Modul Manajemen Strategik
Chapter 5 - 8

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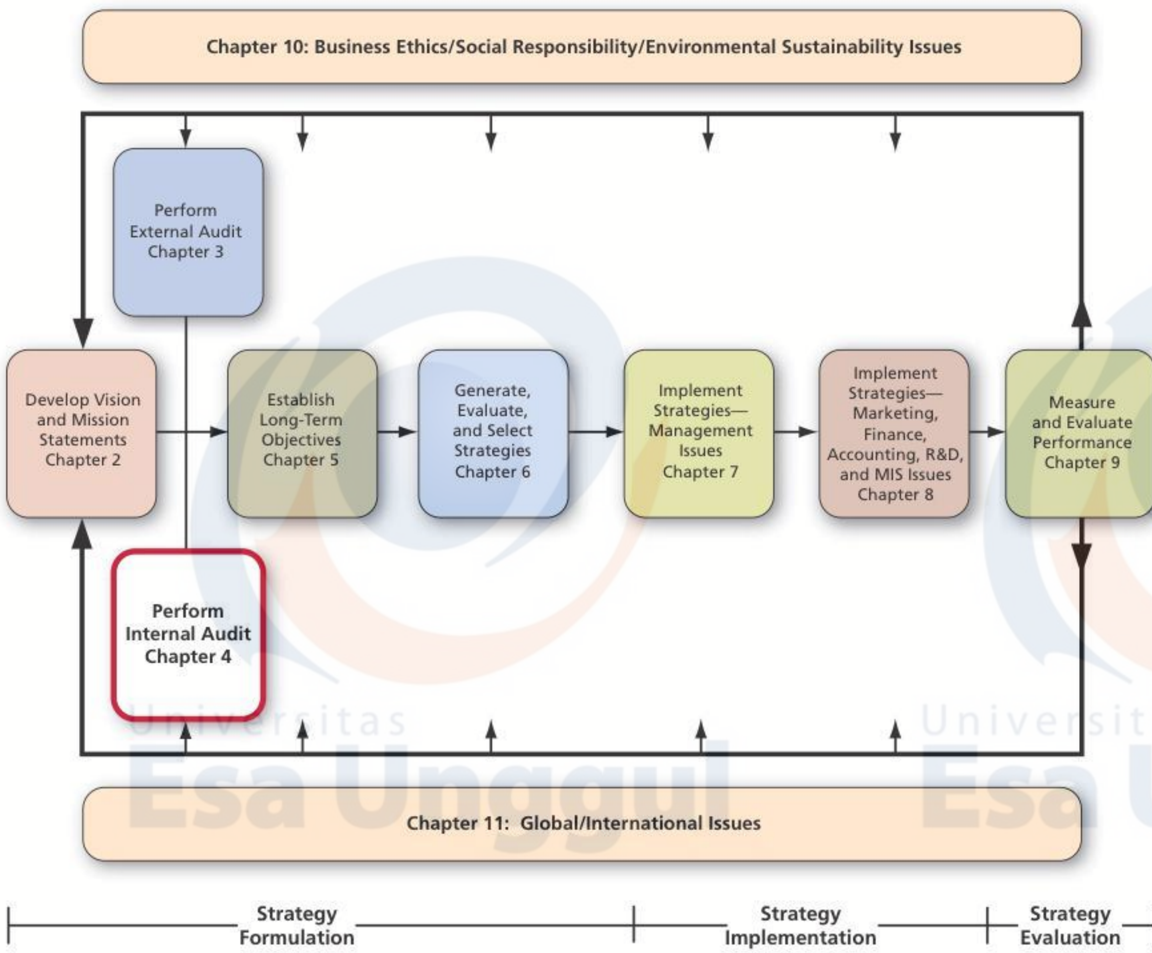
Chapter 5
INTERNAL ANALYSIS

Internal Analysis

A note from David

A Comprehensive Strategic-Management Model



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.

TABLE 4-3 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	Strategy Implementation

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

TABLE 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)

TABLE 4-6 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)

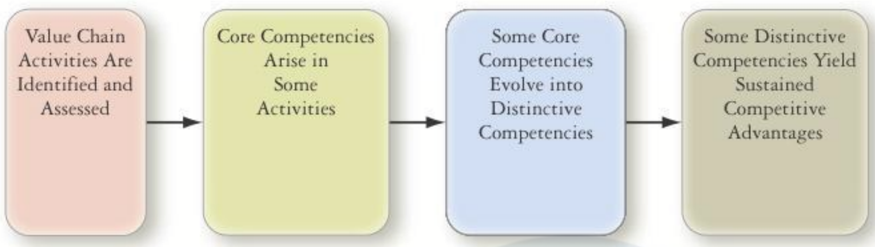
According to Porter, the business of a firm can best be described as a value chain, in which total revenues minus total costs of all activities undertaken to develop and market a product or service yields value. All firms in a given industry have a similar value chain, which includes activities such 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.

Transforming Value Chain Activities into Sustained Competitive Advantage



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**

Chapter 6
Strategic Analysis and Choice

Strategy Analysis and Choice

A note from David

The Nature of Strategy Analysis and Choice

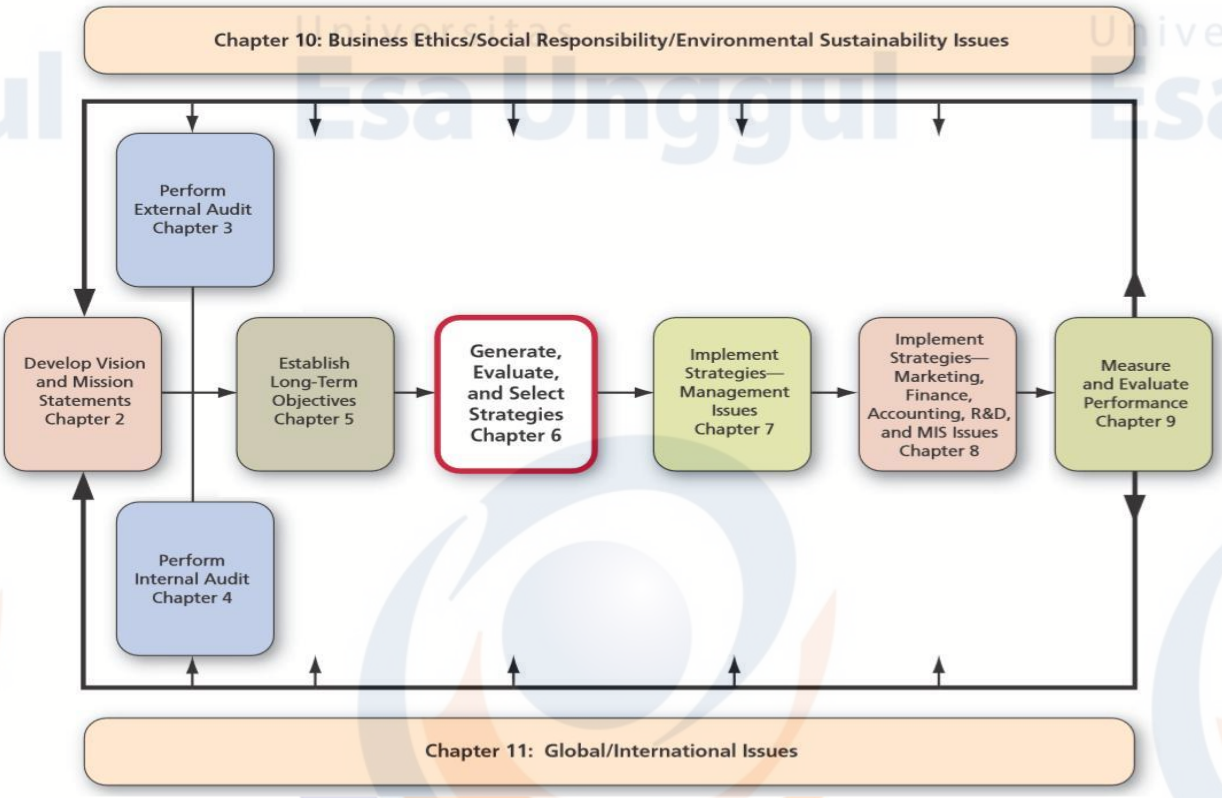
As indicated by Figure 6-1, this chapter focuses on generating and evaluating alternative strategies, as well as selecting strategies to pursue. Strategy analysis and choice seek to determine alternative courses of action that could best enable the firm to achieve its mission and objectives. The firm's present strategies, objectives, and mission, coupled with the external and internal audit information, provide a basis for generating and evaluating feasible alternative strategies. Unless a desperate situation confronts the firm, alternative strategies will likely represent incremental steps that move the firm from its present position to a desired future position. Alternative strategies do not come out of the wild blue yonder; they are derived from the firm's vision, mission, objectives, external audit, and internal audit; they are consistent with, or build on, past strategies that have worked well.

The Process of Generating and Selecting Strategies

Strategists never consider all feasible alternatives that could benefit the firm because there are an infinite number of possible actions and an infinite number of ways to implement those actions. Therefore, a manageable set of the most attractive alternative strategies must be developed. The advantages, disadvantages, trade-offs, costs, and benefits of these strategies should be determined. This section discusses the process that many firms use to determine an appropriate set of alternative strategies. Identifying and evaluating alternative strategies should involve many of the managers and employees who earlier assembled the organizational vision and mission statements, performed the external audit, and conducted the internal audit. Representatives from each department and division of the firm should be included in this process, as was the case in previous strategy-formulation activities. Recall that involvement provides the best opportunity for managers and employees to gain an understanding of what the firm is doing and why and to become committed to helping the firm accomplish its objectives. All participants in the strategy analysis and choice activity should have the firm's external and internal audit information by their sides. This information, coupled with the firm's mission statement, will help participants crystallize in their own minds particular strategies that they believe could benefit the firm most. Creativity should be encouraged in this thought process. Alternative strategies proposed by participants should be considered and discussed in a meeting or series of meetings. Proposed strategies should be listed in writing. When all feasible strategies identified by participants are given and understood, the strategies should be ranked in order of attractiveness by all participants, with 1 = should not be implemented, 2 = possibly should be implemented, 3 = probably should be implemented, and 4 = definitely should be implemented. This process will result in a prioritized list of best strategies that reflects the collective wisdom of the group.

FIGURE 6-1

A Comprehensive Strategic-Management Model

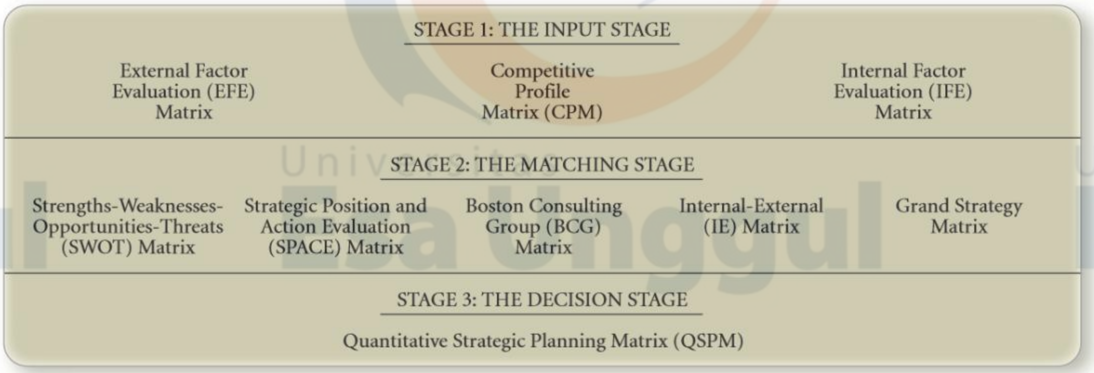


A Comprehensive Strategy-Formulation Framework

Important strategy-formulation techniques can be integrated into a three-stage decisionmaking framework, as shown in Figure 6-2. The tools presented in this framework are applicable to all sizes and types of organizations and can help strategists identify, evaluate, and select strategies. Stage 1 of the formulation framework consists of the EFE Matrix, the IFE Matrix, and the Competitive Profile Matrix (CPM). Called the Input Stage,Stage 1 summarizes the basic input information needed to formulate strategies. Stage 2, called the Matching Stage, focuses upon generating feasible alternative strategies by aligning key external and internal factors. Stage 2 techniques include the Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix, the Strategic Position and Action Evaluation (SPACE) Matrix, the Boston Consulting Group (BCG) Matrix, the Internal-External (IE) Matrix, and the Grand Strategy Matrix. Stage 3, called the Decision Stage, involves a single technique, the Quantitative Strategic Planning Matrix (QSPM). A QSPM uses input information from Stage 1 to objectively evaluate feasible alternative strategies identified in Stage 2. A QSPM reveals the relative attractiveness of alternative strategies and thus provides objective basis for selecting specific strategies.

FIGURE 6-2

The Strategy-Formulation Analytical Framework



All nine techniques included in the strategy-formulation framework require the integration of intuition and analysis. Autonomous divisions in an organization commonly use strategy-formulation techniques to develop strategies and objectives. Divisional analyses provide a basis for identifying, evaluating, and selecting among alternative corporate-level strategies. Strategists themselves, not analytic tools, are always responsible and accountable for strategic decisions. Lenz emphasized that the shift from a words-oriented to a numbersoriented planning process can give rise to a false sense of certainty; it can reduce dialogue, discussion, and argument as a means for exploring understandings, testing assumptions, and fostering organizational learning.1 Strategists, therefore, must be wary of this possibility and use analytical tools to facilitate, rather than to diminish, communication. Without objective information and analysis, personal biases, politics, emotions, personalities, and halo error (the tendency to put too much weight on a single factor) unfortunately may play a dominant role in the strategy-formulation process.

The Input Stage

Procedures for developing an EFE Matrix, an IFE Matrix, and a CPM were presented in Chapters 3 and 4. The information derived from these three matrices provides basic input information for the matching and decision stage matrices described later in this chapter. The input tools require strategists to quantify subjectivity during early stages of the strategy-formulation process. Making small decisions in the input matrices regarding the relative importance of external and internal factors allows strategists to more effectively generate and evaluate alternative strategies. Good intuitive judgment is always needed in determining appropriate weights and ratings.

The Matching Stage

Strategy is sometimes defined as the match an organization makes between its internal resources and skills and the opportunities and risks created by its external factors.2 The matching stage of the strategy-formulation framework consists of five techniques that can be used in any sequence: the SWOT Matrix, the SPACE Matrix, the BCG Matrix, the IE Matrix, and the Grand Strategy Matrix. These tools rely upon information derived from the input stage to match external opportunities and threats with internal strengths and weaknesses. Matching external and internal critical success factors is the key to effectively generating feasible alternative strategies. For example, a firm with excess working capital (an internal strength) could take advantage of the cell phone industry's 20 percent annual growth rate (an external opportunity) by acquiring Cellfone, Inc., a firm in the cell phone industry.

TABLE 6-1 Matching Key External and Internal Factors to Formulate Alternative Strategies

Key Internal Factor		Key External Factor		Resultant Strategy
Excess working capital (an internal strength)	+	20 percent annual growth in the cell phone industry (an external opportunity)	=	Acquire Cellfone, Inc.
Insufficient capacity (an internal weakness)	+	Exit of two major foreign competitors from the industry (an external opportunity)	=	Pursue horizontal integration by buying competitors' facilities
Strong R&D expertise (an internal strength)	+	Decreasing numbers of younger adults (an external threat)	=	Develop new products for older adults
Poor employee morale (an internal weakness)	+	Rising healthcare costs (an external threat)	=	Develop a new wellness program

This example portrays simple one-to-one matching. In most situations, external and internal relationships are more complex, and the matching requires multiple alignments for each strategy generated. The basic concept of matching is illustrated in Table 6-1. Any organization, whether military, product-oriented, service-oriented, governmental, or even athletic, must develop and execute good strategies to win. A good offense without a good defense, or vice versa, usually leads to defeat. Developing strategies that use strengths to capitalize on opportunities could be considered an offense, whereas strategies designed to improve upon weaknesses while avoiding threats could be termed defensive. Every organization has some external opportunities and threats and internal strengths and weaknesses that can be aligned to formulate feasible alternative strategies.

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix

The Strengths-Weaknesses-Opportunities-Threats (SWOT) Matrix is an important matching tool that helps managers develop four types of strategies: SO (strengths-opportunities) Strategies, WO (weaknesses-opportunities) Strategies, ST (strengths-threats) Strategies, and WT (weaknesses-threats) Strategies.3 Matching key external and internal factors is the most difficult part of developing a SWOT Matrix and requires good judgment—and there is no one best set of matches. Note in Table 6-1 that the first, second, third, and fourth strategies are SO, WO, ST, and WT strategies, respectively. SO Strategies use a firm's internal strengths to take advantage of external opportunities. All managers would like their organizations to be in a position in which internal strengths can be used to take advantage of external trends and events. Organizations generally will pursue WO, ST, or WT strategies to get into a situation in which they can apply SO Strategies. When a firm has major weaknesses, it will strive to overcome them and make them strengths. When an organization faces major threats, it will seek to avoid them to concentrate on opportunities. WO Strategies aim at improving internal weaknesses by taking advantage of external opportunities. Sometimes key external opportunities exist, but a firm has internal weaknesses that prevent it from exploiting those opportunities. For example, there may be a high demand for electronic devices to control the amount and timing of fuel injection in automobile engines (opportunity), but a certain auto parts manufacturer may lack the technology required for producing these devices (weakness). One possible WO Strategy would be to acquire this technology by forming a joint venture with a firm having competency in this area. An alternative WO Strategy would be to hire and train people with the required technical capabilities. ST Strategies use a firm's strengths to avoid or reduce the impact of external threats. This does not mean that a strong organization should always meet threats in the external environment head-on. An example of ST Strategy occurred when Texas Instruments used an excellent legal department (a strength) to collect nearly $700 million in damages and royalties from nine Japanese and Korean firms that infringed on patents for semiconductor memory chips (threat).

Rival firms that copy ideas, innovations, and patented products are a major threat in many industries. This is still a major problem for U.S. firms selling products in China. WT Strategies are defensive tactics directed at reducing internal weakness and avoiding external threats. An organization faced with numerous external threats and internal weaknesses may indeed be in a precarious position. In fact, such a firm may have to fight for its survival, merge, retrench, declare bankruptcy, or choose liquidation. A schematic representation of the SWOT Matrix is provided in Figure 6-3. Note that a SWOT Matrix is composed of nine cells. As shown, there are four key factor cells, four strategy cells, and one cell that is always left blank (the upper-left cell). The four strategy cells, labeled SO, WO, ST, and WT, are developed after completing four key factor cells, labeled S, W, O, and T. There are eight steps involved in constructing a SWOT Matrix:

1. List the firm's key external opportunities.
2. List the firm's key external threats.
3. List the firm's key internal strengths.
4. List the firm's key internal weaknesses.
5. Match internal strengths with external opportunities, and record the resultant SO Strategies in the appropriate cell.
6. Match internal weaknesses with external opportunities, and record the resultant WO Strategies.

7. Match internal strengths with external threats, and record the resultant ST Strategies.
8. Match internal weaknesses with external threats, and record the resultant WT Strategies.

Some important aspects of a SWOT Matrix are evidenced in Figure 6-3. For example, note that both the internal/external factors and the SO/ST/WO/WT Strategies are stated in quantitative terms to the extent possible. This is important. For example, regarding the second SO #2 and ST #1 strategies, if the analyst just said, "Add new repair/service persons," the reader might think that 20 new repair/service persons are needed. Actually only two are needed. Always be specific to the extent possible in stating factors and strategies. It is also important to include the "S1, O2" type notation after each strategy in a SWOT Matrix. This notation reveals the rationale for each alternative strategy. Strategies do not rise out of the blue. Note in Figure 6-3how this notation reveals the internal/external factors that were matched to formulate desirable strategies. For example, note that this retail computer store business may need to "purchase land to build new store" because a new Highway 34 will make its location less desirable. The notation (W2, O2) and (S8, T3) in Figure 6-3 exemplifies this matching process. The purpose of each Stage 2 matching tool is to generate feasible alternative strategies, not to select or determine which strategies are best. Not all of the strategies developed in the SWOT Matrix, therefore, will be selected for implementation. The strategy-formulation guidelines provided in Chapter 5 can enhance the process of matching key external and internal factors. For example, when an organization has both the capital and human resources needed to distribute its own products (internal strength) and distributors are unreliable, costly, or incapable of meeting the firm's needs (external threat), forward integration can be an attractive ST Strategy. When a firm has excess production capacity (internal weakness) and its basic industry is experiencing declining annual sales and profits (external threat), related diversification can be an effective WT Strategy. Although the SWOT matrix is widely used in strategic planning, the analysis does have some limitations.4 First, SWOT does not show how to achieve a competitive advantage, so it must not be an end in itself. The matrix should be the starting point for a discussion on how proposed strategies could be implemented as well as cost-benefit considerations that ultimately could lead to competitive advantage. Second, SWOT is a static assessment (or snapshot) in time. A SWOT matrix can be like studying a single frame of a motion picture where you see the lead characters and the setting but have no clue as to the plot. As circumstances, capabilities, threats, and strategies change, the dynamics of a competitive environment may not be revealed in a single matrix.

FIGURE 6-3

A SWOT Matrix for a Retail Computer Store

	Strengths	Weaknesses
	1. Inventory turnover up 5.8 to 6.7 2. Average customer purchase up $97 to $128 3. Employee morale is excellent 4. In-store promotions = 20% increase in sales 5. Newspaper advertising expenditures down 10% 6. Revenues from repair/service in-store up 16% 7. In-store technical support persons have MIS degrees 8. Store's debt-to-total assets ratio down 34%	1. Software revenues in store down 12% 2. Location of store hurt by new Hwy 34 3. Carpet and paint in store in disrepair 4. Bathroom in store needs refurbishing 5. Total store revenues down 8% 6. Store has no Web site 7. Supplier on-time-delivery up to 2.4 days 8. Customer checkout process too slow 9. Revenues per employee up 19%
Opportunities	**SO Strategies**	**WO Strategies**
1. Population of city growing 10% 2. Rival computer store opening 1 mile away 3. Vehicle traffic passing store up 12% 4. Vendors average six new products/yr 5. Senior citizen use of computers up 8% 6. Small business growth in area up 10% 7. Desire for Web sites up 18% by Realtors 8. Desire for Web sites up 12% by small firms	1. Add 4 new in-store promotions monthly (S4,O3) 2. Add 2 new repair/service persons (S6, O5) 3. Send flyer to all seniors over age 55 (S5, O5)	1. Purchase land to build new store (W2, O2) 2. Install new carpet/paint/bath (W3, W4, O1) 3. Up Web site services by 50% (W6, O7, O8) 4. Launch mailout to all Realtors in city (W5, O7)
Threats	**ST Strategies**	**WT Strategies**
1. Best Buy opening new store in 1yr nearby 2. Local university offers computer repair 3. New bypass Hwy 34 in 1 yr will divert traffic 4. New mall being built nearby 5. Gas prices up 14% 6. Vendors raising prices 8%	1. Hire two more repair persons and market these new services (S6, S7, T1) 2. Purchase land to build new store (S8, T3) 3. Raise out-of-store service calls from $60 to $80 (S6, T5)	1. Hire 2 new cashiers (W8, T1, T4) 2. Install new carpet/paint/bath (W3, W4, T1)

Third, SWOT analysis may lead the firm to overemphasize a single internal or external factor in formulating strategies. There are interrelationships among the key internal and external factors that SWOT does not reveal that may be important in devising strategies.

