UNIT 16 EVALUATION OF STRATEGY

Objectives

After going through this unit, you should be able to:

- understand the process of evaluation;
- discuss the aspects of business portfolio analyses;
- understand the importance of qualitative measures used for evaluation;
- understand the concept of balanced score card; and
- discuss the characteristics of an effective evaluation system.

Structure

16.1 Introduction
16.2 Process of Evaluation
16.3 Business Portfolio Analyses
16.4 Qualitative Factors
16.5 Balanced Score Card (BSC)
16.6 Structure of Evaluation
16.7 Evaluation System in a Multi-business Company
16.8 Characteristics of an Effective Evaluation Strategy
16.9 Summary
16.10 Key Words
16.11 Self-Assessment Questions
16.12 References and Further Readings

16.1 INTRODUCTION

Strategy evaluation is the last stage of the strategic management process and comes after strategy formulation and implementation as shown below.

STRATEGY FORMULATION → STRATEGY IMPLEMENTATION → STRATEGY EVALUATION

An organization can have one of the best formulated and implemented strategies but if the evaluation of these are not done, they become obsolete over a period of time. Therefore, it becomes important to have an effective evaluation system so as to help the organization to achieve its objectives.

The evaluation process involves the control mechanism, which helps in taking corrective actions. We have already discussed the control process in unit 15 of the same block. In this unit, we are going to discuss the qualitative aspects and the portfolio analysis so as to develop a complete understanding of evaluation and control.

16.2 PROCESS OF EVALUATION

The key to a successful strategy is the effective implementation and evaluation

system. Any kind of error in the strategic decisions will harm the organization, which in the long-run may be highly dangerous. Therefore, it is very necessary for the management to have a continuous evaluation system based on which the corrective actions may be taken. Figure 16.1 shows the process of evaluation.

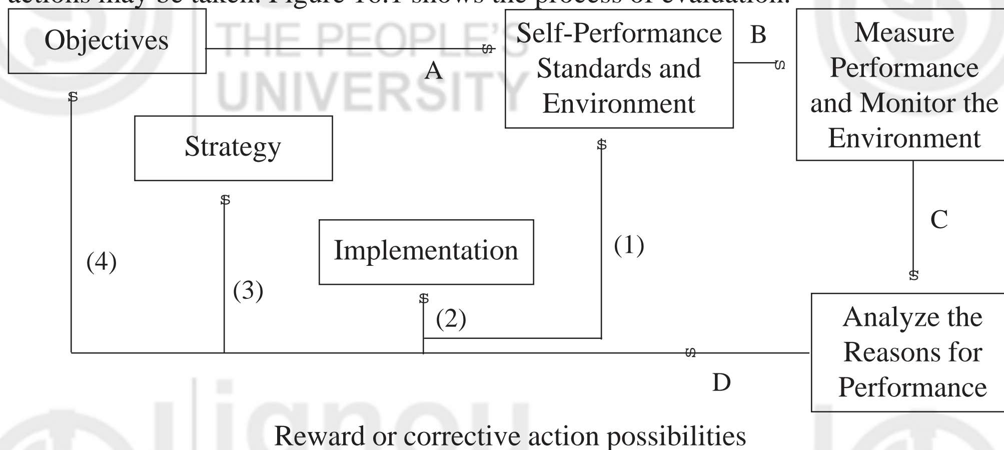

Figure 16.1: Evaluation of Strategy

The first phase of this process consists of selecting the key success factors, developing measures and setting standards for the same, and collecting information about actual state (performance on these measures). The second phase consists of comparison with the standards laid down and initiating action to alter performance, wherever necessary. The follow up action could relate to people/business or both and could be tactical or strategic. For instance, if the business has not picked up as expected, it may be necessary to increase promotional efforts, or revise the product policy, or as a last resort, the firm may pull out of a particular business.

It is necessary to maintain a distinction between the follow up action towards business/people and evaluation/control process. If major changes in environment have taken place and if major assumptions about environment have gone wrong, it may be improper to give credit or discredit to the people for the deviation in performance from standard set. At the same time good performance of a strategy may not be due to good performance of the people as there may be windfall gains due to changes in the environment not imagined at the time of setting the standards of performance or targets.

From Figure 16.1 it can be realised that the process of evaluation is quite complex and there are several pitfalls in proper evaluation and control. The success of an organization is gauged by its effectiveness and efficiency. Effectiveness is measured by the degree to which the organization has achieved its objectives while efficiency refers to the manner of resource utilization for achieving the output. The two can thus be represented as below:

a) $\text{Effectiveness} = \dfrac{\text{Output}}{\text{Objectives}}$ b) $\text{Efficiency} = \dfrac{\text{Output}}{\text{Input}}$

It is easy to evaluate efficiency by comparing output/input of various organizations or organization units with one another. Inputs, by and large, are always quantifiable. An organization is more efficient than the other if it uses less resources (inputs) than another, the same output or if for the same input it gives more output. The latter case requires output to be measured in quantitative terms and hence is more difficult to assess.

Measurement of effectiveness has both numerator and denominator which are comparatively more difficult to quantify. Hence assessment of effectiveness is more

difficult than the assessment of efficiency of the organization.

The success of coporate strategy should be evaluated both in terms of efficiency and effectiveness. It is, however, not common to find an efficient but ineffective organization or *vice versa*.

