Strategic Management

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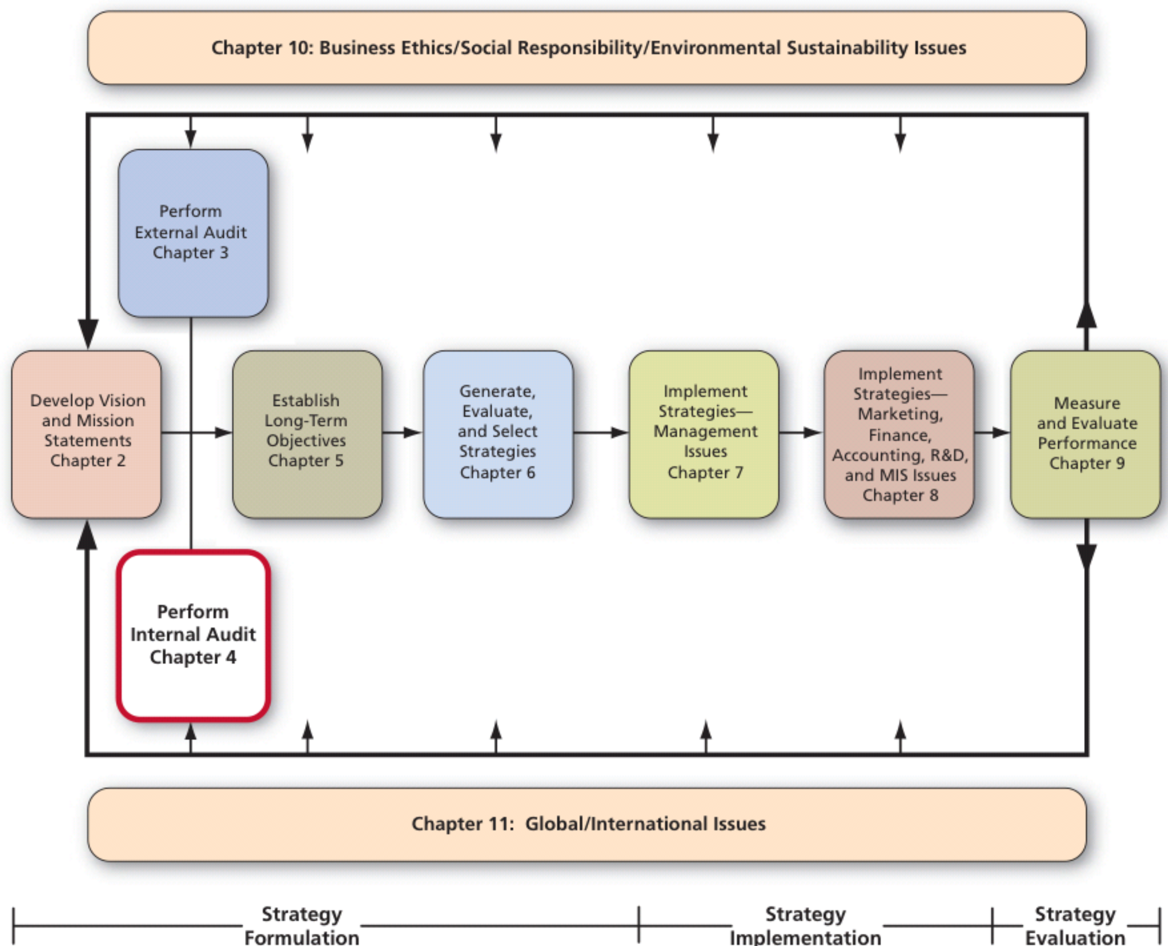
Internal Analysis

A note from David



Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

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. Maytag, for example, is known for excellent production and product design, whereas Procter & Gamble is known for superb marketing. Internal strengths/weaknesses, coupled with external opportunities/threats and a 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. The internal-audit part of the strategic-management process is illustrated in Figure above.

Key Internal Forces

It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production/operations; there are many subareas 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.

Figure below illustrates that all firms should continually strive to improve on their weaknesses, turning them into strengths, and ultimately developing distinctive competencies that can provide the firm with competitive advantages over rival firms.

The Process of Gaining Competitive Advantage in a Firm

Weaknesses ⇒ Strengths ⇒ Distinctive Competencies ⇒ Competitive Advantage

The Process of Performing an Internal Audit

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 management information systems operations. Key factors should be prioritized so that the firm's most important strengths and weaknesses can be determined collectively.

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 the issues, problems, concerns, and needs of 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. Critical success factors, consisting of both strengths and weaknesses, can be identified and prioritized. According to William King, a task force of managers from different units of the organization, supported by staff, should be charged with determining the 10 to 20 most important strengths and weaknesses that should influence the future of the organization.
He says:

"The development of conclusions on the 10 to 20 most important organizational strengths and weaknesses can be, as any experienced manager knows, a difficult task, when it involves managers representing various organizational interests and points of view. Developing a 20-page list of strengths and weaknesses could be accomplished relatively easily, but a list of the 10 to 15 most important ones involves significant analysis and negotiation. This is true because of the judgments that are required and the impact which such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies."

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and management 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 products for which 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. Some firms place too great an emphasis on one function at the expense of others.
Ansoff explained:

"During the first fifty years, successful firms focused their energies on optimizing the performance of one of the principal functions: production/operations, R&D, or marketing. Today, due to the growing complexity and dynamism of the environment, success increasingly depends on a judicious combination of several functional influences. This transition from a single function focus to a multifunction focus is essential for successful strategic management."

Financial ratio analysis exemplifies the complexity of relationships among the functional areas of business. A declining return on investment or profit margin ratio could be the result of ineffective marketing, poor management policies, research and development errors, or a weak management information system. The effectiveness of strategy formulation, implementation, and evaluation activities hinges upon a clear understanding of how major business functions affect one another. For strategies to succeed, a coordinated effort among all the functional areas of business is needed. In the case of planning, George wrote:

We may conceptually separate planning for the purpose of theoretical discussion and analysis, but in practice, neither is it a distinct entity nor is it capable of being separated. The planning function is mixed with all other business functions and, like ink once mixed with water, it cannot be set apart. It is spread throughout and is a part of the whole of managing an organization.

The Resource-Based View (RBV)

Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying:

"In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy. When the external environment is in a state of flux, the firm's own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based upon the needs which the business seeks to satisfy."

The Resource-Based View (RBV) approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining

competitive advantage. In contrast to the I/O theory presented in the previous chapter, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories: physical resources, human resources, and organizational resources. 5 Physical resources include all plant and equipment, location, technology, raw materials, machines; human resources include all employees, training, experience, intelligence, knowledge, skills, abilities; and organizational resources include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on. RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats.

