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# THE EVALUATION OF BUSINESS STRATEGY*

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Strategy can neither be formulated nor adjusted to changing circumstances without a process of strategy evaluation. Whether performed by an individual or as part of an organizational review procedure, strategy evaluation forms an essential step in the process of guiding an enterprise.

For many executives strategy evaluation is simply an appraisal of how well a business performs. Has it grown? Is the profit rate normal or better? If the answers to these questions are affirmative, it is argued that the firm's strategy must be sound. Despite its unassailable simplicity, this line of reasoning misses the whole point of strategy-that the critical factors determining the quality of current results are often not directly observable or simply measured, and that by the time strategic opportunities or threats do directly affect operating results, it may well be too late for an effective response. Thus, strategy evaluation is an attempt to look beyond the obvious facts regarding the short-term health of a business and appraise instead those more fundamental factors and trends that govern success in the chosen field of endeavor.

## THE CHALLENGE OF EVALUATION

However it is accomplished, the products of a business strategy evaluation are answers to these three questions:

1. Are the objectives of the business appropriate?
2. Are the major policies and plans appropriate?
3. Do the results obtained to date confirm or refute critical assumptions on which the strategy rests?

Devising adequate answers to these questions is neither simple nor straightforward. It requires a reasonable store of situation-based knowledge and more than the usual degree of insight. In particular, the major issues which make evaluation difficult and with which the analyst must come to grips are these:

- Each business strategy is unique. For example, one paper manufacturer might rely on -its vast timber holdings to weather almost any storm while another might place primary reliance in modern machinery and an extensive distribution system. Neither strategy is "wrong" nor "night" in any absolute sense; both may be night or wrong for the firms in question. Strategy evaluation must, then, rest on a type of situational logic that does not focus on "one best way" but which can be tailored to each problem as it is faced.
- Strategy is centrally concerned with the selection of goals and objectives. Many people, including seasoned executives, find it much easier to set or try to achieve goals than to evaluate them. In part this is a consequence of training in problem structuring. It also arises out of a

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tendency to confuse *values,* which are fundamental expressions of human personality, with objectives, which are *devices* for lending coherence to action.

- Formal systems of strategic review, while appealing in principle, can create explosive conflict situations. Not only are there serious questions as to who is qualified to give an objective evaluation, the whole idea of strategy evaluation implies management by "much more than results" and runs counter to much of currently popular management philosophy.

<u>THE PRINCIPLES OF STRATEGY EVALUATION</u>

... For our purposes a strategy is a set of objectives, policies, and plans that, taken together, define the scope of the enterprise and its approach to survival and success. Alternatively, we could say that the particular policies, plans, and objectives of a business express its strategy for coping with a complex competitive environment.

One of the fundamental tenets of science is that a theory can never be proven to be absolutely true. A theory can, however, be declared absolutely false if it fails to stand up to testing. Similarly, it is impossible to demonstrate conclusively that a Particular business strategy is optimal or even to guarantee that it will work. One can, nevertheless, test it for critical flaws. Of the many tests which could be justifiably applied to a business strategy, most will fit within one of these broad criteria:

- *Consistency:* The strategy must not present mutually inconsistent goals and policies.
- *Consonance:* The strategy must represent an adaptive response to the external environment and to the critical changes occurring within it.
- *Advantage:* The strategy must provide for the creation and/or maintenance of a competitive advantage in the selected area of activity.
- *Feasibility:* The strategy must neither overtax available resources nor create unsolvable subproblems.

A strategy that fails to meet one or more of these criteria is strongly suspect. It fails to perform at least one of the key functions that are necessary for the survival of the business. Experience within a particular industry or other setting will permit the analyst to sharpen these criteria and add others that are appropriate to the situation at hand.

**Consistency**

Gross inconsistency within a strategy seems unlikely until it is realized that many strategies have not been explicitly formulated but have evolved over time in an ad hoc fashion. Even strategies that are the result of formal procedures may easily contain compromise arrangements between opposing power groups.

