

## Strategic Management - The Competitive Edge

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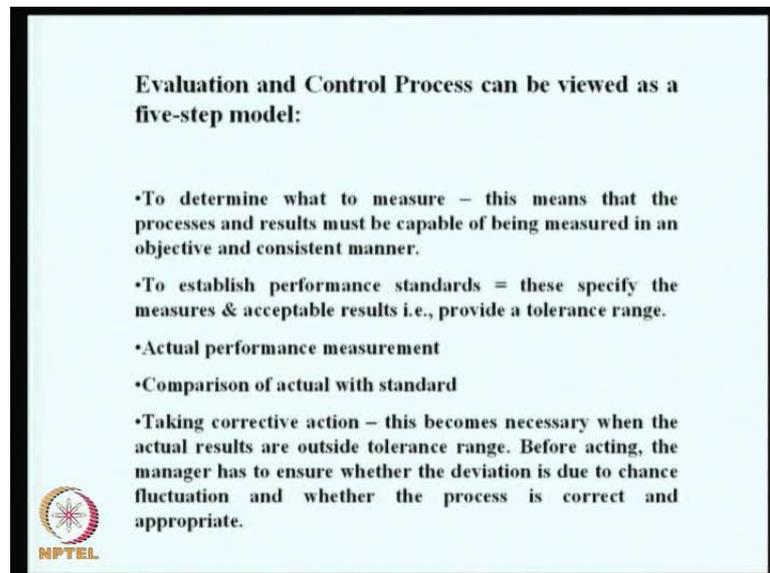
Indian Institute of Science, Bangalore

Lecture No. # 29

Evaluation and Control

Welcome to this class on evaluation and control process. We will look at how to evaluate strategy and what is the type of controls that we can initiate in this whole process.

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**Evaluation and Control Process can be viewed as a five-step model:**

- To determine what to measure – this means that the processes and results must be capable of being measured in an objective and consistent manner.
- To establish performance standards = these specify the measures & acceptable results i.e., provide a tolerance range.
- Actual performance measurement
- Comparison of actual with standard
- Taking corrective action – this becomes necessary when the actual results are outside tolerance range. Before acting, the manager has to ensure whether the deviation is due to chance fluctuation and whether the process is correct and appropriate.

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So, the evaluation and control process can be viewed as having a five step model. In the first step, we look at what is to be measured, that is to determine what to measure. This means, that the processes and results must be capable of being measured in an objective and consistent manner, that is, you must be able to as far as possible give quantitative standards of performance. This is the way we would like an organization, would like to look at. So, instead of making it subjective, it would like to have an objective evaluation of the whole process.

The second step in this, once you determine what you want to measure, the second step would be to establish the performance standards. What do these standards do? They specify the measures and the acceptable results, that is, they provide a tolerance range.

So, they tell you this is the sales performance that is expected from you. Let us say, what is the level to which the management is prepared to give a tolerance, so plus or minus, 10 percent or 15 percent? What is it that the management is prepared to take? So, suppose you exceed the target, the management always welcomes such performance.

Suppose, you are not able to meet the target as a marketing strategist let us say, then the management would like to know by how much the shortfall is. Suppose, the tolerance limit gives the range to which the management is prepared to accept the shortfall, it can be 10 percent or 15 percent, to what extent. Then, that will be known by the actual performance measurement. So, to what level have you been able to achieve the performance? What was the expected level? So, you get what is that type of comparison, when you make that comparison between the actual and the standard. You get to know the gap that is there.

So, what is the reason for taking this gap? The reason for taking this gap is to find out, whether corrective action can be taken and still the performance is achieved even now. That is the type of thinking which as strategic manager would always be having in mind. So, he will be always looking at, suppose there are some corrective actions required, can he initiate those corrective actions and the performance brought to the target levels? So, taking corrective actions becomes necessary, when the actual results are outside the tolerance range. Before acting, the manager has to ensure whether the deviation is due to chance fluctuation or whether the process is correct and appropriate.

