CHAPTER 8

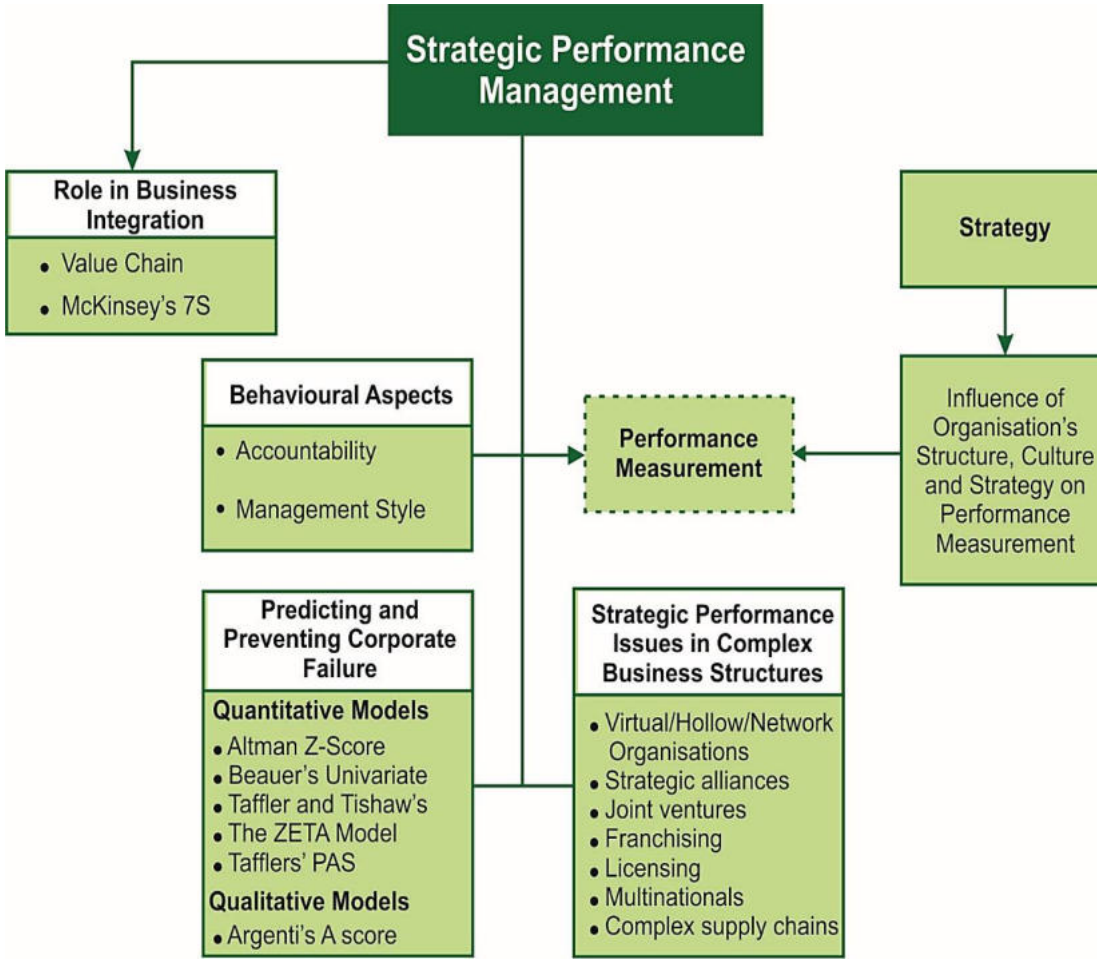
AN INTRODUCTION TO STRATEGIC PERFORMANCE MANAGEMENT

LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- UNDERSTAND the relevance of performance management for strategic decision-making
- ANALYSE the role that performance management systems play in business integration using models such as the value chain and McKinsey's 7S's.
- ANALYSE and EVALUATE how Structure, Culture, and Strategy influencing the selection of methods and techniques of performance measurement.
- ANALYSE and EVALUATE the problems encountered in planning, controlling and measuring performance in complex business structures.
- UNDERSTAND and EVALUATE the behavioural issues involved in performance management.
- UNDERSTAND and EVALUATE why companies do fail, how to predict corporate failure in order to prevent the same and ANALYSE the means thereof.

