to scatter stones and a time to gather them, A time to embrace and a time to refrain, A time to search and a time to give up, A time to keep and a time to throw away, A time to tear and a time to mend, A time to be silent and a time to speak, A time to love and a time to hate, A time for war and a time for peace.4

Managers and employees of the firm should be continually aware of progress being made toward achieving the firm's objectives. As critical success factors change, organizational members should be involved in determining appropriate corrective actions. If assumptions and expectations deviate significantly from forecasts, then the

firm should renew strategy-formulation activities, perhaps sooner than planned. In strategy evaluation, like strategy formulation and strategy implementation, people make the difference. Through involvement in the process of evaluating strategies, managers and employees become committed to keeping the firm moving steadily toward achieving objectives.

A Strategy-Evaluation Framework

Table 9-3 summarizes 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. Relationships among strategy-evaluation activities are illustrated in Figure 9-2.

Reviewing Bases of Strategy

As shown in Figure 9-2, 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 management 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:

TABLE 9-3 A Strategy-Evaluation Assessment Matrix

Have Major Changes Occurred in the Firm Internal Strategic Position?	Have Major Changes Occurred in the Firm External Strategic Position?	Has the Firm Progressed Satisfactorily Toward Achieving Its Stated Objectives?	Result
No	No	No	Take corrective actions
Yes	Yes	Yes	Take corrective actions
Yes	Yes	No	Take corrective actions
Yes	No	Yes	Take corrective actions
Yes	No	No	Take corrective actions
No	Yes	Yes	Take corrective actions
No	Yes	No	Take corrective actions
No	No	Yes	Continue present strategic course

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 prevent 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 prevent 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 lines 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. Here are some key questions to address in evaluating strategies:

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?