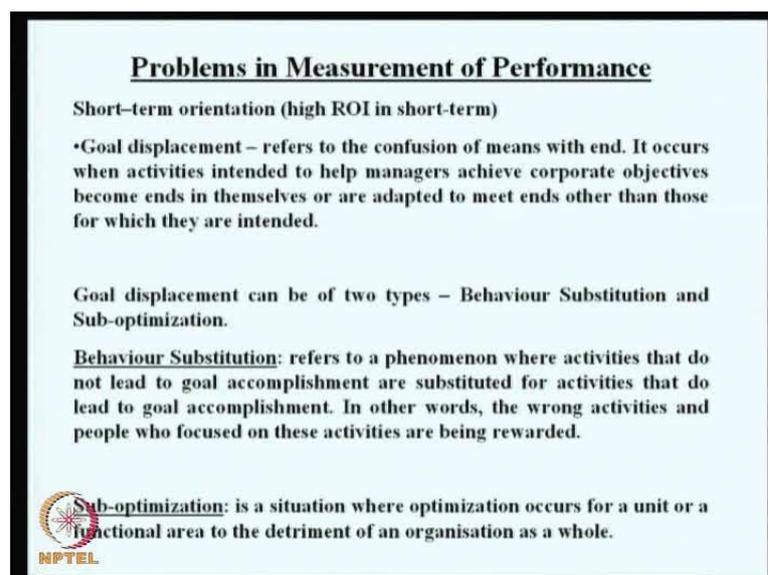
So, in other words, the manager has to find out whether this variation in performance is due to random causes, that is random causes many times beyond his control. Suppose, they are due to causes where he can control, let us say, then he can exercise that control. I will give you a very simple example for this. Let us say, there are two consumer products. You are making one of them; your competitor is making the other one. Both are having, let us say almost the identical attributes. So, you can say, it is a washing powder type of thing. So, you see some advertisements. One advertisement is from one well known company, another advertisement almost countering this advertisement of this well known company, and both of them claiming that they can remove the stain on the clothes.

Now, the question that comes is each of these products claims to have more or less the similar attributes. One wants to cash in on the brand name. Second one having brand name, but not as high as the first one. So, now as a consumer, which one will you prefer- the first or the second one and what consideration?

Suppose, let us say you find that the second one is being priced much lower than number 1, then there is a very good possibility that the consumer might go for this second product. Then, let us say you are the marketing manager for strategic manager for number 1. Then, what is the corrective action that is required from your end, which is possible from your side, that is, to match the competitor in pricing? So, if not be more competitive than him. More competitive in the sense, what is being more competitive than him?

Suppose he is pricing at  $x$ . You are pricing at  $x$  minus  $\Delta x$ , then you become more competitive than him with respect to pricing. So, if you are not able to do that, if you can at least match him at  $x$ , then what will the consumer think? The consumer thinks that he has a better branded product at the same price, then “why not take the better branded product instead of the less branded product?”. According to his perception, so still you are on a safer side. So, this is the type of corrective actions which are possible.

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**Problems in Measurement of Performance**

Short-term orientation (high ROI in short-term)

•Goal displacement – refers to the confusion of means with end. It occurs when activities intended to help managers achieve corporate objectives become ends in themselves or are adapted to meet ends other than those for which they are intended.

Goal displacement can be of two types – Behaviour Substitution and Sub-optimization.

**Behaviour Substitution:** refers to a phenomenon where activities that do not lead to goal accomplishment are substituted for activities that do lead to goal accomplishment. In other words, the wrong activities and people who focused on these activities are being rewarded.

**Sub-optimization:** is a situation where optimization occurs for a unit or a functional area to the detriment of an organisation as a whole.

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So, this is the way things work, but still there are large problems in this measurement of performance. Companies want high return on investment in short term, then it becomes a

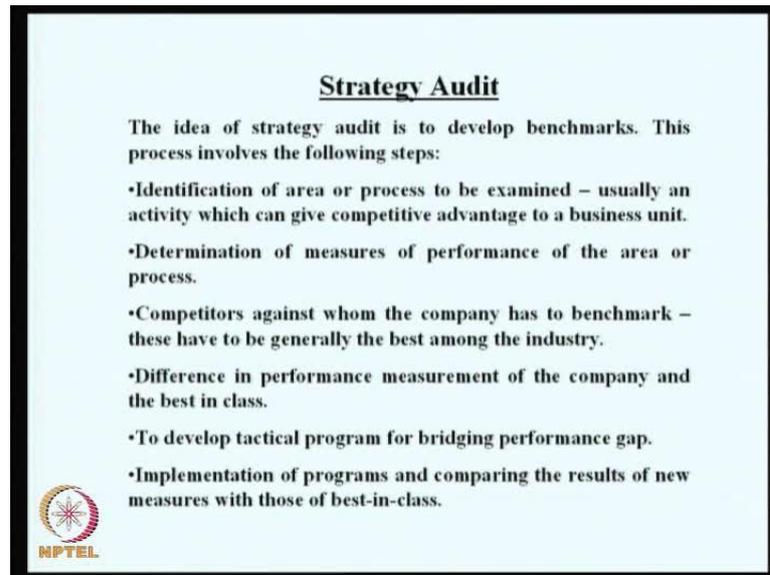
very serious problem to get this high ROI in short term. Then, this can lead to some problems with respect to the goal displacement. What is this goal displacement? It refers to the confusion of means with end. Your end goal is to achieve that sales target. So, you are trying to achieve that by adopting different means, so you should not confuse that means with that end goals.