Chapter Overview



This chapter will help students to understand the need for and importance of performance management (i.e., the selection and applications of tools and techniques for measurement, evaluation, and improvement of performance) in the context of strategy and its role in strategic decision making.

Further, this chapter will also help students to develop and present appropriate strategies taking into consideration the performance, structure, culture, behaviours, and risk profile of the organization.

A. PERFORMANCE MANAGEMENT AND ITS LINK TO STRATEGY

It is essential to have clarity on strategy and performance management to understand the interlinking of the two.

1. What is Strategy?

There is no universally acceptable definition of strategy; here we have to consider the strategy from the perspective of business; hence, the following definitions of strategy are relevant.

Peter F. Drucker's definition of strategy is "a **pattern of activities** that seek to **achieve the objectives** of the organization and **adapt its scope, resources, and operations to environmental changes** in the **long term**". However, Michael E. Porter defines strategy as a **competitive position**, "**deliberately** choosing a different **set of activities** to deliver a **unique mix of value**."

Both of the above definitions signify that *the choice of where and how to compete is central to any business strategy. It is all about achieving a sustainable competitive advantage.*

To illustrate - Biscuit manufacturers know their consumer base is price sensitive; hence, rather than increasing pricing, they are reducing the quantity of packs. In economic terms, this is called *Shrinkflation* (a form of inflation that consists of reducing a product's size while maintaining its retail price; most common in FMCG, especially food and beverage). The company believes that by implementing this strategy, it will be able to maintain its revenue and margins.

It is worth noting that *the effectiveness of a strategy depends on the efficiency of strategic planning and control.*

2. What is Performance Management?

Performance Management is considered as key aspect of management accounting, which deals with–

- Determining an appropriate organisation's structure, level of decentralisation, etc.
- Establishing a responsibility centre and assigning responsibility to the manager.
- Establishing a performance measurement system and fixing the yardsticks.
- Reviewing the performance periodically and taking corrective measures where performance is not acceptable.

In simple words, performance management systems help an organisation in measuring how well it is **performing against its goals and objectives** and identify areas where **performance can be improved** in order to help the organisation achieve those goals and objectives.

To cut a long story short, the central premise of performance management is to **improve an organisation's performance**. For this, performance management system relies on various tools

and models such as the Balanced Scorecard, Performance Pyramid, Building Block, Triple Bottom Lines, etc. Many of these models will be studied in detail in the upcoming chapters.

It is noteworthy that performance evaluation under the performance management system accumulates information related to performance to analyze the same and take corrective action; in order to align efforts to ensure that goals and objectives are attained.

3. Interlinking of Performance Management and Strategy

As stated earlier, *effectiveness of strategy depends upon the efficiency of strategic planning and control.* Informed decision making is an essential requirement for efficient strategic planning and control.

The required set of information to make informed decisions can be obtained from the same information system, which is operated for the purpose of performance measurement and evaluation under the performance management system.

Moreover, performance can be measured and evaluated in terms of those yardsticks (Critical Success Factors (CSFs) and Key Performance Indicators (KPIs) thereto), which are critical for the attainment of the goals and objectives that are linked with strategy. In this way, the performance and goals of individuals are aligned with the performance and objectives of the organisation where they are working.

Hence, performance management can bring ease in strategic planning and control for management of any business, whereas strategy acts as a guiding force for establishing performance indicators and parameters thereof.

To illustrate - Tools used for measurement and evaluation of performance includes Balanced Scorecard (shown in Figure A.1) and Performance Pyramid (shown in Figure A.2). Both models keep strategy as either a focal point or a starting point.

Robert S. Kaplan and David P. Norton, in 1992 suggested the balanced scorecard that can **translate a company's strategy into specific, measurable objectives**. Further, both authors also suggested that "a failure to convert improved operational performance, as measured in the scorecard, into improved financial performance should send executives back to their drawing boards to rethink the company's strategy or its implementation plans".