In a profit oriented organization, profit becomes a surrogate measure for both efficiency as well as effectiveness. Profit is the difference between revenue and expense, and thus is a measure of efficiency. Being the objective itself, profit also becomes a measure of effectiveness. In organizations with multiple objectives, the situation is different if the surrogate measures like profit are not available/not sufficient for evaluating the strategy. In such cases the major problem in evaluating the strategy is to develop measures for evaluating the strategy. The problem is solved by identifying the key variables or key success factors which are measures of performance of certain key activities of the organization.

Activity 1

Analyse the periodical evaluation reports in your organization. Do they emphasise effectiveness or efficiency?

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16.3 BUSINESS PORTFOLIO ANALYSES

Portfolio analysis is an analysis of the corporation as a portfolio of different business with the objective of managing it for returns on its resources. The business may be in the forms of organizational units, such as different subsidiaries or divisions of a parent company or Strategic Business Units (SBUs).

Thus, portfolio analysis looks at the corporate investments in different products or industries under the common corporate jurisdiction. The corporate manager analyses the future implications of their present resource allocations and continuously evaluates which operations or products to expand or add, and which ones to be curtailed or disposed off, so that the overall portfolio balance is maintained or improved. The focus is on the present as well as the future.

The activities of a company and its effectiveness in the market place also depends on what the other competing companies are doing. Therefore, the protfolio analysis takes into consideration such aspects as the company's competitive strengths, resource allocation pattern and the industry characteristics.

Portfolio analysis is primarily concerned with the balancing of the company's investments in different products or industries and is useful for highly diversified multi-product companies operating in a limited market. The different subsidiaries or strategic business units have to be balanced with respect to the three basic aspects of running the business:

- Net Cash Flow
- State of Development
- Risk

Portfolio analysis is one of the methods to assist managers in evaluating the strategy.

Let us now discuss different types of Business Portfolio Analyses.

Display Matrices

The purpose of analysis is to optimally allocate resources for the best total return, with focus on the corporate strategies. Many different approaches involving different display matrices have evolved over the years, with the common objective of successful diversification. Some of the common display matrices are:

- BCG's Growth-share Matrix
- McKinsey Matrix
- Strategic Planning Institute's Matrix
- Arthur D. Little Company's Matrix
- Hofer's Product/Market Evolution Matrix

BCG's Growth-Share Matrix

BCG's Portfolio Analysis is based on the premise that majority of the companies carry out multiple business activities in a number of different product-market segments. Together these different businesses form the Business Portfolio which can be characterised by two parameters:

1) company's relative market share for the business, representing the firms competitive positions; and

2) the overall growth rate of that business.

The BCG model proposes that for each business activity within the corporate portfolio, a separate strategy must be developed depending on its location in a two-by-two portfolio matrix of high and low segments on each of the above mentioned axes.

Relative Market Share is stressed on the assumption that the relative competitive position of the company would determine the rate at which the business generates cash. An organization with a higher relative share of the market compared to its competitors will have higher profit margins and therefore higher cash flows.

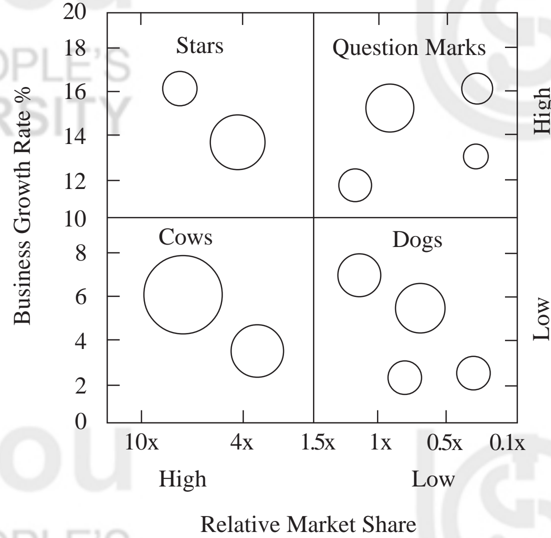
Relative Market Share is defined as the market share of the relevant business divided by the market share of its largest competitor. Thus, if Company X has 10 per cent, Company Y has 20 per cent, and Company Z has 60 per cent share of the market, then X's Relative Market Share is 1/6m, Y's Relative Market Share is 1/3, and Z's Relative Market Share 60/20 = 3. Company Z has Company Y as its leading competitor, whereas Companies X and Y have Company Z as their lead competitor.

The selection of the **Rate of Growth** of the associated industry is based on the understanding that an industrial segment with high growth rate would facilitate expansion of the operations of the participating company. It will also be relatively easier for the company to increase its market share, and have profitable investment opportunities. High growth rate business provides opportunities to plough back earned cash into the business and further enhance the return on investment. The fast growing business, however, demands more cash to finance its growth.

If an industrial sector is not growing, it would be more difficult for the participating company to have profitable investments in that sector. In a slow growth business, increase in the market share of a company would generally come from corresponding reduction in the competitors' market share.