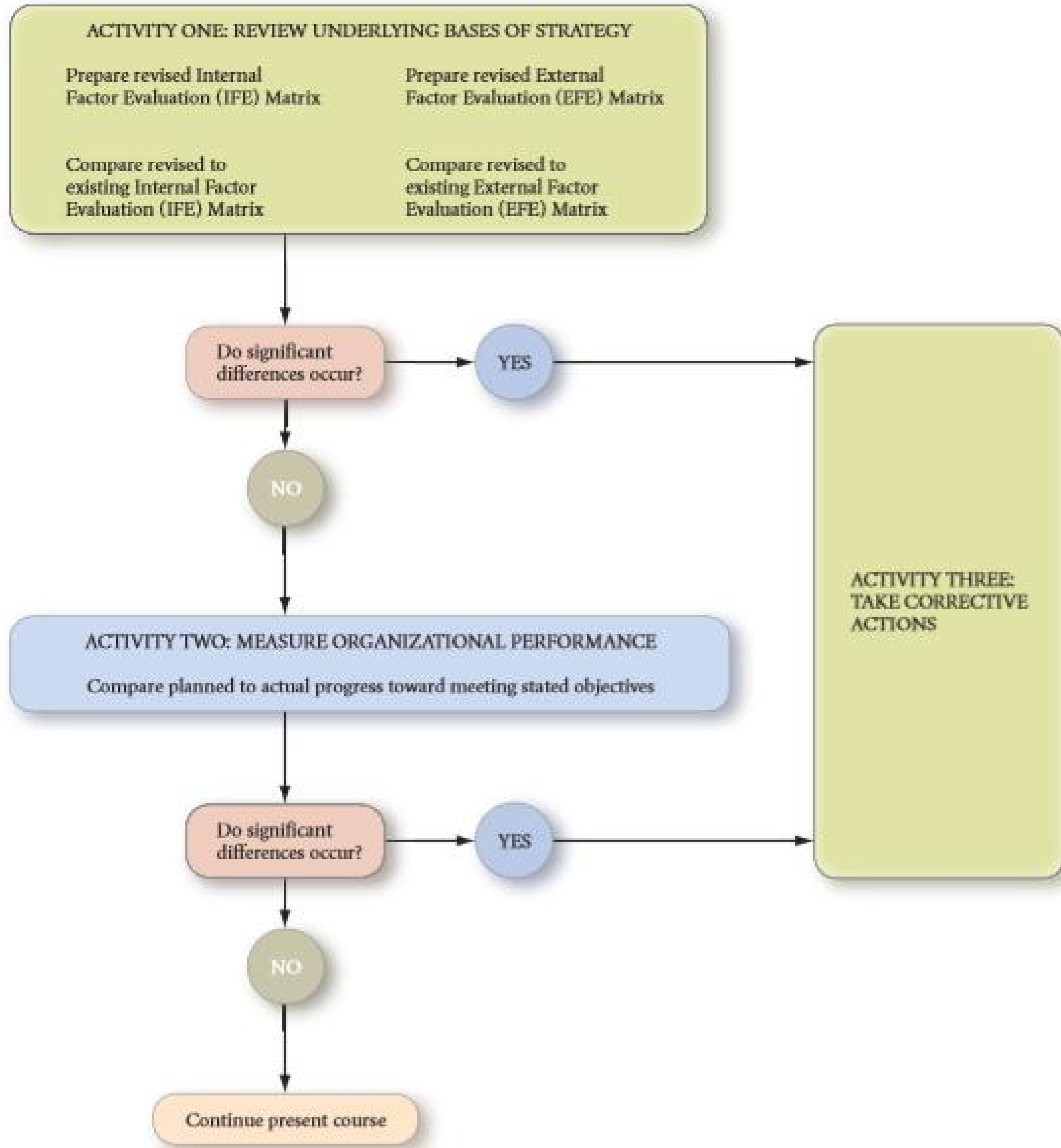
Measuring Organizational Performance

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 thatreveal what already has happened. For example, rather than simply being informed that sales in the last quarter were 20 percent under what was expected, strategists need to know that sales in the 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 (poorly doing the right things). Many variables can and should be included in measuring organizational performance. As indicated in Table 9-4, typically a favorable or unfavorable variance is recorded monthly, quarterly, and annually, and resultant actions needed are then determined. Determining which objectives are most important in the evaluation of strategies can be difficult. Strategy evaluation is based on both quantitative and qualitative criteria. Selecting the exact set of criteria for evaluating strategies depends on a particular organization's size, industry, strategies, and management philosophy. An organization pursuing a retrenchment strategy, for example, could have an entirely different set of evaluative criteria from an organization pursuing a market-development strategy. 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:

FIGURE 9-2

A Strategy-Evaluation Framework



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

TABLE 9-4 A Sample Framework for Measuring Organizational Performance

Factor	Actual Result	Expected Result	Variance	Action Needed
Corporate Revenues				
Corporate Profits				
Corporate ROI				
Region 1 Revenues				
Region 1 Profits				
Region 1 ROI				
Region 2 Revenues				
Region 2 Profits				
Region 2 ROI				
Product 1 Revenues				
Product 1 Profits				
Product 1 ROI				
Product 2 Revenues				
Product 2 Profits				
Product 2 ROI				

But some potential problems are 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 management information systems factors can also cause financial problems. 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 competitively reposition a firm for the future. As indicated in Table 9-5, 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, differently allocating resources, 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.

The probabilities and possibilities for incorrect or inappropriate actions increase geometrically with an arithmetic increase in personnel. Any person directing an overall undertaking must check on the actions of the participants as well as the results that they have achieved. If either the actions or results do not comply with preconceived or planned achievements, then corrective actions are needed.5