In 1989, F. Cross and R. L. Lynch published an article titled "The SMART way to define and sustain success." In this article, they suggested Strategic Measurement Analysis and Reporting Technique (SMART) which is popularly known as performance pyramids due to the four-level hierarchy applied in the framework. The attractiveness of this framework is that it **integrates the business' strategic objectives with operational performance dimensions**, considering the internal efficiency vis-à-vis external effectiveness.

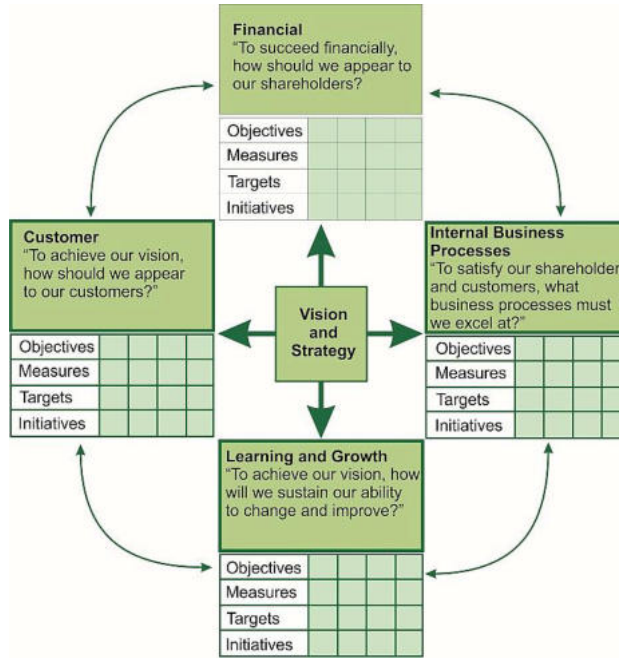


Figure A.1 - Balanced Scorecard[1]

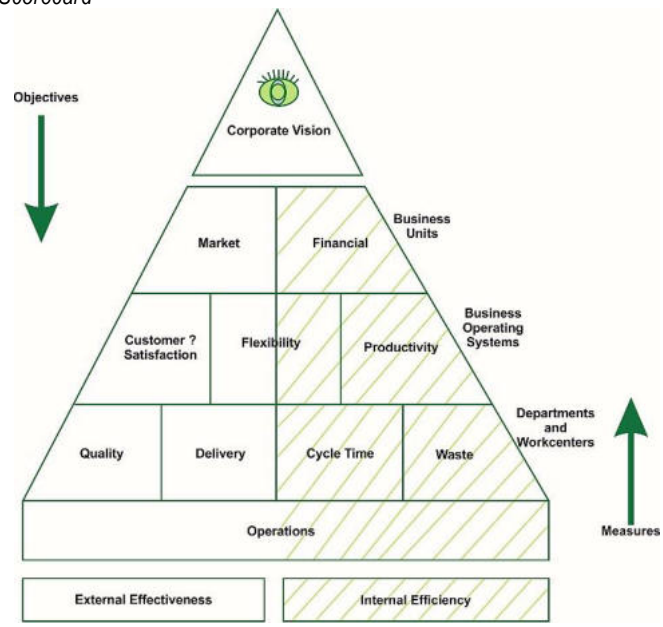


Figure A.2 – Performance Pyramid[2]

Note: Both of these models will be discussed in detail in the next chapter of this module.

[1] Robert S. Kaplan and David P. Norton, The Balanced Scorecard: Translating Strategy into Action (1992)
[2] K. F. Cross and R. L. Lynch, The SMART Way to Define and Sustain Success (1989)

4. Importance of Interlinking of Performance Management and Strategy Multifolds under Modern and Dynamic Business Environment

Historically, performance management has tended to focus on either people management (e.g., performance appraisals) or performance monitoring (e.g., reporting on key performance indicators).

But as business environments become increasingly dynamic and competitive, it is increasingly important for managers to develop coherent business strategies and to have tools and processes in place that provide relevant and reliable information to support strategic decision making, planning, and control.