Inconsistency in strategy Is not simply a flaw in logic. A key function of strategy is to provide coherence to organizational action. A clear and explicit concept of strategy can foster a climate of tacit coordination that is more efficient than most administrative mechanisms. Many high-technology firms, for example, face a basic strategic choice between offering high-cost products with high custom-engineering content and lower-cost products that are more standardized and sold at higher volume. If senior management does not enunciate a clear consistent sense of where the corporation stands on these issues, there will be continuing conflict between sales, design, engineering, and manufacturing people. A clear consistent strategy, by contrast, allows a sales engineer to negotiate a contract with a minimum of coordination-the trade-offs are an explicit part of the firm's posture.

Organizational conflict and interdepartmental bickering are often symptoms of a managerial disorder but may also indicate problems of strategic inconsistency. Here are some indicators that can help sort out these two different problems:

- If problems in coordination and planning continue despite changes in personnel and tend to be issue rather than people based, they are probably due to inconsistencies in strategy.
- If success for one organizational department means, or is interpreted to mean, failure for another department, the basic objective structure is inconsistent.
- If, despite attempts to delegate authority, operating problems continue to be brought to the top for the resolution of policy issues, the basic strategy is probably inconsistent.

A final type of consistency that must be sought in strategy is between organizational objectives and the values of the management group. Inconsistency in this area is more of a problem in strategy formulation than in the evaluation of a strategy that has already been implemented. It can still arise, however, if the future direction of the business requires changes that conflict with managerial values. The most frequent source of such conflict is growth. As a business expands beyond the scale that allows an easy informal method of operation, many executives experience a sharp sense of loss. While growth can of course be curtailed, it often will require special attention to a firm's competitive position if survival without growth is desired. The same basic issues arise when other types of personal or social values come into conflict with existing or apparently necessary policies: the resolution of the conflict will normally require an adjustment in the competitive strategy.

**Consonance**

The way in which a business relates to its environment has two aspects: the business must both match and be adapted to its environment and it must at the same time compete with other firms that are also trying to adapt. This dual character of the relationship between the firm and its environment has its analog in two different aspects of strategic choice and two different methods of strategy evaluation.

The first aspect of fit deals with the basic mission or scope of the business and the second with its special competitive position or "edge." Analysis of the first is normally done by looking at changing economic and social conditions over time. Analysis of the second, by contrast, typically focuses on the differences across firms at a given time. We call the first the "generic" aspect of strategy and the second "competitive" strategy. Table1 summarizes the differences between these concepts.

The notion of consonance, or matching, therefore, invites a focus on generic strategy. The role of the evaluator In this case is to examine the basic pattern of economic relationships that characterize the business and determine whether or not sufficient value is being created to sustain the strategy. Most macroanalysis of changing economic conditions is oriented toward the formulation or evaluation of generic strategies. For example, a planning department forecasts that within 10 years home appliances will no longer use mechanical timers or logic. Instead, microprocessors will do the job more reliably and less expensively. The basic message here for the makers of mechanical timers is that their generic strategies are becoming obsolete, especially if they specialize in major home appliances. Note that the threat in this case is not to a particular firm, competitive position, or individual approach to the marketplace but to the basic generic mission.

**TABLE 1 Generic Versus Competitive Strategy**

| | **GENERIC** | **COMPETITIVE** |
|---|---|---|
| Measure of success | Sales growth | Market share |
| Return to firm | Value added | Return on investment |
| Function | Provision of value to the customer | Maintaining or obtaining a defensible position |
| Basic strategic tasks | Adapting to change and innovation | Creating barriers and deterring rivals |
| Method of expressing strategy | Product/market terms, functional terms | Policies leading to defensible position |
| Basic approach to analysis | Study of group of businesses over time | Comparison across rivals at a given time |

One major difficulty in evaluating consonance is that most of the critical threats to a business are those which come from without, threatening an entire group of firms. Management, however, is often so engrossed in competitive thinking that such threats are only recognized after the damage has reached considerable proportions....

The key to evaluating consonance is an understanding of why the business, as it currently stands, exists at all and how it assumed its current pattern. Once the analyst obtains a good grasp of the basic economic foundation that supports and defines the business, it is possible to study the consequences of key trends and changes. Without such an understanding, there is no good way of deciding what kinds of changes are most crucial and the analyst can be quickly overwhelmed with data.

