UNIT 15 CONTROL

Objectives

After studying this unit, you should be able to understand:

- the strategic control process;
- importance of strategic control in evaluation;
- different methods used in control process; and
- analysis and follow-up action for control.

Structure

15.1 INTRODUCTION

With the completion of the strategy implementation, the organization looks forward to achieving the desired goals and objectives. It is necessary, however, to introduce the process of strategy evaluation and control in the early stages of implementation, to see whether the strategy is successful or not and to carry out mid-course corrections wherever necessary. There are several reasons why a strategy may not lead to desired results. The external environment may not actually follow a trend as was expected at the time of planning the strategy. The internal changes within the organization such as the organizational systems consisting of structure, policies and procedures may not reflect harmony with the strategy. After a while, the top management of even middle-level managers may find it difficult to exercise a substantial degree of control over operating systems. The unexpected moves of the competitors might create major gaps in the strategy. Thus the list of such factors will require a continuous evaluation and control of strategy. In this unit we will describe the control process.

15.2 STRATEGIC CONTROL PROCESS

The evaluation of the strategy of an organization can be done qualitatively as well as quantitatively. The quantitative evaluation is based on data and is possible through post facto analysis to detect whether the content of strategy is working or has worked. However, qualitative evaluation can also be done by addressing the question: Will it work? The qualitative evaluation can thus be done before activating plans of change.

The qualitative evaluation and control of strategy is a real time process. The performance of strategy is monitored and corrective actions are taken. The basic aim of any organization is to achieve its goals. But to achieve the goals, the organization faces lots of hurdles. To overcome these hurdles, it is necessary for any organization to have a sound **stratetgic** control process. The word meaning of 'control' itself means 'to regulate' or 'to clieck'. This means that the top management needs to keep check on how well the strategy is being implemented to achieve the objectives of the organization. For example, if the business is not giving results 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.

The strategic control process is closely related to strategic planning process. Figure 15.1 represents the relationship between strategic planning and strategic control process. Tlie process consists of three phases, which are as follows: 1) Evaluation criteria; 2) Performance evaluation; and 3) Feedback.

The first phase i.e., tlie evaluation criteria consists of selecting ltey success factors, developing measures and setting standards for the same and collecting information about actual performance. As discussed, the evaluation criteria can be qualitative as well as quantitative. In this unit, we will focus on the quantitative aspect. The qualitative aspect would be discussecl in unit 16.

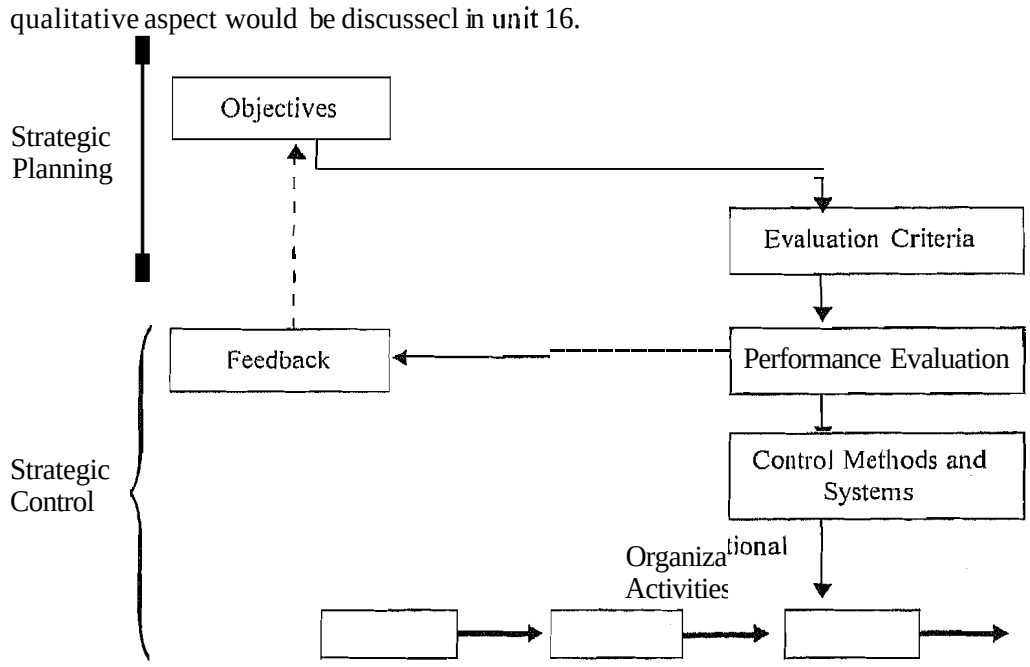

Figure 16.1 : Relationship between Strategic Planning and Strntegic Control Process

Source: Adapted from Byars L. Lloyd, Strategic Management, Planning and Implementation Concepts and Cases, 1987.