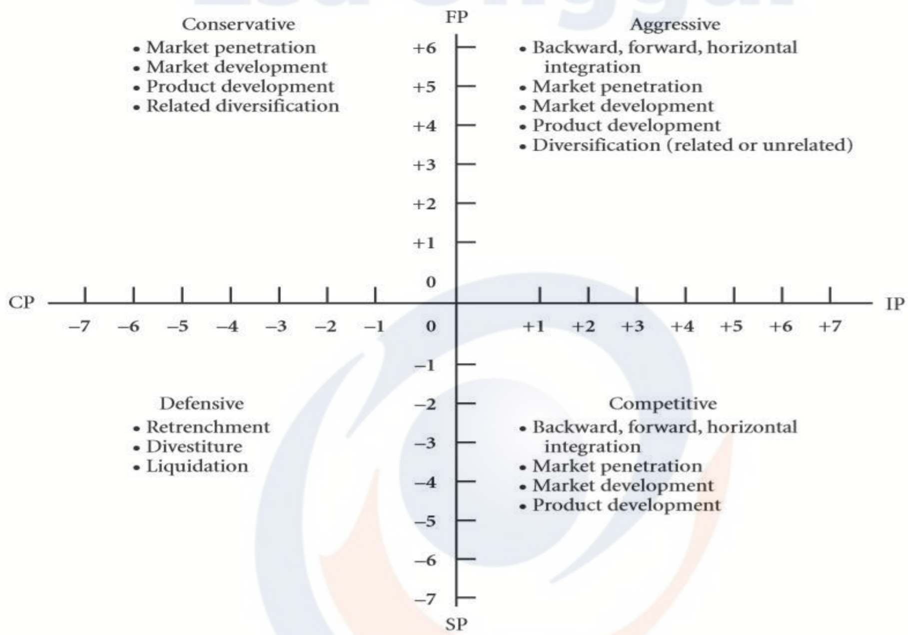
The Strategic Position and Action Evaluation (SPACE) Matrix

The Strategic Position and Action Evaluation (SPACE) Matrix, another important Stage 2 matching tool, is illustrated in Figure 6-4. Its four-quadrant framework indicates whether aggressive, conservative, defensive, or competitive strategies are most appropriate for a given organization. The axes of the SPACE Matrix represent two internal dimensions (financial position [FP] and competitive position [CP]) and two external dimensions (stability position [SP]and industry position [IP]). These four factors are perhaps the most important determinants of an organization’s overall strategic position.5

Depending on the type of organization, numerous variables could make up each of the dimensions represented on the axes of the SPACE Matrix. Factors that were included earlier in the firm’s EFE and IFE Matrices should be considered in developing a SPACE Matrix. Other variables commonly included are given in Table 6-2. For example, return on investment, leverage, liquidity, working capital, and cash flow are commonly considered to be determining factors of an organization’s financial strength. Like the SWOT Matrix, the SPACE Matrix should be both tailored to the particular organization being studied and based on factual information as much as possible.

FIGURE 6-4

The SPACE Matrix



Source: Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155.

TABLE 6-2 Example Factors That Make Up the SPACE Matrix Axes

Internal Strategic Position	External Strategic Position
Financial Position (FP)	*Stability Position (SP)*
Return on investment	Technological changes
Leverage	Rate of inflation
Liquidity	Demand variability
Working capital	Price range of competing products
Cash flow	Barriers to entry into market
Inventory turnover	Competitive pressure
Earnings per share	Ease of exit from market
Price earnings ratio	Price elasticity of demand
	Risk involved in business
Competitive Position (CP)	*Industry Position (IP)*
Market share	Growth potential
Product quality	Profit potential
Product life cycle	Financial stability
Customer loyalty	Extent leveraged
Capacity utilization	Resource utilization
Technological know-how	Ease of entry into market
Control over suppliers and distributors	Productivity, capacity utilization

Source: Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155–156.

The steps required to develop a SPACE Matrix are as follows:

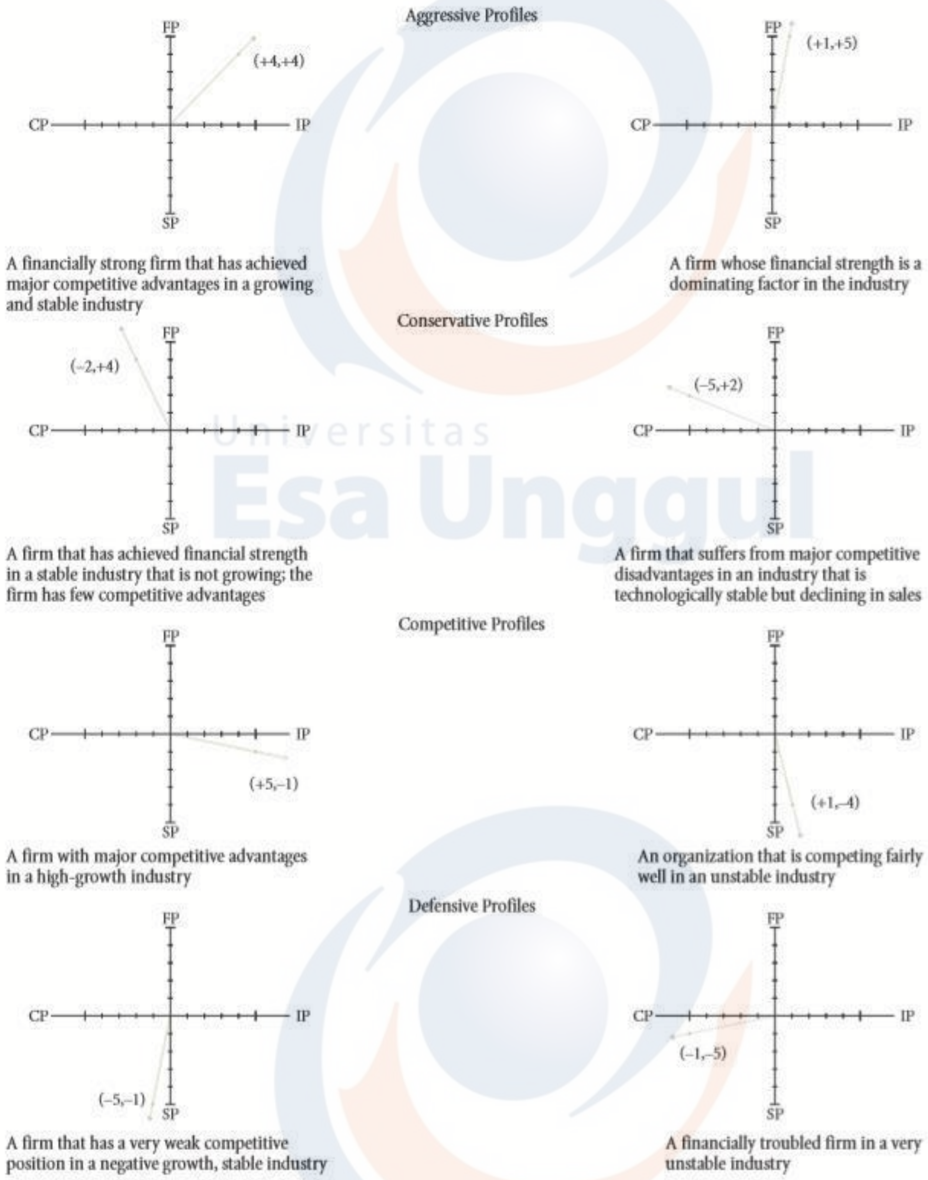
1. Select a set of variables to define financial position (FP), competitive position (CP), stability position (SP), and industry position (IP).
2. Assign a numerical value ranging from +1 (worst) to +7 (best) to each of the variables that make up the FP and IP dimensions. Assign a numerical value ranging from -1 (best) to -7 (worst) to each of the variables that make up the SP and CP dimensions. On the FP and CP axes, make comparison to competitors. On the IP and SP axes, make comparison to other industries.
3. Compute an average score for FP, CP, IP, and SP by summing the values given to the variables of each dimension and then by dividing by the number of variables included in the respective dimension.
4. Plot the average scores for FP, IP, SP, and CP on the appropriate axis in the SPACE Matrix.
5. Add the two scores on the x-axis and plot the resultant point on X. Add the two scores on the y-axis and plot the resultant point on Y. Plot the intersection of the new xy point.

6. Draw a directional vector from the origin of the SPACE Matrix through the new intersection point. This vector reveals the type of strategies recommended for the organization: aggressive, competitive, defensive, or conservative.

Some examples of strategy profiles that can emerge from a SPACE analysis are shown in Figure 6-5. The directional vector associated with each profile suggests the type of strategies to pursue: aggressive, conservative, defensive, or competitive. When a firm's directional vector is located in the aggressive quadrant(upper-right quadrant) of the SPACE Matrix, an organization is in an excellent position to use its internal strengths to (1) take advantage of external opportunities, (2) overcome internal weaknesses, and (3) avoid external threats. Therefore, market penetration, market development, product development, backward integration, forward integration, horizontal integration, or diversification, can be feasible, depending on the specific circumstances that face the firm.

FIGURE 6-5

Example Strategy Profiles



Source: Adapted from H. Rowe, R. Mason, and K. Dickel, *Strategic Management and Business Policy: A Methodological Approach* (Reading, MA: Addison-Wesley Publishing Co. Inc., © 1982): 155.

When a particular company is known, the analyst must be much more specific in terms of implied strategies. For example, instead of saying market penetration is a recommended strategy when your vector goes in the Conservative quadrant, say that adding 34 new stores in India is a recommended strategy. This is a very important point for students doing case analyses because a particular company is generally known, and terms such as market development are too vague to use. That term could refer to adding a manufacturing plant in Thailand or Mexico or South Africa—so students—Be specific to the extent possible regarding implications of all the matrices presented in Chapter 6.

The directional vector may appear in the conservative quadrant (upper-left quadrant) of the SPACE Matrix, which implies staying close to the firm's basic competencies and not taking excessive risks. Conservative strategies most often include market penetration, market development, product development, and related diversification. The directional vector may be located in the lower-left or defensive quadrant of the SPACE Matrix, which suggests that the firm should focus on rectifying internal weaknesses and avoiding external threats. Defensive strategies include retrenchment, divestiture, liquidation, and related diversification. Finally, the directional vector may be located in the lower-right or competitive quadrantof the SPACE Matrix, indicating competitive strategies. Competitive strategies include backward, forward, and horizontal integration; market penetration; market development and product development.

A SPACE Matrix analysis for a bank is provided in Table 6-3. Note that competitive type strategies are recommended.

TABLE 6-3 A SPACE Matrix for a Bank

Financial Position (FP)	Ratings
The bank's primary capital ratio is 7.23 percent, which is 1.23 percentage points over the generally required ratio of 6 percent.	1.0
The bank's return on assets is negative 0.77, compared to a bank industry average ratio of positive 0.70.	1.0
The bank's net income was $183 million, down 9 percent from a year earlier.	3.0
The bank's revenues increased 7 percent to $3.46 billion.	4.0
	9.0
Industry Position (IP)	
Deregulation provides geographic and product freedom.	4.0
Deregulation increases competition in the banking industry.	2.0
Pennsylvania's interstate banking law allows the bank to acquire other banks in New Jersey, Ohio, Kentucky, the District of Columbia, and West Virginia.	4.0
	10.0
Stability Position (SP)	
Less-developed countries are experiencing high inflation and political instability.	−4.0
Headquartered in Pittsburgh, the bank historically has been heavily dependent on the steel, oil, and gas industries. These industries are depressed.	−5.0
Banking deregulation has created instability throughout the industry.	−4.0
	−13.0
Competitive Position (CP)	
The bank provides data processing services for more than 450 institutions in 38 states.	−2.0
Superregional banks, international banks, and nonbanks are becoming increasingly competitive.	−5.0
The bank has a large customer base.	−2.0
	−9.0

Conclusion

SP Average is $-13.0 \div 3 = -4.33$ IP Average is $+10.0 \div 3 = 3.33$

CP Average is $-9.0 \div 3 = -3.00$ FP Average is $+9.0 \div 4 = 2.25$

Directional Vector Coordinates: x-axis: $-3.00 + (+3.33) = +0.33$

y-axis: $-4.33 + (+2.25) = -2.08$

The bank should pursue Competitive Strategies.

The Boston Consulting Group (BCG) Matrix

Autonomous divisions (or profit centers) of an organization make up what is called a business portfolio. When a firm's divisions compete in different industries, a separate strategy often must be developed for each business. The Boston Consulting Group (BCG) Matrix and the Internal-External (IE) Matrix are designed specifically to enhance a multidivisional firm's efforts to formulate strategies. (BCG is a private management consulting firm based in Boston. BCG employs about 4,300 consultants worldwide.)

In a Form 10K or Annual Report, some companies do not disclose financial information by segment, so a BCG portfolio analysis is not possible by external entities. Reasons to disclose by-division financial information in the author's view, however, more than offset the reasons not to disclose, as indicated in Table 6-4.

The BCG Matrix graphically portrays differences among divisions in terms of relative market share position and industry growth rate. The BCG Matrix allows a multidivisional organization to manage its portfolio of businesses by examining the relative market share position and the industry growth rate of each division relative to all other divisions in the organization.

Relative market share position is defined as the ratio of a division's own market share (or revenues) in a particular industry to the market share (or revenues) held by the largest rival firm in that industry. Note in Table 6-5 that other variables can be in this analysis besides revenues. Relative market share position for Heineken could also be determined by dividing Heineken's revenues by the leader Corona Extra's revenues. Relative market share position is given on the x-axis of the BCG Matrix. The midpoint on the x-axis usually is set at .50, corresponding to a division that has half the market share of the leading firm in the industry. The y-axis represents the industry growth rate in sales, measured in percentage terms. The growth rate percentages on the y-axis could range from -20 to +20 percent, with 0.0 being the midpoint. The average annual increase in revenues for several leading firms in the industry would be a good estimate of the value. Also, various sources such as the S&P Industry Survey would provide this value. These numerical ranges on the x- and y-axes are often used, but other numerical values could be established as deemed appropriate for particular organizations, such as –10 to +10 percent.

The basic BCG Matrix appears in Figure 6-6. Each circle represents a separate division. The size of the circle corresponds to the proportion of corporate revenue generated by that business unit, and the pie slice indicates the proportion of corporate profits generated by that division. Divisions located in Quadrant I of the BCG Matrix are called "Question Marks," those located in Quadrant II are called "Stars," those located in Quadrant III are called "Cash Cows," and those divisions located in Quadrant IV are called "Dogs."

1. Question Marks—Divisions in Quadrant I have a low relative market share position, yet they compete in a high-growth industry. Generally these firms' cash needs are high and their cash generation is low. These businesses are called Question Marks because the organization must decide whether to strengthen them by pursuing an intensive strategy (market penetration, market development, or product development) or to sell them.

TABLE 6-4 Reasons to (or Not to) Disclose Financial Information by Segment (by Division)

Reasons to Disclose	Reasons Not to Disclose
1. Transparency is a good thing in today's world of Sarbanes-Oxley	1. Can become free competitive information for rival firms
2. Investors will better understand the firm, which can lead to greater support	2. Can hide performance failures
3. Managers/employees will better understand the firm, which should lead to greater commitment	3. Can reduce rivalry among segments
4. Disclosure enhances the communication process both within the firm and with outsiders	

TABLE 6-5 Market Share Data for Selected Industries in 2009

U.S. Top Five Airlines by Number of Passengers Boarded in 2008 (in millions; estimate)	
Southwest	7.5
American	5.0
Delta	4.5
United	4.0
US Airways	3.5
U.S. Top Five Imported Beers in 2008 (in millions of barrels imported)	
Corona Extra	8.0
Heineken	5.0
Modelo Especial	2.0
Tecate	1.5
Guinness	1.0

Source: Based on David Kesmodel, "U.S. Beer Imports Lose Their Fizz," *Wall Street Journal* (February 20, 2009): B5; S&P Industry Surveys and Company *Form 10-K* Reports.

2. Stars—Quadrant II businesses (Stars) represent the organization's best long-run opportunities for growth and profitability. Divisions with a high relative market share and a high industry growth rate should receive substantial investment to maintain or strengthen their dominant positions. Forward, backward, and horizontal integration;

market penetration; market development; and product development are appropriate strategies for these divisions to consider, as indicated in Figure 6-6.

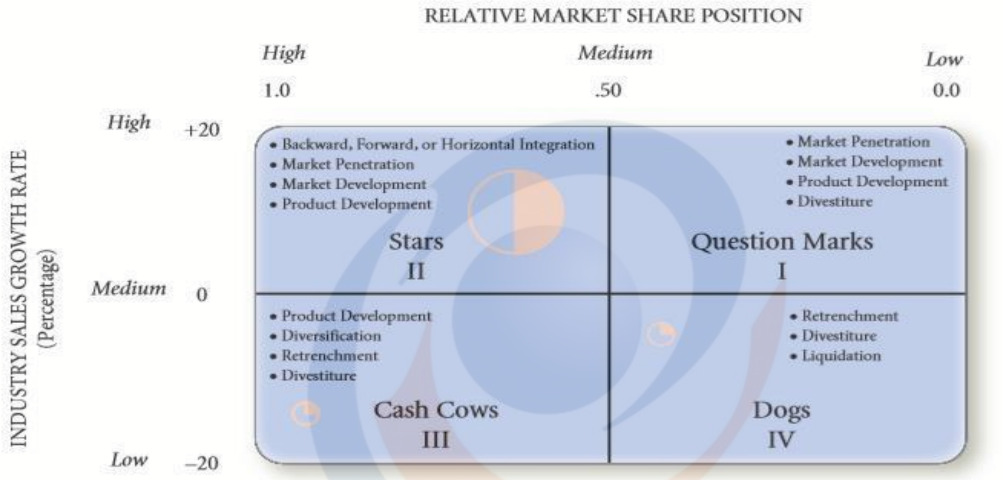
3. Cash Cows—Divisions positioned in Quadrant III have a high relative market share position but compete in a low-growth industry. Called Cash Cows because they generate cash in excess of their needs, they are often milked. Many of today's Cash Cows were yesterday's Stars. Cash Cow divisions should be managed to maintain their strong position for as long as possible. Product development or diversification may be attractive strategies for strong Cash Cows. However, as a Cash Cow division becomes weak, retrenchment or divestiture can become more appropriate.

4. Dogs—Quadrant IV divisions of the organization have a low relative market share position and compete in a slow- or no-market-growth industry; they are Dogs in the firm's portfolio.

   Because of their weak internal and external position, these businesses are often liquidated, divested, or trimmed down through retrenchment. When a division first becomes a Dog, retrenchment can be the best strategy to pursue because many Dogs have bounced back, after strenuous asset and cost reduction, to become viable, profitable divisions.

FIGURE 6-6

The BCG Matrix



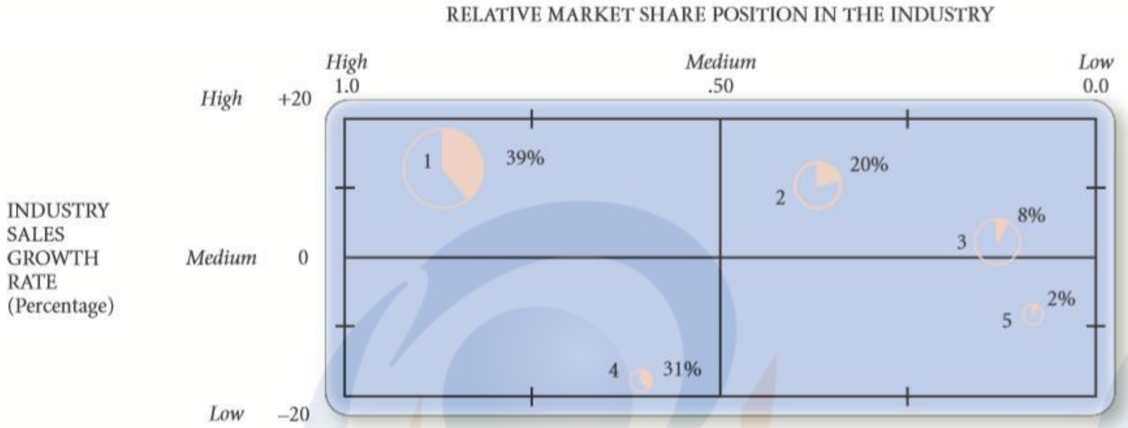
Source: Adapted from the BCG Portfolio Matrix from the Product Portfolio Matrix, © 1970, The Boston Consulting Group.

The major benefit of the BCG Matrix is that it draws attention to the cash flow, investment characteristics, and needs of an organization's various divisions. The divisions of many firms evolve over time: Dogs become Question Marks, Question Marks become Stars, Stars become Cash Cows, and Cash Cows become Dogs in an ongoing counterclockwise motion. Less frequently, Stars become Question Marks, Question Marks become Dogs, Dogs become Cash Cows, and Cash Cows become Stars (in a clockwise motion). In some organizations, no cyclical motion is apparent. Over time, organizations should strive to achieve a portfolio of divisions that are Stars.

An example BCG Matrix is provided in Figure 6-7, which illustrates an organization composed of five divisions with annual sales ranging from \$5,000 to \$60,000. Division 1 has the greatest sales volume, so the circle representing that division is the largest one in the matrix. The circle corresponding to Division 5 is the smallest because its sales volume ($5,000) is least among all the divisions. The pie slices within the circles reveal the percent of corporate profits contributed by each division. As shown, Division 1 contributes the highest profit percentage, 39 percent. Notice in the diagram that Division 1 is considered a Star, Division 2 is a Question Mark, Division 3 is also a Question Mark, Division 4 is a Cash Cow, and Division 5 is a Dog.

FIGURE 6-7

An Example BCG Matrix



Division	Revenues	Percent Revenues	Profits	Percent Profits	Relative Market Share	Industry Growth Rate (%)
1	$60,000	37	$10,000	39	.80	+15
2	40,000	24	5,000	20	.40	+10
3	40,000	24	2,000	8	.10	+1
4	20,000	12	8,000	31	.60	–20
5	5,000	3	500	2	.05	–10
Total	**$165,000**	**100**	**$25,500**	**100**	—	—

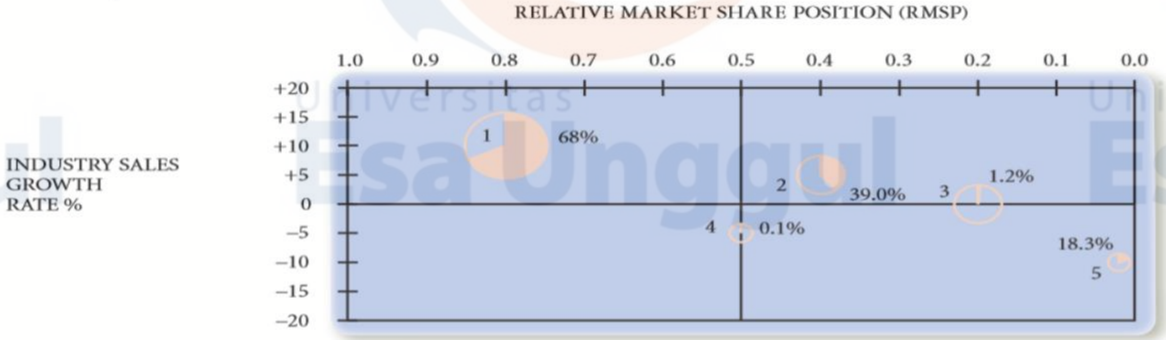
The BCG Matrix, like all analytical techniques, has some limitations. For example, viewing every business as either a Star, Cash Cow, Dog, or Question Mark is an oversimplification; many businesses fall right in the middle of the BCG Matrix and thus are not easily classified. Furthermore, the BCG Matrix does not reflect whether or not various divisions or their industries are growing over time; that is, the matrix has no temporal qualities, but rather it is a snapshot of an organization at a given point in time. Finally, other variables besides relative market share position and industry growth rate in sales, such as size of the market and competitive advantages, are important in making strategic decisions about various divisions. An example BCG Matrix is provided in Figure 6-8. Note in Figure 6-8 that Division 5 had an operating loss of $188 million. Take note how the percent profit column is still calculated because oftentimes a firm will have a division that incurs a loss for a year. In terms of the pie slice in circle 5 of the diagram, note that it is a different color from the positive profit segments in the other circles.