The BCG matrix classifies the business activities along the vertical axis according to the 'Business Growth Rate" (meaning growth of the market for the product), and the 'Relative Market Share' along the horizontal axis. The two axes are divided into

Low and High sectors, so that the BCG matrix is divided into four quadrants (refer to Figure 16.2). Businesses falling into each of these quadrants are classified with broadly different strategic categories, as explained below:



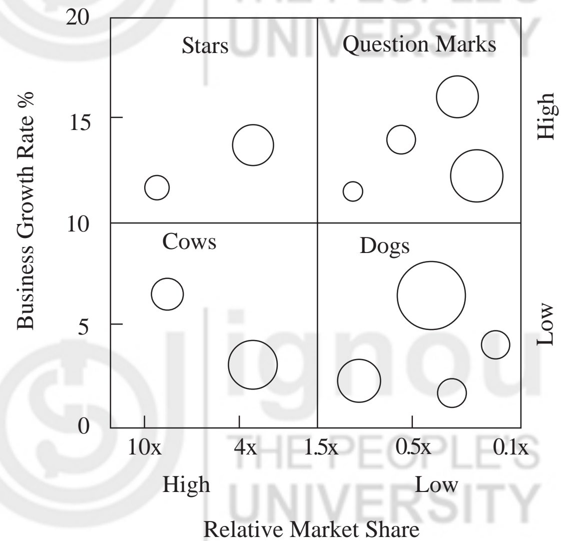


Figure 16.2: BCG Matrix

Cash Cows

The businesses with low growth rate and high market share are classified in this quadrant. High market share leads to high generation of cash and profits. The low rate of growth of the business implies that the cash demand for the business would be low. Thus, Cash Cows normally generate large cash surpluses. Cows can be 'milked' for cash to help to provide cash required for running other diverse operations of the company. Cash Cows provide the financial base for the company. These businesses have superior market position and invariably low costs. But, in terms of their future potential, one must keep in mind that these are mature businesses with low growth rate.

Dogs

If the business growth rate is low and the company's relative market share is also low, the business is classified as DOG. The low market share normally also means poor profits. As the growth rate is also low, attempts to increase market share would demand prohibitive investments. Thus, the cash required to maintain a competitive position often exceeds the cash generated, and there is a net negative cash flow.

Under such circumstances, the strategic solution is to either liquidate, or if possible harvest or divest the DOG business.

Question Marks

Like Dogs, Question Marks are businesses with low market share but the businesses have a high growth rate. Because of their high growth, the cash requirement is high, but due to their low market share, the cash generated is also low.

As the business growth rate is high, one strategic option is to invest more to gain market share, pushing from low share to high. The Question Mark business then moves to a STAR (discussed later) quadrant, and subsequently has the potential to become cash low, when the business growth rate reduces to a lower level.

Another strategic option is when the company cannot improve its low competitive position (represented by low market share). The management may then decide to divest the Question Mark business.

These businesses are called Question Marks because they raise the question as to whether more money should be invested in them to improve their relative market share and profitability, or they should be divested and dropped from the portfolio.

Stars

Businesses which have high growth rate and high market share, are called Stars. Such businesses generate as well as use large amounts of cash. The Stars generate high profits and represent the best investment oppotunities for growth.

The best strategy regarding Stars is to make the necessary investments and consolidate the company's high relative competitive position.

Methodology for Building BCG Matrix

The Boston Consulting Group suggests the following step-by-step procedure to develop the business portfolio matrix and identify the appropriate strategies for different businesses.

- Classify various activities of the company into different business segments or Strategic Business Units (SBUs).
- For each business segment determine the growth rate of the market. This is later plotted on a linear scale.
- Compile the assets employed for each business segment and determine the relative size of the business within the company.
- Estimate the relative market shares for the different business segments. This is generally plotted on a logarithmic scale.
- Plot the position of each business on a matrix of business growth rate and relative market share.

Strategic Implications

Most companies will have different segments scattered across the four quadrants of BCG matrix, corresponding to Cash Cow, Dog, Question Mark and Star businesses.

The general strategy of a company with diverse portfolio is to maintain its competitive position in the Cash Cows, but avoid over-investing. The surplus cash generated by Cash Cows should be invested first in Star businesses, if they are not self-sufficient, to maintain their relative competitive position. Any surplus cash left with the company may be used for selected Question Mark businesses to gain market

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share for them. Those businesses with low market share, and which cannot adequately be funded, may be considered for divestment. The Dogs are generally considered as the weak segments of the company with limited or now new investments allocated to them.

The BCG Growth-share matrix links the industry growth characteristic with the company's competitive strength (market share), and develops a visual display of the company's market involvement, thereby indirectly indicating current resource deployment. (The sales to asset ratio is generally stable over time across industries). The underlying logic is that investment is required for growth while maintaining or building market share. But, while doing so, a strong competitive business in an industry with low growth rate will provide surplus cash for deployment elsewhere in the Corporation. Thus, growth uses cash whereas market competitive strength is a potential source of cash. In terms of BCG classification, the cash position of various types of businesses can be visualised as in Table 16.1

Table 16.1: Cash Positions of Various Businesses

	Business Type	*Cash Source*	*Cash Use*	*Net Cash Balance*
1.	COW	More	Less	Funds available, so milk and deploy
2.	STAR	More	More	Build competitive position and grow
3.	DOG	Less	More	Divest and redeploy proceeds
4.	QUESTION	Less	More	Funds needed to invest selectively to improve competitive position

Limitations of BCG Matrix

The Growth-share BCG Matrix has certain limitations and weak points which must be kept in mind while using portfolio analysis for developing strategic alternatives. These are now briefly discussed.