The basic premise of the RBV is that the mix, type, amount, and nature of a firm's internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm's unique resources and capabilities, and continually maintaining and strengthening those resources. The theory asserts that it is advantageous for a firm to pursue a strategy that is not currently being implemented by any competing firm. When other firms are unable to duplicate a particular strategy, then the focal firm has a sustainable competitive advantage, according to RBV theorists.

For a resource to be valuable, it must be either (1) rare, (2) hard to imitate, or (3) not easily substitutable. Often called empirical indicators, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, non-imitable, and nonsubstitutable, the stronger a firm's competitive advantage will be and the longer it will last.

Rare resources are resources that other competing firms do not possess. If many firms have the same resource, then those firms will likely implement similar strategies, thus giving no one firm a sustainable competitive advantage. This is not to say that resources that are common are not valuable; they do indeed aid the firm in its chance for economic prosperity. However, to sustain a competitive advantage, it is more advantageous if the resource(s) is also rare.

It is also important that these same resources be difficult to imitate. If firms cannot easily gain the resources, say RBV theorists, then those resources will lead to a competitive advantage more so than resources easily imitable. Even if a firm employs resources that are rare, a sustainable competitive advantage may be achieved only if other firms cannot easily obtain these resources.

The third empirical indicator that can make resources a source of competitive advantage is substitutability. Borrowing from Porter's Five-Forces Model, to the degree that there are no viable substitutes, a firm will be able to sustain its competitive advantage. However, even if a competing firm cannot perfectly imitate a firm's resource, it can still obtain a sustainable competitive advantage of its own by obtaining resource substitutes.

The RBV has continued to grow in popularity and continues to seek a better understanding of the relationship between resources and sustained competitive advantage in strategic management. However, one cannot say with any degree of certainty that either external or internal factors will always or even consistently be more important in seeking competitive advantage. Understanding

both external and internal factors, and more importantly, understanding the relationships among them, will be the key to effective strategy formulation (discussed in Chapter 6). Because both external and internal factors continually change, strategists seek to identify and take advantage of positive changes and buffer against negative changes in a continuing effort to gain and sustain a firm's competitive advantage. This is the essence and challenge of strategic management, and oftentimes survival of the firm hinges on this work.

Integrating Strategy and Culture

Relationships among a firm's functional business activities perhaps can be exemplified best by focusing on organizational culture, an internal phenomenon that permeates all departments and divisions of an organization. Organizational culture can be defined as "a pattern of behavior that has been developed by an organization as it learns to cope with its problem of external adaptation and internal integration, and that has worked well enough to be considered valid and to be taught to new members as the correct way to perceive, think, and feel." This definition emphasizes the importance of matching external with internal factors in making strategic decisions.

Organizational culture captures the subtle, elusive, and largely unconscious forces that shape a workplace. Remarkably resistant to change, culture can represent a major strength or weakness for the firm. It can be an underlying reason for strengths or weaknesses in any of the major business functions.

Defined in Table below, cultural products include values, beliefs, rites, rituals, ceremonies, myths, stories, legends, sagas, language, metaphors, symbols, heroes, and heroines. These products or dimensions are levers that strategists can use to influence and direct strategy formulation, implementation, and evaluation activities. An organization's culture compares to an individual's personality in the sense that no two organizations have the same culture and no two individuals have the same personality. Both culture and personality are enduring and can be warm, aggressive, friendly, open, innovative, conservative, liberal, harsh, or likable.

At Google, the culture is very informal. Employees are encouraged to wander the halls on employee-sponsored scooters and brainstorm on public whiteboards provided everywhere.

Example Cultural Products Defined

Rites	Planned sets of activities that consolidate various forms of cultural expressions into one event.
Ceremonial	Several rites connected together.
Ritual	A standardized set of behaviors used to manage anxieties.
Myth	A narrative of imagined events, usually not supported by facts.
Saga	A historical narrative describing the unique accomplishments of a group and its leaders.
Legend	A handed-down narrative of some wonderful event, usually not supported by facts.
Story	A narrative usually based on true events.
Folktale	A fictional story.
Symbol	Any object, act, event, quality, or relation used to convey meaning.
Language	The manner in which members of a group communicate.
Metaphors	Shorthand of words used to capture a vision or to reinforce old or new values
Values	Life-directing attitudes that serve as behavioral guidelines
Belief	An understanding of a particular phenomenon
Heroes/Heroines	Individuals greatly respected.

Source: Based on H. M. Trice and J. M. Beyer, "Studying Organizational Cultures through Rites and Ceremonials," *Academy of Management Review* 9, no. 4 (October 1984): 655.

In contrast, the culture at Procter & Gamble (P&G) is so rigid that employees jokingly call themselves "Proctoids." Despite this difference, the two companies are swapping employees and participating in each other's staff training sessions. Why? Because P&G spends more money on advertising than any other company and Google desires more of P&G's $8.7 billion annual advertising expenses; P&G has come to realize that the next generation of laundry-detergent, toilet-paper, and skin-cream customers now spend more time online than watching TV. Consumers age 18 to 27 say they use the Internet nearly 13 hours a week, compared to 10 hours of TV, according to market-data firm Forrester Research.

Dimensions of organizational culture permeate all the functional areas of business. It is something of an art to uncover the basic values and beliefs that are deeply buried in an organization's rich collection of stories, language, heroes, and rituals, but cultural products can represent both important strengths and weaknesses. Culture is an aspect of an organization that can no longer be taken for granted in performing an internal strategic-management audit because culture and strategy must work together.

Table below provides some example (possible) aspects of an organization's culture. Note you could ask employees/managers to rate the degree that the dimension characterizes the firm. When one firm acquires another firm, integrating the two cultures can be important. For example, in Table below, one firm may score mostly 1's and the other firm may score mostly 5's, which would present a challenging strategic problem.

The strategic-management process takes place largely within a particular organization's culture. Lorsch found that executives in successful companies are emotionally committed to the firm's culture, but he concluded that culture can inhibit strategic management in two basic ways. First, managers frequently miss the significance of changing external conditions because they are blinded by strongly held beliefs. Second, when a particular culture has been effective in the past,

the natural response is to stick with it in the future, even during times of major strategic change. 8 An organization's culture must support the collective commitment of its people to a common purpose. It must foster competence and enthusiasm among managers and employees.

Organizational culture significantly affects business decisions and thus must be evaluated during an internal strategic-management audit. If strategies can capitalize on cultural strengths, such as a strong work ethic or highly ethical beliefs, then management often can swiftly and easily implement changes. However, if the firm's culture is not supportive, strategic changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, with the result being confusion and disorientation.