The Internal-External (IE) Matrix T

he Internal-External (IE) Matrix positions an organization’s various divisions in a ninecell display, illustrated in Figure 6-9. The IE Matrix is similar to the BCG Matrix in that both tools involve plotting organization divisions in a schematic diagram; this is why they are both called “portfolio matrices.” Also, the size of each circle represents the percentage sales contribution of each division, and pie slices reveal the percentage profit contribution of each division in both the BCG and IE Matrix. But there are some important differences between the BCG Matrix and the IE Matrix. First, the axes are different. Also, the IE Matrix requires more information about the divisions than the BCG Matrix. Furthermore, the strategic implications of each matrix are different. For these reasons, strategists in multidivisional firms often develop both the BCG Matrix and the IE Matrix in formulating alternative strategies. A common practice is to develop a BCG Matrix and an IE Matrix for the present and then develop projected matrices to reflect expectations of the future. This before-and-after analysis forecast the expected effect of strategic decisions on an organization’s portfolio of divisions.

FIGURE 6-8

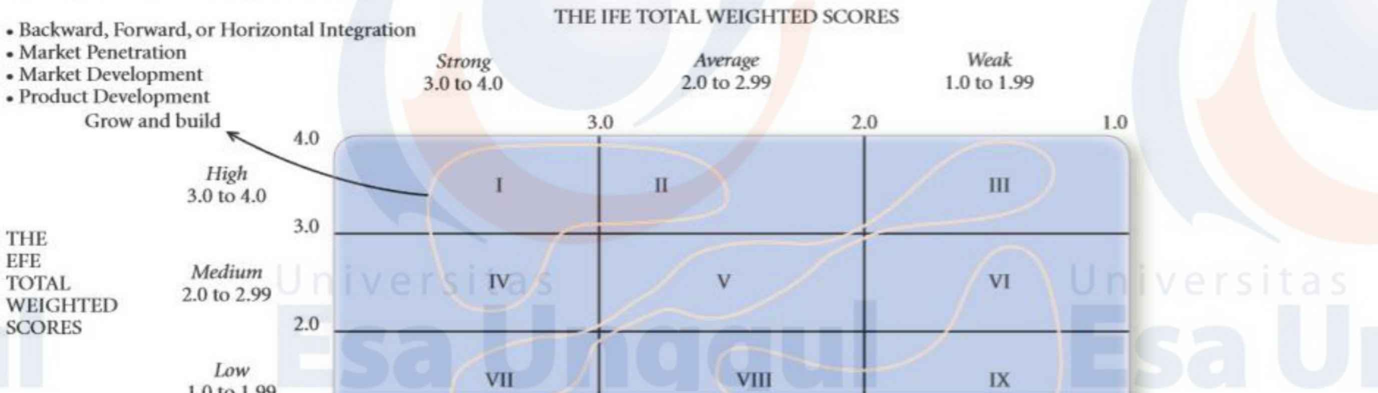
An Example BCG Matrix



Division	*$ Sales (millions)*	*% Sales*	*$ Profits (millions)*	*% Profits*	*RMSP*	*IG Rate %*
1.	$5,139	51.5	$799	68.0	0.8	10
2.	2,556	25.6	400	39.0	0.4	05
3.	1,749	17.5	12	1.2	0.2	00
4.	493	4.9	4	0.1	0.5	–05
5.	42	0.5	–188	(18.3)	.02	–10
Total	$9,979	100.0	$1,027	100.0		

FIGURE 6-9

The Internal–External (IE) Matrix



The IE Matrix is based on two key dimensions: the IFE total weighted scores on the x-axis and the EFE total weighted scores on the y-axis. Recall that each division of an organization should construct an IFE Matrix and an EFE Matrix for its part of the organization. The total weighted scores derived from the divisions allow construction of the corporate-level IE Matrix. On the x-axis of the IE Matrix, an IFE total weighted score of 1.0 to 1.99 represents a weak internal position; a score of 2.0 to 2.99 is considered average; and a score of 3.0 to 4.0 is strong. Similarly, on the y-axis, an EFE total weighted score of 1.0 to 1.99 is considered low; a score of 2.0 to 2.99 is medium; and a score of 3.0 to 4.0 is high.

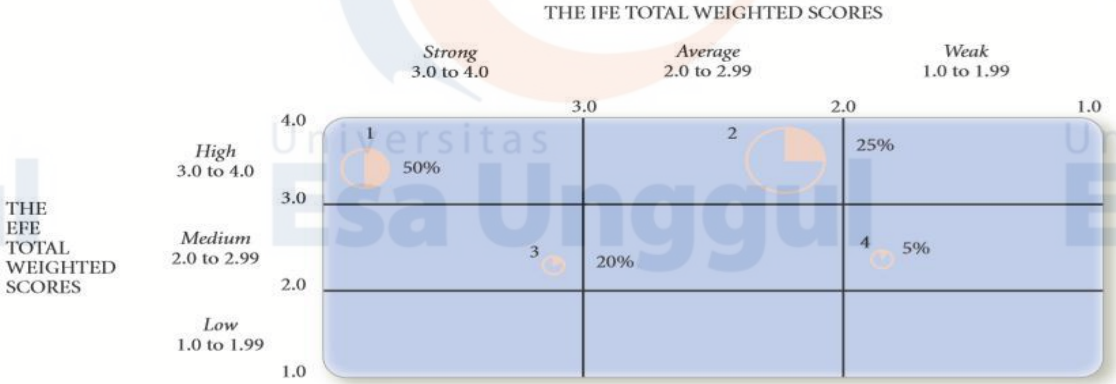
The IE Matrix can be divided into three major regions that have different strategy implications. First, the prescription for divisions that fall into cells I, II, or IV can be described as grow and build. Intensive (market penetration, market development, and product development) or integrative (backward integration, forward integration, and horizontal integration) strategies can be most appropriate for these divisions. Second, divisions that fall into cells III, V, or VII can be managed best with hold and maintain strategies; market penetration and product development are two commonly employed strategies for these types of divisions. Third, a common prescription for divisions that fall into cells VI, VIII, or IX is harvest or divest. Successful organizations are able to achieve a portfolio of businesses positioned in or around cell I in the IE Matrix.

An example of a completed IE Matrix is given in Figure 6-10, which depicts an organization composed of four divisions. As indicated by the positioning of the circles, grow and build strategies are appropriate for Division 1, Division 2, and Division 3. Division 4 is a candidate for harvest or divest. Division 2 contributes the greatest percentage of company sales and thus is represented by the largest circle. Division 1 contributes the greatest proportion of total profits; it has the largest-percentage pie slice.

As indicated in Figure 6-11, the IE Matrix has five product segments. Note that Division #1 has the largest revenues (as indicated by the largest circle) and the largest profits (as indicated by the largest pie slice) in the matrix. It is common for organizations to develop both geographic and product-based IE Matrices to more effectively formulate strategies and allocate resources among divisions. In addition, firms often prepare an IE (or BCG) Matrix for competitors. Furthermore, firms will often prepare "before and after" IE (or BCG) Matrices to reveal the situation at present versus the expected situation after one year. This latter idea minimizes the limitation of these matrices being a "snapshot in time." In performing case analysis, feel free to estimate the IFE and EFE scores for the various divisions based upon your research into the company and industry—rather than preparing a separate IE Matrix for each division.

FIGURE 6-10

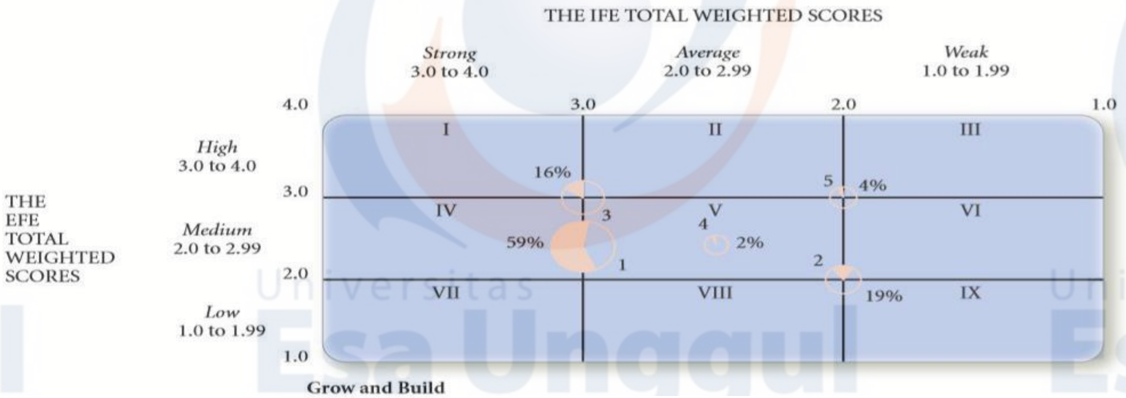
An Example IE Matrix



Division	Sales	Percent Sales	Profits	Percent Profits	IFE Scores	EFE Scores
1	$100	25.0	10	50	3.6	3.2
2	200	50.0	5	25	2.1	3.5
3	50	12.5	4	20	3.1	2.1
4	50	12.5	1	5	1.8	2.5
Total	**400**	**100.0**	**20**	**100**		

FIGURE 6-11

The IE Matrix



The Grand Strategy Matrix

In addition to the SWOT Matrix, SPACE Matrix, BCG Matrix, and IE Matrix, the Grand Strategy Matrix has become a popular tool for formulating alternative strategies. All organizations can be positioned in one of the Grand Strategy Matrix's four strategy quadrants. A firm's divisions likewise could be positioned. As illustrated in Figure 6-12, the Grand Strategy Matrix is based on two evaluative dimensions: competitive position and market (industry) growth. Any industry whose annual growth in sales exceeds 5 percent could be considered to have rapid growth. Appropriate strategies for an organization to consider are listed in sequential order of attractiveness in each quadrant of the matrix.

Firms located in Quadrant I of the Grand Strategy Matrix are in an excellent strategic position. For these firms, continued concentration on current markets (market penetration and market development) and products (product development) is an appropriate strategy. It is unwise for a Quadrant I firm to shift notably from its established competitive advantages. When a Quadrant I organization has excessive resources, then backward, forward, or horizontal integration may be effective strategies. When a Quadrant I firm is too heavily committed to a single product, then related diversification may reduce the risks associated with a narrow product line. Quadrant I firms can afford to take advantage of external opportunities in several areas. They can take risks aggressively when necessary.

Firms positioned in Quadrant II need to evaluate their present approach to the marketplace seriously. Although their industry is growing, they are unable to compete effectively, and they need to determine why the firm's current approach is ineffective and how the company can

FIGURE 6-12

The Grand Strategy Matrix

best change to improve its competitiveness. Because Quadrant II firms are in a rapid-market-growth industry, an intensive strategy (as opposed to integrative or diversification) is usually the first option that should be considered. However, if the firm is lacking a distinctive competence or competitive advantage, then horizontal integration is often a desirable alternative. As a last resort, divestiture or liquidation should be considered. Divestiture can provide funds needed to acquire other businesses or buy back shares of stock.

Quadrant III organizations compete in slow-growth industries and have weak competitive positions. These firms must make some drastic changes quickly to avoid further decline and possible liquidation. Extensive cost and asset reduction (retrenchment) should be pursued first. An alternative strategy is to shift resources away from the current business into different areas (diversify). If all else fails, the final options for Quadrant III businesses are divestiture or liquidation.

Finally, Quadrant IV businesses have a strong competitive position but are in a slowgrowth industry. These firms have the strength to launch diversified programs into more promising growth areas: Quadrant IV firms have characteristically high cash-flow levels and limited internal growth needs and often can pursue related or unrelated diversification successfully. Quadrant IV firms also may pursue joint ventures.

The Decision Stage

Analysis and intuition provide a basis for making strategy-formulation decisions. The matching techniques just discussed reveal feasible alternative strategies. Many of these strategies will likely have been proposed by managers and employees participating in the strategy analysis and choice activity. Any additional strategies resulting from the matching analyses could be discussed and added to the list of feasible alternative options. As indicated earlier in this chapter, participants could rate these strategies on a 1 to 4 scale so that a prioritized list of the best strategies could be achieved.

The Quantitative Strategic Planning Matrix (QSPM)

Other than ranking strategies to achieve the prioritized list, there is only one analytical technique in the literature designed to determine the relative attractiveness of feasible

alternative actions. This technique is the Quantitative Strategic Planning Matrix (QSPM), which comprises Stage 3 of the strategy-formulation analytical framework.6 This technique objectively indicates which alternative strategies are best. The QSPM uses input from Stage 1 analyses and matching results from Stage 2 analyses to decide objectively among alternative strategies. That is, the EFE Matrix, IFE Matrix, and Competitive Profile Matrix that make up Stage 1, coupled with the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix that make up Stage 2, provide the needed information for setting up the QSPM (Stage 3). The QSPM is a tool that allows strategists to evaluate alternative strategies objectively, based on previously identified external and internal critical success factors. Like other strategy-formulation analytical tools, the QSPM requires good intuitive judgment.

The basic format of the QSPM is illustrated in Table 6-6. Note that the left column of a QSPM consists of key external and internal factors (from Stage 1), and the top row consists of feasible alternative strategies (from Stage 2). Specifically, the left column of a QSPM consists of information obtained directly from the EFE Matrix and IFE Matrix. In a column adjacent to the critical success factors, the respective weights received by each factor in the EFE Matrix and the IFE Matrix are recorded.

The top row of a QSPM consists of alternative strategies derived from the SWOT Matrix, SPACE Matrix, BCG Matrix, IE Matrix, and Grand Strategy Matrix. These matching tools usually generate similar feasible alternatives. However, not every strategy suggested by the matching techniques has to be evaluated in a QSPM. Strategists should use good intuitive judgment in selecting strategies to include in a QSPM.

TABLE 6-6 The Quantitative Strategic Planning Matrix—QSPM

		Strategic Alternatives		
Key Factors	Weight	Strategy 1	Strategy 2	Strategy 3
Key External Factors				
Economy				
Political/Legal/Governmental				
Social/Cultural/Demographic/Environmental				

Conceptually, the QSPM determines the relative attractiveness of various strategies based on the extent to which key external and internal critical success factors are capitalized upon or improved. The relative attractiveness of each strategy within a set of alternatives is computed by determining the cumulative impact of each external and internal critical success factor. Any number of sets of alternative strategies can be included in the QSPM, and any number of strategies can make up a given set, but only strategies within a given set are evaluated relative to each other. For example, one set of strategies may include diversification, whereas another set may include issuing stock and selling a division to raise needed capital. These two sets of strategies are totally different, and the QSPM evaluates strategies only within sets. Note in Table 6-6that three strategies are included, and they make up just one set.

A QSPM for a retail computer store is provided in Table 6-7. This example illustrates all the components of the QSPM: Strategic Alternatives, Key Factors, Weights, Attractiveness Scores (AS), Total Attractiveness Scores (TAS), and the Sum Total Attractiveness Score. The three new terms just introduced—(1) Attractiveness Scores, (2) Total Attractiveness Scores, and (3) the Sum Total Attractiveness Score—are defined and explained as the six steps required to develop a QSPM are discussed:

Step 1 Make a list of the firm's key external opportunities/threats and internal strengths/weaknesses in the left column of the QSPM. This information should be taken directly from the EFE Matrix and IFE Matrix. A minimum of 10 external key success factors and 10 internal key success factors should be included in the QSPM.

Step 2 Assign weights to each key external and internal factor. These weights are identical to those in the EFE Matrix and the IFE Matrix. The weights are presented in a straight column just to the right of the external and internal critical success factors. S

Step 3 Examine the Stage 2 (matching) matrices, and identify alternative strategies that the organization should consider implementing. Record these strategies in the top row of the QSPM. Group the strategies into mutually exclusive sets if possible.

Step 4 Determine the Attractiveness Scores (AS) defined as numerical values that indicate the relative attractiveness of each strategy in a given set of alternatives. Attractiveness Scores (AS) are determined by examining each key external or internal factor, one at a time, and asking the question "Does this factor affect the choice of strategies being made?" If the answer to this question is yes, then the strategies should be compared relative to that key factor. Specifically, Attractiveness Scores should be assigned to each strategy to indicate the relative attractiveness of one strategy over others, considering the particular factor. The range for Attractiveness Scores is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. By attractive, we mean the extent that one strategy, compared to others, enables the firm to either capitalize on the strength, improve on the weakness, exploit the opportunity, or avoid the threat. Work row by row in developing a QSPM. If the answer to the previous question is no, indicating that the respective key factor has no effect upon the specific choice being made, then do not assign Attractiveness Scores to the strategies in that set. Use a dash to indicate that the key factor does not affect the choice being made. Note: If you assign an AS score to one strategy, then assign AS score(s) to the other. In other words, if one strategy receives a dash, then all others must receive a dash in a given row.

Step 5 Compute the Total Attractiveness Scores. Total Attractiveness Scores (TAS) are defined as the product of multiplying the weights (Step 2) by the Attractiveness Scores (Step 4) in each row. The Total Attractiveness Scores indicate the relative attractiveness of each alternative strategy, considering only the impact of the adjacent external or internal critical success factor. The higher the Total Attractiveness Score, the more attractive the strategic alternative (considering only the adjacent critical success factor).

Step 6 Compute the Sum Total Attractiveness Score. Add Total Attractiveness Scores in each strategy column of the QSPM. The Sum Total Attractiveness Scores (STAS) reveal which strategy is most attractive in each set of alternatives. Higher scores indicate more attractive strategies, considering all the relevant external and internal factors that could affect the strategic decisions. The magnitude of the difference between the Sum Total Attractiveness Scores in a given set of strategic alternatives indicates the relative desirability of one strategy over another.

TABLE 6-7 A QSPM for a Retail Computer Store

		STRATEGIC ALTERNATIVES			
		1		2	
		Buy New Land and Build New Larger Store		Fully Renovate Existing Store	
Key Factors	*Weight*	*AS*	*TAS*	*AS*	*TAS*
Opportunities					
1. Population of city growing 10%	0.10	4	0.40	2	0.20
2. Rival computer store opening 1 mile away	0.10	2	0.20	4	0.40
3. Vehicle traffic passing store up 12%	0.08	1	0.08	4	0.32
4. Vendors average six new products/year	0.05	—		—	
5. Senior citizen use of computers up 8%	0.05	—		—	
6. Small business growth in area up 10%	0.10	—		—	
7. Desire for Web sites up 18% by Realtors	0.06	—		—	
8. Desire for Web sites up 12% by small firms	0.06	—		—	
Threats					
1. Best Buy opening new store nearby in 1 year	0.15	4	0.60	3	0.45
2. Local university offers computer repair	0.08	—		—	
3. New bypass for Hwy 34 in 1 year will divert traffic	0.12	4	0.48	1	0.12
4. New mall being built nearby	0.08	2	0.16	4	0.32
5. Gas prices up 14%	0.04	—		—	
6. Vendors raising prices 8%	0.03	—		—	
	1.00				
Strengths					
1. Inventory turnover increased from 5.8 to 6.7	0.05	—		—	
2. Average customer purchase increased from $97 to $128	0.07	2	0.14	4	0.28
3. Employee morale is excellent	0.10	—		—	
4. In-store promotions resulted in 20% increase in sales	0.05	—		—	
5. Newspaper advertising expenditures increased 10%	0.02	—		—	
6. Revenues from repair/service segment of store up 16%	0.15	4	0.60	3	0.45
7. In-store technical support personnel have MIS college degrees	0.05	—		—	
8. Store's debt-to-total assets ratio declined to 34%	0.03	4	0.12	2	0.06
9. Revenues per employee up 19%	0.02	—		—	
Weaknesses					
1. Revenues from software segment of store down 12%	0.10	—		—	
2. Location of store negatively impacted by new Hwy 34	0.15	4	0.60	1	0.15
3. Carpet and paint in store somewhat in disrepair	0.02	1	0.02	4	0.08
4. Bathroom in store needs refurbishing	0.02	1	0.02	4	0.08
5. Revenues from businesses down 8%	0.04	3	0.12	4	0.16
6. Store has no Web site	0.05	—		—	
7. Supplier on-time delivery increased to 2.4 days	0.03	—		—	
8. Often customers have to wait to check out	0.05	2	0.10	4	0.20
Total	1.00		4.36		3.27

In Table 6-7, two alternative strategies—(1) buy new land and build new larger store and (2) fully renovate existing store—are being considered by a computer retail store. Note by sum total attractiveness scores of 4.63 versus 3.27 that the analysis indicates the business should buy new land and build a new larger store. Note the use of dashes to indicate which factors do not affect the strategy choice being considered. If a particular factor affects one strategy but not the other, it affects the choice being made, so attractiveness scores should be recorded for both strategies. Never rate one strategy and not the other. Note also in Table 6-7that there are no double 1's, 2's, 3's, or 4's in a row. Never duplicate scores in a row. Never work column by column; always prepare a QSPM working row by row. If you have more than one strategy in the QSPM, then let the AS scores range from 1 to "the number of strategies being evaluated." This will enable you to have a different AS score for each strategy. These are all important guidelines to follow in developing a QSPM. In actual practice, the store did purchase the new land and build a new store; the business also did some minor refurbishing until the new store was operational.

There should be a rationale for each AS score assigned. Note in Table 6-7 in the first row that the "city population growing 10 percent annually" opportunity could be capitalized on best by strategy 1, "building the new, larger store," so an AS score of 4 was assigned to Strategy 1. AS scores, therefore, are not mere guesses; they should be rational, defensible, and reasonable.

Avoid giving each strategy the same AS score. Note in Table 6-7 that dashes are inserted all the way across the row when used. Also note that double 4's, or double 3's, or double 2's, or double 1's are never in a given row. Again work row by row, not column by column. These are important guidelines to follow in constructing a QSPM.

Positive Features and Limitations of the QSPM

A positive feature of the QSPM is that sets of strategies can be examined sequentially or simultaneously. For example, corporate-level strategies could be evaluated first, followed by division-level strategies, and then function-level strategies. There is no limit to the number of strategies that can be evaluated or the number of sets of strategies that can be examined at once using the QSPM.

Another positive feature of the QSPM is that it requires strategists to integrate pertinent external and internal factors into the decision process. Developing a QSPM makes it less likely that key factors will be overlooked or weighted inappropriately. A QSPM draws attention to important relationships that affect strategy decisions.