Predicting Profitability from Growth and Market Share

BCG analysis assumes that profits depend on growth and market share. The attractiveness of an industry may be different from its simple growth rate, and the firm's competitive position may not be reflected in its market share. Some other sophisticated approaches have been evolved to overcome such limitations.

There have been specific research studies which illustrate that the well-managed Dog businesses can also become good cash generators. These organizations relying on high-quality goods, with medium pricing and judicious expenditure on R & D and marketing, can still provide impressive return on investment of above 20 per cent.

Difficulty in Determining Market Share

There is a heavy dependence on the market share of a business as an indicator of its competitive strength. The calculation of market share is strongly influenced by the way the business activity and the total market are defined. For instance, the market for helicopters may encompass all types of helicopters, or only heavy helicopters or only heavy military helicopters. Furthermore, from geographical point of view the market may be defined on worldwide, national or an even regional bases. In case of complex and interdependent industries, it may also be quite difficult to determine the

market share based on the sales turnover of the final product only.

No Consideration for Experience Curve Synergy

In the BCG approach, businesses in each of the different quadrants are viewed independently for strategic purposes. Thus, Dogs are to be liquidated or divested. But, within the framework of the overall corporation, useful experiences and skills can be acquired by operating low-profit Dog businesses which may help in lowering the costs of Star or Cash Cow businesses. And this may contribute to higher corporate profits.

Disregard for Human Aspect

The BCG analysis, while considering different businesses does not take into consideration the human aspects of running an organization. Cash generated within a business unit may come to be symbolically associated with the power of the concerned manager. As such managing a Cash Cow business may be reluctant to part with the surplus cash generated by his unit. Similarly, the workers of a Dog business which has been decided to be divested may react strongly against changes in the ownership. They may deem the divestiture as a threat to their livelihood or security. Thus, BCG analysis could throw up strategic options which may or may not be easy to implement.

BCG Modifications

It was in 1981 that the Boston Consulting Group realied the limitations of equating market share with the competitive strength of the company. They have admitted that the calculation of market share is strongly influenced by the way business activity and the total market domain are defined. A broadly defined market will give lower market share, whereas a narrow market definition will result in higher market share resulting in the company as the leader. It was, therefore, recommended that products should be regrouped according to the manufacturing process to highlight the economies of scale manufacturing, instead of stressing the market leadership.

On the other hand, BCG still maintain that for branded goods it is important to be the market leader so that the advantages of economies of scale and price leadership can be fully utilised. But they also concede that such advantages may still be achieved even if the company is not the largest producer in the industry. Some other verions of portfolio analysis have however developed much beyond these minor modifications of BCG analysis.

Activity 2

Consider a company with which you are familiar. Collect information regarding its various businesses and describe them using the BCG growth-share matrix. First give the chronology of year-wise business development and then the matrix.

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GE's Strategic Business Planning Grid

General Electric (or McKinsey) matrix uses market attractiveness as not merely the growth rate of sales of the product, but as a compound variable dependent on different factors influencing the future profitability of the business sector. These

different factors are either subjectively judged or objectively computed on the basis of certain weightages, to arrive at the Industry Attractiveness Index. The Index is thus based on a thorough environmental assessment influencing the sector profitabilities.

Factors determing Industry Attractiveness:

		Typical weightage
1)	Size of market	10%
2)	Rate of growth of sales and cyclic nature of business	15%
3)	Nature of competition including vulnerability to foreign competition	15%
4)	Susceptibility to technological obsolescence and new products	10%
5)	Entry conditions and social factors	10%
6)	Profitability	40%
		100%

Against each of these factors, the concerned business is rated on a scale of 1 to 10, and then the weighted score is determined from a maximum of 10. This gives the **Industry Attractiveness Index** for the business under consideration.

Factors determining Competitive Position of the Company as with Industry attractiveness, the Competitive Position of the Company is analysed not only in terms of company's market share, but also in terms of other factors often appearing in the Strength and Weakness analysis of the company. Thus, product quality, technological and managerial excellence, industrial relations etc. are also incorporated besides market share and plant capacity.

A typical scoring of company's Competitive Position would be as illustrated below :

	Factor	weightage	rating (1 to 10)	score
1)	Market Share and Capacity	20%	7	1.4
2)	Growth Rate	10%	7	0.7
3)	Location and Distribution	10%	5	0.5
4)	Management Skill	15%	6	0.9
5)	Workforce Harmony	20%	7	1.4
6)	Technical Excellence including Product and Process Engg.	20%	8	1.6
7)	Company Image	5%	8	0.4

The Industry Attractiveness Index is then plotted along the vertical axis and divided into low, medium and high sectors. Correspondingly, the Competitive Position is plotted along the Horizontal axis divided into Strong, Average and Weak segments. For each business in the portfolio, a circle denoting the size of the industry is shown in the 3 x 3 matrix grid while shaded portion corresponds to the company's market share as shown in Figure 16.3.