Fifteen Example (Possible) Aspects of an Organization's Culture

Dimension	Degree				
1. Strong work ethic; arrive early and leave late	1	2	3	4	5
2. High ethical beliefs; clear code of business ethics followed	1	2	3	4	5
3. Formal dress; shirt and tie expected	1	2	3	4	5
4. Informal dress; many casual dress days	1	2	3	4	5
5. Socialize together outside of work	1	2	3	4	5
6. Do not question supervisor's decision	1	2	3	4	5
7. Encourage whistle-blowing	1	2	3	4	5
8. Be health conscious; have a wellness program	1	2	3	4	5
9. Allow substantial "working from home"	1	2	3	4	5
10. Encourage creativity/innovation/openmindness	1	2	3	4	5
11. Support women and minorities; no glass ceiling	1	2	3	4	5
12. Be highly socially responsible; be philanthropic	1	2	3	4	5
13. Have numerous meetings	1	2	3	4	5
14. Have a participative management style	1	2	3	4	5
15. Preserve the natural environment; have a sustainability program	1	2	3	4	5

An organization's culture should infuse individuals with enthusiasm for implementing strategies. Allarie and Firsirotu emphasized the need to understand culture:

Culture provides an explanation for the insuperable difficulties a firm encounters when it attempts to shift its strategic direction. Not only has the "right" culture become the essence and foundation of corporate excellence, it is also claimed that success or failure of reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in time with required changes in strategies.

The potential value of organizational culture has not been realized fully in the study of strategic management. Ignoring the effect that culture can have on relationships among the functional areas of business can result in barriers to communication, lack of coordination, and an inability to adapt to changing conditions. Some tension between culture and a firm's strategy is inevitable, but the

tension should be monitored so that it does not reach a point at which relationships are severed and the culture becomes antagonistic. The resulting disarray among members of the organization would disrupt strategy formulation, implementation, and evaluation. In contrast, a supportive organizational culture can make managing much easier.

Internal strengths and weaknesses associated with a firm's culture sometimes are overlooked because of the interfunctional nature of this phenomenon. It is important, therefore, for strategists to understand their firm as a sociocultural system. Success is often determined by linkages between a firm's culture and strategies. The challenge of strategic management today is to bring about the changes in organizational culture and individual mind-sets that are needed to support the formulation, implementation, and evaluation of strategies.

Management

The functions of management consist of five basic activities: planning, organizing, motivating, staffing, and controlling. An overview of these activities is provided in Table below.

The Basic Functions of Management

Function	Description	Stage of Strategic-Management Process When Most Important
Planning	Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals.	Strategy Formulation
Organizing	Organizing includes all those managerial activities that result in a structure of task and authority relationships. Specific areas include organizational design, job specialization, job descriptions, job specifications, span of control, unity of command, coordination, job design, and job analysis.	Strategy Implementation
Motivating	Motivating involves efforts directed toward shaping human behavior. Specific topics include leadership, communication, work groups, behavior modification, delegation of authority, job enrichment, job satisfaction, needs fulfillment, organizational change, employee morale, and managerial morale.	Strategy Implementation
Staffing	Staffing activities are centered on personnel or human resource management. Included are wage and salary administration, employee benefits, interviewing, hiring, firing, training, management development, employee safety, affirmative action, equal employment opportunity, union relations, career development, personnel research, discipline policies, grievance procedures, and public relations.	Strategy Implementation
Controlling	Controlling refers to all those managerial activities directed toward ensuring that actual results are consistent with planned results. Key areas of concern include quality control, financial control, sales control, inventory control, expense control, analysis of variances, rewards, and sanctions.	Strategy Evaluation

Planning

The only thing certain about the future of any organization is change, and planning is the essential bridge between the present and the future that increases the likelihood of achieving desired results. Planning is the process by which one determines whether to attempt a task, works out the most effective way of reaching desired objectives, and prepares to overcome unexpected difficulties with adequate resources. Planning is the start of the process by which an individual or business may turn empty dreams into achievements. Planning enables one to avoid the trap of working extremely hard but achieving little.

Planning is an up-front investment in success. Planning helps a firm achieve maximum effect from a given effort. Planning enables a firm to take into account relevant factors and focus on the critical ones. Planning helps ensure that the firm can be prepared for all reasonable eventualities and for all changes that will be needed. Planning enables a firm to gather the resources needed and carry out tasks in the most efficient way possible. Planning enables a firm to conserve its own resources, avoid wasting ecological resources, make a fair profit, and be seen as an effective, useful firm. Planning enables a firm to identify precisely what is to be achieved and to detail precisely the who, what, when, where, why, and how needed to achieve desired objectives. Planning enables a firm to assess whether the effort, costs, and implications associated with achieving desired objectives are warranted. 10 Planning is the cornerstone of effective strategy formulation. But even though it is considered the foundation of management, it is commonly the task that managers neglect most. Planning is essential for successful strategy implementation and strategy evaluation, largely because organizing, motivating, staffing, and controlling activities depend upon good planning.

The process of planning must involve managers and employees throughout an organization. The time horizon for planning decreases from two to five years for top-level to less than six months for lower-level managers. The important point is that all managers do planning and should involve subordinates in the process to facilitate employee understanding and commitment.

Planning can have a positive impact on organizational and individual performance. Planning allows an organization to identify and take advantage of external opportunities as well as minimize the impact of external threats. Planning is more than extrapolating from the past and present into the future. It also includes developing a mission, forecasting future events and trends, establishing objectives, and choosing strategies to pursue.

An organization can develop synergy through planning. Synergy exists when everyone pulls together as a team that knows what it wants to achieve; synergy is the 2 + 2 = 5 effect. By establishing and communicating clear objectives, employees and managers can work together toward desired results. Synergy can result in powerful competitive advantages. The strategic-management process itself is aimed at creating synergy in an organization.

Planning allows a firm to adapt to changing markets and thus to shape its own destiny. Strategic management can be viewed as a formal planning process that allows an organization to pursue proactive rather than reactive strategies. Successful organizations strive to control their own futures rather than merely react to external forces and events as they occur. Historically, organisms and organizations that have not adapted to changing conditions have become extinct. Swift adaptation is needed today more than ever because changes in markets, economies, and competitors worldwide are accelerating. Many firms did not adapt to the global recession of late and went out of business.

Organizing

The purpose of organizing is to achieve coordinated effort by defining task and authority relationships. Organizing means determining who does what and who reports to whom. There are countless examples in history of well-organized enterprises successfully competing against—and

in some cases defeating—much stronger but less-organized firms. A well-organized firm generally has motivated managers and employees who are committed to seeing the organization succeed. Resources are allocated more effectively and used more efficiently in a well-organized firm than in a disorganized firm.