Quantitative criteria for evaluation : This is important for measuring the organizational performance whereby the actual results are compared with tlie expected results. Usually the organizations use financial ratios as quantitative criteria for evaluating strategies. These are used due to the following reasons:

1) To compare the performance of the organization over different time periods;
2) To compare the performance of the organization with its competitors in the industry;
3) To compare the organizations' performance to industry averages.

Some of the major financial ratios which can be used **as** criteria for evaluation of strategy are:

1) Return on investment
2) Return on equity

3) Profit margin
4) Market share
5) Debt to equity
6) Earnings per share
7) Sales growth
8) Asset growth

These ratios are used by different organizations to measurethe performance of the organization. Here, one thing is to be noted that the qualitative criteria are related more to short-term objectives than the long-term ones. This is the reason why qualitative criteria are very important in evaluating strategies. Therefore, to evaluate strategies certain qualitative questions should also be taken into consideration. These questions can be:

- Whether the strategy is internally consistent or not?
- Whether it is appropriate considering the available resources or not?
- How is the firm balancing its investments between high-risk and low-risk prospects?

This shows that answers to all these qualitative questions is important to evaluate and control the strategy.

15.3 METHODS OF CONTROL

There are many methods/techniques used in strategic control systems. Every organization has its own way of using a particular technique according to the requirement of the organization. Most of the methods related to the strategic management are regarding the financial control systems. Figure 16.2 shows one of the effective systems of financial control, which is universally accepted and is used by many organizations throughout the world. This is system of financial control is known as DuPont's system of financial control.

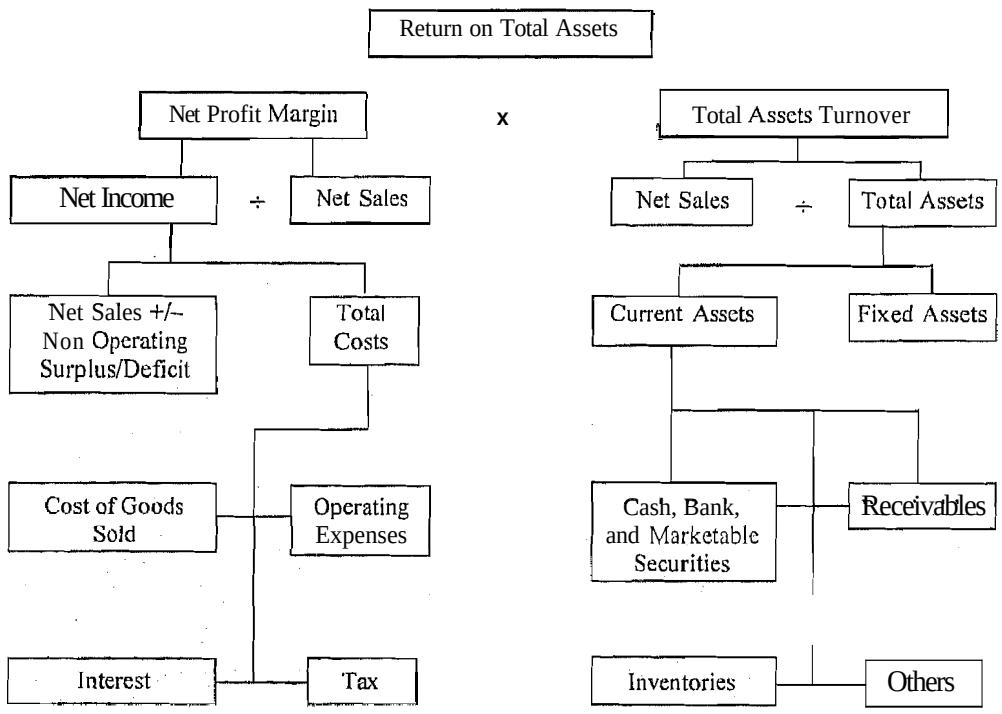

Figure 16.2: DuPont Chart

Source: Adapted **from** Chandra, Prasanna (1995), *Fundamentals of Financial Management.*

The other methods which are used most frequently are: Budgets, Audits, time-related control techniques like: PERT and CPM, Management by Objectives (MBO). We will discuss these methods in brief to develop an understanding of the Strategic Control Process.