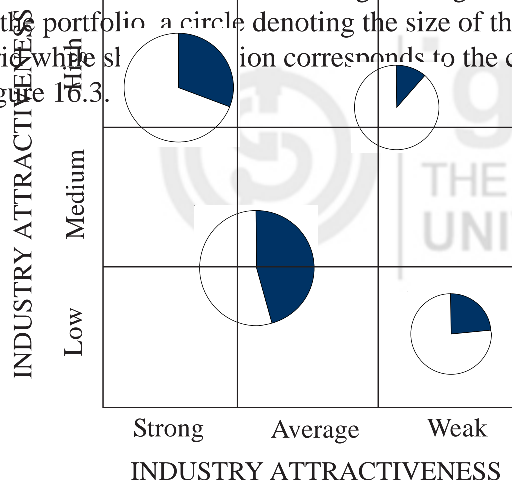

Figure 16.3: GE's Business Planning Matrix

GE rates each of its businesses every year on such a framework. If Industry's Attractiveness as well as GE's Competitive Position is low, a no-growth red stoplight strategy is adopted. Thus, GE expects to generate earnings but does not plan for any additional investments in this business. If for a business the Industry Attractiveness is medium and GE's Competitive Position is high, a growth green stoplight strategy is evolved for further investment. But if a business has high Industry Attractiveness Index and low GE's Competitive Position, this is branded as yellow stoplight business that may be moved either to growth or no growth category. Such grids are developed at different managerial levels. The final strategic decisions are made by GE's Corporate Policy Committee comprising the Chairman, the Vice-Chairman and Vice-Presidents of Operational areas, including finance.

Shell's Directional Policy Matrix

As in the GE's approach, the Business Prospects and Competitive Capabilites are plotted in Shell's Directional Policy Matrix. The three-by-three matrix as shown in Figure 16.4. identifies different strategies for each grid sector. These are explained in Table 16.2.

DIRECTIONAL POLICY MATRIX

SECTORAL PROSPECTS	Strong	Average	Weak
Attractive	Leader	Try Harder	Double or Quit
Average	Leader Growth	Custodial	Phased Withdrawal
Attractive	Cash Generation	Phased Withdrawal	Disinvest

UNIT'S COMPETITIVE POSITION

Figure 16.4: Three-by-three Matrix

Table 16.2: Strategies for different grid sector

	Strategy	Business Prospects	Competitive Capability	Recommended Strategies
1.	Leader	High	Strong	High priority with all necessary resources to hold high market position.
2.	Try Harder	High	Medium	Allocate more resources to move to leader position.
3.	Double or Quit	High	Weak	Pick products likely to be future high flyers for doubling and abandon others.
4.	Growth	Average	Avg. Strong	May have some strong competition with no one company as leader. Allocate enough resources to grow with market.

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5.	Custodial	Average	Average	May have many competitors, so maximise cash generation with minimal new resources.
6.	Phase Withdrawal	Low	Average	Slowly withdraw to recover most of investments.
7.	Cash Generation	Low	Strong	Spend little cash for further expansion, and use this as a cash source for faster growing.
8.	Disinvest	Low	Weak	Assets should be liquidated as soon as possible and invested elsewhere.

While using the above analysis, Shell realised that the various zones were of irregular shape, sometimes with overlapping boundaries.

PIMS Model

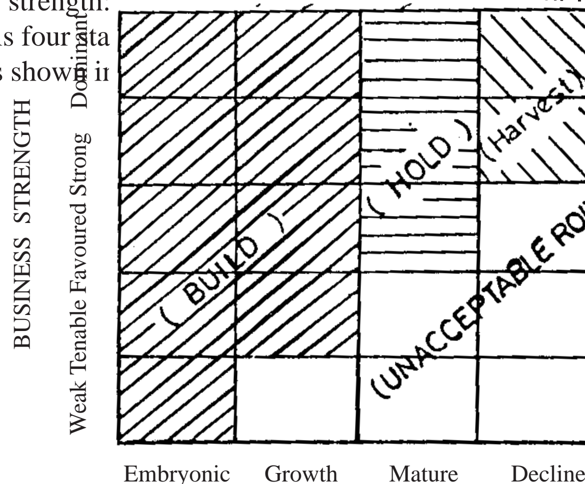
A programme for the Profit Impact of Market Strategy (PIMS) was started at General Electric, and was later used by the Strategic Planning Institute. The PIMS programme analyses data provided by member companies to discover 'general laws which determine the business strategy in different competitive environments producing different profit results'.

Unlike the earlier approaches using judgement for multidimensional factors, the SPI uses multidimensional cross-sectional regression studies of the profitability of more than 2,000 businesses. It then develops an industry characteristic, Business Average Profitability, and compares it with the performance in the concerned company. This model uses statistical relationship estimated from past experience in place of the judgmental weightages assigned for the importance of different factors behind Industry Attractiveness and Competitive Position in previous approaches.
This scientific objective approach has been criticised that the analysis relationship in it is based on heterogeneous population, i.e., different types of business, taken at different time periods.

Profitability is closely linked with market share. A 10 per cent improvement in profitability is linked with 5 per cent improvement in Return on Investment. This has since been rationalised by a number of arguments, such as 'the Experience Curve Effect' which implies reduction in average cost with increase in accumulated production. The larger company can use better quality management, and thus can exercise greater market power.