When does it occur? It occurs when activities intended to help the managers achieve corporate objectives become ends in themselves or are adapted to meet ends, other than those for which they are intended. So, this is the type of confusion, the manager is likely to get in. So, if you keep on asking him or goading him to give quick performance results, it is possible that he may confuse the means to the end. So, this goal displacement can occur. Then, it can be of two types. One is behavior substitution and sub-optimization.

What is behavior substitution refers to? A phenomenon where activities that do not lead to goal accomplishment are substituted for activities, that leads to goal accomplishment. In other words, the wrong activities and people who focused on these activities are being rewarded, so you may end up with rewarding the wrong person. Sub-optimization is a situation, where optimization occurs for a unit or a functional area to the detriment of the organization as a whole. So, what you are looking at is the entire organization. You may achieve optimization in one area. So just like your one day international. It is not enough that if the team feels very well. The team that puts in a very good fielding performance, it is also required should be backed by a good bowling and batting performance. In other words, the team which wins the match has to be competent in all the 3 areas, that is, the bowling, batting and the fielding. Any let off in any one of these areas can cost the team dearly.

Similarly, in an organization, it is not enough if you just say, I achieved the marketing targets with respect to one product, whereas the product line you might not have achieved, but with respect to one of the products, you might achieve the target. That is not going to be helpful. It is in fact resulting in sub-optimization and the organization as a whole, you are not benefitted. Only a particular product you have been able to achieve the performance. This is the type of thing which can cause this sub-optimization.

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**Strategy Audit**

The idea of strategy audit is to develop benchmarks. This process involves the following steps:

- Identification of area or process to be examined – usually an activity which can give competitive advantage to a business unit.
- Determination of measures of performance of the area or process.
- Competitors against whom the company has to benchmark – these have to be generally the best among the industry.
- Difference in performance measurement of the company and the best in class.
- To develop tactical program for bridging performance gap.
- Implementation of programs and comparing the results of new measures with those of best-in-class.



Now, in order to a certain extent, overcome all this or to a certain extent, mitigate all this. These strategy managers do what is called the strategy audit. What is this strategy audit? The idea of the strategy audit is to develop benchmarks. So, what does it involve? It involves identification of the area or the process to be examined, usually an activity which can give competitive advantage to a business unit, then determination of measures of performance of the area or process and then, the competitors against whom the company has to bench mark. These have to be generally the best among the industry. Then the difference in performance measurement of the company and the best in the class, then to develop practical program for bridging performance gap, then implementation of programs and comparing the results of the new measures with those of best in class.

In other words, you start looking at the firm which has got the best performance in each of the functional areas; be it marketing, be it production, be it finance, be it HR. Why are you looking at these organizations? These are the ones by which you can set the bench marks for yourself. In other words, these are the ones which are leading in the industry sector concerned. So, do a bench marking using these leaders in the industry, then find out where is the gap, which functional area needs to be strengthened and to that extent, you develop a tactical program.

So, a certain amount of strategic shift may be required, but not the entire shift. So, a short change can bring in some of the desired results. So, these are the results which can help you to bridge the performance gap. So, this is what you look at in this system of strategy audit and if you refer to my book, this book gives you a table and this table on page numbers 166, 167, 168, 169 and partially 170. It gives you how to develop this check list, what are the things to develop in the check list for strategy audit.

So, if you look at what is the type of check list which you can adopt, I will just read one or two of this. The current situation, how is the company performing in terms of its slated objectives, return on investment, overall market share, profitability trends, EPS etcetera. Then, how does the performance of the company compare with that of its close rivals, similar companies or industry as a whole? Then, what are the company's current mission, objectives, strategies and policies? Are they clearly stated? Are the objectives, strategies and policies consistent with each other and with the internal and external environment and what are the short term and long term problems facing the company? So, you are doing a small check list for this company, where you are associated with this. Then, you start recording the performance with respect to profitability and the financial performance.