The organizing function of management can be viewed as consisting of three sequential activities: breaking down tasks into jobs (work specialization), combining jobs to form departments (departmentalization), and delegating authority. Breaking down tasks into jobs requires the development of job descriptions and job specifications. These tools clarify for both managers and employees what particular jobs entail. In The Wealth of Nations, published in 1776, Adam Smith cited the advantages of work specialization in the manufacture of pins:

One man draws the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head. Ten men working in this manner can produce 48,000 pins in a single day, but if they had all wrought separately and independently, each might at best produce twenty pins in a day.

Combining jobs to form departments results in an organizational structure, span of control, and a chain of command. Changes in strategy often require changes in structure because positions may be created, deleted, or merged. Organizational structure dictates how resources are allocated and how objectives are established in a firm. Allocating resources and establishing objectives geographically, for example, is much different from doing so by product or customer.

The most common forms of departmentalization are functional, divisional, strategic business unit, and matrix.

Delegating authority is an important organizing activity, as evidenced in the old saying "You can tell how good a manager is by observing how his or her department functions when he or she isn't there." Employees today are more educated and more capable of participating in organizational decision making than ever before. In most cases, they expect to be delegated authority and responsibility and to be held accountable for results. Delegation of authority is embedded in the strategic-management process.

Motivating

Motivating can be defined as the process of influencing people to accomplish specific objectives. Motivation explains why some people work hard and others do not. Objectives, strategies, and policies have little chance of succeeding if employees and managers are not motivated to implement strategies once they are formulated. The motivating function of management includes at least four major components: leadership, group dynamics, communication, and organizational change.

When managers and employees of a firm strive to achieve high levels of productivity, this indicates that the firm's strategists are good leaders. Good leaders establish rapport with subordinates, empathize with their needs and concerns, set a good example, and are trustworthy and fair. Leadership includes developing a vision of the firm's future and inspiring people to work hard to

achieve that vision. Kirkpatrick and Locke reported that certain traits also characterize effective leaders: knowledge of the business, cognitive ability, self-confidence, honesty, integrity, and drive.

Research suggests that democratic behavior on the part of leaders results in more positive attitudes toward change and higher productivity than does autocratic behavior. Drucker said:

Leadership is not a magnetic personality. That can just as well be demagoguery. It is not "making friends and influencing people." That is flattery. Leadership is the lifting of a person's vision to higher sights, the raising of a person's performance to a higher standard, the building of a person's personality beyond its normal limitations.

Group dynamics play a major role in employee morale and satisfaction. Informal groups or coalitions form in every organization. The norms of coalitions can range from being very positive to very negative toward management. It is important, therefore, that strategists identify the composition and nature of informal groups in an organization to facilitate strategy formulation, implementation, and evaluation. Leaders of informal groups are especially important in formulating and implementing strategy changes.

Communication, perhaps the most important word in management, is a major component in motivation. An organization's system of communication determines whether strategies can be implemented successfully. Good two-way communication is vital for gaining support for departmental and divisional objectives and policies. Top-down communication can encourage bottom-up communication. The strategic-management process becomes a lot easier when subordinates are encouraged to discuss their concerns, reveal their problems, provide recommendations, and give suggestions. A primary reason for instituting strategic management is to build and support effective communication networks throughout the firm.

The manager of tomorrow must be able to get his people to commit themselves to the business, whether they are machine operators or junior vice-presidents. The key issue will be empowerment, a term whose strength suggests the need to get beyond merely sharing a little information and a bit of decision making.

Staffing

The management function of staffing, also called personnel management or human resource management, includes activities such as recruiting, interviewing, testing, selecting, orienting, training, developing, caring for, evaluating, rewarding, disciplining, promoting, transferring, demoting, and dismissing employees, as well as managing union relations.

Staffing activities play a major role in strategy-implementation efforts, and for this reason, human resource managers are becoming more actively involved in the strategic-management process. It is important to identify strengths and weaknesses in the staffing area.

The complexity and importance of human resource activities have increased to such a degree that all but the smallest organizations now need a full-time human resource manager. Numerous court cases that directly affect staffing activities are decided each day. Organizations and individuals

can be penalized severely for not following federal, state, and local laws and guidelines related to staffing. Line managers simply cannot stay abreast of all the legal developments and requirements regarding staffing. The human resources department coordinates staffing decisions in the firm so that an organization as a whole meets legal requirements. This department also provides needed consistency in administering company rules, wages, policies, and employee benefits as well as collective bargaining with unions.

Human resource management is particularly challenging for international companies. For example, the inability of spouses and children to adapt to new surroundings can be a staffing problem in overseas transfers. The problems include premature returns, job performance slumps, resignations, discharges, low morale, marital discord, and general discontent. Firms such as Ford Motor and ExxonMobil screen and interview spouses and children before assigning persons to overseas positions. 3M Corporation introduces children to peers in the target country and offers spouses educational benefits.

Controlling

The controlling function of management includes all of those activities undertaken to ensure that actual operations conform to planned operations. All managers in an organization have controlling responsibilities, such as conducting performance evaluations and taking necessary action to minimize inefficiencies. The controlling function of management is particularly important for effective strategy evaluation. Controlling consists of four basic steps:

1. Establishing performance standards
2. Measuring individual and organizational performance
3. Comparing actual performance to planned performance standards
4. Taking corrective actions

Measuring individual performance is often conducted ineffectively or not at all in organizations. Some reasons for this shortcoming are that evaluations can create confrontations that most managers prefer to avoid, can take more time than most managers are willing to give, and can require skills that many managers lack. No single approach to measuring individual performance is without limitations. For this reason, an organization should examine various methods, such as the graphic rating scale, the behaviorally anchored rating scale, and the critical incident method, and then develop or select a performance-appraisal approach that best suits the firm’s needs. Increasingly, firms are striving to link organizational performance with managers’ and employees’ pay.

Management Audit Checklist of Questions

The following checklist of questions can help determine specific strengths and weaknesses in the functional area of business. An answer of no to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or yes answers to the checklist questions suggest potential areas of strength.

1. Does the firm use strategic-management concepts?
2. Are company objectives and goals measurable and well communicated?
3. Do managers at all hierarchical levels plan effectively?
4. Do managers delegate authority well?
5. Is the organization's structure appropriate?
6. Are job descriptions and job specifications clear?
7. Is employee morale high?
8. Are employee turnover and absenteeism low?
9. Are organizational reward and control mechanisms effective?