Arthur D. Little Company's Matrix

Arthur D. Little Company's matrix links the stages of the **product life cycle** with the business strength. On the vertical axis, the businesses are classified with respect to their business strength: ... Strong, or Dominant. Along the horizontal axis four sta... and Decline are marked as shown i...



INDUSTRY PRODUCT LIFE CYCLE

Figure 16.5: Arthur D. Little Co.'s Matrix

In the Embryonic and Growth stages, the businesses are recommended for Build strategy, except when the Business Strength is weak. For Mature stage businesses with dominant to favourable strength, HOLD Strategy is recommended. Harvest strategy is proposed for businesses in Decline stage, with Strong or Dominant position. For weaker businesse in Mature/Decline stage unacceptable ROI is marked.

Hofer's Product/Market Evolution Matrix

Charles Hofer has proposed a three-by-five matrix where businesses are plotted in terms of their product/market evolution and the comeptitive position. Relative sizes of industries are shown by circles wherein in the market share of the company is shaded as shown in Figure 16.6.

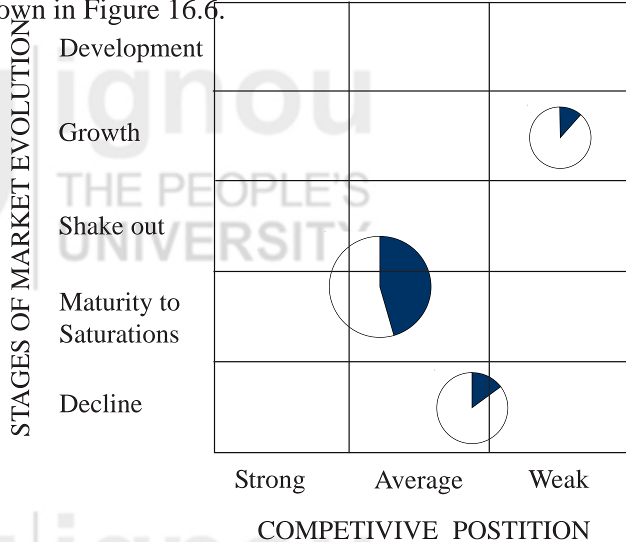


Figure 16.6: Hofer's Market Evolution

- A business in the Developmet or Growth stage has a potential to be a Star. If the market share is large in these growth oriented stages, more resources must be invested to develop competitive position. But if market share is low, a strategy to improve the same must be developed. If the industry is relatively small and market share is low despite high growth stage, management must consider divesting and redeploying resources in other more competitive businesses.
- A business in the Shake-out or Maturity stage has a potential to be a Cash Cow. Investments could be made to maintain high market share.
- A business in Decline stage with a low market share would be a Dog business. Though in the short run it may generate cash, in the long run, however, it should be considered for divestment or liquidation.

Activity 3

Meet a local representative of any diversified enterprise (e.g., ITC, Reliance) and gather information on its portfolio. Give your comments.

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16.4 QUALITATIVE FACTORS

Measuring in organizational performance is one of the important parts of strategy evaluation process. It consists of the qualitative as well as quantitative aspects. We have already discussed the quantitative measures in unit 15. Here, we will stress upon the qualitative factors as a criteria for performance measurement.

Basically the qualitative factors constitute human factors. According to Seymour Tilles (David, 1997), six qualitative questions are useful in evaluating strategies. They are :

1) Is the strategy internally consistent?
2) Is the strategy consistent with the environment?
3) Is the strategy appropriate in view of available resources?
4) Does the strategy involve an acceptable degree of risk?
5) Does the strategy have an appropriate time framework?
6) Is the strategy workable?

Some additional factors also have an impact on strategy evaluation. They can be :

1) How good is the firm's balance of investments between high-risk and low-risk projects?
2) How good is the firm's balance of investments between long-term and short-term projects?
3) To what extent are the firm's alternative strategies socially responsible? etc.

There can be many more such questions which can have an impact on strategy evaluation.

After assessing all these questions, the final step is to take corrective actions to reposition the firm. This is necessary to adapt to the changing conditions and be able to face the competition.

16.5 BALANCED SCORE CARD (BSC)

Any organization, be it private or public, uses certain parameters as a tool for performance meaurement. This is important to incorporate suggestions thereby working on a continuous improvement process, in turn evaluating the strategy so as to transform it into action. This section gives you an insight into one of the tools, i.e. Balance Score Card (BSC) to measure the performance of a business thereby evaluating the strategy. We have already learnt about BSC in block 2, unit 6. Here, we are going to look into this aspect of performance measurement in little detail.

Performance measures are said to be the indicators of success and form a major part of any organization. These indicators should be such that they are understood by all levels of the organization and help in achieving the specific objectives of the organization. Each organization has its own set of performance measurement framework. Let us now discuss the concept of BSC and how it can help an organization in performing effectively.

History

1990s saw the emergence of strategic management as a whole new concept. In the same time period a very new approach to it was developed by Dr. Robert Kaplan (Harvard Business School) and David Norton (Balance Score and Collaborative) and named it as 'Balanced Scorecard'. According to them, it provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective (www.hrfolks.com).

The BSC is a **Management system** that enables organizations **to clarify their vision and strategy and translate them into action**. It provides a feedback around both the internal business processes and external outcomes so as to improve the strategic performance and results continuously.