**Advantage**

It is no exaggeration to say that competitive strategy is the art of creating or exploiting those advantages that are most telling, enduring, and most difficult to duplicate.

Competitive strategy, in contrast with generic strategy, focuses on the differences among firms rather than their common missions. The problem it addresses is not so much "how can this function be performed" but "how can we perform it either better than, or at least instead of our rivals?" The chain supermarket, for example, represents a successful generic strategy. As a way of doing business, of organizing economic transactions, it has replaced almost all the smaller owner-managed food shops of an earlier era. Yet a potential or actual participant in the retail food business must go beyond this generic strategy and find a way of competing in this business. As another illustration, American Motors' early success in compact cars was generic -- other firms soon copied the basic product concept. Once this happened, AMC had to try to either forge a strong competitive strategy in this area or seek a different type of competitive arena.

Competitive advantages can normally be traced to one of three roots:

- Superior resources
- Superior skills
- Superior position

The nature of the advantages produced by the first two are obvious. They represent the ability of a business to do more and/or do it better than its rivals. The critical analytical issue here is the question of which skills and resources represent advantages in which competitive arenas. The skills that make for success in the aerospace electronics industry, for instance, do not seem to have much to do with those needed in consumer electronics. Similarly, what makes for success in the early phases of an industry life cycle may be quite different than what ensures top performance in the later phases.

The idea that certain arrangements of one's resources can enhance their combined effectiveness, and perhaps even put rival forces in a state of disarray, is at the heart of the traditional notion of strategy. This kind of "positional" advantage is familiar to military theorists, chess players, and diplomats. Position plays a crucial role in business strategy as well....

Positional advantage can be gained by foresight, superior skill and/or resources, or just plain luck. Once gained, a good position is defensible. This means that it (1) returns enough value to warrant its continued maintenance and (2) would be so costly to capture that rivals are deterred from full-scale attacks on the core of the business. Position, it must be noted, tends to be self-sustaining as long as the basic environmental factors that underlie it remain stable. Thus, entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. And when a shifting environment allows position to be gained by a new entrant or innovator, the results can be spectacular.

The types of positional advantage that are most well known are those associated with size or scale. As the scale of operations increases, most firms are able to reduce both the marginal and the total cost of each additional unit produced. Marginal costs fall due to the effects of learning and more efficient processes, and total costs per unit fall even faster as fixed overheads are spread over a larger volume of activity. The larger firm can simply take these gains in terms of increased profitability Or it can invest some of the extra returns in position-maintaining activities. By engaging in more research and development, being first to go abroad, having the largest advertising budget, and absorbing the costs involved with acting as an industry spokesman, the dominant business is rechanneling the gains obtained from its advantages into activities designed to maintain those advantages. This kind of positive feedback is the source of the power of position-based advantages -- the policies that act to enhance position do not require unusual skills, they simply work most effectively for those who are already in the position in the first place.

While it is not true that larger businesses always have the advantages, it Is true that larger businesses will tend to operate in markets and use procedures that turn their size to advantage. Large national consumer-products firms, for example, will normally have an advantage Over smaller regional firms in the efficient use of mass advertising, especially network TV. The larger firm will, then, tend to deal in those products where the marginal effect of advertising is most potent, while the smaller firms will seek product-market positions that exploit other types of advantage.

Not all positional advantages are associated with size, although some type of uniqueness is a virtual prerequisite. The principal characteristic of good position is that it Permits the firm to obtain advantage from policies that would not similarly benefit rivals without the position. For example, Volkswagen in 1966 had a strong, well-defined position as the preeminent maker of inexpensive, well-engineered, functional automobiles. This position allowed it to follow a policy of not changing its body styling. The policy both enhanced VW’s position and reduced costs. Rivals could not similarly benefit from such a policy unless they could also duplicate the other aspects of VW’s position. At the other end of the spectrum, Rolls-Royce employed a policy of deliberately limiting its output, a policy which enhanced its unique position and which could do so only because of that position in the first place. Mintzberg (1973b) calls strongly defensible positions and the associated policies "gestalt strategies," recognizing that they are difficult to either analyze or attack in a piecemeal fashion.