A performance management system should be derived from the company's strategic objectives so that it supports those objectives. It should also change over time as the strategies of the organisation change and should be flexible enough to remain coherent with the objectives of the organisation.

B. ROLE OF PERFORMANCE MANAGEMENT IN BUSINESS INTEGRATION USING MODELS SUCH AS VALUE CHAIN AND MCKINSEY'S 7S

1. Introduction

Business may be seen as a grouping of specialized departments or functions. But in practical reality, value is added by the activities and processes that business performs. Such business processes and activities may stretch a number of departments. Hence, these business **processes and activities** need to be **linked or integrated** effectively across the organisation to **create value**.

*Whatever **business structure** (be it functional, line, entrepreneurial, matrix, etc.) is adopted, the need to **integrate** the different aspects of the business is inevitable to **create value**.*

2. Business Integration

Business integration brings all aspects of business into alignment so that business **objectives** can be achieved through **effective implementation** of **strategies** while making **efficient use** of the available set of **resources**.

*Resources available to businesses are usually **scarce** in nature, hence the multifold importance of business integration.*

Four aspects in particular need to be linked as part of the business integration effort: **people, operations, strategy, and technology.** Performance management improves as a result of the integration of these four aspects.

Do You Know?

Business integration can overcome the problem of sub-optimisation as well.

BPR experts such as Hammer and Davenport highlight through their research findings that many organisations have departments and functions that try to maximise their own performance and efficiency at the expense of the whole, which leads to sub-optimisation.

Business integration can be seen as proposed solution because, through it –

- Processes are viewed from an entity's perspective (rather than from the viewpoint of an individual department or function), that stretch from the initial order to the final delivery of a product.
- Information Technology breakthroughs can be used to integrate these processes and activities.

Dynamics of business integration can be understood with a variety of business models; in the upcoming headings of this chapter, frameworks like **Porter's Value Chain** and **McKinsey's 7S** will be discussed in detail.

3. Value Chain/ Value Chain Analysis

Value Chain[3] is the sequential chain of activities that leads to the delivery of the final product to the customer. It also depicts how value (utility) accumulates for the customer.

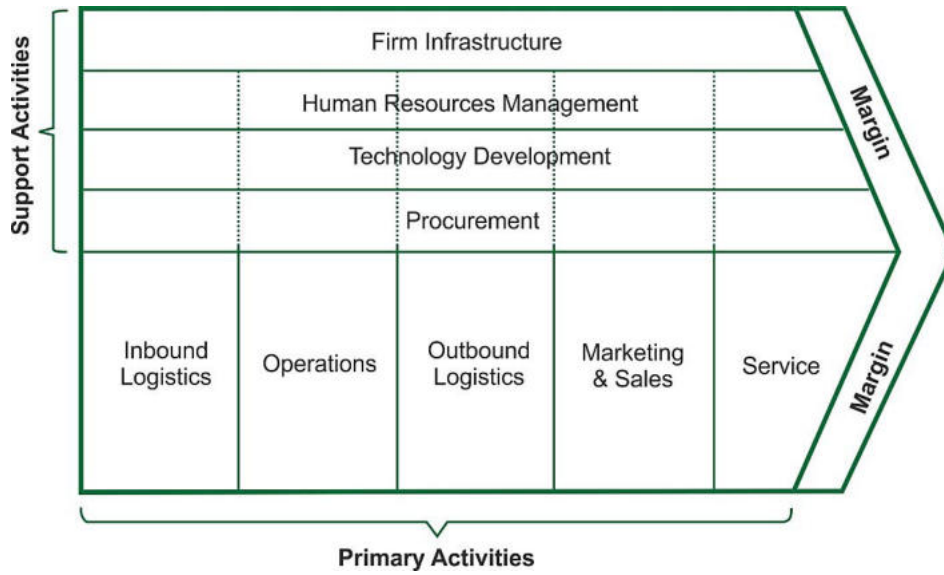


Figure B.1 – The Generic Value Chain[4]

[3] In his book Competitive Advantage: Creating and Sustaining Superior Performance, Michael E. Porter introduced the generic value chain in 1985. This book answered the questions he posed in his earlier book, 'Competitive Strategy - Techniques for Analysing Industries and Competitors' written in 1980.