According to Kaplan & Norton "The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate strong for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation." It is important to note that according to BSC we view the organization from four perspectives and they are:

- The Learning and Growth perspectives
- The Business Process perspective
- The Customer perspective
- The Financial perspective

The learning and growth perspective includes employee training and corporate cultural attitudes which are related to both individual and corporate self-improvement. The business process perspective refers to paternal business processes. This includes the strategic management process. The customer perspective, as the name suggests, aims at satisfying the customers' needs and wants as the customer satisfaction is one of the performance indicators for any organization.

The last perspective, i.e., the financial perspective relates to the handling and processing of financial data. Figure 16.7 can be the diagrammatic representation of BSC for an organization.

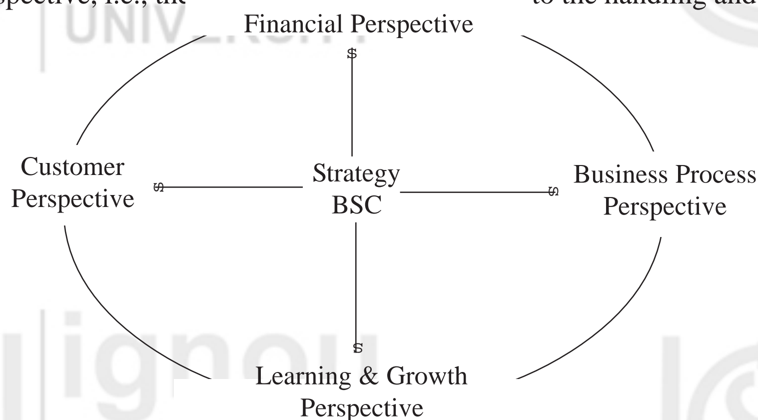

Figure 16.7: Balanced Score Card

Let us understand this concept with the help of an illustration.

Illustration: The business of enterprise is the production and sale of a localcommunity newspaper. The main focus is on cost control and reduction, low

levels of wastage and high levels of output. Interpersonal relationships are the key to growing revenue through advertising sales where the client can expect a well-targeted and relatively low-cost entry into the local marketing channels. The following is the BSC for X enterprise.

Financial Perspective		Customer Perspective	
CSF	**Measures**	**CSF**	**Measures**
Maintain low Overheads Shared computer facilities Flexible credit arrangements	Cost Ratios Asset Ratios Efficiency Ratios	Positive one-on one relationships with core advertisers	Number of sales % of available space sold
Business Process Perspective		**Learning and Growth Perspectives**	
CSF	**Measures**	**CSF**	**Merasures**
Home Based Operations Rapid production, e.g., Desk Top Publishing,	Measured in deadlines met and units produced - print run	Flot organizational structure High capacity utilisation Efficient and cost effective information systems	# of processing errors, % of raw material wastage Time to response

CSF: Critical Success Factors

Source: Adapted from IGNOU study material for CEMBA/CEMPA

In short we can say that BSC is a strategic performance management system for the organization. It is not only a measurement tool but is also a communication tool to make strategy clear to all working in the organization and tries to balance the financial and non-financial aspects of the organization. There is a commitment to manage and improve continuously. One of the bestsellers 'You can win' by Shiv Khera quotes that "winners don't do different things, they do things differently". Therefore, BSC is all about doing right thing at right time, but differently.

16.6 STRUCTURE FOR EVALUATION

For effective implementation of strategy, it is necessary that someone is made exclusively responsible for carrying out the operations. Responsibility centres, therefore, may be created for achieving the objective of the organistion following the selected strategy. The responsibility centres should have full freedom to take operational decisions relevant to their businesses. To an extent the responsibility centres will be restricted in taking decisions relating to functional policies as those decisions will not be within the jurisdiction of them.

Responsibility centres may be of several types. In a profit oriented organization, there could be profit centre, there could be revenue centres or there could be expense or cost centres.

Profit centre managers are responsible for profits. They have full freedom to decide their level of sales, margins and production, what to make and what to buy, etc. At times, however, they do not have jurisdiction over financial policies (sources of financing) and basic personnel policies. The revenue centre heads are held responsible for generating the revenue (within the approved costs) and cost centre heads are responsible for a certain level of production or activities.

In the functional structure the only person who can be held responsible for profits is the chief executive, since the very next level below (i.e., the functional heads) does

not have operational jurisdiction over issues related to other functional areas (but which influence profits all the same). Functional structure of the organization can thus have revenue and expense centres. In divisional structure the divisions will have most of the key operational decisions under their jurisdiction. Hence they can have profit centres for the success of strategy. The structure, thus, facilitates keeping of records for managerial accounting (so crucial for strategic decisions and strategy evaluation), and taking up/divesting a new product/business. The most appropriate structure for strategy of growth through diversification or expansion is to create profit centres in the form of divisional structure. Divisional structure also facilitates grooming of functional executives as general managers, although it dilutes the functional specialisation to some extent. The holding company-subsidiary structure also provides similar advantages from evaluation and control point of view, though it limits the scope of business portfolio management as different companies may be catering to different businesses.