Although developing a QSPM requires a number of subjective decisions, making small decisions along the way enhances the probability that the final strategic decisions will be best for the organization. A QSPM can be adapted for use by small and large for-profit and nonprofit organizations so can be applied to virtually any type of organization. A QSPM can especially enhance strategic choice in multinational firms because many key factors and strategies can be considered at once. It also has been applied successfully by a number of small businesses.7

The QSPM is not without some limitations. First, it always requires intuitive judgments and educated assumptions. The ratings and attractiveness scores require judgmental decisions, even though they should be based on objective information. Discussion among strategists, managers, and employees throughout the strategy-formulation process, including development of a QSPM, is constructive and improves strategic decisions. Constructive discussion during strategy analysis and choice may arise because of genuine differences of interpretation of information and varying opinions. Another limitation of the QSPM is that it can be only as good as the prerequisite information and matching analyses upon which it is based.

Cultural Aspects of Strategy Choice

All organizations have a culture. Culture includes the set of shared values, beliefs, attitudes, customs, norms, personalities, heroes, and heroines that describe a firm. Culture is the unique way an organization does business. It is the human dimension that creates solidarity and meaning, and it inspires commitment and productivity in an organization when strategy changes are made. All human beings have a basic need to make sense of the world, to feel in control, and to make meaning. When events threaten meaning, individuals react defensively. Managers and employees may even sabotage new strategies in an effort to recapture the status quo.

It is beneficial to view strategic management from a cultural perspective because success often rests upon the degree of support that strategies receive from a firm’s culture. If a firm’s strategies are supported by cultural products such as values, beliefs, rites, rituals, ceremonies, stories, symbols, language, heroes, and heroines, then managers often can implement changes swiftly and easily. However, if a supportive culture does not exist and is not cultivated, then strategy changes may be ineffective or even counterproductive. A firm's culture can become antagonistic to new strategies, and the result of that antagonism may be confusion and disarray.

Strategies that require fewer cultural changes may be more attractive because extensive changes can take considerable time and effort. Whenever two firms merge, it becomes especially important to evaluate and consider culture-strategy linkages.

Culture provides an explanation for the difficulties a firm encounters when it attempts to shift its strategic direction, as the following statement explains:

Not only has the "right" corporate culture become the essence and foundation of corporate excellence, but success or failure of needed corporate reforms hinges on management's sagacity and ability to change the firm's driving culture in time and in tune with required changes in strategies.8

The Politics of Strategy Choice

All organizations are political. Unless managed, political maneuvering consumes valuable time, subverts organizational objectives, diverts human energy, and results in the loss of some valuable employees. Sometimes political biases and personal preferences get unduly embedded in strategy choice decisions. Internal politics affect the choice of strategies in all organizations. The hierarchy of command in an organization, combined with the career aspirations of different people and the need to allocate scarce resources, guarantees the formation of coalitions of individuals who strive to take care of themselves first and the organization second, third, or fourth. Coalitions of individuals often form around key strategy issues that face an enterprise. A major responsibility of strategists is to guide the development of coalitions, to nurture an overall team concept, and to gain the support of key individuals and groups of individuals. In the absence of objective analyses, strategy decisions too often are based on the politics of the moment. With development of improved strategy-formation tools, political factors become less important in making strategic decisions.

In the absence of objectivity, political factors sometimes dictate strategies, and this is unfortunate. Managing political relationships is an integral part of building enthusiasm and esprit de corps in an organization.

A classic study of strategic management in nine large corporations examined the political tactics of successful and unsuccessful strategists.9 Successful strategists were found to let weakly supported ideas and proposals die through inaction and to establish additional hurdles or tests for strongly supported ideas considered unacceptable but not openly opposed. Successful strategists kept a low political profile on unacceptable proposals and strived to let most negative decisions come from subordinates or a group consensus, thereby reserving their personal vetoes for big issues and crucial moments.

Successful strategists did a lot of chatting and informal questioning to stay abreast of how things were progressing and to know when to intervene. They led strategy but did not dictate it. They gave few orders, announced few decisions, depended heavily on informal questioning, and sought to probe and clarify until a consensus emerged.

Successful strategists generously and visibly rewarded key thrusts that succeeded. They assigned responsibility for major new thrusts to champions, the individuals most strongly identified with the idea or product and whose futures were linked to its success. They stayed alert to the symbolic impact of their own actions and statements so as not to send false signals that could stimulate movements in unwanted directions.

Successful strategists ensured that all major power bases within an organization were represented in, or had access to, top management. They interjected new faces and new views into considerations of major changes. This is important because new employees and managers generally have more enthusiasm and drive than employees who have been with the firm a long time. New employees do not see the world the same old way; nor do they act as screens against changes. Successful strategists minimized their own political exposure on highly controversial issues and in circumstances in which major opposition from key power centers was likely. In combination, these findings provide a basis for managing political relationships in an organization.

Because strategies must be effective in the marketplace and capable of gaining internal commitment, the following tactics used by politicians for centuries can aid strategists:

1. **Equifinality—It** is often possible to achieve similar results using different means or paths. Strategists should recognize that achieving a successful outcome is more important than imposing the method of achieving it. It may be possible to generate new alternatives that give equal results but with far greater potential for gaining commitment.
2. **Satisfying**—Achieving satisfactory results with an acceptable strategy is far better than failing to achieve optimal results with an unpopular strategy.
3. **Generalization**—Shifting focus from specific issues to more general ones may increase strategists' options for gaining organizational commitment.
4. **Focus on Higher-Order Issues**—By raising an issue to a higher level, many shortterm interests can be postponed in favor of long-term interests. For instance, by focusing on issues of survival, the airline and automotive industries were able to persuade unions to make concessions on wage increases.
5. **Provide Political Access on Important Issues**—Strategy and policy decisions with significant negative consequences for middle managers will motivate intervention behavior from them. If middle managers do not have an opportunity to take a position on such decisions in appropriate political forums, they are capable of successfully resisting the decisions after they are made. Providing such political access provides strategists with information that otherwise might not be available and that could be useful in managing intervention behavior.10

Governance Issues

A "director," according to Webster's Dictionary, is "one of a group of persons entrusted with the overall direction of a corporate enterprise." A board of directors is a group of individuals who are elected by the ownership of a corporation to have oversight and guidance over management and who look out for shareholders' interests. The act of oversight and direction is referred to as governance. The National Association of Corporate Directors defines governance as "the characteristic of ensuring that long-term strategic objectives and plans are established and that the proper management structure is in place to achieve those objectives, while at the same time making sure that the structure functions to maintain the corporation's integrity, reputation, and responsibility to its various constituencies." This broad scope of responsibility for the board shows how boards are being held accountable for the entire performance of the firm. In the

Worldcom, Tyco, and Enron bankruptcies and scandals, the firms' boards of directors were sued by shareholders for mismanaging their interests. New accounting rules in the United States and Europe now enhance corporate-governance codes and require much more extensive financial disclosure among publicly held firms. The roles and duties of a board of directors can be divided into four broad categories, as indicated in Table 6-8.

The recession and credit crunch of 2008–2009 prompted shareholders to become more wary of boards of directors. Shareholders of hundreds of firms are demanding that their boards do a better job of governing corporate America.11 New compensation policies are needed as well as direct shareholder involvement in some director activities. For example, boards could require CEOs to groom possible replacements from inside the firm because exorbitant compensation is most often paid to new CEOs coming from outside the firm.

TABLE 6-8 Board of Director Duties and Responsibilities

1. CONTROL AND OVERSIGHT OVER MANAGEMENT
   a. Select the Chief Executive Officer (CEO).
   b. Sanction the CEO's team.
   c. Provide the CEO with a forum.
   d. Ensure managerial competency.
   e. Evaluate management's performance.
   f. Set management's salary levels, including fringe benefits.
   g. Guarantee managerial integrity through continuous auditing.
   h. Chart the corporate course.
   i. Devise and revise policies to be implemented by management.
2. ADHERENCE TO LEGAL PRESCRIPTIONS
   a. Keep abreast of new laws.
   b. Ensure the entire organization fulfills legal prescriptions.
   c. Pass bylaws and related resolutions.
   d. Select new directors.
   e. Approve capital budgets.
   f. Authorize borrowing, new stock issues, bonds, and so on.
3. CONSIDERATION OF STAKEHOLDERS' INTERESTS
   a. Monitor product quality.
   b. Facilitate upward progression in employee quality of work life.
   c. Review labor policies and practices.
   d. Improve the customer climate.
   e. Keep community relations at the highest level.
   f. Use influence to better governmental, professional association, and educational contacts.
   g. Maintain good public image.
4. ADVANCEMENT OF STOCKHOLDERS' RIGHTS
   a. Preserve stockholders' equity.
   b. Stimulate corporate growth so that the firm will survive and flourish.
   c. Guard against equity dilution.
   d. Ensure equitable stockholder representation.
   e. Inform stockholders through letters, reports, and meetings.
   f. Declare proper dividends.
   g. Guarantee corporate survival.

Shareholders are also upset at boards for allowing CEOs to receive huge end-of-year bonuses when the firm's stock price drops drastically during the year.12 For example, Chesapeake Energy Corp. and its board of directors are under fire from shareholders for paying Chairman and CEO Aubrey McClendon $112 million in 2008 as the firm's stock price plummeted. Investor Jeffrey Bronchick wrote in a letter to the Chesapeake board that the CEO's compensation was a "near perfect illustration of the complete collapse of appropriate corporate governance."

Until recently, boards of directors did most of their work sitting around polished wooden tables. However, Hewlett-Packard's directors, among many others, now log on to their own special board Web site twice a week and conduct business based on extensive confidential briefing information posted there by the firm's top management team. Then the board members meet face to face and fully informed every two months to discuss the biggest issues facing the firm. Even the decision of whether to locate operations in countries with low corporate tax rates would be reviewed by a board of directors.

Today, boards of directors are composed mostly of outsiders who are becoming more involved in organizations' strategic management. The trend in the United States is toward much greater board member accountability with smaller boards, now averaging 12 members rather than 18 as they did a few years ago. BusinessWeek recently evaluated the boards of most large U.S. companies and provided the following "principles of good governance":

1. No more than two directors are current or former company executives.
2. No directors do business with the company or accept consulting or legal fees from the firm.
3. The audit, compensation, and nominating committees are made up solely of outside directors.
4. Each director owns a large equity stake in the company, excluding stock options.
5. At least one outside director has extensive experience in the company's core business and at least one has been CEO of an equivalent-size company.
6. Fully employed directors sit on no more than four boards and retirees sit on no more than seven.
7. Each director attends at least 75 percent of all meetings.
8. The board meets regularly without management present and evaluates its own performance annually.

9. The audit committee meets at least four times a year.
10. The board is frugal on executive pay, diligent in CEO succession oversight responsibilities, and prompt to act when trouble arises.
11. The CEO is not also the chairperson of the board.
12. Shareholders have considerable power and information to choose and replace directors.
13. Stock options are considered a corporate expense.
14. There are no interlocking directorships (where a director or CEO sits on another director's board).13

Being a member of a board of directors today requires much more time, is much more difficult, and requires much more technical knowledge and financial commitment than in the past. Jeff Sonnerfeld, associate dean of the Yale School of Management, says, "Boards of directors are now rolling up their sleeves and becoming much more closely involved with management decision making." Since the Enron and Worldcom scandals, company CEOs and boards are required to personally certify financial statements; company loans to company executives and directors are illegal; and there is faster reporting of insider stock transactions.

Just as directors are beginning to place more emphasis on staying informed about an organization's health and operations, they are also taking a more active role in ensuring that publicly issued documents are accurate representations of a firm's status. It is becoming widely recognized that a board of directors has legal responsibilities to stockholders and society for all company activities, for corporate performance, and for ensuring that a firm has an effective strategy. Failure to accept responsibility for auditing or evaluating a firm's strategy is considered a serious breach of a director's duties. Stockholders, government agencies, and customers are filing legal suits against directors for fraud, omissions, inaccurate disclosures, lack of due diligence, and culpable ignorance about a firm's operations with increasing frequency. Liability insurance for directors has become exceptionally expensive and has caused numerous directors to resign.

The Sarbanes-Oxley Act resulted in scores of boardroom overhauls among publicly traded companies. The jobs of chief executive and chairman are now held by separate persons, and board audit committees must now have at least one financial expert as a member. Board audit committees now meet 10 or more times per year, rather than 3 or 4 times as they did prior to the act. The act put an end to the “country club” atmosphere of most boards and has shifted power from CEOs to directors. Although aimed at public companies, the act has also had a similar impact on privately owned companies.14

In Sweden, a new law has recently been passed requiring 25 percent female representation in boardrooms. The Norwegian government has passed a similar law that requires 40 percent of corporate director seats to go to women. In the United States, women currently hold about 13 percent of board seats at S&P500 firms and 10 percent at S&P1,500 firms. The Investor Responsibility Research Center in Washington, D.C. reports that minorities hold just 8.8 percent of board seats of S&P1,500 companies. Progressive firms realize that women and minorities ask different questions and make different suggestions in boardrooms than white men, which is helpful because women and minorities comprise much of the consumer base everywhere.

Adirect response of increased pressure on directors to stay informed and execute their responsibilities is that audit committees are becoming commonplace. Aboard of directors should conduct an annual strategy audit in much the same fashion that it reviews the annual financial audit. In performing such an audit, a board could work jointly with operating management and/or seek outside counsel. Boards should play a role beyond that of performing a strategic audit. They should provide greater input and advice in the strategyformulation process to ensure that strategists are providing for the long-term needs of the firm. This is being done through the formation of three particular board committees: nominating committees to propose candidates for the board and senior officers of the firm; compensation committees to evaluate the performance of top executives and determine the terms and conditions of their employment; and audit committees to give board-level attention to company accounting and financial policies and performance.

Chapter 7
BALANCED SCORECARD - SUSTAINABLE DEVELOPMENT TOOL

BALANCED SCORECARD – SUSTAINABLE DEVELOPMENT TOOL

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Abstract

The sustainable management of a business requires the consideration of all the business components, both the economic activity and the aspects related to its impact on the environment and its social implications. The Balanced Scorecard (BSC) is a management tool supporting the successful implementation of corporative strategies. This helps connecting operational and non-financial activities that have a significant impact on the economic success of a business. BSC is therefore a promising starting point to include in a company's management system both the social and environmental aspects. This paper deals with the traditional BSC and the current BSC development trends, which consider sustainability.

Keywords: balanced scorecard, sustainable development, performance

1. INTRODUCTION

According to Harvard Business Review, the Balanced Scorecard (BSC) is one of the most important management concepts of this century. In addition to the measuring of current performance in financial terms, the novelty brought about by this method consists of the evaluation of a company's efforts focused on future performance. The term "scorecard" involves the measuring of performance that can be quantified, while "balanced" illustrates the fact that the system has to have equilibrium, as it has to consider the following: medium and long-term objectives, financial and non-financial measures, a set of specific indices, as well as internal and external performance, etc [8]. The classical entity performance measuring methods refer to a short period of time and they rely mainly on a post-factum analysis. For this reason, the outcome of such analysis is not useful on the long run, as a comprehensive analysis is necessary, which focuses on future income forecasts, on the evaluation of the current state of the business as well as on future trends, in general.

The Balanced Scorecard is a strategic management system able to handle the entity's activities depending on its vision and strategies. The reason for BSC implementation was the avoidance of the deficiencies occurring within the traditional management systems, which rely primarily on financial values. This concept was first presented in 1992 by the professors Robert Kaplan and David Norton and it supports the need to use a performance measuring system based both on financial and non-financial indices [3]. According to the authors, the Balanced Scorecard preserves the traditional financial indices, which provide information on past events, but which are inadequate when it comes to guiding companies towards value creation by investing in the relations with their customers, suppliers, employees, as well as in technology and innovation. Thus, Kaplan and Norton state that, *according to the studies carried out, it has been found that a specific type of evaluation is often preferred to another. Therefore, a balanced presentation is necessary of both the financial and operational evaluation. The study consisted of performance evaluation and developed a "global performance indicator", that is a set of evaluations allowing the management to have the complete picture of the company they run [9].*

BSC has both quantitative and qualitative objectives. The main advantage of this tool is that it includes strategic long-term objectives and short-term actions. Most company management and control systems are designed around financial indices and objectives and they place a small emphasis on long-term strategic objectives, which leads to discrepancies between strategy drafting and strategy implementation. Unlike traditional performance measuring systems, which rely mostly on financial indices, the Balanced Scorecard first identifies the company vision and strategy, which it transposes in performance indicators. Depending on the developed methodology and starting from the entity strategy, strategic objectives for each single component are identified, and the extent of objective achievement is measured using the chosen indicators [2]. Both monetary and non-monetary indicators are defined in order to ensure the reliability of the information on the achievements in the vital entity business sectors, which indicators refer to, for instance, to customer satisfaction, in-house process functionality or innovations.

The Balanced Scorecard concept supports strategic planning and implementation by coordinating all the entity activities around common goals and by creating a strategy evaluation and improvement tool. BSC concept implementation is an ongoing process, which starts at the central level of strategic units and is implemented all the way to the operational level. Since the BSC concept implementation actually consists of introducing a new strategic management system and not an indicator project, the active top management involvement is essential.

2. THE "CLASSIC" BALANCED SCORECARD

The preset goal of BSC implementation is turning the company mission or strategy into objectives as concrete as possible for the company's current business, so that the contribution of each person involved becomes as clear and transparent as possible. Balanced Scorecard implementation is aimed at [8]:

- getting the support of the strategic management;
- achieving the consensus as concerns terminology and notations;
- establishing the assessment criteria for the most important objectives;
- implementing the management processes;
- periodically assessing the performance;
- evaluating the performance improvement opportunities.

When assessing the company performance, the managers using BSC no longer rely on short-term financial indices alone. Actually, the BSC allows the use of 4 processes, which contribute to the correlation between long-term objectives and short-term actions (strategy and vision definition, communication and relations, business planning, innovation and learning).

Strategy and vision definition is the process helping managers to reach a consensus as regards the development strategy. Despite the strategic management's good intentions, most of the times, statements such as "the best in the x category" or "the number one supplier" are not easily transposed in operational terms able to provide action directions at local level [1]. In order for people to act according to the strategy statements, the latter should be expressed in an integrated set of objectives and measures, agreed on by all the managers, describing the long-term success factors.

Communication and relations definition allows managers to communicate the strategy both upstream and downstream and to connect it to individual and department objectives. Traditionally speaking, departments are evaluated according to their financial performance, while the financial motivations are related to short-term financial objectives. The BSC gives the managers the certainty that all the hierarchy levels understand the long-term strategy and that both individual and department objectives are aligned to the former.

Business planning enables entities to integrate their financial and operational plans. Almost all companies implement change programs, each having its own project managers and consultants, being all in competition for the executive managers' time, energy and resources, which often leads to disappointments related to the outcome of those programs [4]. But when managers use ambitious objectives for the BSC as a means to allot resources and set priorities, they are able to understand and coordinate those initiatives meant to achieve the preset long-term strategies.

Innovation and learning is the fourth BSC process and offers a strategic learning possibility. The existence of feedback and the evaluation of processes impacting the entity, its departments or individual employees, ensures the achievement of the preset financial objectives.

The performance indicators set by the BSC help setting the objectives and measuring the results, with a view to objective achievement [5]. The indicators that the Balanced Scorecard model relies on may be divided in the first stage into early indicators and late indicators. Early indicators are used at the beginning, in the incipient stage of a process, and they are set according to specific forecasts. They measure the activities that need to establish with great accuracy the profit or cash flow of the entity after 5 years. Early indicators show to what extent the customer's desires and expectations have been studied and, also, how familiar the customer is with the means of production of the desired product or service, before signing the contract. This is the way to establish the direction to follow in order to provide services that meet the customer's needs, which enables the company to consolidate its position on the market. Late indicators are calculated at the end of a process and they indicate, in a retrospective approach, the way in which the activity was conducted (for instance, the turnover, the profit, the employees' satisfaction, etc.) [8].

The BSC indicators are generally delineated depending on the manager's priorities, into four categories corresponding to four dimensions of the classical model [4]:

- **the financial perspective** generally approaches aspects regarding profitability, turnover, value added, new products, new customers, etc. The profitability strategy considers the costs structure designed to reduce expenses and ensure a more efficient assets use;
- **the customer perspective** includes indicators that should answer at least two questions: "who are the target customers?" and "what is the value that the entity offers to its customers?". Entities generally choose one of the following three directions: operational excellence (small prices and high quality), product leader (providing the best product) or customer familiarity (interest in a long-term cooperation instead of short-term relations) [1]. This perspective actually tackles the connection between internal processes and customer relations, the main goal being customer satisfaction, and it is aimed at determining indicators like the number of goods returned by the customers, the market share held, etc;
- **the internal processes perspective** identifies the critical activities and considers the indicators assigned to the company's key processes, which need to be subjected to continuous surveillance and improvement in order to add value

to the services to the customers, such as the delivery service, development, reporting, innovation and development of new products designed to penetrate new markets or to attract new customers, product quality, production duration, faulty goods percentage, etc. [5];

- **the innovation and learning perspective** comprises indicators on the employees' degree of satisfaction, availability, information dissemination extent, etc. [7]

Within each of these categories (financial performance, in-house processes, customer relations and innovation), the entity must accurately define the following components (Fig. 1):

- *objectives*, more precisely the strategies that have to be fulfilled at the strategic level;
- *measures*, the actual progress assessment for a particular objective;
- *targets*, the value estimates for each action;
- *initiatives*, the actions that will be taken to facilitate the fulfillment of the proposed goals.

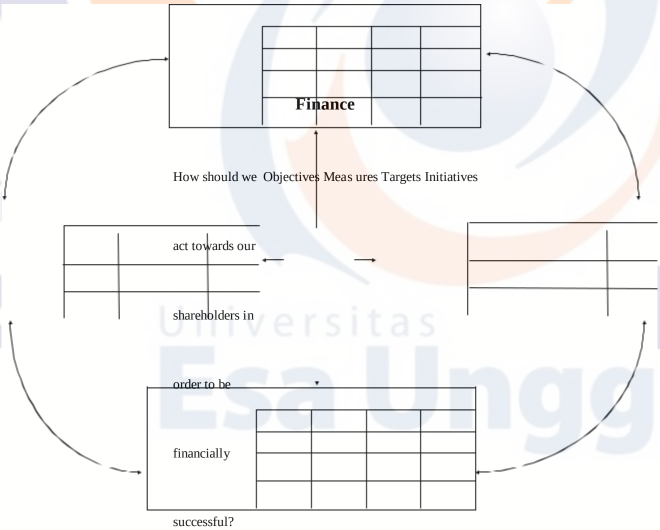

Fig. 1. *The methodology of the Balanced Scorecard*

How can we foster objectives measures targets intiative our potentials to change and growth in order to realize our vision.

Source: CMA Canada, *Application et mise en oeuvre du tableau de bord équilibré,* Collection gestion stratégique, 1999, www.cma-canada.org, p.5

Among the main advantages of the Balanced Scorecard concept implementation and use, we distinguish the minimization of the amount of information used by the reduction of the number of indicators employed, the management focusing mainly on the critical indicators related to the entity's current and future performance, the simultaneous obtaining of information on the different competitiveness levels, the priority orientation towards customer relations, the reduction of the time of reaction to the external environment changes, the improvement of the product and service quality, a better teamwork spirit, the reduction of the time needed for launching new products, the easy implementation of an efficient manager and employee motivation and performance assessment system, etc.