Then, the third one is you look at the corporate and the top management going to BOD and the top management. Then, the fourth one is you evaluate the strategies followed by the company, that is the corporate strategy. So, find out what is your assessment of the present corporate portfolio, that is, is the company in attractive business or not? Then, what is the competitive position of each of the businesses of the company and what are the future prospects for each of these businesses? Is the business portfolio well balanced? We have looked at how to balance these portfolios in our earlier classes and how this is being managed and whether, the company has a competitive advantage.

You can look at the core competitive advantages whether it can be sustained, to what extent or to what levels you can sustain that, that is the time levels. Then, what is the type of strategic alternatives which the company can explore? Is it exploring? If it is not, why it is not exploring? All those issues. Then, you look at the external environment, that is can the social, cultural, economic, political, legal, technological, which are the most important ones and look at the external agents, that is the competitors, suppliers,

customers, labor unions, government, trading associations, local community and shareholders, who are affecting the company most.

Then, what are the barriers for performance? Then, you look at the internal environment with respect to structure, the culture, that is, the corporate culture in tune with the strategies. Do the organizations values, norms, attitudes and behavior support your strategy? Do employees have a strong sense of what is expected of them? To what extent is the emphasis on result orientation? Are targets fixed for groups and individuals? Does the present culture compose of shared beliefs, values and expectations? Then, how is the present culture conducive for productivity, quality of performance and adaptability to changing conditions?

So, you look at each of the functional areas, whether it is HR or finance or marketing or manufacturing and now, the R and D also because when you are looking at a changing technological environment, the role of R and D also becomes extremely important. So, your R and D has to keep in pace with the changing technological scenario, adapt the changing scenario, technology scenarios into product development. This is what I discussed in the earlier classes.

So, what is happening in the present day set up with respect to R and D? Industries are more looking at applied R and D. The focus is all the more severe in the present competitive context. So, even the performance of an R and D unit in a company is sort to be measured against objective standards. So, this is what I said, R and D cannot afford to work in isolation in the present day competitive context in a company. It has to be in sync with marketing and production.

So, the marketing department gets the feed from the consumer on the product, and passes it on R and D and sometimes, the R and D and the marketing people, both go to the field to get the feedback from the consumer. So, I gave you in the earlier classes the example of a two-wheeler, where the feed was when it was first introduced. The feed that the company got was the time it takes for the two-wheeler to accelerate, that is to pick up, speed is very slow. By the time it picks up speed, the signal would have changed from green to red. That is the type of thing which people gave, that is the raw feedback. So, the company has to work, what exactly is the thing, what is the signal pattern, how it is changing 30 seconds 40 seconds? Now, suppose it is changing in 30 seconds, what

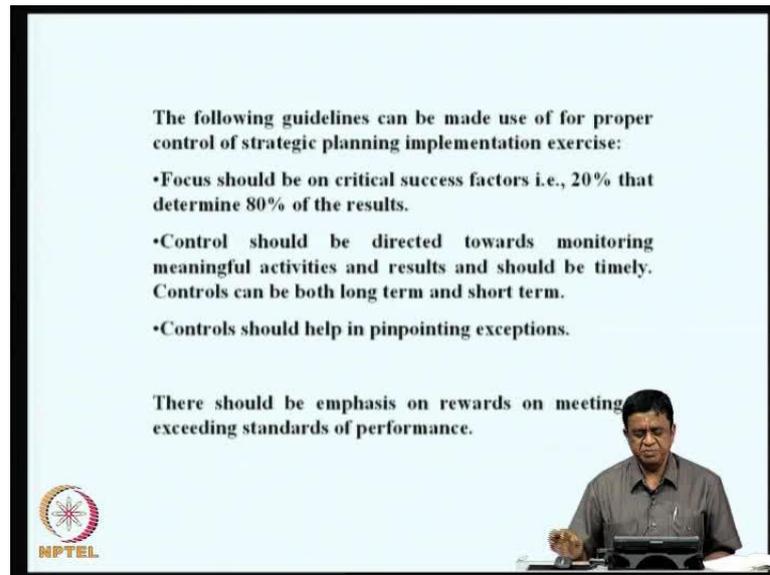
should be the speed at which it should accelerate? All those types of things, it is for them to solve the problem, but the market is giving you this type of a feedbacks.