Budgets: These are one of the most widely used control methods. Budget preparation is one of them. In simple terms budget means 'a plan of income and expenditure'. Budget usually deals with allocation of resources to different organizational units. Table 15.1 shows an example of a budget report. Budget gives an idea about the future expenditures and income and at this juncture only the analysis of the performance of the company is done and corrective action can be taken up for flaws, if any. Since budget is actually a forecast, its revision would be required from time to time depending upon the requirement of the company. It is one of the key elements in implementing the strategy successfully.

Table 15.1: Budget **Report**

	June				*5 months (year-to-date)*			
Budget	Actual	Difference	%	Budget	Actual	Difference		%
Total cost (Rs)	40,000	50,000	10,000	+25	20,00,00	20,50,00	5,000	+25
Total units produced	10,00,000	12,00,000	20,00,00	+20	1,000,0000	1,000.0000		+0%

Audits: This is another method of control. As per American Accounting Association (AAA), auditing is defined as "a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users" (Byars, 1987).

Audit functions come under three basic groups, viz.

- Independent auditors
- Government auditors
- Internal auditors

Independent auditors are professionals who provide their services to the organization.

Government auditors: This precludes the agencies who perform government audits for organizations.

Internal auditors are employees within the organization and perform their function from within.

There is one more group known as Management Audit, which examines and evaluates the overall performance of all organization's management team. Audit teams assess the efficiency of various units in the organization and the control system of the organization. The information provided by them becomes crucial for the management. Nowadays most of the organization go in for management audits.

Time-related Control Methods

This includes useful graphical and analytical methods and these methods serve as a tool in the strategic control process. The most popular methods include Critical Path Method (CPM) and Programme Evaluation and Review Technique (PERT). These are graphical network depicting the different segments of work that must be completed within a given span of time to complete a project or task. These provide information for both project planning and control and is helpful for the management in allocating its limited resources.

Management By Objectives (MBO)

This is one of the methods, which is used both in strategic planning and control. In this the objectives are establislied for the organization as a whole for functional areas, departments and finally individuals of the organization. It has three minimum requirements which are as follows:

1) Objectives for individuals.
2) Individuals are evaluated and receive feed back on their performance.
3) Individuals are evaluated and rewarded on the basis of their performance.

This helps in keeping a check on working of employees in the organization and helps achieve the goals of the organization. Apart from these control methods, other methods like: Management Information Systems (MIS) and Decision Support Systems (DSS) also can be included under the control methods.

Activity 1

Suppose you are a financial expert working for a bank. Identify tlie key financial ratios important to evaluate the strategy of the bank.

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15.4 PERFORMANCE STANDARDS

Having identified the measures relevant for asessing the success of the strategy, the next important issue is to set the standards against which actual performance is to be measured. The standards of performance could be any of the following three types.

a) Historical Standards

In this type of standards, comparison of present performance is made with the past performance. Though simplest, this type does not take into account the changes in environmental conditions between the two periods. Moreover, the prior-period performance itself may not have been acceptable. It also could be misleading in the fonnative years when the numerator (previous years figures) is small.

b) Industry Standards

In this type of standards, the coinparison of a firm's performance is made against similar other firms in the industry. The difficulty here is that all the firms may not be exactly the same for purposes of comparison.

c) Present Standards

The goals/targets are decided by the firm's management to be achieved in a particular period. Present standards convey the aspiration levels and take into account environmental conditions, if properly derived. These are more realistic and also consider the organizations' capacity to achieve them. These, however, require tremendous analysis. Absence of such analysis may lead to shocking results. However, for a company developing a conscious strategy, present standards provide the best alternative.

Activity 2

What kinds of standards are being used in your organization? What, in your view, are the problems arising out of it?

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15.5 ANALYSIS AND FOLLOW-UP ACTION FOR CONTROL

Once the actual operations start, information about the actual performance has to be collected periodically and compared with tlie standards set. If the objectives or major components of strategy include such factors as market leadership, information about market share will also have to be collected. Information may also be collected regarding performance of tlie other key factors. If the performance on key success factors is unsatisfactory, the long-term success of the strategy may be endangered. This may be despite tlie current success which may be due to favourable current environment, for example, boom in tlie industry, scarcity etc.

If the performance is unsatisfactory, two courses of action are possible. The responsibility centre manager may be asked to improve performance, or if it is not possible, target or standards of performance may be revised.