Marketing

Marketing can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services. There are seven basic functions of marketing: (1) customer analysis, (2) selling products/services, (3) product and service planning, (4) pricing, (5) distribution, (6) marketing research, and (7) opportunity analysis. 16 Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

Customer Analysis

Customer analysis—the examination and evaluation of consumer needs, desires, and wants—involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies. The information generated by customer analysis can be essential in developing an effective mission statement. Customer profiles can reveal the demographic characteristics of an organization's customers. Buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors can all participate in gathering information to successfully identify customers' needs and wants. Successful organizations continually monitor present and potential customers' buying patterns.

Selling Products/Services

Successful strategy implementation generally rests upon the ability of an organization to sell some product or service. Selling includes many marketing activities, such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. These activities are especially critical when a firm pursues a market penetration strategy.

The effectiveness of various selling tools for consumer and industrial products varies. Personal selling is most important for industrial goods companies, and advertising is most important for consumer goods companies.

U.S. advertising expenditures are expected to fall 6.2 percent in 2009 to $161.8 billion. 17 One aspect of ads in a recession is that they generally take more direct aim at competitors, and this marketing practice is holding true in our bad economic times. Nick Brien at Mediabrands says, "Ads have to get combative in bad times. It's a dog fight, and it's about getting leaner and meaner." Marketers in 2009 also say ads will be less lavish and glamorous in a recession. Table 4-4 lists specific characteristics of ads forthcoming in late 2009 and 2010 in response to the economic hard times people nationwide and worldwide are facing. Total U.S. online advertising sending is expected to decline 0.3 percent to $36.9 billion in 2009, after growing 8.5 percent in 2008.

A 30-second advertisement on the Super Bowl in 2009 was $3 million. The NBC network airing the Super Bowl took in $206 million of ad revenue from the broadcast as just over 95 million people watched the Pittsburgh Steelers defeat the Arizona Cardinals in Super Bowl XLIII. The most watched television show in history was the 1983 season finale of M*A*S*H, which drew 106 million viewers.

Visa in 2009 launched a $140 million advertising campaign that includes print, TV, outdoor, and Internet ads designed to persuade consumers that debit cards "are more convenient, safer, and secure than cash or checks."

Pharmaceutical companies on average reduced their spending on consumer advertising of prescription drugs by 8 percent in 2008 to $4.4 billion. This was the first annual decrease since 1997 in their efforts to get patients to request a particular medicine from their doctor.

Determining organizational strengths and weaknesses in the selling function of marketing is an important part of performing an internal strategic-management audit. With regard to advertising products and services on the Internet, a new trend is to base advertising rates exclusively on sales rates. This new accountability contrasts sharply with traditional broadcast and print advertising, which bases rates on the number of persons expected to see a given advertisement. The new cost-per-sale online advertising rates are possible because any Web site can monitor which user clicks on which advertisement and then can record whether that consumer actually buys the product. If there are no sales, then the advertisement is free.

Product and Service Planning

Product and service planning includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, features, style, and quality; deleting old products; and providing for customer service. Product and service planning is particularly important when a company is pursuing product development or diversification.

One of the most effective product and service planning techniques is test marketing. Test markets allow an organization to test alternative marketing plans and to forecast future sales of new products. In conducting a test market project, an organization must decide how many cities to

include, which cities to include, how long to run the test, what information to collect during the test, and what action to take after the test has been completed. Test marketing is used more frequently by consumer goods companies than by industrial goods companies. Test marketing can allow an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins. Starbucks is currently test marketing selling beer and wine in its stores to boost its “after 5 PM” sales.

Pricing

Five major stakeholders affect pricing decisions: consumers, governments, suppliers, distributors, and competitors. Sometimes an organization will pursue a forward integration strategy primarily to gain better control over prices charged to consumers. Governments can impose constraints on price fixing, price discrimination, minimum prices, unit pricing, price advertising, and price controls. For example, the Robinson-Patman Act prohibits manufacturers and wholesalers from discriminating in price among channel member purchasers (suppliers and distributors) if competition is injured.

Competing organizations must be careful not to coordinate discounts, credit terms, or condition of sale; not to discuss prices, markups, and costs at trade association meetings; and not to arrange to issue new price lists on the same date, to rotate low bids on contracts, or to uniformly restrict production to maintain high prices. Strategists should view price from both a short-run and a long-run perspective, because competitors can copy price changes with relative ease. Often a dominant firm will aggressively match all price cuts by competitors.

With regard to pricing, as the value of the dollar increases, U.S. multinational companies have a choice. They can raise prices in the local currency of a foreign country or risk losing sales and market share. Alternatively, multinational firms can keep prices steady and face reduced profit when their export revenue is reported in the United States in dollars.

Intense price competition, created by the global economic recession, coupled with Internet price-comparative shopping has reduced profit margins to bare minimum levels for most companies. For example, airline tickets, rental car prices, hotel room rates, and computer prices are lower today than they have been in many years.

In response to the economic recession, the family-dining chain Denny’s did something that no family-dining chain had ever done before: give away breakfast from 6 AM until 2 PM on February 8, 2009, at all of its restaurants in the United States. More than 2 million people took advantage of the free breakfast at all but two of Denny’s 1,550 restaurants nationwide. The entire promotion, including food, labor, and airing an ad on the Super Bowl the Sunday before, cost Denny’s about $5 million. However, the firm reaped tons of positive public relations as well as $50 million of free news coverage nationwide and greatly increased customer loyalty. “People love free stuff when money’s tight,” says Dan Ariely, a business professor at Duke University. Other firms recently set a price of zero on their products, including McDonald’s, Starbucks, Dunkin’ Donuts, and Panera Bread. Denny’s CEO Nelson Marchioli says that Denny’s did better than break even on the free breakfast day, and it may do this promotion again.

Distribution

Distribution includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing. Most producers today do not sell their goods directly to consumers. Various marketing entities act as intermediaries; they bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, vendors—or simply distributors.

Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy. Some of the most complex and challenging decisions facing a firm concern product distribution. Intermediaries flourish in our economy because many producers lack the financial resources and expertise to carry out direct marketing. Manufacturers who could afford to sell directly to the public often can gain greater returns by expanding and improving their manufacturing operations.

Successful organizations identify and evaluate alternative ways to reach their ultimate market. Possible approaches vary from direct selling to using just one or many wholesalers and retailers. Strengths and weaknesses of each channel alternative should be determined according to economic, control, and adaptive criteria. Organizations should consider the costs and benefits of various wholesaling and retailing options. They must consider the need to motivate and control channel members and the need to adapt to changes in the future. Once a marketing channel is chosen, an organization usually must adhere to it for an extended period of time.

Marketing Research

Marketing research is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services. Marketing research can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information. Marketing research activities support all of the major business functions of an organization. Organizations that possess excellent marketing research skills have a definite strength in pursuing generic strategies.