3. ECO BALANCED SCORECARD

Over the last few decades, an increasing number of specialists have been analyzing the idea of using the Balanced Scorecard model as the basis for a sustainable management [6]. The question that arises therefore is how sustainability may be measured using the Balanced Scorecard. The starting point of a good environmental management is to acknowledge the costs generated by the damages caused to the environment and their consideration during the decision-making process. The "Triple Bottom Line" approach should be therefore chosen, as it includes the three sustainable development pillars: economic, social and environment performance (Fig. 2).

Fig. 2. *Sustainable development "pyramid"*

Several management systems have been developed for the three components of the "Triple Bottom Line" approach:

- the *financial management* systems have been obviously used for centuries (although it has been recently proven that they may be further improved);

- the *environment management* systems were developed in the early 1990s with the implementation of the ISO 14000 (Environmental Management Systems) worldwide and of the European Eco-Management and Audit Scheme – EMAS, in Europe;

- the late 1990s witnessed the development of a set of *social accountability management systems* - SA 8000 (Social Accountability 8000), AA 1000, etc.

Also, in addition to the three systems abovementioned that focus each on a particular aspect, certain reporting systems combining several aspects (Corporate Social Responsibility – CSR, Global Reporting Initiative – GRI, developing sustainable development indicators: economic, social and environmental indicators) have also been acquiring a growing popularity.

In addition to these preoccupations related to individual management, specialists have tried to develop a system able to incorporate them as a whole and to ensure better management.

Given the impact and usefulness of the classical BSC, numerous debates have been organized in the last few years meant to extend it to include also sustainable development issues. According to the supporters of this idea, the four traditional perspectives should only be a general framework, a structure applicable and adaptable to the ever-changing needs and not a strait jacket limiting them.

There are several opposite opinions as concerns this approach, and several studies have been carried out lately on this issue. For instance, Zingales & Hockerts conducted a study on the inclusion of the environmental and social indicators in the Balanced Scorecard, in companies operating in the telecommunication, oil and gas / energy business, or in the pharmaceutical field [12]. Crawford & Scaletta analyzed how the measures proposed by GRI could be included in the four traditional BSC perspectives [5]. Möller & Schaltegger suggested that the eco-efficiency analysis requires a tight relation between the traditional BSC indicators and those regarding the evaluation of the product shelf life and the sustainable development [10].

Two main approaches have been singled out during the debates on the identification of the best possible ways to include the sustainable development aspects in the BSC. The first requires that each of the four traditional perspectives should be developed to include both the environmental and social aspects. Fig. 3 shows this approach, and the environmental issues are often presented at the confluence between traditional perspectives.

Fig. 3 *Inclusion of the environment-related issues into the BSC*

Source: Capron, M., Quairel, F., *Evaluer les stratégies de développement durable des entreprises: l'utopie mobilisatrice de la performance globale*, Journée développement durable

- AIMS - IAE d'Aix en Provence, 11/05/2005, http://www.strategie-aims.com/dd04 /comdd/ quairel-capron05%20.pdf, p.12

The second approach proposes the extension of the BSC framework to include, in addition to the four traditional approaches, two new ones, that is the social and environmental ones (Fig. 4). Due to this inclusion, the environmental and social factors will be considered to ground the decisions made, which may impede upon the current activity and business continuity [5]. This is actually imposed by the principles of sustainable development, which entities should consider in their decision-making processes.

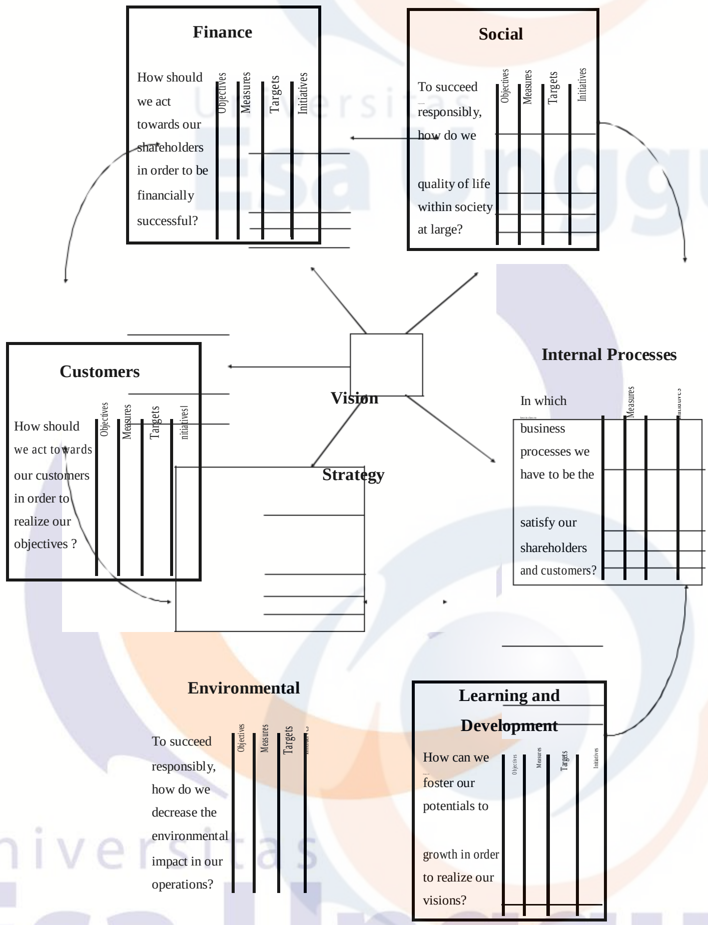
Finance
How should we act towards our shareholders in order to be financially successful?
Objectives
Measures
Targets
Initiatives
Social
To succeed responsibly, how do we
quality of life within society at large?
Objectives
Measures
Targets
Initiatives
Customers
How should we act towards our customers in order to realize our objectives ?
Objectives
Measures
Targets
nitiatives
Vision
Strategy
Internal Processes
In which business processes we have to be the
satisfy our shareholders and customers?
Measures
Environmental
To succeed responsibly, how do we decrease the environmental impact in our operations?
Objectives
Measures
Targets
Learning and Development
How can we foster our potentials to
growth in order to realize our visions?
Objectives
Measures
Targets
Initiatives

Fig. 4. *The BSC framework including the social and environmental perspectives*

Source: Reingruber, M., *The (Un) Balanced Scorecard,* http://www.plexsci.com/site/pdf/the_unbalanced_score card.pdf , p.3

This approach proposes the setting of the strategic objectives from each of the six perspectives, which will be then communicated at the operational level, thus ensuring the horizontal inclusion. The communication on each of the six perspectives provides complete focus and development, which means that the lack of objectives for each perspective would be noticed immediately. This approach actually facilitates objective development at all organizational levels, by establishing various responsibilities, so that every manager or employee may be able to understand the way in which the environment and social aspects influence company performance, achieving thus good business coordination. The degree of strategy concretization will increase depending on objectives, units of measurement, and actions carried out. The BSC actually prevents one from placing a disproportionate emphasis on the financial perspective alone, which strongly influences the whole system of indictors employed.

It seems that the BSC development including the six perspectives is preferred. Considering that any economic activity has strong economic, social and environmental influences, and given the fact that these effects are long-term, involving the whole shelf life of the products, an increasing number of companies choose to invest to reduce the negative effects and they try to combine to the best of their abilities. Thus, the large companies have published such information in their annual reports, in the last few years, although they do not always include explicit information on the BSC. In its annual report for 2009, Novo Nordisk presents the

BSC indicators, both financial and especially non-financial indicators, since many environment-related aspects cannot be easily assessed [13].

Due to the fact that the Balanced Scorecard supports strategic planning and implementation by coordinating the activities of all the company components around common objectives and by creating a strategy assessment and improvement tool, it has been gaining an increasing number of fans.

4. CONCLUSIONS

The Balanced Scorecard is a powerful sustainable corporative management tool, since it enables decision makers to discuss strategies from the very stage of their development. Although this strategic management concept has been built on a well-balanced system of financial and non-financial indicators, it is especially useful for the managers' in-house information needs. The relevance of the information provided by the Balanced Scorecard requires the use of this concept as a standard communication with the exterior tool in the process of reporting the information to the investors on the capital market, since the latter are no longer interested in the financial performance alone, and the decisions they make also depend on factors such as management quality, new product launching, strategy quality and strategy implementation degree, etc. Also, in addition to the financial viewpoint, one should also consider the impact of the business of a company on the environment. The BSC model has proven, these last few years, an extremely valuable tool in strategy operationalization, as it develops well-balanced and transparent communication relations. This is one of the most important tools used by companies to improve its performance.

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Chapter 8
IMPLEMENTING STRATEGIES: MANAGEMENT OPERATIONAL AND OPERATIONS ISSUES

Implementing Strategies: Management Operational and Operations Issues

A note from David

The Nature of Strategy Implementation

The strategic-management process does not end when the firm decides what strategy or strategies to pursue. There must be a translation of strategic thought into strategic action. This translation is much easier if managers and employees of the firm understand the business, feel a part of the company, and through involvement in strategy-formulation activities have become committed to helping the organization succeed. Without understanding and commitment, strategy-implementation efforts face major problems. Implementing strategy affects an organization from top to bottom; it affects all the functional and divisional areas of a business. It is beyond the purpose and scope of this text to examine all of the business administration concepts and tools important in strategy implementation. This chapter focuses on management issues most central to implementing strategies in 2010–2011 and Chapter 8 focuses on marketing, finance/accounting, R&D, and management information systems issues.

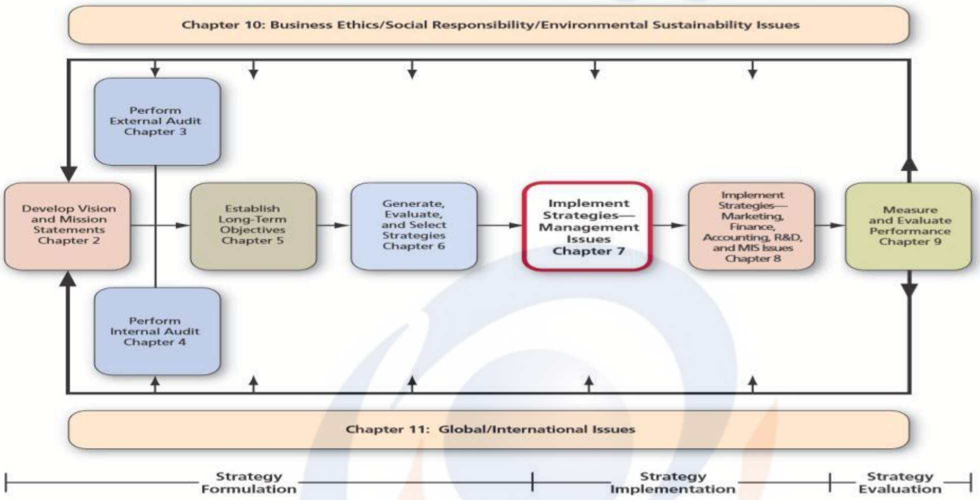
Even the most technically perfect strategic plan will serve little purpose if it is not implemented. Many organizations tend to spend an inordinate amount of time, money, and effort on developing the strategic plan, treating the means and circumstances under which it will be implemented as afterthoughts! Change comes through implementation and evaluation, not through the plan. A technically imperfect plan that is implemented well will achieve more than the perfect plan that never gets off the paper on which it is typed.

The strategy-implementation stage of strategic management is revealed in Figure 7-1. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Strategy formulation and implementation can be contrasted in the following ways:

1. Strategy formulation is positioning forces before the action.
2. Strategy implementation is managing forces during the action.

3. Strategy formulation focuses on effectiveness.
4. Strategy implementation focuses on efficiency.
5. Strategy formulation is primarily an intellectual process.
6. Strategy implementation is primarily an operational process.
7. Strategy formulation requires good intuitive and analytical skills.
8. Strategy implementation requires special motivation and leadership skills.
9. Strategy formulation requires coordination among a few individuals.
10. Strategy implementation requires coordination among many individuals.

Strategy-formulation concepts and tools do not differ greatly for small, large, for-profit, or nonprofit organizations. However, strategy implementation varies substantially among different types and sizes of organizations. Implementing strategies requires such actions as altering sales territories, adding new departments, closing facilities, hiring new employees, changing an organization's pricing strategy, developing financial budgets, developing new employee benefits, establishing cost-control procedures, changing advertising strategies, building new facilities, training new employees, transferring managers among divisions, and building a better management information system. These types of activities obviously differ greatly between manufacturing, service, and governmental organizations.



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

Management Perspectives

In all but the smallest organizations, the transition from strategy formulation to strategy implementation requires a shift in responsibility from strategists to divisional and functional managers. Implementation problems can arise because of this shift in responsibility, especially if strategy-formulation decisions come as a surprise to middle- and lower-level managers. Managers and employees are motivated more by perceived self-interests than by organizational interests, unless the two coincide. Therefore, it is essential that divisional and functional managers be involved as much as possible in strategy-formulation activities. Of equal importance, strategists should be involved as much as possible in strategy-implementation activities.

As indicated in Table 7-1, management issues central to strategy implementation include establishing annual objectives, devising policies, allocating resources, altering an existing organizational structure, restructuring and reengineering, revising reward and incentive plans, minimizing resistance to change, matching managers with strategy, developing a strategysupportive culture, adapting production/operations processes, developing an effective human resources function, and, if necessary, downsizing. Management changes are necessarily more extensive when strategies to be implemented move a firm in a major new direction.

TABLE 7-1 Some Management Issues Central to Strategy Implementation

Establish annual objectives
Devise policies
Allocate resources
Alter an existing organizational structure
Restructure and reengineer
Revise reward and incentive plans
Minimize resistance to change
Match managers with strategy
Develop a strategy-supportive culture
Adapt production/operations processes
Develop an effective human resources function
Downsize and furlough as needed
Link performance and pay to strategies

Managers and employees throughout an organization should participate early and directly in strategy-implementation decisions. Their role in strategy implementation should build upon prior involvement in strategy-formulation activities. Strategists' genuine personal commitment to implementation is a necessary and powerful motivational force for managers and employees. Too often, strategists are too busy to actively support strategy-implementation efforts, and their lack of interest can be detrimental to organizational success. The rationale for objectives and strategies should be understood and clearly communicated throughout an organization. Major competitors' accomplishments, products, plans, actions, and performance should be apparent to all organizational members. Major external opportunities and threats should be clear, and managers' and employees' questions should be answered. Topdown flow of communication is essential for developing bottom-up support.

Firms need to develop a competitor focus at all hierarchical levels by gathering and widely distributing competitive intelligence; every employee should be able to benchmark her or his efforts against best-in-class competitors so that the challenge becomes personal. For example, Starbucks Corp. in 2009–2010 is instituting "lean production/operations" at its 11,000 U.S. stores. This system eliminates idle employee time and unnecessary employee motions, such as walking, reaching, and bending. Starbucks says 30 percent of employees' time is motion and the company wants to reduce that. They say "motion and work are two different things."

Annual Objectives

Establishing annual objectives is a decentralized activity that directly involves all managers in an organization. Active participation in establishing annual objectives can lead to acceptance and commitment. Annual objectives are essential for strategy implementation because they (1) represent the basis for allocating resources; (2) are a primary mechanism for evaluating managers; (3) are the major instrument for monitoring progress toward achieving long-term objectives; and (4) establish organizational, divisional, and departmental priorities. Considerable time and effort should be devoted to ensuring that annual objectives are well conceived, consistent with long-term objectives, and supportive of strategies to be implemented. Approving, revising, or rejecting annual objectives is much more than a rubber-stamp activity. The purpose of annual objectives can be summarized as follows:

Annual objectives serve as guidelines for action, directing and channeling efforts and activities of organization members. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders. They serve as standards of performance.

They serve as an important source of employee motivation and identification. They give incentives for managers and employees to perform. They provide a basis for organizational design.

Clearly stated and communicated objectives are critical to success in all types and sizes of firms. Annual objectives, stated in terms of profitability, growth, and market share by business segment, geographic area, customer groups, and product, are common in organizations. Figure 7-2 illustrates how the Stamus Company could establish annual objectives based on long-term objectives. Table 7-2 reveals associated revenue figures that correspond to the objectives outlined in Figure 7-2. Note that, according to plan, the Stamus Company will slightly exceed its long-term objective of doubling company revenues between 2010 and 2012.

FIGURE 7-2

The Stamus Company's Hierarchy of Aims

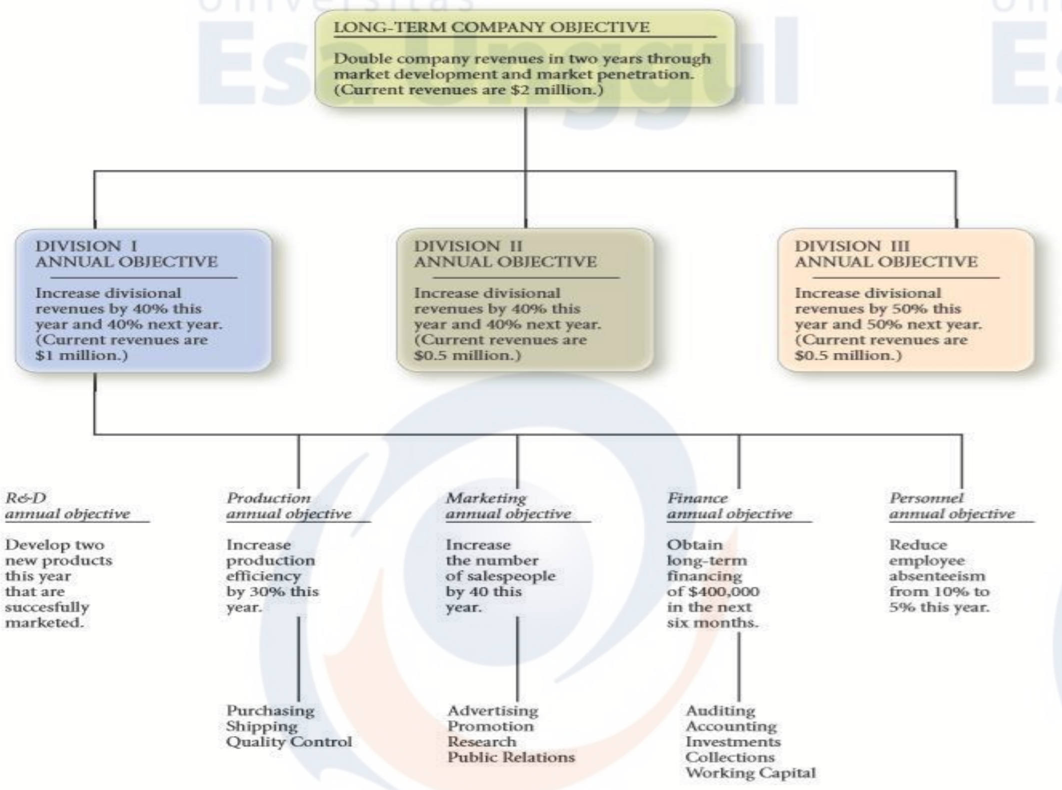


TABLE 7-2 The Stamus Company's Revenue Expectations (in $Millions)

	2010	2011	2012
Division I Revenues	1.0	1.400	1.960
Division II Revenues	0.5	0.700	0.980
Division III Revenues	0.5	0.750	1.125
Total Company Revenues	**2.0**	**2.850**	**4.065**

Figure 7-2 also reflects how a hierarchy of annual objectives can be established based on an organization's structure. Objectives should be consistent across hierarchical levels and form a network of supportive aims. Horizontal consistency of objectives is as important as vertical consistency of objectives. For instance, it would not be effective for manufacturing to achieve more than its annual objective of units produced if marketing could not sell the additional units.

Annual objectives should be measurable, consistent, reasonable, challenging, clear, communicated throughout the organization, characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Too often, objectives are stated in generalities, with little operational usefulness. Annual objectives, such as "to improve communication" or "to improve performance," are not clear, specific, or measurable. Objectives should state quantity, quality, cost, and time—and also be verifiable. Terms and phrases such as maximize, minimize, as soon as possible, and adequate should be avoided.

Annual objectives should be compatible with employees' and managers' values and should be supported by clearly stated policies. More of something is not always better. Improved quality or reduced cost may, for example, be more important than quantity. It is important to tie rewards and sanctions to annual objectives so that employees and managers understand that achieving objectives is critical to successful strategy implementation. Clear annual objectives do not guarantee successful strategy implementation, but they do increase the likelihood that personal and organizational aims can be accomplished. Overemphasis on achieving objectives can result in undesirable conduct, such as faking the numbers, distorting the records, and letting objectives become ends in themselves. Managers must be alert to these potential problems.

Policies

Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, policy refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organization's objectives. For example, Carnival's Paradiseship has a no smoking policy anywhere, anytime aboard ship. It is the first cruise ship to ban smoking comprehensively. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use the Internet at work.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organizational units, and reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organizations have a policy manual that serves to guide and direct behavior. Wal-Mart has a policy that it calls the "10 Foot" Rule, whereby customers can find assistance within 10 feet of anywhere in the store. This is a welcomed policy in Japan, where Wal-Mart is trying to gain a foothold; 58 percent of all retailers in Japan are mom-and-pop stores and consumers historically have had to pay "top yen" rather than "discounted prices" for merchandise.

Policies can apply to all divisions and departments (for example, "We are an equal opportunity employer"). Some policies apply to a single department ("Employees in this department must take at least one training and development course each year"). Whatever their scope and form, policies serve as a mechanism for implementing strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table 7-3. Some example issues that may require a management policy are provided in Table 7-4.

TABLE 7-3 A Hierarchy of Policies

Company Strategy

Acquire a chain of retail stores to meet our sales growth and profitability objectives.

Supporting Policies

1. "All stores will be open from 8 A.M. to 8 P.M. Monday through Saturday." (This policy could increase retail sales if stores currently are open only 40 hours a week.)
2. "All stores must submit a Monthly Control Data Report." (This policy could reduce expense-to-sales ratios.)
3. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose." (This policy could allow the company to establish a national reputation.)
4. "All stores must adhere to the uniform pricing guidelines set forth in the Company Handbook." (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)

Divisional Objective

Increase the division's revenues from $10 million in 2009 to $15 million in 2010.

Supporting Policies

1. "Beginning in January 2010, each one of this division's salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened." (This policy could ensure that salespersons do not place too great an emphasis in certain areas.)
2. "Beginning in January 2010, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus." (This policy could increase employee productivity.)
3. "Beginning in January 2010, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach." (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective

Increase production from 20,000 units in 2009 to 30,000 units in 2010.

Supporting Policies

1. "Beginning in January 2010, employees will have the option of working up to 20 hours of overtime per week." (This policy could minimize the need to hire additional employees.)
2. "Beginning in January 2010, perfect attendance awards in the amount of $100 will be given to all employees who do not miss a workday in a given year." (This policy could decrease absenteeism and increase productivity.)
3. "Beginning in January 2010, new equipment must be leased rather than purchased." (This policy could reduce tax liabilities and thus allow more funds to be invested in modernizing production processes.)