The evaluation and control reports may be of two types namely; tlie motivational and the economic reports. The motivational reports relate to the performance of the people in the responsibility centres. Economic reports are concerned with the economic performance of the responsibility centres. The basic difference in the two is that while the latter gives actual economic performance covering all factors, tlie former reports tlie performance of a responsibility centre. For instance, while an economic report will include all costs, tlie motivational report will include only those items of cost over which it has control.

For example, tlie division may not have any control over purchase price of materials, but it may have control over material consumption. Similarly, the responsibility centre has control over market share while it may not have control over industry volume. It is advisable to keep the two reports separate. For instance, if the economic performance is going down despite best efforts of the responsibility centre, there may be a need to make a shift in the strategy. Similarly, strategic performance based on economic reports may be satisfactory but still there may be need for modification of the strategy if the good performance is due to unexpected favourable developments.

From the control point of view the reports must be timely, otherwise corrective action may not be possible. The frequency of reports is determined by the lead time required for corrective action and is constrained by the lead time for processing tlie transactional data and its transmittal to retrieve data in the form of reports. If on the other hand, tlie evaluations are made too early kneejerk reactions are likely which may hurt tlie plan.

A strategy need not be changed or abandoned just because evaluation has revealed the causes of poor performance over a short period. It should be tested for a sufficiently

long period of time because certain assumptions might have gone wrong and there was no contingency plan to take care of such situations. If even after reasonable period of time the performance is not coming up to expectations, it may be due to serious deficiencies in the business strategy. However, before changing the strategy, it would be advisable to check its implementation on the test of adequacy. It is quite possible that some of the Ss of the 7-S model may be grossly out of line with the strategy. And, if corrected, the strategy may still be quite useful. However, there might have been serious errors in assessing the external and internal environments even though the evaluation of implementation reveals no major mismatches.

Activity 3

How are the targets fixed for various divisions/departments in your organization? How and why are the targets revised? Give comments on the duration of target fixing and revising.

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15.6 PROBLEMS OF CONTROL SYSTEMS

There are a large number of problems associated with control systems for strategy evaluation. An efficient system may collect a lot of irrelevant data whereas a sophisticated system might ignore crucial information. Some of the typical problems encountered in designing and managing control system are:

- There may not be a consensus on the criteria for measuring the effectiveness and efficiency of the strategy.
- The reporting data may be invalid.
- The performance norms may be based on outputs on which the relevant business inay not have a control.
- Often performance standards may be set with inherent contradictions. For example, an increase in market share inay be expected in conjunction with an absolute decrease in marketing expenditure.
- Employees inay consider the system to be unfair and therefore may not accept it.
- Overemphasis on measuring short-term performance may make managers forget about the strategy which inherently has long connotations.
- It is very difficult to set "good", "average" and "poor" levels of performance in situations where the outputs are not very tangible.

15.7 SUMMARY

An effective system of evaluation and control is important for the success of corporate strategy. It is also necessary for taking decisions on whether strategy should be continued or modified. The success of a strategy should be considered both in terms of effectiveness and efficiency. While it is easy to measure efficiency, it is relatively more difficult to measure effectiveness.

The problem in evaluation and control is that of developing appropriate measures. The key variables of the organization may guide the duration of measures for evaluation and control. Structure also plays an important role in evaluation and control of strategy. Defective structures may lead to inadequate evaluation and control. The economic performance of an organization unit must be distinguished from the performance of people of the unit from the viewpoint offollow-up action. Factors which are not under the control of a responsibility centre must be excluded from the reports in evaluating the performance of the responsibility centre people. For evaluation of a strategy or concrete action, all factors of cost and environment must be included. On tlie basis of evaluation tlie corrective action may be taken if the performance is not up to the planned levels. If it is found that the performance of the responsibility centre is not improving or is unlikely to improve, tlie targets may be revised.

If there are successive failures, the strategy may have to be abandoned. Before abandoning tlie strategy, however, an examination should be made as to whether implementation has been adequate.

15.8 KEY WORDS

Control : To regulate.

Perforniance Stantlards : Standards against which actual performance is to be measured.

Ratio Analysis : The principal tool of financial statement analysis.

15.9 SELF-ASSESSMENT QUESTIONS

1) Compare and contrast different types of standards which can be used for control of strategy.
2) Discuss the strategic control process.
3) Briefly explain some areas in which organizations establish quantitative evaluation criteria.
4) What can be the characteristics of an effective control system? Discuss.

15.10 REFERENCES AND FURTHER READINGS

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