No organization can survive as an island; no organization can escape change. Taking corrective actions is necessary to keep an organization on track toward achieving stated objectives. In his thought-provoking books Future Shock and The Third Wave, Alvin Toffler argued that business environments are becoming so dynamic and complex that they threaten people and organizations with future shock, which occurs when the nature, types, and speed of changes overpower an individual's or organization's ability and capacity to adapt. Strategy evaluation enhances an organization's ability to adapt successfully to changing circumstances. Taking corrective actions raises employees' and managers' anxieties. Research suggests that participation in strategy-evaluation activities is one of the best ways to overcome individuals' resistance to change. According to Erez and Kanfer, individuals accept change best when they have a cognitive understanding of the changes, a sense of control over the situation, and an awareness that necessary actions are going to be taken to implement the changes.6 Strategy evaluation can lead to strategy-formulation changes, strategy-implementation changes, both formulation and implementation changes, or no changes at all. Strategists cannot escape having to revise strategies and implementation approaches sooner or later. Hussey and Langham offered the following insight on taking corrective actions:

Resistance to change is often emotionally based and not easily overcome by rational argument. Resistance may be based on such feelings as loss of status, implied criticism of present competence, fear of failure in the new situation, annoyance at not being consulted, lack of understanding of the need for change, or insecurity in changing from well-known and fixed methods. It is necessary, therefore, to overcome such resistance by creating situations of participation and full explanation when changes are envisaged.7

Corrective actions should place an organization in a better position to capitalize upon internal strengths; to take advantage of key external opportunities; to avoid, reduce, or mitigate external threats; and to improve internal weaknesses. Corrective actions should have a proper time horizon and an appropriate amount of risk. They should be internally consistent and socially responsible. Perhaps most important, corrective actions strengthen an organization's competitive position in its basic industry. Continuous strategy evaluation keeps strategists close to the pulse of an organization and provides information needed for an effective strategic-management system. Carter Bayles described the benefits of strategy evaluation as follows:

Evaluation activities may renew confidence in the current business strategy or point to the need for actions to correct some weaknesses, such as erosion of product superiority or technological edge. In many cases, the benefits of strategy evaluation are much more far-reaching, for the outcome of the process may be a fundamentally new strategy that will lead, even in a business that is already turning a respectable profit, to substantially increased earnings. It is this possibility that justifies strategy evaluation, for the payoff can be very large.8

TABLE 9-5 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 and/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

Introduced earlier in the Chapter 5 discussion of objectives, the Balanced Scorecard is an important strategy-evaluation tool. It is a process that allows firms to evaluate strategies from four perspectives: financial performance, customer knowledge, internal business processes, and learning and growth. The Balanced Scorecard analysis requires that firms seek answers to the following questions and utilize that information, in conjunction with financial measures, to adequately and more effectively evaluate strategies being implemented:

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

A sample Balanced Scorecard is provided in Table 9-6. Notice that the firm examines six key issues in evaluating its strategies: (1) Customers, (2) Managers/Employees, (3) Operations/Processes, (4) Community/Social Responsibility, (5) Business Ethics/Natural Environment, and (6) Financial. The basic form of a Balanced Scorecard may differ for different organizations. The Balanced Scorecard approach to strategy evaluation aims to balance long-term with short-term concerns, to balance financial with nonfinancial concerns, and to balance internal with external concerns. It can be an excellent management tool, and it is used successfully today by Chemical Bank, Exxon/Mobil Corporation, CIGNA Property and Casualty Insurance, and numerous other firms. The Balanced Scorecard would be constructed differently, that is, adapted, to particular firms in various industries with the underlying theme or thrust being the same, which is to evaluate the firm's strategies based upon both key quantitative and qualitative measures.

TABLE 9-6 An Example Balanced Scorecard

Area of Objectives	Measure or Target	Time Expectation	Primary Responsibility
Customers			
1.			
2.			
3.			
4.			
Managers/Employees			
1.			
2.			
3.			
4.			
Operations/Processes			
1.			
2.			
3.			
4.			
Community/Social Responsibility			
1.			
2.			
3.			
4.			
Business Ethics/Natural Environment			
1.			
2.			
3.			
4.			
Financial			
1.			
2.			
3.			
4.			