So, the R and D has to work on that whether the design of the fuel jet, should there be some changes and if there are to be some changes, how those changes can be incorporated. Then, work in tandem with the production department to implement those changes, find out good are the results. All these things are to be brought in. So, these are the ways by which you have to look at the audit of each of this department. Then, the question that comes is when you are looking at the implementation and control of all this, you also look at whether the organization structure is, whether it is decentralization or delegation compatible with strategy. So, it may be required that when you are implementing certain strategies, you have to delegate certain powers to the lower runs in the organization, that is, you must be willing to delegate. So, is the organization structure compatible with this type of scenario?

So, all this has to be brought or has to be understood clearly. So, these are the things which will help you to do check list for audit, and when you do this check list for audit, it will also tell you, what the steps are that you can adopt for effective implementation of this whole strategy audit.

Now, if you really look at the competitive scenario in which the Indian companies are doing their business, it is essential for them, it is compelling for them in fact to do a strategy audit. So, you cannot afford to get away from this strategy audit. You have to do it in order survive in a market place. So, you have to look at each of your functional areas and you have to look at one more in the present day scenario, as I told you the R and D. So, it is not as if you look at your HR, finance, marketing and production, you also look at R and D because the R and D cannot be kept in isolation any longer because the technology changes, which are taking place are also getting reflected in the changes in market scenario. So, this is the type of thing which is happening in a market place.

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The following guidelines can be made use of for proper control of strategic planning implementation exercise:

- Focus should be on critical success factors i.e., 20% that determine 80% of the results.
- Control should be directed towards monitoring meaningful activities and results and should be timely. Controls can be both long term and short term.
- Controls should help in pinpointing exceptions.

There should be emphasis on rewards on meeting exceeding standards of performance.

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Now, given this type of a scenario, what could be some guidelines? So, the guidelines which can be made use of, the following guidelines can be made use of are proper control of strategic planning, implementation exercise. One is focus should be on critical success factors. This is a Pareto's rules. The Pareto's rule that is 20 percent, that determines 80 percent of the results.

Then, second one, control should be directed towards monitoring meaningful activities and results should be timed controls can be both long term and short term. So, focus on those areas where the results you can see by your control process, whether in the short term or the long term and controls should help in pinpointing exceptions. So, there may be some exception to this. Your control should pinpoint those exceptions. There should be emphasis on rewards on meeting or exceeding standards of performance.

See the present day scenario is such that, the markets are highly competitive. When the markets are highly competitive, you cannot expect your employee to keep on performing without being rewarded adequately. This is in fact, one of the negative points with respect to public sector units. Due to the system in which they are operating, they are not able to reward an employee who meets the performance or exceeds the standards of performance viz-a-viz an employee who does not, that puts them on a weak wicket in this competitive market scenario. So, this is what is called as what the PSU's are

referring to as level playing field. So, they keep on arguing with the government that they should be allowed to have a level playing field. What is this level playing field? One is this type of performance, rewards. Then, second is the type of recruitments. So, the PSU's should be able or should be allowed to recruit the best in the market and also pay them, according to market expectations. Unfortunately, again they are not able to do it due to certain constraints which they are having.

So, all these puts them on a what do you call, back foot in this type of competitive markets scenario, where the other private players are able to really give this performance rewards very well to and then, the recruitments, then what you call so many other types of benefits which a private sector employee is able to get, which the public sector employee is not able to get in the present set up. This is what is called the current situation. So, that is what I just said in the first, this thing with respect to strategy audit.

Now, given this type of a scenario, if you look at the way information systems has developed, so earlier when it started, you had what is called the management information systems. So, what was this management information system trying to do? It was collecting data for the management, may be with respect to the different areas of operations of the company. So, from this MIS came out the DSS. What is this DSS? It is the Decision Support System. So, you made use of the MIS to take decisions. So the MIS since transformed itself to DSS, so it was no longer MIS. It was helping the management to take decisions. Now, what is the present scenario? The present scenario is it is not stopping at the DSS. It has gone one step further. What is it? It is the strategic information systems. So, the information systems or the type of information that you are getting is such that, they can help the management to drop strategies or if the strategies are already drawn up, if some corrective actions are required, the information systems can help them to do this all.