Another type of positional advantage derives from successful trade names. These brands, especially when advertised, place retailers in the position of having to stock them which, in turn, reinforces the position and raises the barrier to entry still further. Such famous names as Sara Lee, Johnson & Johnson, and Kraft greatly reduce, for their holders, both the problems of gaining wide distribution for new products and obtaining trial use of new products by the buying public.

Other position-based advantages follow from such factors as:

- The ownership of special raw material sources or long-term supply contracts
- Being geographically located near key customers in a business involving significant fixed investment and high transport costs

- Being a leader in a service field that permits or requires the building of a unique experience base while serving clients
- Being a full-line producer in a market with heavy trade-up phenomena
- Having a wide reputation for providing a needed product or service trait reliably and dependably

In each case, the position permits competitive policies to be adopted that can serve to reinforce the position. *Whenever* this type of positive-feedback phenomena is encountered, the particular policy mix that creates it will be found to be a defensible business position. The key factors that sparked industrial success stories such as IBM and Eastman Kodak were the *early* and rapid domination of strong positions opened up by new technologies.

**Feasibility**

The final broad test of strategy is its feasibility. Can the strategy be attempted within the physical, human, and financial resources available? The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is tested. It is sometimes forgotten, however, that innovative approaches to financing expansion can both stretch the ultimate limitations and provide a competitive advantage, even if it is only temporary. Devices such as captive finance subsidiaries, sale-leaseback arrangements, and tying plant mortgages to long-term contracts have all been used effectively to help win key positions in suddenly expanding industries.

The less quantifiable but actually more rigid limitation on strategic choice is that imposed by the individual and organizational capabilities that are available.

In assessing the organization's ability to carry out a strategy, it is helpful to ask three separate questions.

1. Has the organization demonstrated that it possesses the problem-solving abilities and/or special competences required by the strategy? A strategy, as such, does not and cannot specify in detail each action that must be carried out. Its purpose is to provide structure to the general issue of the business' goals and approaches to coping with its environment. It is up to the members and departments of the organization to carry out the tasks defined by strategy. A strategy that requires tasks to be accomplished which fall outside the realm of available or easily obtainable skill and knowledge cannot be accepted. It is either infeasible or incomplete.
2. Has the organization demonstrated the degree of coordinative and integrative skill necessary to carry out the strategy? The key tasks required of a strategy not only require specialized skill, but often make considerable demands on the organization's ability to integrate disparate activities....
3. Does the strategy challenge and motivate key personnel and is it acceptable to those who must lend their support? The purpose of strategy is to effectively deploy the unique and distinctive

> resources of an enterprise. If key managers are unmoved by a strategy, not excited by its goals or methods, or strongly support an alternative, it fails in a major way....

<u>CONCLUSIONS</u>

. . . In most medium- to large-size firms, strategy evaluation is not a purely intellectual task. The issues involved are too important and too closely associated with the distribution of power and authority for either strategy formulation or evaluation to take place in an ivory tower environment. In fact, most firms rarely engage in explicit formal strategy evaluation. Rather, the evaluation of current strategy is a continuing process and one that is difficult to separate from the normal planning, reporting, control, and reward systems of the firm. From this point of view, strategy evaluation is not so much an intellectual task as it is an organizational process.

As process, strategy evaluation is the outcome of activities and events which are strongly shaped by the firm's control and reward systems. Its information and planning systems, its structure, and its history and particular culture. Thus, its performance is, in practice, tied more directly to the quality of the firm's strategic management than to any particular analytical scheme. In particular, organizing major units around the primary strategic tasks and making the extra effort required to incorporate measures of strategic success in the control system may play vital roles in facilitating strategy evaluation within the firm.

Ultimately, a firm's ability to maintain its competitive position in a world of rivalry and change may be best served by managers who can maintain a dual view of strategy and strategy evaluation -- they must be willing and able to perceive the strategy within the welter of daily activity and to build and maintain structures and systems that make strategic factors the object of current activity.