TABLE 7-4 Some Issues That May Require a Management Policy

- To offer extensive or limited management development workshops and seminars
- To centralize or decentralize employee-training activities
- To recruit through employment agencies, college campuses, and/or newspapers
- To promote from within or to hire from the outside
- To promote on the basis of merit or on the basis of seniority
- To tie executive compensation to long-term and/or annual objectives
- To offer numerous or few employee benefits
- To negotiate directly or indirectly with labor unions
- To delegate authority for large expenditures or to centrally retain this authority
- To allow much, some, or no overtime work
- To establish a high- or low-safety stock of inventory
- To use one or more suppliers
- To buy, lease, or rent new production equipment
- To greatly or somewhat stress quality control
- To establish many or only a few production standards
- To operate one, two, or three shifts
- To discourage using insider information for personal gain
- To discourage sexual harassment
- To discourage smoking at work
- To discourage insider trading
- To discourage moonlighting

Resource Allocation

Resource allocation is a central management activity that allows for strategy execution. In organizations that do not use a strategic-management approach to decision making, resource allocation is often based on political or personal factors. Strategic management enables resources to be allocated according to priorities established by annual objectives.

Nothing could be more detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated by approved annual objectives.

All organizations have at least four types of resources that can be used to achieve desired objectives: financial resources, physical resources, human resources, and technological resources. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. A number of factors commonly prohibit effective resource allocation, including an overprotection of resources, too great an emphasis on short-run financial criteria, organizational politics, vague strategy targets, a reluctance to take risks, and a lack of sufficient knowledge.

Below the corporate level, there often exists an absence of systematic thinking about resources allocated and strategies of the firm. Yavitz and Newman explain why:

Managers normally have many more tasks than they can do. Managers must allocate time and resources among these tasks. Pressure builds up. Expenses are too high. The CEO wants a good financial report for the third quarter. Strategy formulation and implementation activities often get deferred. Today's problems soak up available energies and resources. Scrambled accounts and budgets fail to reveal the shift in allocation away from strategic needs to currently squeaking wheels.

The real value of any resource allocation program lies in the resulting accomplishment of an organization's objectives. Effective resource allocation does not guarantee successful strategy implementation because programs, personnel, controls, and commitment must breathe life into the resources provided. Strategic management itself is sometimes referred to as a "resource allocation process."

TABLE 7-5 Some Management Trade-Off Decisions Required in Strategy Implementation

To emphasize short-term profits or long-term growth
To emphasize profit margin or market share
To emphasize market development or market penetration
To lay off or furlough
To seek growth or stability
To take high risk or low risk
To be more socially responsible or more profitable
To outsource jobs or pay more to keep jobs at home
To acquire externally or to build internally
To restructure or reengineer
To use leverage or equity to raise funds
To use part-time or full-time employees

Managing Conflict

Interdependency of objectives and competition for limited resources often leads to conflict. Conflict can be defined as a disagreement between two or more parties on one or more issues. Establishing annual objectives can lead to conflict because individuals have different expectations and perceptions, schedules create pressure, personalities are incompatible, and misunderstandings between line managers (such as production supervisors) and staff managers (such as human resource specialists) occur. For example, a collection manager's objective of reducing bad debts by 50 percent in a given year may conflict with a divisional objective to increase sales by 20 percent.

Establishing objectives can lead to conflict because managers and strategists must make trade-offs, such as whether to emphasize short-term profits or long-term growth, profit margin or market share, market penetration or market development, growth or stability, high risk or low risk, and social responsiveness or profit maximization. Trade-offs are necessary because no firm has sufficient resources pursue all strategies to would benefit the firm. Table 7-5 reveals some important management trade-off decisions required in strategy implementation.

Conflict is unavoidable in organizations, so it is important that conflict be managed and resolved before dysfunctional consequences affect organizational performance.

Conflict is not always bad. An absence of conflict can signal indifference and apathy. Conflict can serve to energize opposing groups into action and may help managers identify problems.

Various approaches for managing and resolving conflict can be classified into three categories: avoidance, defusion, and confrontation. Avoidance includes such actions as ignoring the problem in hopes that the conflict will resolve itself or physically separating the conflicting individuals (or groups). Defusion can include playing down differences between conflicting parties while accentuating similarities and common interests, compromising so that there is neither a clear winner nor loser, resorting to majority rule, appealing to a higher authority, or redesigning present positions.

Confrontation is exemplified by exchanging members of conflicting parties so that each can gain an appreciation of the other's point of view or holding a meeting at which conflicting parties present their views and work through their differences.

Matching Structure with Strategy

Changes in strategy often require changes in the way an organization is structured for two major reasons. First, structure largely dictates how objectives and policies will be established. For example, objectives and policies established under a geographic organizational structure are couched in geographic terms. Objectives and policies are stated largely in terms of products in an organization whose structure is based on product groups. The structural strategy-implementation activities.

The second major reason why changes in strategy often require changes in structure is that structure dictates how resources will be allocated. If an organization's structure is based on customer groups, then resources will be allocated in that manner. Similarly, if an organization's structure is set up along functional business lines, then resources are allocated by functional areas. Unless new or revised strategies place emphasis in the same areas as old strategies, structural reorientation commonly becomes a part of strategy implementation.

Changes in strategy lead to changes in organizational structure. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, follow strategy. Without a strategy or reasons for being (mission), companies find it difficult to design an effective structure. Chandler found a particular structure sequence to be repeated often as organizations grow and change strategy over time; this sequence is depicted in Figure 7-3.

There is no one optimal organizational design or structure for a given strategy or type of organization. What is appropriate for one organization may not be appropriate for a similar firm, although successful firms in a given industry do tend to organize themselves in a similar way. For example, consumer goods companies tend to emulate the divisional structure-by-product form of organization. Small firms tend to be functionally structured (centralized). Medium-sized firms tend to be divisionally structured (decentralized). Large firms tend to use a strategic business unit (SBU) or matrix structure. As organizations grow, their structures generally change from simple to complex as a result of concatenation, or the linking together of several basic strategies.

Numerous external and internal forces affect an organization; no firm could change its structure in response to every one of these forces, because to do so would lead to chaos. However, when a firm changes its strategy, the existing organizational structure may become ineffective. As indicated in Table 7-6, symptoms of an ineffective organizational structure include too many levels of management, too many meetings attended by too many people, too much attention being directed toward solving interdepartmental conflicts, too large a span of control, and too many unachieved objectives. Changes in structure can facilitate strategy-implementation efforts, but changes in structure should not be expected to make a bad strategy good, to make bad managers good, or to make bad products sell.

Structure undeniably can and does influence strategy. Strategies formulated must be workable, so if a certain new strategy required massive structural changes it would not be an attractive choice. In this way, structure can shape the choice of strategies. But a more important concern is determining what types of structural changes are needed to implement new strategies and how these changes can best be accomplished. We examine this issue by focusing on seven basic types of organizational structure: functional, divisional by geographic area, divisional by product, divisional by customer, divisional process, strategic business unit (SBU), and matrix.

FIGURE 7-3

Chandler's Strategy-Structure Relationship

Source: Adapted from Alfred Chandler, *Strategy and Structure* (Cambridge, MA: MIT Press, 1962).

TABLE 7-6 Symptoms of an Ineffective Organizational Structure

1. Too many levels of management
2. Too many meetings attended by too many people
3. Too much attention being directed toward solving interdepartmental conflicts
4. Too large a span of control
5. Too many unachieved objectives
6. Declining corporate or business performance
7. Losing ground to rival firms
8. Revenue and/or earnings divided by number of employees and/or number of managers is low compared to rival firms

The Functional Structure

The most widely used structure is the functional or centralized type because this structure is the simplest and least expensive of the seven alternatives. A functional structure groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research and development, and management information systems. A university may structure its activities by major functions that include academic affairs, student services, alumni relations, athletics, maintenance, and accounting. Besides being simple and inexpensive, a functional structure also promotes specialization of labor, encourages efficient use of managerial and technical talent, minimizes the need for an elaborate control system, and allows rapid decision making.

Some disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, and is sometimes characterized by low employee morale, line/staff conflicts, poor delegation of authority, and inadequate planning for products and markets.

A functional structure often leads to short-term and narrow thinking that may undermine what is best for the firm as a whole. For example, the research and development department may strive to overdesign products and components to achieve technical elegance, while manufacturing may argue for low-frills products that can be mass produced more easily. Thus, communication is often not as good in a functional structure. Schein gives an example of a communication problem in a functional structure:

The word "marketing" will mean product development to the engineer, studying customers through market research to the product manager, merchandising to the salesperson, and constant change in design to the manufacturing manager. Then when these managers try to work together, they often attribute disagreements to personalities and fail to notice the deeper, shared assumptions that vary and dictate how each function thinks.

Most large companies have abandoned the functional structure in favor of decentralization and improved accountability. However, two large firms that still successfully use a functional structure are Nucor Steel, based in Charlotte, North Carolina, and Sharp, the $17 billion consumer electronics firm. Table 7-7summarizes the advantages and disadvantages of a functional organizational structure.

The Divisional Structure

The divisional or decentralized structure is the second most common type used by U.S. businesses. As a small organization grows, it has more difficulty managing different products and services in different markets. Some form of divisional structure generally becomes necessary to motivate employees, control operations, and compete successfully in diverse locations. The divisional structure can be organized in one of four ways: by geographic area, by product or service, by customer, or by process. With a divisional structure, functional activities are performed both centrally and in each separate division.

TABLE 7-7 Advantages and Disadvantages of a Functional Organizational Structure

Advantages	Disadvantages
1. Simple and inexpensive	1. Accountability forced to the top
2. Capitalizes on specialization of business activities such as marketing and finance	2. Delegation of authority and responsibility not encouraged
3. Minimizes need for elaborate control system	3. Minimizes career development
4. Allows for rapid decision making	4. Low employee/manager morale
	5. Inadequate planning for products and markets
	6. Leads to short-term, narrow thinking
	7. Leads to communication problems

Cisco Systems recently discarded its divisional structure by customer and reorganized into a functional structure. CEO John Chambers replaced the threecustomer structure based on big businesses, small businesses, and telecoms, and now the company has centralized its engineering and marketing units so that they focus on technologies such as wireless networks. Chambers says the goal was to eliminate duplication, but the change should not be viewed as a shift in strategy. Chambers's span of control in the new structure is reduced from 15 to 12 managers reporting directly to him. He continues to operate Cisco without a chief operating officer or a number-two executive.

Sun Microsystems recently reduced the number of its business units from seven to four. Kodak recently reduced its number of business units from seven by-customer divisions to five by-product divisions. As consumption patterns become increasingly similar worldwide, a by-product structure is becoming more effective than a by-customer or a by-geographic type divisional structure. In the restructuring, Kodak eliminated its global operations division and distributed those responsibilities across the new by-product divisions.

A divisional structure has some clear advantages. First and perhaps foremost, accountability is clear. That is, divisional managers can be held responsible for sales and profit levels. Because a divisional structure is based on extensive delegation of authority, managers and employees can easily see the results of their good or bad performances. As a result, employee morale is generally higher in a divisional structure than it is in a centralized structure. Other advantages of the divisional design are that it creates career development opportunities for managers, allows local control of situations, leads to a competitive climate within an organization, and allows new businesses and products to be added easily.

The divisional design is not without some limitations, however. Perhaps the most important limitation is that a divisional structure is costly, for a number of reasons. First, each division requires functional specialists who must be paid. Second, there exists some duplication of staff services, facilities, and personnel; for instance, functional specialists are also needed centrally (at headquarters) to coordinate divisional activities. Third, managers must be well qualified because the divisional design forces delegation of authority; better-qualified individuals require higher salaries. A divisional structure can also be costly because it requires an elaborate, headquarters-driven control system. Fourth, competition between divisions may become so intense that it is dysfunctional and leads to limited sharing of ideas and resources for the common good of the firm. Table 7-8 summarizes the advantages and disadvantages of divisional organizational structure.

TABLE 7-8 Advantages and Disadvantages of a Divisional Organizational Structure

Advantages	Disadvantages
1. Accountability is clear	1. Can be costly
2. Allows local control of local situations	2. Duplication of functional activities
3. Creates career development chances	3. Requires a skilled management force
4. Promotes delegation of authority	4. Requires an elaborate control system
5. Leads to competitive climate internally	5. Competition among divisions can become so intense as to be dysfunctional
6. Allows easy adding of new products or regions	6. Can lead to limited sharing of ideas and resources
7. Allows strict control and attention to products, customers, and/or regions	7. Some regions/products/customers may receive special treatment

Ghoshal and Bartlett, two leading scholars in strategic management, note the following: As their label clearly warns, divisions divide. The divisional model fragments companies' resources; it creates vertical communication channels that insulate business units and prevents them from sharing their strengths with one another. Consequently, the whole of the corporation is often less than the sum of its parts. A final limitation of the divisional design is that certain regions, products, or customers may sometimes receive special treatment, and it may be difficult to maintain consistent, companywide practices. Nonetheless, for most large organizations and many small firms, the advantages of a divisional structure more than offset the potential limitations.5 A divisional structure by geographic area is appropriate for organizations whose strategies need to be tailored to fit the particular needs and characteristics of customers in different geographic areas. This type of structure can be most appropriate for organizations that have similar branch facilities located in widely dispersed areas.

A divisional structure by geographic area allows local participation in decision making and improved coordination within a region. Hershey Foods is an example of a company organized using the divisional by geographic region type of structure. Hershey's divisions are United States, Canada, Mexico, Brazil, and Other. Analysts contend that this type of structure may not be best for Hershey because consumption patterns for candy are quite similar worldwide. An alternative—and perhaps better—type of structure for Hershey would be divisional by product because the company produces and sells three types of products worldwide: (1) chocolate, (2) nonchocolate, and (3) grocery.

The divisional structure by product (or services) is most effective for implementing strategies when specific products or services need special emphasis. Also, this type of structure is widely used when an organization offers only a few products or services or when an organization's products or services differ substantially. The divisional structure allows strict control over and attention to product lines, but it may also require a more skilled management force and reduced top management control. General Motors, DuPont, and Procter & Gamble use a divisional structure by product to implement strategies. Huffy, the largest bicycle company in the world, is another firm that is highly decentralized based on a divisional-by-product structure. Based in Ohio, Huffy's divisions are the Bicycle division, the Gerry Baby Products division, the Huffy Sports division, YLC Enterprises, and Washington Inventory Service. Harry Shaw, Huffy's chairman, believes decentralization is one of the keys to Huffy's success.

Eastman Chemical established a new by-product divisional organizational structure. The company's two new divisions, Eastman Company and Voridian Company, focus on chemicals and polymers, respectively. The Eastman division focuses on coatings, adhesives, inks, and plastics, whereas the Voridian division focuses on fibers, polyethylene, and other polymers. Microsoft recently reorganized the whole corporation into three large divisions-by-product. Headed by a president, the new divisions are (1) platform products and services, (2) business, and (3) entertainment and devices. The Swiss electrical-engineering company ABB Ltd. recently scrapped its two core divisions, (1) power technologies and (2) automation technologies, and replaced them with five new divisions: (1) power products, (2) power systems, (3) automation products, (4) process automation, and (5) robotics.

When a few major customers are of paramount importance and many different services are provided to these customers, then a divisional structure by customercan be the most effective way to implement strategies. This structure allows an organization to cater effectively to the requirements of clearly defined customer groups. For example, book publishing companies often organize their activities around customer groups, such as colleges, secondary schools, and private commercial schools. Some airline companies have two major customer divisions: passengers and freight or cargo services.

Merrill Lynch is organized into separate divisions that cater to different groups of customers, including wealthy individuals, institutional investors, and small corporations. Motorola's semiconductor chip division is also organized divisionally by customer, having three separate segments that sell to (1) the automotive and industrial market, (2) the mobile phone market, and (3) the data-networking market. The automotive and industrial segment is doing well, but the other two segments are faltering, which is a reason why Motorola is trying to divest its semiconductor operations. A divisional structure by process is similar to a functional structure, because activities are organized according to the way work is actually performed. However, a key difference between these two designs is that functional departments are not accountable for profits or revenues, whereas divisional process departments are evaluated on these criteria. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding, grinding, painting, and foundry work. In this case, all operations related to these specific processes would be grouped under the separate divisions. Each process (division) would be responsible for generating revenues and profits.

A divisional structure by process is similar to a functional structure, because activities are organized according to the way work is actually performed. However, a key difference between these two designs is that functional departments are not accountable for profits or revenues, whereas divisional process departments are evaluated on these criteria. An example of a divisional structure by process is a manufacturing business organized into six divisions: electrical work, glass cutting, welding, grinding, painting, and foundry work. In this case, all operations related to these specific processes would be grouped under the separate divisions. Each process (division) would be responsible for generating revenues and profits. The divisional structure by process can be particularly effective in achieving objectives when distinct production processes represent the thrust of competitiveness in an industry.

The Strategic Business Unit (SBU) Structure

As the number, size, and diversity of divisions in an organization increase, controlling and evaluating divisional operations become increasingly difficult for strategists. Increases in sales often are not accompanied by similar increases in profitability. The span of control becomes too large at top levels of the firm. For example, in a large conglomerate organization composed of 90 divisions, such as ConAgra, the chief executive officer could have difficulty even remembering the first names of divisional presidents. In multidivisional organizations, an SBU structure can greatly facilitate strategy-implementation efforts. ConAgra has put its many divisions into three primary SBUs: (1) food service (restaurants), (2) retail (grocery stores), and (3) agricultural products.

The SBU structure groups similar divisions into strategic business units and delegates authority and responsibility for each unit to a senior executive who reports directly to the chief executive officer. This change in structure can facilitate strategy implementation by improving coordination between similar divisions and channeling accountability to distinct business units. In a 100-division conglomerate, the divisions could perhaps be regrouped into 10 SBUs according to certain common characteristics, such as competing in the same industry, being located in the same area, or having the same customers.

Two disadvantages of an SBU structure are that it requires an additional layer of management, which increases salary expenses. Also, the role of the group vice president is often ambiguous. However, these limitations often do not outweigh the advantages of improved coordination and accountability. Another advantage of the SBU structure is that it makes the tasks of planning and control by the corporate office more manageable.

Citigroup in 2009 reorganized the whole company into two SBUs: (1) Citigroup, which includes the retail bank, the corporate and investment bank, the private bank, and global transaction services; and (2) Citi Holdings, which includes Citi's asset management and consumer finance segments, CitiMortgage, CitiFinancial, and the joint brokerage operations with Morgan Stanley. Citigroup's CEO, Vikram Pandit, says the restructuring will allow the company to reduce operating costs and to divest (spin off) Citi Holdings.

The huge computer firm Dell Inc., reorganized in 2009 into two SBUs. One SBU is Consumer Products and the other is Commercial. As part of its reorganization, Dell deleted the geographic divisions within its Consumer Products segment. However within its Commercial segment, there are now three worldwide units: (1) large enterprise, (2) public sector, and (3) small and midsize businesses. Dell is also closing a manufacturing facility in Austin, Texas, and laying off more employees as the company struggles to compete. Computer prices and demand are falling as competition increases. Atlantic Richfield Fairchild Industries, and Honeywell International are examples of firms that successfully use an SBU-type structure.
As illustrated in Figure 7-4, Sonoco Products Corporation, based in Hartsville, South Carolina, utilizes an SBU organizational structure. Note that Sonoco's

SBUs—Industrial Products and Consumer Products—each have four autonomous divisions that have their own sales, manufacturing, R&D, finance, HRM, and MIS functions.

The Matrix Structure

A matrix structure is the most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication (hence the term matrix). In contrast, functional and divisional structures depend primarily on vertical flows of authority and communication. A matrix structure can result in higher overhead because it creates more management positions. Other disadvantages of a matrix structure that contribute to overall complexity include dual lines of budget authority (a violation of the unity-of-command principle), dual sources of reward and punishment, shared authority, dual reporting channels, and a need for an extensive and effective communication system.

Despite its complexity, the matrix structure is widely used in many industries, including construction, health care, research, and defense. As indicated in Table 7-9, some advantages of a matrix structure are that project objectives are clear, there are many channels of communication, workers can see the visible results of their work, and shutting down a project can be accomplished relatively easily. Another advantage of a matrix structure is that it facilitates the use of specialized personnel, equipment, and facilities. Functional resources are shared in a matrix structure, rather than duplicated as in a divisional structure. Individuals with a high degree of expertise can divide their time as needed among projects, and they in turn develop their own skills and competencies more than in other structures. Walt Disney Corp. relies on a matrix structure.

FIGURE 7-4

Sonoco Products' SBU Organizational Chart

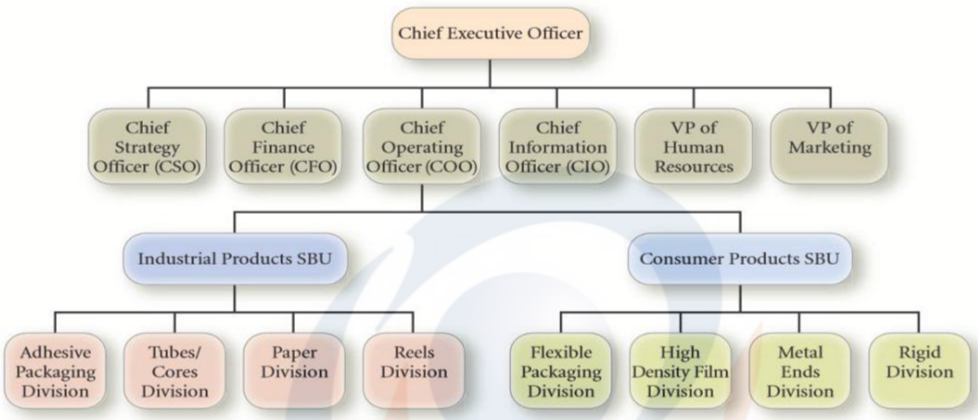


TABLE 7-9 Advantages and Disadvantages of a Matrix Structure

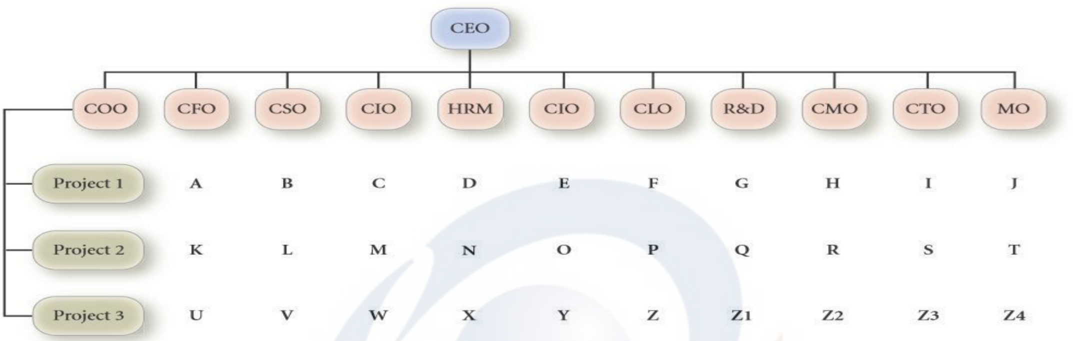
Advantages	Disadvantages
1. Project objectives are clear	1. Requires excellent vertical and horizontal flows of communication
2. Employees can clearly see results of their work	2. Costly because creates more manager positions
3. Shutting down a project is easily accomplished	3. Violates unity of command principle
4. Facilitates uses of special equipment/ personnel/facilities	4. Creates dual lines of budget authority
5. Functional resources are shared instead of duplicated as in a divisional structure	5. Creates dual sources of reward/punishment
	6. Creates shared authority and reporting
	7. Requires mutual trust and understanding

A typical matrix structure is illustrated in Figure 7-5. Note that the letters (A through Z4) refer to managers. For example, if you were manager A, you would be responsible for financial aspects of Project 1, and you would have two bosses: the Project 1 Manager on site and the CFO off site.