In other words, the role of the information systems is becoming more and more pronounced in strategy now. So, you are making use of information systems for strategy formulation, for strategy implementation and for strategy control and also for strategy audit. So, one of the mechanisms which can be helpful for this type of evaluating strategies is what is called the balanced score card. This balanced score card was developed by these 2 people, Robert S. Kaplan of the Harvard business school and a consultant by name David P. Norton. So, looks at four parameters, the financial

perspective, the customer perspective, the internal business perspective, then the learning and growth. So, looks at these four perspectives. Then, make use of the four processes of translating the vision, communication and linking, business planning and feedback and learning to manage strategy.

So, what does the balance card give? For the companies using the balanced score card, these companies can clarify and update their strategy. Then, improve the communication throughout the company, then align unit and individual goals throughout the company, then identify and align strategic initiatives and conduct periodic performance reviews. So, to that extent, this balanced score card could be helpful in strategy implementation and control for an organization, but you have also got to realize that this is only a tool with certain limitations, that is it is not without limitations. What are the limitations? It is only a score card, but by itself, it cannot be a decision making tool. It gives you a score card with respect to the perspectives that we consider. Then, it cannot be used as a tool, though it can help in assessing performance. So, kindly note that.

So, the reference of to balanced score card as a tool in several instances, it has got only limited meaning. Kindly note this. So, many times they say, you can use this tool balance score card. It can be done only in a very limited context. Many times, it has to be understood, it is not a tool; it is only a score card. So, focusing on score boards can lead to a lack of focus on the underlying actions that produce a good score. So, this can be very serious limitation.

I have quoted in my book an example of a tennis player who watches the score board instead of the ball, court and the opponent. He would not be able to win a game, much less a match, no matter how well designed the score card is. In other words, you have to be very alive to your current competitive performance, the marketing scenario, then the current performance which the company is able to put up in the current marketing environment or the current business environment.

Given this type of a setting, what happens? The role of performance management systems becomes quite crucial. So, I have dealt this performance management system in my book on page number 172. So, just I will read a few points from this book, that is, a performance management system incorporates a number of effective tools and processes that deliver into managers and the capabilities to identify and achieve the full near to

intermediate term potential of the business. It can also enable companies to achieve greater levels of connectedness.

The process involves 4 steps. One, understanding the true financial potential of the business in the near to intermediate term through rigorous modeling, then using the results of the modeling to set achievable excellence targets that reflect substantial stretch and yet are fully accepted by the management, that is your setting the goals and commitments. Then, creating, planning, budgeting and reporting systems that reward the desired behaviors and facilitate a continuing stream of management decisions and actions gear to achieve aggressive, but attainable goals.

This is the third one that is achieving plan goals and continues improvements. So, it may involve self-corrections also, it may involve monitoring and feedback, it may involve (()) empowerment and pressure, whatever it be whether it is a decision support tools or the best practices, all these. So, you are only trying to achieve the planned goals, that is the plan, what are the goals that you are set for and continuous improvement. Then, trying accountability for achievement of the goals directly to tangible rewards, this is rewarding performance that is what I said. So, what I have mentioned with respect to PSU's and private sector companies beat MNC's or whatever.

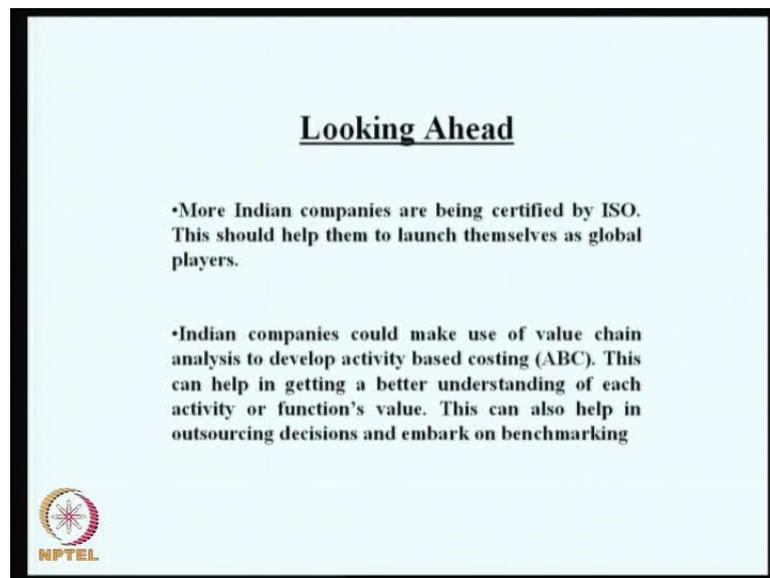
Now, so the rewarding performances you have to develop appropriate measures, show discipline in application of these measures, then link to reward and recognition system, then should contribute to self-development. So, what I have given, it is in the book is as simple model or a concise model of an explicit framework for division of a bank, where it looks at, you are looking at the retail deposit profitability. So, you are looking at two heads. One is the revenue, the second is the cost.