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 1,000 (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. In its March issue each year, Fortune publishes its strategy-evaluation research in an article entitled "America's Most Admired Companies." Eight key attributes serve as evaluative criteria: people management; innovativeness; quality of products or services; financial soundness; social responsibility; use of corporate assets; long-term investment; and quality of management. In October of each year, Fortune publishes additional strategy-evaluation research in an article entitled "The World's Most Admired Companies." Fortune's 2009 evaluation in Table 9-7 reveals the firms most admired (best managed) in their industry. The most admired company in the world in 2009 was Nike, followed by Anheuser-Busch, Nestle, and Procter & Gamble.9 Another excellent evaluation of corporations in America, "The Annual Report on American Industry," is published annually in the January issue of Forbes. It provides a detailed and comprehensive evaluation of hundreds of U.S. companies in many different industries.BusinessWeek,Industry Week, and Dun's Business Monthalso periodically publish detailed evaluations of U.S. businesses and industries. 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.

TABLE 9-7 The Most Admired Company in Various Industries (2009)

Industry	The Most Admired Company
Apparel	Nike
Beverages	Anheuser-Busch
Consumer food products	Nestle
Soaps and cosmetics	Procter & Gamble
Credit card services	Visa
Insurance	Berkshire Hathaway
Megabanks	Bank of America
Forest and paper products	International Paper
Pharmaceuticals	Johnson & Johnson
Petroleum refining	Exxon Mobil
Electronics	General Electric
Food services	McDonald's
Railroads	Union Pacific
Motor vehicles	BMW
Industrial and farm equipment	Caterpillar
Airlines	Continental Airlines
Aerospace and defense	United Technologies
Metals	Alcoa

Source: Based on Adam Lashinsky, "The World's Most Admired Companies," *Fortune* (March 16, 2009): 81–91.

Characteristics of an Effective Evaluation System

Strategy evaluation must meet several basic requirements to be effective. First, strategyevaluation 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 daily need information. 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 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. 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 daily with each other and their employees 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.10

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 their 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, 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. U.S. companies and governments are increasingly considering nuclear-generated electricity as the most efficient means of power generation. Many contingency plans certainly call for nuclear power rather than for coaland gas-derived electricity.

When strategy-evaluation activities reveal the need for a major change quickly, an appropriate contingency plan can be executed in a timely way. Contingency plans can promote a strategist's ability to respond quickly to key changes in the internal and external bases of an organization's current strategy. For example, if underlying assumptions about the economy turn out to be wrong and contingency plans are ready, then managers can make appropriate changes promptly.

In some cases, external or internal conditions present unexpected opportunities. When such opportunities occur, contingency plans could allow an organization to quickly capitalize on them. Linneman and Chandran reported that contingency planning gave users, such as DuPont, Dow Chemical, Consolidated Foods, and Emerson Electric, three major benefits: (1) It permitted quick response to change, (2) it prevented panic in crisis situations, and (3) it made managers more adaptable by encouraging them to appreciate just how variable the future can be. They suggested that effective contingency planning involves a seven-step process:

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 counterimpact 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.11

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."12

Auditors examine the financial statement 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 SEC in late 2009 charged General Electric with accounting fraud, specifically for inflating its earnings and revenues in prior years. GE has agreed to pay $50 million to settle the charges. (Students—when preparing projected financial statements as described in Chapter 8, do not inflate the numbers.)

The new era of international financial reporting standards (IFRS) appears unstoppable, and businesses need to go ahead and get ready to use IFRS. Many U.S. companies now report their finances using both the old generally accepted accounting standards (GAAP) and the new IFRS. "If companies don't prepare, if they don't start three years in advance," warns business professor Donna Street at the University of Dayton, "they're going to be in big trouble." GAAP standards comprised 25,000 pages, whereas IFRS comprises only 5,000 pages, so in that sense IFRS is less cumbersome. This accounting switch from GAAP to IFRS in the United States is going to cost businesses millions of dollars in fees and upgraded software systems and training. U.S. CPAs need to study global accounting principles intensely, and business schools should go ahead and begin teaching students the new accounting standards.