For a matrix structure to be effective, organizations need participative planning, training, clear mutual understanding of roles and responsibilities, excellent internal communication, and mutual trust and confidence. The matrix structure is being used more frequently by U.S. businesses because firms are pursuing strategies that add new products, customer groups, and technology to their range of activities. Out of these changes are coming product managers, functional managers, and geographic-area managers, all of whom have important strategic responsibilities. When several variables, such as product, customer, technology, geography, functional area, and line of business, have roughly equal strategic priorities, a matrix organization can be an effective structural form.

FIGURE 7-5

An Example Matrix Structure



Notes: Titles spelled out as follows.
Chief Executive Officer (CEO)
Chief Finance Officer (CFO)
Chief Strategy Officer (CSO)
Chief Information Officer (CIO)
Human Resources Manager (HRM)
Chief Operating Officer (COO)
Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Competitive Intelligence Officer (CIO)
Maintenance Officer (MO)

Some Do's and Don'ts in Developing Organizational Charts

Students analyzing strategic management cases are often asked to revise and develop a firm's organizational structure. This section provides some basic guidelines for this endeavor. There are some basic do's and don'ts in regard to devising or constructing organizational charts, especially for midsize to large firms. First of all, reserve the title CEO for the top executive of the firm. Don't use the title "president" for the top person; use it for the division top managers if there are divisions within the firm. Also, do not use the title "president" for functional business executives. They should have the title "chief," or "vice president," or "manager," or "officer," such as "Chief Information Officer," or "VP of Human Resources." Further, do not recommend a dual title (such as "CEO and president") for just one executive. The chairman of the board and CEO of Bristol-Myers Squibb, Peter Dolan, recently gave up his title as chairman. However, Pfizer's CEO, Jeffrey Kindler, recently added chairman of the board to his title when he succeeded Hank McKinnell as chairman of Pfizer's board. And Comverse Technology recently named Andre Dahan as its president, chief executive officer, and board director. Actually, "chairperson" is much better than "chairman" for this title.

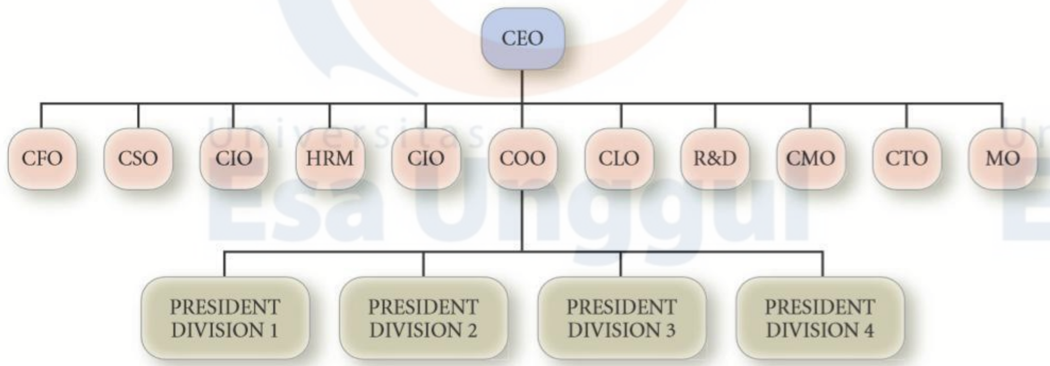
A significant movement began among corporate America in mid-2009 to split the chairperson of the board and the CEO positions in publicly held companies.6 The movement includes asking the New York Stock Exchange and Nasdaq to adopt listing rules that would require separate positions. About 37 percent of companies in the S&P 500 stock index have separate positions, up from 22 percent in 2002, but this still leaves plenty of room for improvement. Among European and Asian companies, the split in these two positions is much more common. For example, 79 percent of British companies split the positions, and all German and Dutch companies split the position.
Directly below the CEO, it is best to have a COO (chief operating officer) with any division presidents reporting directly to the COO. On the same level as the COO and also reporting to the CEO, draw in your functional business executives, such as a CFO (chief financial officer), VP of human resources, a CSO (chief strategy officer), a CIO (chief information officer), a CMO (chief marketing Officer), a VP of R&D, a VP of legal affairs, an investment relations officer, maintenance officer, and so on. Note in Figure 7-6 that these positions are labeled and placed appropriately. Note that a controller and/or treasurer would normally report to the CFO.

In developing an organizational chart, avoid having a particular person reporting tomore than one person above in the chain of command. This would violate the unity-of-command principle of management that "every employee should have just one boss." Also, do not have the CFO, CIO, CSO, human resource officer, or other functional positions report to the COO. All these positions report directly to the CEO.
A key consideration in devising an organizational structure concerns the divisions. Note whether the divisions (if any) of a firm presently are established based upon geography, customer, product, or process. If the firm's organizational chart is not available, you often can devise a chart based on the titles of executives. An important case analysis activity is for you to decide how the divisions of a firm should be organized for maximum effectiveness. Even if the firm presently has no divisions, determine whether the firm would operate better with divisions. In other words, which type of divisional breakdown do you (or your group or team) feel would be best for the firm in allocating resources, establishing objectives, and devising compensation incentives? This important strategic decision faces many midsize and large firms (and teams of students analyzing a strategic-management case). As consumption patterns become more and more similar worldwide, the divisionalby-product form of structure is increasingly the most effective. Be mindful that all firms have functional staff below their top executive and often readily provide this information, so be wary of concluding prematurely that a particular firm utilizes a functional structure. If you see the word "president" in the titles of executives, coupled with financial-reporting segments, such as by product or geographic region, then the firm is divisionally structured.

If the firm is large with numerous divisions, decide whether an SBU type of structure would be more appropriate to reduce the span of control reporting to the COO. Note in Figure 7-4 that the Sonoco Products' strategic business units (SBUs) are based on product groupings. An alternative SBU structure would have been to base the division groupings on location. One never knows for sure if a proposed or actual structure is indeed most effective for a particular firm. Note from Chandler's strategy-structure relationship (p. 221) illustrated previously in this chapter that declining financial performance signals a need for altering the structure.

FIGURE 7-6

Typical Top Managers of a Large Firm



Notes: Titles spelled out as follows.

Chief Executive Officer (CEO)
Chief Finance Officer (CFO)
Chief Strategy Officer (CSO)
Chief Information Officer (CIO)
Human Resources Manager (HRM)
Chief Operating Officer (COO)
Chief Legal Officer (CLO)
Research & Development Officer (R&D)
Chief Marketing Officer (CMO)
Chief Technology Officer (CTO)
Competitive Intelligence Officer (CIO)
Maintenance Officer (MO)

Restructuring, Reengineering, and E-Engineering

Restructuring and reengineering are becoming commonplace on the corporate landscape across the United States and Europe. Restructuring—also called downsizing, rightsizing, or delayering—involves reducing the size of the firm in terms of number of employees, number of divisions or units, and number of hierarchical levels in the firm's organizational structure. This reduction in size is intended to improve both efficiency and effectiveness. Restructuring is concerned primarily with shareholder well-being rather than employee well-being.

Recessionary economic conditions have forced many European companies to downsize, laying off managers and employees. This was almost unheard of prior to the mid-1990s because European labor unions and laws required lengthy negotiations or huge severance checks before workers could be terminated. In contrast to the United States, labor union executives of large European firms sit on most boards of directors.

Job security in European companies is slowly moving toward a U.S. scenario, in which firms lay off almost at will. From banks in Milan to factories in Mannheim, European employers are starting to show people the door in an effort to streamline operations, increase efficiency, and compete against already slim and trim U.S. firms. Massive U.S.-style layoffs are still rare in Europe, but unemployment rates throughout the continent are rising quite rapidly. European firms still prefer to downsize by attrition and retirement rather than by blanket layoffs because of culture, laws, and unions.

In contrast, reengineering is concerned more with employee and customer well-being than shareholder well-being. Reengineering—also called process management, process innovation, or process redesign—involves reconfiguring or redesigning work, jobs, and processes for the purpose of improving cost, quality, service, and speed. Reengineering does not usually affect the organizational structure or chart, nor does it imply job loss or employee layoffs. Whereas restructuring is concerned with eliminating or establishing, shrinking or enlarging, and moving organizational departments and divisions, the focus of reengineering is changing the way work is actually carried out. Reengineering is characterized by many tactical (short-term, business-function-specific) decisions, whereas restructuring is characterized by strategic (long-term, affecting all business functions) decisions. Developed by Motorola in 1986 and made famous by CEO Jack Welch at General Electric and more recently by Robert Nardelli, former CEO of Home Depot, Six Sigma is a quality-boosting process improvement technique that entails training several key persons in the firm in the techniques to monitor, measure, and improve processes and eliminate defects. Six Sigma has been widely applied across industries from retailing to financial services. CEO Dave Cote at Honeywell and CEO Jeff Immelt at General Electric spurred acceptance of Six Sigma, which aims to improve work processes and eliminate waste by training "select" employees who are given judo titles such as Master Black Belts, Black Belts, and Green Belts. Six Sigma was criticized in a 2007 Wall Street Journal article that cited many example firms whose stock price fell for a number of years after adoption of Six Sigma. The technique's reliance on the special group of trained employees is problematic and its use within retail firms such as Home Depot has not been as successful as in manufacturing firms.7

Restructuring

Firms often employ restructuring when various ratios appear out of line with competitors as determined through benchmarking exercises. Recall that benchmarking simply involves comparing a firm against the best firms in the industry on a wide variety of performancerelated criteria. Some benchmarking ratios commonly used in rationalizing the need for restructuring are headcount-to-sales-volume, or corporate-staff-to-operating-employees, or span-of-control figures.

The primary benefit sought from restructuring is cost reduction. For some highly bureaucratic firms, restructuring can actually rescue the firm from global competition and demise. But the downside of restructuring can be reduced employee commitment, creativity, and innovation that accompanies the uncertainty and trauma associated with pending and actual employee layoffs. In 2009, Walt Disney merged its ABC television network with its ABC Studios television production as part of a restructuring to cope with declining advertising and shrinking viewership. Disney also is laying off employees and offering buyouts to more than 600 executives. The Disney restructuring is paralleled by rival General Electric Company's merger of its NBC Network with its Universal Media Studios, which is also a bid to cut costs. Ad revenues at the four largest television networks in the United States fell 3 percent in 2009.

Another downside of restructuring is that many people today do not aspire to become managers, and many present-day managers are trying to get off the management track.8 Sentiment against joining management ranks is higher today than ever. About 80 percent of employees say they want nothing to do with management, a major shift from just a decade ago when 60 to 70 percent hoped to become managers. Managing others historically led to enhanced career mobility, financial rewards, and executive perks; but in today's global, more competitive, restructured arena, managerial jobs demand more hours and headaches with fewer financial rewards. Managers today manage more people spread over different locations, travel more, manage diverse functions, and are change agents even when they have nothing to do with the creation of the plan or disagree with its approach. Employers today are looking for people who can do things, not for people who make other people do things. Restructuring in many firms has made a manager's job an invisible, thankless role. More workers today are self-managed, entrepreneurs, interpreneurs, or team-managed. Managers today need to be counselors, motivators, financial advisors, and psychologists. They also run the risk of becoming technologically behind in their areas of expertise. "Dilbert" cartoons commonly portray managers as enemies or as morons.

Reengineering

The argument for a firm engaging in reengineering usually goes as follows: Many companies historically have been organized vertically by business function. This arrangement has led over time to managers' and employees' mind-sets being defined by their particular functions rather than by overall customer service, product quality, or corporate performance. The logic is that all firms tend to bureaucratize over time. As routines become entrenched, turf becomes delineated and defended, and politics takes precedence over performance. Walls that exist in the physical workplace can be reflections of "mental" walls.

In reengineering, a firm uses information technology to break down functional barriers and create a work system based on business processes, products, or outputs rather than on functions or inputs. Cornerstones of reengineering are decentralization, reciprocal interdependence, and information sharing. A firm that exemplifies complete information sharing is Springfield Remanufacturing Corporation, which provides to all employees a weekly income statement of the firm, as well as extensive information on other companies' performances.

The Wall Street Journal noted that reengineering today must go beyond knocking down internal walls that keep parts of a company from cooperating effectively; it must also knock down the external walls that prohibit or discourage cooperation with other firms—even rival firms.9 A maker of disposable diapers echoes this need differently when it says that to be successful "cooperation at the firm must stretch from stump to rump."

Hewlett-Packard is a good example of a company that has knocked down the external barriers to cooperation and practices modern reengineering. The HP of today shares its forecasts with all of its supply-chain partners and shares other critical information with its distributors and other stakeholders. HP does all the buying of resin for its many manufacturers, giving it a volume discount of up to 5 percent. HP has established many alliances and cooperative agreements of the kind discussed in Chapter 5.

A benefit of reengineering is that it offers employees the opportunity to see more clearly how their particular jobs affect the final product or service being marketed by the firm. However, reengineering can also raise manager and employee anxiety, which, unless calmed, can lead to corporate trauma.

Linking Performance and Pay to Strategies

Caterpillar Inc. is slashing its executive compensation by roughly 50 percent in 2009 and cutting pay for senior managers by up to 35 percent. Wages of other Caterpillar managers and employees are being lowered 15 percent. The company is cutting 20,000 more jobs amid a global slowdown in construction. Caterpillar’s sales for 2009 are projected to be $40 billion, down sharply from $51.32 billion in 2008.

CEOs at Japanese companies with more than $10 billion in annual revenues are paid about $1.3 million annually, including bonuses and stock options.10 This compares to an average CEO pay among European firms of $6 million and an average among U.S. firms of $12 million. As firms acquire other firms in other countries, these pay differences can cause resentment and even turmoil. Larger pay packages of American CEOs are socially less acceptable in many other countries. For example, in Japan, seniority rather than performance has been the key factor in determining pay, and harmony among managers is emphasized over individual excellence.

How can an organization’s reward system be more closely linked to strategic performance? How can decisions on salary increases, promotions, merit pay, and bonuses be more closely aligned to support the long-term strategic objectives of the organization? There are no widely accepted answers to these questions, but a dual bonus system based on both annual objectives and long-term objectives is becoming common. The percentage of a manager’s annual bonus attributable to short-term versus long-term results should vary by hierarchical level in the organization. A chief executive officer’s annual bonus could, for example, be determined on a 75 percent shortterm and 25 percent long-term basis. It is important that bonuses not be based solely on short-term results because such a system ignores long-term company strategies and objectives.

Wal-Mart Stores recently revamped its bonus program for hourly employees as the firm began paying bonuses based on sales, profit, and inventory performance at individual stores on a quarterly, rather than annual, basis. The average full-time employee at WalMart in the United States is paid $10.51 per hour, but this is significantly below the $17.46 average paid to Costco Wholesale Corp. employees.11 One aspect of the deepening global recession is that companies are instituting policies to allow their shareholders to vote on executive compensation policies. A “sayon-pay” policy was installed at 14 large companies in 2008–2009. Aflac was the first U.S. corporation to voluntarily give shareholders an advisory vote on executive compensation. Aflac did this back in 2007. Apple did this in 2008, as did H&R Block. Several companies that instituted say-on-pay policies in 2009 were Ingersoll-Rand, Verizon, and Motorola. In 2010 and 2011, Occidental Petroleum and Hewlett-Packard are expected to institute such policies. These new policies underscore how the financial crisis and shareholder outrage about top executive pay has affected compensation practice. None of the shareholder votes are binding on the companies, however, at least not so far. The U.S. House of Representatives recently passed a bill to formalize this shareholder tactic, which is gaining steam across the country as a means to combat exorbitant executive pay.

In an effort to cut costs and increase productivity, more and more Japanese companies are switching from seniority-based pay to performance-based approaches. Toyota has switched to a full merit system for 20,000 of its 70,000 white-collar workers. Fujitsu, Sony, Matsushita Electric Industrial, and Kao also have switched to merit pay systems. This switching is hurting morale at some Japanese companies, which have trained workers for decades to cooperate rather than to compete and to work in groups rather than individually.

Richard Brown, CEO of Electronic Data Systems (EDS), once said,
You have to start with an appraisal system that gives genuine feedback and differentiates performance. Some call it ranking people. That seems a little harsh. But you can’t have a manager checking a box that says you’re either stupendous, magnificent, very good, good, or average. Concise, constructive feedback is the fuel workers use to get better. A company that doesn’t differentiate performance risks losing its best people.

Profit sharing is another widely used form of incentive compensation. More than 30 percent of U.S. companies have profit sharing plans, but critics emphasize that too many factors affect profits for this to be a good criterion. Taxes, pricing, or an acquisition would wipe out profits, for example. Also, firms try to minimize profits in a sense to reduce taxes.

Still another criterion widely used to link performance and pay to strategies is gain sharing. Gain sharing requires employees or departments to establish performance targets; if actual results exceed objectives, all members get bonuses. More than 26 percent of U.S. companies use some form of gain sharing; about 75 percent of gain sharing plans have been adopted since 1980. Carrier, a subsidiary of United Technologies, has had excellent success with gain sharing in its six plants in Syracuse, New York; Firestone's tire plant in Wilson, North Carolina, has experienced similar success with gain sharing.

Criteria such as sales, profit, production efficiency, quality, and safety could also serve as bases for an effective bonus system.If an organization meets certain understood, agreedupon profit objectives, every member of the enterprise should share in the harvest. A bonus system can be an effective tool for motivating individuals to support strategy-implementation efforts. BankAmerica, for example, recently overhauled its incentive system to link pay to sales of the bank's most profitable products and services. Branch managers receive a base salary plus a bonus based both on the number of new customers and on sales of bank products. Every employee in each branch is also eligible for a bonus if the branch exceeds its goals. Thomas Peterson, a top BankAmerica executive, says, "We want to make people responsible for meeting their goals, so we pay incentives on sales, not on controlling costs or on being sure the parking lot is swept."

Five tests are often used to determine whether a performance-pay plan will benefit an organization:

1. Does the plan capture attention? Are people talking more about their activities and taking pride in early successes under the plan?
2. Do employees understand the plan? Can participants explain how it works and what they need to do to earn the incentive?
3. Is the plan improving communication? Do employees know more than they used to about the company's mission, plans, and objectives?

4. Does the plan pay out when it should? Are incentives being paid for desired results—and being withheld when objectives are not met?
5. Is the company or unit performing better? Are profits up? Has market share grown? Have gains resulted in part from the incentives?

In addition to a dual bonus system, a combination of reward strategy incentives, such as salary raises, stock options, fringe benefits, promotions, praise, recognition, criticism, fear, increased job autonomy, and awards, can be used to encourage managers and employees to push hard for successful strategic implementation. The range of options for getting people, departments, and divisions to actively support strategy-implementation activities in a particular organization is almost limitless. Merck, for example, recently gave each of its 37,000 employees a 10-year option to buy 100 shares of Merck stock at a set price of $127. Steven Darien, Merck's vice president of human resources, says, "We needed to find ways to get everyone in the workforce on board in terms of our goals and objectives. Company executives will begin meeting with all Merck workers to explore ways in which employees can contribute more."

Many countries worldwide are curbing executive pay in the wake of a global financial crisis. For example, the German cabinet recently imposed a $650,000 annual salary cap on banks that receive any government-backed capital injections. The German cabinet also imposed a ban on bank executive bonuses, stock options, and severance payments through 2012. Companies worldwide that participate in government bailouts or capital infusions are increasingly being constrained in executive compensation. The U.S. House of Representatives and Senate members severely criticized the CEOs of Ford, GM, and Chrysler for being paid so much in the face of failing companies.

There is rising public resentment over executive pay, and there are government restrictions on compensation. Based in Thousand Oaks, California, Amgen recently directed all shareholders to a 10-item questionnaire asking them what they think about the firm's compensation plan. Schering-Plough Corp. was going to use a similar survey just as it agreed to be acquired by Merck & Co. Home Depot now meets with shareholders regularly to hear their concerns. In April 2009, Royal Bank of Scotland Group PLC voted 9-to-1 against the bank's 2008 compensation package.

Executive pay declined slightly in 2008 and is expected to decrease somewhat substantially in 2009 as pressure for shareholders and government subsidy constraints lower payouts. The five CEOs who in 2008 received the highest compensation in a recent survey are Sanjay Jha at Motorola ($104 million), Ray Irani at Occidental Petroleum ($49.9 million), Robert Iger at Walt Disney ($49.7 million), Vikram Pandit at Citigroup ($38.2 million), and Louis Camilleri at Philip Morris ($36.4 million).

Managing Resistance to Change

No organization or individual can escape change. But the thought of change raises anxieties because people fear economic loss, inconvenience, uncertainty, and a break in normal social patterns. Almost any change in structure, technology, people, or strategies has the potential to disrupt comfortable interaction patterns. For this reason, people resist change. The strategic-management process itself can impose major changes on individuals and processes. Reorienting an organization to get people to think and act strategically is not an easy task.

Resistance to changecan be considered the single greatest threat to successful strategy implementation. Resistance regularly occurs in organizations in the form of sabotaging production machines, absenteeism, filing unfounded grievances, and an unwillingness to cooperate. People often resist strategy implementation because they do not understand what is happening or why changes are taking place. In that case, employees may simply need accurate information. Successful strategy implementation hinges upon managers' ability to develop an organizational climate conducive to change. Change must be viewed as an opportunity rather than as a threat by managers and employees.

Resistance to change can emerge at any stage or level of the strategy-implementation process. Although there are various approaches for implementing changes, three commonly used strategies are a force change strategy, an educative change strategy, and a rational or self-interest change strategy. A force change strategy involves giving orders and enforcing those orders; this strategy has the advantage of being fast, but it is plagued by low commitment and high resistance. The educative change strategy is one that presents information to convince people of the need for change; the disadvantage of an educative change strategy is that implementation becomes slow and difficult. However, this type of strategy evokes greater commitment and less resistance than does the force change strategy. Finally, a rational or self-interest change strategy is one that attempts to convince individuals that the change is to their personal advantage. When this appeal is successful, strategy implementation can be relatively easy. However, implementation changes are seldom to everyone's advantage.

The rational change strategy is the most desirable, so this approach is examined a bit further. Managers can improve the likelihood of successfully implementing change by carefully designing change efforts. Jack Duncan described a rational or self-interest change strategy as consisting of four steps. First, employees are invited to participate in the process of change and in the details of transition; participation allows everyone to give opinions, to feel a part of the change process, and to identify their own self-interests regarding the recommended change. Second, some motivation or incentive to change is required; self-interest can be the most important motivator. Third, communication is needed so that people can understand the purpose for the changes. Giving and receiving feedback is the fourth step: everyone enjoys knowing how things are going and how much progress is being made.

Because of diverse external and internal forces, change is a fact of life in organizations. The rate, speed, magnitude, and direction of changes vary over time by industry and organization. Strategists should strive to create a work environment in which change is recognized as necessary and beneficial so that individuals can more easily adapt to change. Adopting a strategic-management approach to decision making can itself require major changes in the philosophy and operations of a firm.