The President of PepsiCo said, "Looking at the competition is the company's best form of market research. The majority of our strategic successes are ideas that we borrow from the marketplace, usually from a small regional or local competitor. In each case, we spot a promising new idea, improve on it, and then out-execute our competitor."

Cost/Benefit Analysis

The seventh function of marketing is cost/benefit analysis, which involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform a cost/benefit analysis: (1) compute the total costs associated with a decision, (2) estimate the total benefits from the decision, and (3) compare the total costs with the total benefits. When expected benefits exceed total costs, an opportunity becomes more attractive. Sometimes the variables included in a cost/benefit analysis cannot be quantified or even measured, but usually reasonable estimates can be made to allow the analysis to be performed. One key factor to be considered is

risk. Cost/benefit analysis should also be performed when a company is evaluating alternative ways to be socially responsible.

Marketing Audit Checklist of Questions

The following questions about marketing must be examined in strategic planning:

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm's market share been increasing?
4. Are present channels of distribution reliable and cost effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market research?
7. Are product quality and customer service good?
8. Are the firm's products and services priced appropriately?
9. Does the firm have an effective promotion, advertising, and publicity strategy?
10. Are marketing, planning, and budgeting effective?
11. Do the firm's marketing managers have adequate experience and training?
12. Is the firm's Internet presence excellent as compared to rivals?

Finance/Accounting

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to effectively formulating strategies. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans.

Finance/Accounting Functions

According to James Van Horne, the functions of finance/accounting comprise three decisions: the investment decision, the financing decision, and the dividend decision. 20 Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses in the investment, financing, and dividend areas. Because the functional areas of business are so closely related, financial ratios can signal strengths or weaknesses in management, marketing, production, research and development, and management information systems activities. It is important to note here that financial ratios are equally applicable in for-profit and nonprofit organizations. Even though nonprofit organizations obviously would not have return-on-investment or earnings-per-share ratios, they would routinely monitor many other special ratios. For example, a church would monitor the ratio of dollar contributions to number of members, while a zoo would monitor dollar food sales to number of visitors. A university would monitor number of students divided by number of professors. Therefore, be creative when performing ratio analysis for nonprofit organizations because they strive to be financially sound just as for-profit firms do.

The investment decision, also called capital budgeting, is the allocation and reallocation of capital and resources to projects, products, assets, and divisions of an organization. Once strategies are formulated, capital budgeting decisions are required to successfully implement strategies. The financing decision determines the best capital structure for the firm and includes examining various methods by which the firm can raise capital (for example, by issuing stock, increasing debt, selling assets, or using a combination of these approaches). The financing decision must consider both short-term and long-term needs for working capital. Two key financial ratios that indicate whether a firm's financing decisions have been effective are the debt-to-equity ratio and the debt-to-total-assets ratio.

Dividend decisions concern issues such as the percentage of earnings paid to stockholders, the stability of dividends paid over time, and the repurchase or issuance of stock. Dividend decisions determine the amount of funds that are retained in a firm compared to the amount paid out to stockholders. Three financial ratios that are helpful in evaluating a firm's dividend decisions are the earnings-per-share ratio, the dividends-per-share ratio, and the price-earnings ratio. The benefits of paying dividends to investors must be balanced against the benefits of internally retaining funds, and there is no set formula on how to balance this trade-off. For the reasons listed here, dividends are sometimes paid out even when funds could be better reinvested in the business or when the firm has to obtain outside sources of capital:

1. Paying cash dividends is customary. Failure to do so could be thought of as a stigma. A dividend change is considered a signal about the future.
2. Dividends represent a sales point for investment bankers. Some institutional investors can buy only dividend-paying stocks.
3. Shareholders often demand dividends, even in companies with great opportunities for reinvesting all available funds.
4. A myth exists that paying dividends will result in a higher stock price

A Summary of Key Financial Ratios

Ratio	How Calculated	What It Measures
Liquidity Ratios		
Current Ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations
Quick Ratio	$\frac{\text{Current assets minus inventory}}{\text{Current liabilities}}$	The extent to which a firm can meet its short-term obligations without relying upon the sale of its inventories
Leverage Ratios		
Debt-to-Total-Assets Ratio	$\frac{\text{Total debt}}{\text{Total assets}}$	The percentage of total funds that are provided by creditors
Debt-to-Equity Ratio	$\frac{\text{Total debt}}{\text{Total stockholders' equity}}$	The percentage of total funds provided by creditors versus by owners
Long-Term Debt-to-Equity Ratio	$\frac{\text{Long-term debt}}{\text{Total stockholders' equity}}$	The balance between debt and equity in a firm's long-term capital structure
Times-Interest-Earned Ratio	$\frac{\text{Profits before interest and taxes}}{\text{Total interest charges}}$	The extent to which earnings can decline without the firm becoming unable to meet its annual interest costs
Activity Ratios		
Inventory Turnover	$\frac{\text{Sales}}{\text{Inventory of finished goods}}$	Whether a firm holds excessive stocks of inventories and whether a firm is slowly selling its inventories compared to the industry average
Fixed Assets Turnover	$\frac{\text{Sales}}{\text{Fixed assets}}$	Sales productivity and plant and equipment utilization
Total Assets Turnover	$\frac{\text{Sales}}{\text{Total assets}}$	Whether a firm is generating a sufficient volume of business for the size of its asset investment
Accounts Receivable Turnover	$\frac{\text{Annual credit sales}}{\text{Accounts receivable}}$	The average length of time it takes a firm to collect credit sales (in percentage terms)
Average Collection Period	$\frac{\text{Accounts receivable}}{\text{Total credit sales/365 days}}$	The average length of time it takes a firm to collect on credit sales (in days)
Profitability Ratios		
Gross Profit Margin	$\frac{\text{Sales minus cost of goods sold}}{\text{Sales}}$	The total margin available to cover operating expenses and yield a profit
Operating Profit Margin	$\frac{\text{Earnings before interest and taxes (EBIT)}}{\text{Sales}}$	Profitability without concern for taxes and interest
Net Profit Margin	$\frac{\text{Net income}}{\text{Sales}}$	After-tax profits per dollar of sales
Return on Total Assets (ROA)	$\frac{\text{Net income}}{\text{Total assets}}$	After-tax profits per dollar of assets; this ratio is also called return on investment (ROI)
Return on Stockholders' Equity (ROE)	$\frac{\text{Net income}}{\text{Total stockholders' equity}}$	After-tax profits per dollar of stockholders' investment in the firm

(continued)

A Summary of Key Financial Ratios—continued

Ratio	How Calculated	What It Measures
Profitability Ratios		
Earnings Per Share (EPS)	$\frac{\text{Net income}}{\text{Number of shares of common stock outstanding}}$	Earnings available to the owners of common stock
Price-Earnings Ratio	$\frac{\text{Market price per share}}{\text{Earnings per share}}$	Attractiveness of firm on equity markets
Growth Ratios		
Sales	Annual percentage growth in total sales	Firm's growth rate in sales
Net Income	Annual percentage growth in profits	Firm's growth rate in profits
Earnings Per Share	Annual percentage growth in EPS	Firm's growth rate in EPS
Dividends Per Share	Annual percentage growth in dividends per share	Firm's growth rate in dividends per share

Production/Operations

The production/operations function of a business consists of all those activities that transform inputs into goods and services. Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services. As indicated in Table below, Roger Schroeder suggested that production/operations management comprises five functions or decision areas: process, capacity, inventory, workforce, and quality.