All companies have the option to use the IFRS procedures in 2011, and then all companies are required to use IFRS in 2014, unless that timetable is changed. The U.S. Chamber of Commerce supports the change, saying it will lead to much more cross-border commerce and will help the United States compete in the world economy. Already the European Union and 113 nations have adopted or soon plan to use international rules, including Australia, China, India, Mexico, and Canada. So the United States likely will also adopt IFRS rules on schedule, but this switch could unleash a legal and regulatory nightmare. The United States lags the rest of the world in global accounting. But a few U.S. multinational firms already use IFRS for their foreign subsidiaries, such as United Technologies (UT). UT derives more than 60 percent of its revenues from abroad and is already training its entire staff to use IFRS. UT has redone its 2007 through 2009 financial statements in the IFRS format.

Movement to IFRS from GAAP encompasses a company's entire operations, including auditing, oversight, cash management, taxes, technology, software, investing, acquiring, merging, importing, exporting, pension planning, and partnering. Switching from GAAP to IFRS is also likely to be plagued by gaping differences in business customs, financial regulations, tax laws, politics, and other factors. One critic of the upcoming switch is Charles Niemeier of the Public Company Accounting Oversight Board, who says the switch "has the potential to be a Tower of Babel," costing firms millions when they do not even have thousands to spend.

Others say the switch will help U.S. companies raise capital abroad and do business with firms abroad. Perhaps the biggest upside of the switch is that IFRS rules are more streamlined and less complex than GAAP. Lenovo, the China-based technology firm that bought IBM's personal computer business, is a big advocate of

IFRS. Lenovo's view is that they desire to be a world company rather than a U.S. or Chinese company, so the faster the switch to IFRS, the better for them. The bottom line is that IFRS is coming to the United States, sooner than later, so we all need to gear up for this switch as soon as possible.13

Twenty-First-Century Challenges in Strategic Management

Three particular challenges or decisions that face all strategists today are (1) deciding whether the process should be more an art or a science, (2) deciding whether strategies should be visible or hidden from stakeholders, and (3) deciding whether the process should be more top-down or bottom-up in their firm.14

The Art or Science Issue

This textbook is consistent with most of the strategy literature in advocating that strategic management be viewed more as a science than an art. This perspective contends that firms need to systematically assess their external and internal environments, conduct research, carefully evaluate the pros and cons of various alternatives, perform analyses, and then decide upon a particular course of action. In contrast, Mintzberg's notion of "crafting" strategies embodies the artistic model, which suggests that strategic decision making be based primarily on holistic thinking, intuition, creativity, and imagination.15 Mintzberg and his followers reject strategies that result from objective analysis, preferring instead subjective imagination. "Strategy scientists" reject strategies that emerge from emotion, hunch, creativity, and politics. Proponents of the artistic view often consider strategic planning exercises to be time poorly spent. The Mintzberg philosophy insists on informality, whereas strategy scientists (and this text) insist on more formality. Mintzberg refers to strategic planning as an "emergent" process whereas strategy scientists use the term "deliberate" process.16

The answer to the art versus science question is one that strategists must decide for themselves, and certainly the two approaches are not mutually exclusive. In deciding which approach is more effective, however, consider that the business world today has become increasingly complex and more intensely competitive. There is less room for error in strategic planning. Recall that Chapter 1 discussed the importance of intuition and experience and subjectivity in strategic planning, and even the weights and ratings discussed in Chapters 3, 4, and 6certainly require good judgment. But the idea of deciding on strategies for any firm without thorough research and analysis, at least in the mind of this writer, is unwise. Certainly, in smaller firms there can be more informality in the process compared to larger firms, but even for smaller firms, a wealth of competitive information is available on the Internet and elsewhere and should be collected, assimilated, and evaluated before deciding on a course of action upon which survival of the firm may hinge. The livelihood of countless employees and shareholders may hinge on the effectiveness of strategies selected. Too much is at stake to be less than thorough in formulating strategies. It is not wise for a strategist to rely too heavily on gut feeling and opinion instead of research data, competitive intelligence, and analysis in formulating strategies.