Strategists can take a number of positive actions to minimize managers' and employees' resistance to change. For example, individuals who will be affected by a change should be involved in the decision to make the change and in decisions about how to implement the change. Strategists should anticipate changes and develop and offer training and development workshops so that managers and employees can adapt to those changes. They also need to effectively communicate the need for changes. The strategic-management process can be described as a process of managing change.

Organizational change should be viewed today as a continuous process rather than as a project or event. The most successful organizations today continuously adapt to changes in the competitive environment, which themselves continue to change at an accelerating rate. It is not sufficient today to simply react to change. Managers need to anticipate change and ideally be the creator of change. Viewing change as a continuous process is in stark contrast to an old management doctrine regarding change, which was to unfreeze behavior, change the behavior, and then refreeze the new behavior. The new "continuous organizational change" philosophy should mirror the popular "continuous quality improvement philosophy."

Creating a Strategy-Supportive

Culture Strategists should strive to preserve, emphasize, and build upon aspects of an existing culture that support proposed new strategies. Aspects of an existing culture that are antagonistic to a proposed strategy should be identified and changed. Substantial research indicates that new strategies are often market-driven and dictated by competitive forces. For this reason, changing a firm's culture to fit a new strategy is usually more effective than changing a strategy to fit an existing culture. As indicated in Table 7-10, numerous techniques are available to alter an organization's culture, including recruitment, training, transfer, promotion, restructure of an organization's design, role modeling, positive reinforcement, and mentoring.

Schein indicated that the following elements are most useful in linking culture to strategy:

1. Formal statements of organizational philosophy, charters, creeds, materials used for recruitment and selection, and socialization.
2. Designing of physical spaces, facades, buildings.
3. Deliberate role modeling, teaching, and coaching by leaders.
4. Explicit reward and status system, promotion criteria.
5. Stories, legends, myths, and parables about key people and events.
6. What leaders pay attention to, measure, and control.

7. Leader reactions to critical incidents and organizational crises.

8. How the organization is designed and structured.
9. Organizational systems and procedures.
10. Criteria used for recruitment, selection, promotion, leveling off, retirement, and "excommunication" of people.

TABLE 7-10 Ways and Means for Altering an Organization's Culture

1. Recruitment
2. Training
3. Transfer
4. Promotion
5. Restructuring
6. Reengineering
7. Role modeling
8. Positive reinforcement
9. Mentoring
10. Revising vision and/or mission
11. Redesigning physical spaces/facades
12. Altering reward system
13. Altering organizational policies/procedures/practices

In the personal and religious side of life, the impact of loss and change is easy to see. Memories of loss and change often haunt individuals and organizations for years. Ibsen wrote, "Rob the average man of his life illusion and you rob him of his happiness at the same stroke." When attachments to a culture are severed in an organization's attempt to change direction, employees and managers often experience deep feelings of grief. This phenomenon commonly occurs when external conditions dictate the need for a new strategy. Managers and employees often struggle to find meaning in a situation that changed many years before. Some people find comfort in memories; others find solace in the present. Weak linkages between strategic management and organizational culture can jeopardize performance and success. Deal and Kennedy emphasized that making strategic changes in an organization always threatens a culture:

People form strong attachments to heroes, legends, the rituals of daily life, the hoopla of extravaganza and ceremonies, and all the symbols of the workplace. Change strips relationships and leaves employees confused, insecure, and often angry. Unless something can be done to provide support for transitions from old to new, the force of a culture can neutralize and emasculate strategy changes

Production/Operations Concerns When Implementing Strategies

Production/operations capabilities, limitations, and policies can significantly enhance or inhibit the attainment of objectives. Production processes typically constitute more than 70 percent of a firm's total assets. A major part of the strategy-implementation process takes place at the production site. Production-related decisions on plant size, plant location, product design, choice of equipment, kind of tooling, size of inventory, inventory control, quality control, cost control, use of standards, job specialization, employee training, equipment and resource utilization, shipping and packaging, and technological innovation can have a dramatic impact on the success or failure of strategy-implementation efforts. Examples of adjustments in production systems that could be required to implement various strategies are provided in Table 7-11 for both for-profit and nonprofit organizations. For instance, note that when a bank formulates and selects a strategy to add 10 new branches, a production-related implementation concern is site location. The largest bicycle company in the United States, Huffy, recently ended its own production of bikes and now contracts out those services to Asian and Mexican manufacturers. Huffy focuses instead onthe design, marketing, and distribution of bikes, but it no longer produces bikes itself. The Dayton, Ohio, company closed its plants in Ohio, Missouri, and Mississippi.

TABLE 7-11 Production Management and Strategy Implementation

Type of Organization	Strategy Being Implemented	Production System Adjustments
Hospital	Adding a cancer center (Product Development)	Purchase specialized equipment and add specialized people.
Bank	Adding 10 new branches (Market Development)	Perform site location analysis.
Beer brewery	Purchasing a barley farm operation (Backward Integration)	Revise the inventory control system.
Steel manufacturer	Acquiring a fast-food chain (Unrelated Diversification)	Improve the quality control system.
Computer company	Purchasing a retail distribution chain (Forward Integration)	Alter the shipping, packaging, and transportation systems.

Just-in-time (JIT) production approaches have withstood the test of time. JIT significantly reduces the costs of implementing strategies. With JIT, parts and materials are delivered to a production site just as they are needed, rather than being stockpiled as a hedge against later deliveries. Harley-Davidson reports that at one plant alone, JIT freed $22 million previously tied up in inventory and greatly reduced reorder lead time.

Factors that should be studied before locating production facilities include the availability of major resources, the prevailing wage rates in the area, transportation costs related to shipping and receiving, the location of major markets, political risks in the area or country, and the availability of trainable employees.

For high-technology companies, production costs may not be as important as production flexibility because major product changes can be needed often. Industries such as biogenetics and plastics rely on production systems that must be flexible enough to allow frequent changes and the rapid introduction of new products. An article in the Harvard Business Review explained why some organizations get into trouble:

They too slowly realize that a change in product strategy alters the tasks of a production system. These tasks, which can be stated in terms of requirements for cost, product flexibility, volume flexibility, product performance, and product consistency, determine which manufacturing policies are appropriate. As strategies shift over time, so must production policies covering the location and scale of manufacturing facilities, the choice of manufacturing process, the degree of vertical integration of each manufacturing facility, the use of R&D units, the control of the production system, and the licensing of technology.

A common management practice, cross-training of employees, can facilitate strategy implementation and can yield many benefits. Employees gain a better understanding of the whole business and can contribute better ideas in planning sessions. Cross-training employees can, however, thrust managers into roles that emphasize counseling and coaching over directing and enforcing and can necessitate substantial investments in training and incentives.

Human Resource Concerns When Implementing Strategies

More and more companies are instituting furloughs to cut costs as an alternative to laying off employees. Furloughs are temporary layoffs and even white-collar managers are being given furloughs, once confined to blue-collar workers. A few organizations furloughing professional workers in 2009 included Gulfstream Aerospace, Media General, Gannett, the University of Maryland, Clemson University, and Spansion. Recent research shows that 11 percent of larger U.S. companies implemented furloughs during the global economic recession.21 Winnebago Industries, for example, required all salaried employees to take a week-long furlough, which saved the company $850,000. The Port of Seattle saved $2.9 million by furloughing all of its 800 nonunion workers, mostly professionals, for two weeks. Table 7-12 lists ways that companies today are reducing labor costs to stay financially sound.

The job of human resource manager is changing rapidly as companies continue to downsize and reorganize. Strategic responsibilities of the human resource manager include assessing the staffing needs and costs for alternative strategies proposed during strategy formulation and developing a staffing plan for effectively implementing strategies. This plan must consider how best to manage spiraling health care insurance costs. Employers’ health coverage expenses consume an average 26 percent of firms’ net profits, even though most companies now require employees to pay part of their health insurance premiums. The plan must also include how to motivate employees and managers during a time when layoffs are common and workloads are high.

TABLE 7-12 Labor Cost-Saving Tactics

Salary freeze
Hiring freeze
Salary reductions
Reduce employee benefits
Raise employee contribution to health-care premiums
Reduce employee 401(k)/403(b) match
Reduce employee workweek
Mandatory furlough
Voluntary furlough
Hire temporary instead of full-time employees
Hire contract employees instead of full-time employees
Volunteer buyouts (Walt Disney is doing this)
Halt production for 3 days a week (Toyota Motor is doing this)
Layoffs
Early retirement
Reducing/eliminating bonuses

Source: Based on Dana Mattioli, "Employers Make Cuts Despite Belief Upturn Is Near," *Wall Street Journal* (April 23, 2009): B4.

The human resource department must develop performance incentives that clearly link performance and pay to strategies. The process of empowering managers and employees through their involvement in strategic-management activities yields the greatest benefits when all organizational members understand clearly how they will benefit personally if the firm does well. Linking company and personal benefits is a major new strategic responsibility of human resource managers. Other new responsibilities for human resource managers may include establishing and administering an employee stock ownership plan (ESOP), instituting an effective child-care policy, and providing leadership for managers and employees in a way that allows them to balance work and family.

A well-designed strategic-management system can fail if insufficient attention is given to the human resource dimension. Human resource problems that arise when businesses implement strategies can usually be traced to one of three causes: (1) disruption of social and political structures, (2) failure to match individuals' aptitudes with implementation tasks, and (3) inadequate top management support for implementation activities.

Strategy implementation poses a threat to many managers and employees in an organization. New power and status relationships are anticipated and realized. New formal and informal groups' values, beliefs, and priorities may be largely unknown. Managers and employees may become engaged in resistance behavior as their roles, prerogatives, and power in the firm change. Disruption of social and political structures that accompany strategy execution must be anticipated and considered during strategy formulation and managed during strategy implementation.

A concern in matching managers with strategy is that jobs have specific and relatively static responsibilities, although people are dynamic in their personal development. Commonly used methods that match managers with strategies to be implemented include transferring managers, developing leadership workshops, offering career development activities, promotions, job enlargement, and job enrichment. A number of other guidelines can help ensure that human relationships facilitate rather than disrupt strategy-implementation efforts. Specifically, managers should do a lot of chatting and informal questioning to stay abreast of how things are progressing and to know when to intervene. Managers can build support for strategy-implementation efforts by giving few orders, announcing few decisions, depending heavily on informal questioning, and seeking to probe and clarify until a consensus emerges. Key thrusts that succeed should be rewarded generously and visibly.

It is surprising that so often during strategy formulation, individual values, skills, and abilities needed for successful strategy implementation are not considered. It is rare that a firm selecting new strategies or significantly altering existing strategies possesses the right line and staff personnel in the right positions for successful strategy implementation. The need to match individual aptitudes with strategy-implementation tasks should be considered in strategy choice.

Inadequate support from strategists for implementation activities often undermines organizational success. Chief executive officers, small business owners, and government agency heads must be personally committed to strategy implementation and express this commitment in highly visible ways. Strategists' formal statements about the importance of strategic management must be consistent with actual support and rewards given for activities completed and objectives reached. Otherwise, stress created by inconsistency can cause uncertainty among managers and employees at all levels.

Perhaps the best method for preventing and overcoming human resource problems in strategic management is to actively involve as many managers and employees as possible in the process. Although time consuming, this approach builds understanding, trust, commitment, and ownership and reduces resentment and hostility. The true potential of strategy formulation and implementation resides in people.

Employee Stock Ownership Plans (ESOPs)

An ESOP is a tax-qualified, defined-contribution, employee-benefit plan whereby employees purchase stock of the company through borrowed money or cash contributions. ESOPs empower employees to work as owners; this is a primary reason why the number of ESOPs have grown dramatically to more than 10,000 firms covering more than 10 million employees. ESOPs now control more than $600 billion in corporate stock in the United States.

Besides reducing worker alienation and stimulating productivity, ESOPs allow firms other benefits, such as substantial tax savings. Principal, interest, and dividend payments on ESOP-funded debt are tax deductible. Banks lend money to ESOPs at interest rates below prime. This money can be repaid in pretax dollars, lowering the debt service as much as 30 percent in some cases. "The ownership culture really makes a difference, when management is a facilitator, not a dictator," says Corey Rosen, executive director of the National Center for Employee Ownership. Fifteen employee-owned companies are listed in Table 7-13.

TABLE 7-13 Fifteen Example ESOP Firms

Firm	Headquarters Location
Publix Supermarkets	Florida
Science Applications	California
Lifetouch	Minnesota
John Lewis Partnership	United Kingdom
Mondragon Cooperative	Spain
Houchens Industries	Kentucky
Amsted Industries	Illinois
Mast General Store	North Carolina
HDR, Inc.	Nebraska
Yoke's Fresh Market	Washington
SPARTA, Inc.	California
Hy-Vee	Iowa
Bi-Mart	Washington
Ferrellgas Partners	Kansas

Source: Based on Edward Iwata, "ESOPs Can Offer Both Upsides, Drawbacks," *USA Today* (April 3, 2007): 2B.

If an ESOP owns more than 50 percent of the firm, those who lend money to the ESOP are taxed on only 50 percent of the income received on the loans. ESOPs are not for every firm, however, because the initial legal, accounting, actuarial, and appraisal fees to set up an ESOP are about $50,000 for a small or midsized firm, with annual administration expenses of about $15,000. Analysts say ESOPs also do not work well in firms that have fluctuating payrolls and profits. Human resource managers in many firms conduct preliminary research to determine the desirability of an ESOP, and then they facilitate its establishment and administration if benefits outweigh the costs.

Wyatt Cafeterias, a southwestern United States operator of 120 cafeterias, also adopted the ESOP concept to prevent a hostile takeover. Employee productivity at Wyatt greatly increased since the ESOP began, as illustrated in the following quote:
The key employee in our entire organization is the person serving the customer on the cafeteria line. In the past, because of high employee turnover and entry-level wages for many line jobs, these employees received far less attention and recognition than managers. We now tell the tea cart server, "You own the place. Don't wait for the manager to tell you how to do your job better or how to provide better service. You take care of it." Sure, we're looking for productivity increases, but since we began pushing decisions down to the level of people who deal directly with customers, we've discovered an awesome side effect— suddenly the work crews have this "happy to be here" attitude that the customers really love.

Balancing Work Life and Home Life

Work/family strategies have become so popular among companies today that the strategies now represent a competitive advantage for those firms that offer such benefits as elder care assistance, flexible scheduling, job sharing, adoption benefits, an on-site summer camp, employee help lines, pet care, and even lawn service referrals. New corporate titles such as work/life coordinator and director of diversity are becoming common.

Working Mother magazine annually published its listing of "The 100 Best Companies for Working Mothers" (www.workingmother.com). Three especially important variables used in the ranking were availability of flextime, advancement opportunities, and equitable distribution of benefits among companies. Other important criteria are compressed weeks, telecommuting, job sharing, childcare facilities, maternity leave for both parents, mentoring, career development, and promotion for women. Working Mother's top eight best companies for working women in 2009 are provided in Table 7-14. Working Mother also conducts extensive research to determine the best U.S. firms for women of color.

TABLE 7-14 A Few Excellent Workplaces for Women

1. Abbott—An elaborate child care center at headquarters serves 670 infants, toddlers, and pre-schoolers; employees can visit their children during the day.
2. Allstate Insurance—Child care centers are abundant: all employees have access to discounted child care.
3. American Express—Flex scheduling and tuition reimbursement enable most employees to continue their education.
4. Citi—Telecommuting for employees makes caring for family a priority.
5. Fannie Mae—Reimburses tuition-related expenses up to $10,000 per child; provides four weeks of paid maternity leave.
6. IBM—Work/life balance is an integral part of the IBM culture.
7. Johnson & Johnson—Nearly all employees say you never have to choose between family and work at J&J.
8. Merck & Company—Flextime and tuition reimbursement are available to nearly all Merck employees.

Source: Based on 2009 Web site, http://www.workingmother.com/web?service=direct/1/ViewArticlePage/dlinkFullArticle&sp=1780&sp=94.

Human resource managers need to foster a more effective balancing of professional and private lives because nearly 60 million people in the United States are now part of two-career families. A corporate objective to become more lean and mean must today include consideration for the fact that a good home life contributes immensely to a good work life.

The work/family issue is no longer just a women's issue. Some specific measures that firms are taking to address this issue are providing spouse relocation assistance as an employee benefit; providing company resources for family recreational and educational use; establishing employee country clubs, such as those at IBM and Bethlehem Steel; and creating family/work interaction opportunities. A study by Joseph Pleck of Wheaton College found that in companies that do not offer paternity leave for fathers as a benefit, most men take short, informal paternity leaves anyway by combining vacation time and sick days.

Some organizations have developed family days, when family members are invited into the workplace, taken on plant or office tours, dined by management, and given a chance to see exactly what other family members do each day. Family days are inexpensive and increase the employee's pride in working for the organization. Flexible working hours during the week are another human resource response to the need for individuals to balance work life and home life. The work/family topic is being made part of the agenda at meetings and thus is being discussed in many organizations.

Only 2.6 percent of Fortune 500 firms have a woman CEO. However, recent studies have found that companies with more female executives and directors outperform other firms.24 Judy Rosener at the University of California, Irvine, says, "Brain scans prove that men and women think differently, so companies with a mix of male and female executives will outperform competitors that rely on leadership of a single sex." It is not that women are better than men, Rosener says. It is the mix of thinking styles that is key to management effectiveness.

During the first week of 2009, Ellen Kullman replaced Chad Holliday as CEO of DuPont, which brought to 13 the number of female CEOs running the 500 largest public firms in the United States. Thirteen is a record number, but only one more than the total for the prior year. Lynn Elsenhans became CEO of Sunoco in 2008. In 2008, two Fortune 500 women CEOs departed: Meg Whitman at eBay and Paula Reynolds at Safeco.

USA Today tracks the performance of women CEOs versus male CEOs, and their research shows virtually no difference in the two groups.25 The year 2008 saw the S&P 500 stocks fall 38.5 percent, its worst year since 1937. The stock of firms that year with women CEOs fell 42.7 percent, but some firms run by women CEOs did much better, such as Kraft Foods, down only 18 percent under Irene Rosenfeld. Two firms doing great under woman CEOs are Avon under Andrea Jung and Reynolds American under Susan Ivey. Those stocks are up 65.4 percent and 20.8 percent, respectively, since those women became CEO. Table 7-15 gives the 13 Fortune 500 Women CEOs in 2009.

TABLE 7-15 Fortune 500 Women CEOs in 2009

CEO	Company	Fortune 500 Rank
Angela Braly	WellPoint	33
Patricia Woertz	Archer Daniels Midland	52
Lynn Elsenhans	Sunoco	56
Indra Nooyi	PepsiCo	59
Irene Rosenfeld	Kraft Foods	63
Carol Meyrowitz	TJX	132
Mary Sammons	Rite Aid	142
Anne Mulcahy	Xerox	144
Brenda Barnes	Sara Lee	203
Andrea Jung	Avon Products	265
Susan Ivey	Reynolds American	290
Christina Gold	Western Union	473

There is great room for improvement in removing the glass ceilingdomestically, especially considering that women make up 47 percent of the U.S. labor force. Glass ceiling refers to the invisible barrier in many firms that bars women and minorities from top-level management positions. The United States leads the world in promoting women and minorities into mid- and top-level managerial positions in business.

Boeing's firing of CEO Harry Stonecipher for having an extramarital affair raised public awareness of office romance. However, just 12 percent of 391 companies surveyed by the American Management Association have written guidelines on office dating.26 The fact of the matter is that most employers in the United States turn a blind eye to marital cheating. Some employers, such as Southwest Airlines, which employs more than 1,000 married couples, explicitly allow consensual office relationships. Research suggests that more men than women engage in extramarital affairs at work, roughly 22 percent to 15 percent; however, the percentage of women having extramarital affairs is increasing steadily, whereas the percentage of men having affairs with co-workers is holding steady.27 If an affair is disrupting your work, then "the first step is to go to the offending person privately and try to resolve the matter. If that fails, then go to the human-resources manager seeking assistance."28 Filing a discrimination lawsuit based on the affair is recommended only as a last resort because courts generally rule that co-workers' injuries are not pervasive enough to warrant any damages.

Benefits of a Diverse Workforce

Toyota has committed almost $8 billion over 10 years to diversify its workforce and to use more minority suppliers. Hundreds of other firms, such as Ford Motor Company and CocaCola, are also striving to become more diversified in their workforces. TJX Companies, the parent of 1,500 T. J. Maxx and Marshall's stores, has reaped great benefits and is an exemplary company in terms of diversity.

An organization can perhaps be most effective when its workforce mirrors the diversity of its customers. For global companies, this goal can be optimistic, but it is a worthwhile goal.

Corporate Wellness

Programs A recent BusinessWeek cover story article details how firms are striving to lower the accelerating costs of employees' health-care insurance premiums.29 Many firms such as Scotts Miracle-Gro Company (based in Marysville, Ohio), IBM, and Microsoft are implementing wellness programs, requiring employees to get healthier or pay higher insurance premiums. Employees that do get healthier win bonuses, free trips, and pay lower premiums; nonconforming employees pay higher premiums and receive no "healthy" benefits. Wellness of employees has become a strategic issue for many firms. Most firms require a health examination as a part of an employment application, and healthiness is more and more becoming a hiring factor. Michael Porter, coauthor of Redefining Health Care, says, "We have this notion that you can gorge on hot dogs, be in a pie-eating contest, and drink every day, and society will take care of you. We can't afford to let individuals drive up company costs because they're not willing to address their own health problems."

Slightly more than 60 percent of companies with 10,000 or more employees had a wellness program in 2008, up from 47 percent in 2005.30 Among firms with wellness programs, the average cost per employee was $7,173. However, in the weak economy of late, companies are cutting back on their wellness programs. Many employees say they are so stressed about work and finances they have little time to eat right and exercise. PepsiCo in 2008 introduced a $600 surcharge for all its employees that smoke; the company has a smoking-cessation program. PepsiCo's smoking quit rate among employees increased to 34 percent in 2008 versus 20 percent in 2007.

Wellness programs provide counseling to employees and seek lifestyle changes to achieve healthier living. For example, trans fats are a major cause of heart disease. Near elimination of trans fats in one's diet will reduce one's risk for heart attack by as much as 19 percent, according to a recent article. New York City now requires restaurants to inform customers about levels of trans fat being served in prepared foods. Chicago is considering a similar ban on trans fats. Denmark in 2003 became the first country to strictly regulate trans fats.

Restaurant chains are only slowly reducing trans fat levels in served foods because (1) trans fat oils make fried foods crispier, (2) trans fats give baked goods a longer shelf life, (3) trans fat oils can be used multiple times compared to other cooking oils, and
(4) trans fat oils taste better. Three restaurant chains have switched to oils free of trans fat—Chili's, Ruby Tuesday, and Wendy's—but some chains still may use trans fat oils, including Kentucky Fried Chicken, McDonald's, Dunkin' Donuts, Taco Bell, and Burger King. Marriott International in February 2007 eliminated trans fats from the food it serves at its 2,300 North American hotels, becoming the first big hotel chain to do so, although the 18-hotel Lowes luxury chain is close behind. Marriott's change includes its Renaissance, Courtyard, and Residence Inn brands.
Saturated fats are also bad, so one should avoid eating too much red meat and dairy products, which are high in saturated fats. Seven key lifestyle habits listed in Table 7-16 may significantly improve health and longevity.