The Basic Functions (Decisions) Within Production/Operations

Decision Areas	Example Decisions
1. Process	These decisions include choice of technology, facility layout, process flow analysis, facility location, line balancing, process control, and transportation analysis. Distances from raw materials to production sites to customers are a major consideration.
2. Capacity	These decisions include forecasting, facilities planning, aggregate planning, scheduling, capacity planning, and queuing analysis. Capacity utilization is a major consideration.
3. Inventory	These decisions involve managing the level of raw materials, work-in-process, and finished goods, especially considering what to order, when to order, how much to order, and materials handling.
4. Workforce	These decisions involve managing the skilled, unskilled, clerical, and managerial employees by caring for job design, work measurement, job enrichment, work standards, and motivation techniques.
5. Quality	These decisions are aimed at ensuring that high-quality goods and services are produced by caring for quality control, sampling, testing, quality assurance, and cost control.

Source: Adapted from R. Schroeder, *Operations Management* (New York: McGraw-Hill, 1981): 12.

Most automakers require a 30-day notice to build vehicles, but Toyota Motor fills a buyer's new car order in just 5 days. Honda Motor was considered the industry's fastest producer, filling orders in 15 days. Automakers have for years operated under just-in-time inventory systems, but Toyota's 360 suppliers are linked to the company via computers on a virtual assembly line. The new Toyota production system was developed in the company's Cambridge, Ontario, plant and now applies to its Solara, Camry, Corolla, and Tacoma vehicles.

Production/operations activities often represent the largest part of an organization's human and capital assets. In most industries, the major costs of producing a product or service are incurred within operations, so production/operations can have great value as a competitive weapon in a company's overall strategy. Strengths and weaknesses in the five functions of production can mean the success or failure of an enterprise.

Many production/operations managers are finding that cross-training of employees can help their firms respond faster to changing markets. Cross-training of workers can increase efficiency, quality, productivity, and job satisfaction. For example, at General Motors' Detroit gear and axle plant, costs related to product defects were reduced 400 percent in two years as a result of cross-training workers. A shortage of qualified labor in the United States is another reason cross-training is becoming a common management practice.

Singapore rivals Hong Kong as an attractive site for locating production facilities in Southeast Asia. Singapore is a city-state near Malaysia. An island nation of about 4 million, Singapore is changing from an economy built on trade and services to one built on information technology. A large-scale program in computer education for older (over age 26) residents is very popular. Singapore children receive outstanding computer training in schools. All government services are computerized nicely. Singapore lures multinational businesses with great tax breaks, world-class infrastructure, excellent courts that efficiently handle business disputes, exceptionally low tariffs, large land giveaways, impressive industrial parks, excellent port facilities, and a government very receptive to and cooperative with foreign businesses. Foreign firms now account for 70 percent of manufacturing output in Singapore.

In terms of ship container traffic processed annually, Singapore has the largest and busiest seaport in the world, followed by Hong Kong, Shanghai, Los Angeles, Busan (South Korea), Rotterdam, Hamburg, New York, and Tokyo. The Singapore seaport is five times the size of the New York City seaport.

There is much reason for concern that many organizations have not taken sufficient account of the capabilities and limitations of the production/operations function in formulating strategies. Scholars contend that this neglect has had unfavorable consequences on corporate performance in America. As shown in Table below, James Dilworth outlined implications of several types of strategic decisions that a company might make.

Implications of Various Strategies on Production/Operations

Various Strategies	Implications
1. Low-cost provider	Creates high barriers to entry Creates larger market Requires longer production runs and fewer product changes
2. A high-quality provider	Requires more quality-assurance efforts Requires more expensive equipment Requires highly skilled workers and higher wages
3. Provide great customer service	Requires more service people, service parts, and equipment Requires rapid response to customer needs or changes in customer tastes Requires a higher inventory investment
4. Be the first to introduce new products	Has higher research and development costs Has high retraining and tooling costs
5. Become highly automated	Requires high capital investment Reduces flexibility May affect labor relations Makes maintenance more crucial
6. Minimize layoffs	Serves the security needs of employees and may develop employee loyalty Helps to attract and retain highly skilled employees

Source: Based on: J. Dilworth, *Production and Operations Management: Manufacturing and Nonmanufacturing,* 2nd ed. Copyright © 1983 by Random House, Inc.

Value Chain Analysis (VCA)

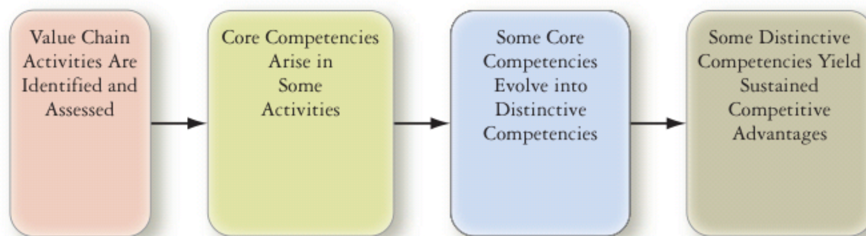
According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such as obtaining raw materials, designing products, building manufacturing facilities, developing cooperative agreements, and providing customer service. A firm will be profitable as long as total revenues exceed the total costs incurred in creating and delivering the product or service. Firms should strive to understand not only their own value chain operations but also their competitors', suppliers', and distributors' value chains.

Value chain analysis (VCA) refers to the process whereby a firm determines the costs associated with organizational activities from purchasing raw materials to manufacturing product(s) to marketing those products. VCA aims to identify where low-cost advantages or disadvantages exist anywhere along the value chain from raw material to customer service activities. VCA can enable a firm to better identify its own strengths and weaknesses, especially as compared to competitors' value chain analyses and their own data examined over time.