The Visible or Hidden Issue

An interesting aspect of any competitive analysis discussion is whether strategies themselves should be secret or open within firms. The Chinese warrior Sun Tzu and military leaders today strive to keep strategies secret, as war is based on deception. However, for a business organization, secrecy may not be best. Keeping strategies

secret from employees and stakeholders at large could severely inhibit employee and stakeholder communication, understanding, and commitment and also forgo valuable input that these persons could have regarding formulation and/or implementation of that strategy. Thus strategists in a particular firm must decide for themselves whether the risk of rival firms easily knowing and exploiting a firm's strategies is worth the benefit of improved employee and stakeholder motivation and input. Most executives agree that some strategic information should remain confidential to top managers, and that steps should be taken to ensure that such information is not disseminated beyond the inner circle. For a firm that you may own or manage, would you advocate openness or secrecy in regard to strategies being formulated and implemented? There are certainly good reasons to keep the strategy process and strategies themselves visible and open rather than hidden and secret. There are also good reasons to keep strategies hidden from all but top-level executives.

Strategists must decide for themselves what is best for their firms. This text comes down largely on the side of being visible and open, but certainly this may not be best for all strategists and all firms. As pointed out in Chapter 1, Sun Tzu argued that all war is based on deception and that the best maneuvers are those not easily predicted by rivals. Business and war are analogous. Some reasons to be completely open with the strategy process and resultant decisions are these:

1. Managers, employees, and other stakeholders can readily contribute to the process. They often have excellent ideas. Secrecy would forgo many excellent ideas.
2. Investors, creditors, and other stakeholders have greater basis for supporting a firm when they know what the firm is doing and where the firm is going.
3. Visibility promotes democracy, whereas secrecy promotes autocracy. Domestic firms and most foreign firms prefer democracy over autocracy as a management style.
4. Participation and openness enhance understanding, commitment, and communication within the firm.

Reasons why some firms prefer to conduct strategic planning in secret and keep strategies hidden from all but the highest-level executives are as follows:

1. Free dissemination of a firm's strategies may easily translate into competitive intelligence for rival firms who could exploit the firm given that information.
2. Secrecy limits criticism, second guessing, and hindsight.
3. Participants in a visible strategy process become more attractive to rival firms who may lure them away.
4. Secrecy limits rival firms from imitating or duplicating the firm's strategies and undermining the firm.

The obvious benefits of the visible versus hidden extremes suggest that a working balance must be sought between the apparent contradictions. Parnell says that in a perfect world all key individuals both inside and outside the firm should be involved in strategic planning, but in practice particularly sensitive and confidential information should always remain strictly confidential to top managers.17 This balancing act is difficult but essential for survival of the firm.

The Top-Down or Bottom-Up Approach

Proponents of the top-down approach contend that top executives are the only persons in the firm with the collective experience, acumen, and fiduciary responsibility to make key strategy decisions. In contrast, bottom-up advocates argue

that lower- and middle-level managers and employees who will be implementing the strategies need to be actively involved in the process of formulating the strategies to ensure their support and commitment. Recent strategy research and this textbook emphasize the bottom-up approach, but earlier work by Schendel and Hofer stressed the need for firms to rely on perceptions of their top managers in strategic planning.18 Strategists must reach a working balance of the two approaches in a manner deemed best for their firms at a particular time, while cognizant of the fact that current research supports the bottom-up approach, at least among U.S. firms. Increased education and diversity of the workforce at all levels are reasons why middle- and lower-level managers—and even nonmanagers—should be invited to participate in the firm's strategic planning process, at least to the extent that they are willing and able to contribute.