The product divisional structure does not provide any significant advantage for growth through expansion in the same business or through (backward/forward) vertical integration. It is so because little flexibility is available to the divisions involved in the intermediate stages of production and all of them stand or fall together with changes in environment. Indeed it may be more appropriate in such cases to make the marketing divisions as revenue centres and production divisions as expense centres. The situation may be different if the intermediate product lines too have a significant market of their own. In such cases, making all such divisions as profit centres may be advisable.

Activity 4

What kind of responsibility centres exist in your organization? If you were given a free hand, what responsibility centres you would have created? Why?

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16.7 EVALUATION SYSTEM IN A MULTI-BUSINESS COMPANY

The identification of key success factors and their exact trend values is a complex process because of inter-business unit transfers of goods and services. Often these transfers take place at price levels which might suppress the true profitability of the supplying division. In suh cases transfer price adjustments are carried out for the purpose of fair evaluation of each unit.

In a multi-product/multi-business company, having several divisions as profit centres, there may be several products/components which are manufactured and sold by one division and at the same time required by others for their product/business. In such cases a system of transfer pricing needs to be developed for transfer of products/ components from one division to another, otherwise a situation may arise when two divisions may take decisions which may be against the overall interest of the

company. For instance, take two divisions A and B as profit centres. Division A produces a component which is a monopoly item and can fetch a margin as high as Rs. 30. The component price is say Rs. 100. Division B needs this component for one of its products. However, if it gets it at a price of Rs. 100, it cannot earn any profit on its product. Division A is not prepared to reduce its price to Rs. 85 as it cuts its margin by Rs. 15 to give 10% return on sales to Division B. Division B is left with two options to ensure 10% cut off return for its operations, either to drop the product or invest in facilities. The minimum size of facilities is far in excess of the requirements of the product in Division B, hence it will have to sell in open market. The prices in that case are likely to fall to Rs. 75 a piece. Division B may also not like to divert its energies to sell the component separately. It will, therefore, decide to drop the product. The actions of Divisions A & B in maintaining profitbility of their respective divisions thus lead to loss to the company as a whole on the margin that was available to it on product B, if only Division A had reduced the price a bit.

Similar would be the case if Division A has created capacity to meet the requirements of Division B. However, at a later stage, a situation of glut appears and the other suppliers resort to heavy price cutting, and B decides to purchase from open market at a price which A cannot afford to supply without running into losses. The situation may be even more damaging to the company, if the price reduction by the other supplier was to force some of the manufacturers (like Division A) to close the manufacturing facilities for the component and to rise prices again after the closures. Not only the company as a whole but even Dvision B will be a loser.

It would be realised that there are two issues involved in situations of transfer pricing. Firstly, the sourcing decision, i.e., whether the product is to be bought/sold by a division internally or externally. In view of profit centres as independent responsibility centres, normally the divisions should be allowed to decide it themselves. But a situation may arise when the intervention of top management may be necessary to give sourcing decisions to ensure that buying/selling by divisions is in the interest of the company. The second question is what should be the (transfer) price for the transfer of goods from one division to another.

It should be remembered that the purpose of transfer pricing is not to encourage inefficient operation by dictating a transfer price that will fetch a profit, but to ensure a fair price to the concerned divisions in the absence of an open and free competitive market price. That unifies the interests of the divisions with the interest of the company. Thus, whenever market place prices are available and when the divisions can meet all their requirements of buying and selling there may be no need of intervention. Indeed even when these conditions do not prevail, the level of inter-division transfer may not be significant or no intervention may be necessary/ advisable.

16.8 CHARACTERISTICS OF AN EFFECTIVE EVALUATION STRATEGY

There are certain basics which should be followed for making the strategic evaluation effective. These characteristics are as follows:

1) The activities of evaluation must be economical.
2) The information should neither be too much nor too little.
3) The control should neither be too much nor too less. It should be balanced.
4) The evaluation activities should relate to the firm's objectives.

5) It should be designed in such a manner so that a true picuture is portrayed.

There can be many more such requirements. Large organizations require a more elaborate system than the smaller ones.

Activity 5

Think of more such characteristics of an effective evaluation strategy and list them.

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16.9 SUMMARY

This unit discusses the different concepts of strategy evaluation. The effort has been to make you understand the qualitative issues of evaluation system and the importance of portfolio analysis in strategy evaluation. Portfolio analysis is an important task of a corporate strategist. It provides a framework for analysing the mutual compatibility of diverse operations of an organization. Balanced score card is one of the methods to measure the performance of the organization. There are many such methods which help in evaluation system.

The crux of the unit is to understand the concept of strategy evaluation as a whole.

16.10 KEY WORDS

Balanced Score Card: A management system that enables organizations to clarify their vision and strategy and translate them into action.

Evaluation Process: The control mechanism, which helps in taking corrective actions.

Portfolio analysis: One of the methods to assist managers in evaluating the strategy.

Qualitative Factors: These are the human factors used for evaluation process.

16.11 SELF-ASSESSMENT QUESTIONS

1) What is the importance of structure for the evaluation of strategy? What are the advantages of profit centres?
2) What is the purpose of transfer pricing? What are the merits and demerits of transfer pricing?
3) Discuss the importance of the Balanced Score Card in the present context.
4) Discuss the application of portfolio analysis.
5) What basic considerations have to be kept in mind while balancing portfolios?

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