Substantial judgment may be required in performing a VCA because different items along the value chain may impact other items positively or negatively, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. Cost and price differences among rival firms can have their origins in activities performed by suppliers, distributors, creditors, or even shareholders. Despite the complexity of VCA, the initial step in implementing this procedure is to divide a firm's

operations into specific activities or business processes. Then the analyst attempts to attach a cost to each discrete activity, and the costs could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield competitive advantage or disadvantage. Conducting a VCA is supportive of the RBV's examination of a firm's assets and capabilities as sources of distinctive competence.

When a major competitor or new market entrant offers products or services at very low prices, this may be because that firm has substantially lower value chain costs or perhaps the rival firm is just waging a desperate attempt to gain sales or market share. Thus value chain analysis can be critically important for a firm in monitoring whether its prices and costs are competitive. An example value chain is illustrated in Figure below. There can be more than a hundred particular value-creating activities associated with the business of producing and marketing a product or service, and each one of the activities can represent a competitive advantage or disadvantage for the firm. The combined costs of all the various activities in a company's value chain define the firm's cost of doing business. Firms should determine where cost advantages and disadvantages in their value chain occur relative to the value chain of rival firms.



Value chains differ immensely across industries and firms. Whereas a paper products company, such as Stone Container, would include on its value chain timber farming, logging, pulp mills, and papermaking, a computer company such as Hewlett-Packard would include programming, peripherals, software, hardware, and laptops. A motel would include food, housekeeping, check-in and check-out operations, Web site, reservations system, and so on. However all firms should use value chain analysis to develop and nurture a core competence and convert this competence into a distinctive competence. A core competence is a value chain activity that a firm performs especially well. When a core competence evolves into a major competitive advantage, then it is called a distinctive competence.

More and more companies are using VCA to gain and sustain competitive advantage by being especially efficient and effective along various parts of the value chain. For example, Wal-Mart has built powerful value advantages by focusing on exceptionally tight inventory control, volume purchasing of products, and offering exemplary customer service. Computer companies in contrast compete aggressively along the distribution end of the value chain. Of course, price competitiveness is a key component of effectiveness among both mass retailers and computer firms.

Benchmarking

Benchmarking is an analytical tool used to determine whether a firm's value chain activities are competitive compared to rivals and thus conducive to winning in the marketplace. Benchmarking entails measuring costs of value chain activities across an industry to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices. Benchmarking enables a firm to take action to improve its competitiveness by identifying (and improving upon) value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation.

The hardest part of benchmarking can be gaining access to other firms' value chain activities with associated costs. Typical sources of benchmarking information, however, include published reports, trade publications, suppliers, distributors, customers, partners, creditors, shareholders, lobbyists, and willing rival firms. Some rival firms share benchmarking data. However, the International Benchmarking Clearinghouse provides guidelines to help ensure that restraint of trade, price fixing, bid rigging, bribery, and other improper business conduct do not arise between participating firms.
Due to the popularity of benchmarking today, numerous consulting firms such as Accenture, AT Kearney, Best Practices Benchmarking & Consulting, as well as the Strategic Planning Institute's Council on Benchmarking, gather benchmarking data, conduct benchmarking studies, and distribute benchmark information without identifying the sources.

The Internal Factor Evaluation (IFE) Matrix

A summary step in conducting an internal strategic-management audit is to construct an Internal Factor Evaluation (IFE) Matrix. This strategy-formulation tool summarizes and evaluates the major strengths and weaknesses in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all-powerful technique. A thorough understanding of the factors included is more important than the actual numbers. Similar to the EFE Matrix and Competitive Profile Matrix, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use a total of from 10 to 20 internal factors, including both strengths and weaknesses. List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. Recall that Edward Deming said, "In God we trust. Everyone else bring data."
2. Assign a weight that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.
3. Assign a 1-to-4 rating to each factor to indicate whether that factor represents a major weakness (rating = 1), a minor weakness (rating = 2), a minor strength (rating = 3), or a major strength (rating = 4). Note that strengths must receive a 3 or 4 rating and weaknesses

must receive a 1 or 2 rating. Ratings are thus company-based, whereas the weights in step 2 are industry-based.

4. Multiply each factor's weight by its rating to determine a weighted score for each variable.
5. Sum the weighted scores for each variable to determine the total weighted score for the organization.

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position. Like the EFE Matrix, an IFE Matrix should include from 10 to 20 key factors. The number of factors has no effect upon the range of total weighted scores because the weights always sum to 1.0.

When a key internal factor is both a strength and a weakness, the factor should be included twice in the IFE Matrix, and a weight and rating should be assigned to each statement. For example, the Playboy logo both helps and hurts Playboy Enterprises; the logo attracts customers to Playboy magazine, but it keeps the Playboy cable channel out of many markets. Be as quantitative as possible when stating factors. Use monetary amounts, percentages, numbers, and ratios to the extent possible.

An example of an IFE Matrix is provided in Table below for a retail computer store. Note that the two most important factors to be successful in the retail computer store business are "revenues from repair/service in the store" and "location of the store." Also note that the store is doing best on "average customer purchase amount" and "in-store technical support." The store is having major problems with its carpet, bathroom, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store receives a 2.5 total weighted score, which on a 1-to-4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

The IFE Matrix provides important information for strategy formulation. For example, this retail computer store might want to hire another checkout person and repair its carpet, paint, and bathroom problems. Also, the store may want to increase advertising for its repair/services, because that is a really important (weight 0.15) factor to being successful in this business.

In multidivisional firms, each autonomous division or strategic business unit should construct an IFE Matrix. Divisional matrices then can be integrated to develop an overall corporate IFE Matrix.

TABLE 4.10 A Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
1. Inventory turnover increased from 5.8 to 6.7	0.05	3	0.15
2. Average customer purchase increased from $97 to $128	0.07	4	0.28
3. Employee morale is excellent	0.10	3	0.30
4. In-store promotions resulted in 20 percent increase in sales	0.05	3	0.15
5. Newspaper advertising expenditures increased 10 percent	0.02	3	0.06
6. Revenues from repair/service segment of store up 16 percent	0.15	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	4	0.20
8. Store's debt-to-total assets ratio declined to 34 percent	0.03	3	0.09
9. Revenues per employee up 19 percent	0.02	3	0.06
Weaknesses			
1. Revenues from software segment of store down 12 percent	0.10	2	0.20
2. Location of store negatively impacted by new Highway 34	0.15	2	0.30
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02
4. Bathroom in store needs refurbishing	0.02	1	0.02
5. Revenues from businesses down 8 percent	0.04	1	0.04
6. Store has no Web site	0.05	2	0.10
7. Supplier on-time delivery increased to 2.4 days	0.03	1	0.03
8. Often customers have to wait to check out	0.05	1	0.05
Total	**1.00**		**2.50**