Revenue is controlled by the balance size and the yield. Then, costs are controlled by the transaction volumes per account and productivity. So, balance size in turn is controlled by demographics, branch network, competition, cross setting and pricing. Yield is controlled again by demographics, competition, pricing and product mismanagement. Then, transaction volume per account is controlled again by demographics, ATM penetration and usage, productivity by staffing approach, scale percent of part time retail. In other words, these are the types of variables you can be looking at for the performance. So, in a division of a bank with respect to one particular head, kindly note

this, one particular head, that is retail deposit profitability, one particular business head of the branch. So, this is the way you can look at it. This is given to you on page number 173 of this book.

So, when you are looking at control as I said, try to go through the Pareto principle. Given all these types of things, that is you try to put your efforts on the critical success factors, that is 20 percent that determine 80 percent of the results. So, this is where you can be more successful. So, if you look at what Peterson Waterman have to say, the stronger the culture and the more it was directed towards the market place, less need was there for policy manuals, organization chart or detail procedures and rules. In these companies, people way down the line know, what they are supposed to do in most situations because of the handful of guiding values is crystal clear. So, this is where the evaluated, the excellent companies have said, why they are excellent. This is the reason why they are excellent companies.

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**Looking Ahead**

- More Indian companies are being certified by ISO. This should help them to launch themselves as global players.
- Indian companies could make use of value chain analysis to develop activity based costing (ABC). This can help in getting a better understanding of each activity or function's value. This can also help in outsourcing decisions and embark on benchmarking

  
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Now, what is the scenario which you can look at for the Indian business? If you look at the Indian business, more Indian companies are being certified by ISO. So, you are looking at advertisements. Each company says, I mean ISO 9001 company that all those types of things. So, how does it help? It should help them to launch themselves as global players. So, you are recognized as a player who is capable of performing up to expected standards in the international business scenario. So, you are an internationally

competent business player. That is the types of setting which this ISO can give the Indian companies.

Now, given this type of a setup, where many companies are getting the ISO tag. So, what can companies do? The Indian companies could make use of value chain analysis to develop what is called activity based costing. So, in other words, this is what we discussed earlier also in the class, this particular session. We said, you look at each of these units and then, also at the organization as a whole. So, each of the product lines should be profitable and when all the product lines are profitable, you are contributing to the profitability of the organization as a whole. So, the Indian companies could make use of value chain analysis to develop what we call the activity based costing, that is, the ABC. What can these do for the companies? This can help in getting a better understanding of each activity or functions value.

So, using this, the companies can get a better understanding of the different activities which are involved in the value chain analysis, and when they get a better understanding of the different activities, then the value of that function will also be better registered with the company.

How is this helpful? This can be very helpful in outsourcing decisions and also in benchmarking. So, this is what we dealt in the earlier classes. We said the Indian software companies are outsourcing many activities. How do they decide to outsource these activities? This was one of the questions which might have gotten into your mind. The outsourcing of these activities is precisely by this development of activity based costing. So, this is our core performance area which can impact strategy.

Now, which are the other areas which you can outsource without impacting strategy or even if it impacts to a minimum extent? So, these are the types of decisions which a strategic management team will have to take. So, if you really see, like Infosys or any other major software player in the Indian scenario, many activities like transportation, canteen, so many activities of HR are all outsourced. Why outsourced? Because the company through this ABC said, it would be better for the company to concentrate on these activities to develop strategic edge in the business scenario in which they are operating.

So, we have looked at in this class, what is the method of this evaluation of the performance with respect to strategies, and what are the types of controls that you can have and what is the road ahead for the Indian companies. So, this is a very important part of this, what do you call the strategy exercise where you start looking at evaluation and control, how this evaluation and the types of decisions that you took, how they are helpful for the company.

We will stop here and in the next few classes, we will consider some of the strategic enablers for performance. Thank you.