[4] Figure 2-2 at p.37 of Competitive Advantage: Creating and Sustaining Superior Performance (1985) by Michael E. Porter.

3.1 Description of Activities and Margin

Value chain comprises the activities in two sets, the first being **primary activities** (vertical) which are directly involved in the transformation of products or provisioning of services; whereas the second set is **support activates** (horizontal) which ensure support to perform primary activities.

Margin is the excess of the value that a customer ready to pay over the cost incurred by the firm for the product.

3.1.1 Primary Activities

- **Inbound logistics** cover receiving, storing, and handling raw material inputs.
- **Operations** include transformation of raw materials into finished goods and services.
- **Outbound logistics** cover storing, distributing, and delivering finished goods to customers.
- **Marketing and sales** activities comprise market research and the marketing mix (product, price, place, and promotion).
- **After sales service** includes all those activities that occur after the point of sale, such as installation, training, and repair.

Note – Description of activities along with illustrations, is explained in detail under Chapter 1 of this book. Students are advised to refer to the same for details.

Practical Insight

Primary activities at Apple Inc.[5]

Inbound logistics - Apple collects its raw materials from China, America, Europe, and various Asian countries. Although it doesn't apply the Just-in-Time principle in inbound logistics, its supply chain practices are a benchmark for efficiency for global businesses. The main source of value is economies of scale due to the massive scope and scale of business operations. This helps them to be cost-effective.

Operations - Apple operations are conducted by around 150k full-time equivalent employees worldwide. Apple designs and sells; it hardly manufactures the components of the product it is selling. Outsourcing manufacturing to locations with lower resource costs is the main source of value for Apple operations. Apart from a few models of Mac that are manufactured in the USA and Ireland, the rest are outsourced to manufacturing units based in Asia, largely in China. This strategy provides advantages such as a focus on the core competencies of the business, such as research and development and designing new products. It tries to keep operations lean, but it does not apply the six sigma principles like its competitor, Samsung.

One may appreciate to note that Apple's operations are divided into the following reportable operating segments: America, Europe, Greater China, Japan, and the Rest of Asia Pacific.

[5] https://www.edrawmax.com/article/apple-value-chain-analysis.html

Outbound logistics - For technology items such as smartphones, tablets, and laptops inventory depreciation rates are very high due to short product life cycles. The company tries to keep minimum inventory in their warehouses.

The company ships finished products to Apple Stores, that are typically located at high-traffic locations in quality shopping malls and urban shopping districts. But currently, the company is focusing on E-Commerce sales because E-Commerce is more cost-effective compared to sales via Apple Store.

One may appreciate to note - In the US, in terms of size of e-commerce business, Apple is only behind Amazon.com and Wal-Mart Stores Inc.

The massive source of value addition also lies in Apple's market penetration into Asia in general and China in particular, because selling in this particular geographical market would not involve massive outbound logistics expenses (as assembly took place in China largely), and this cost advantage can be passed on to customers to increase the overall appeal of offers.

Marketing and Sales - Apple sells its products through the following seven sales channels i.e., retail stores; online stores; direct sales force, third-party cellular network carriers, wholesalers, retailers, and value-added resellers.

Apple is consistently increasing its share of sales through direct sales channels as opposed to indirect sales channels. In 2020, the company's net sales through its direct and indirect distribution channels accounted for 34% and 66%, respectively, of the total net sales.

After sale service - Apple is famous for the exceptional quality of customer service during all three stages: pre-purchase, during the purchase, and post-purchase. Apple sales assistants are usually trained and polite young males and females who are technically savvy and happy to demonstrate product features and capabilities. Products can be returned within 14 calendar days after the purchase. Post-purchase customer service is also impressive, with unique iPhone trade-in programs that allow iPhone users to upgrade their phone to newer models with additional payment.

3.1.2 Support Activities (also referred as to Secondary Activities)

- **Firm Infrastructure** describes how the firm is organised.
- **Technology development** describes how the firm uses technology.
- **Human resource management** describes how people contribute to competitive advantage.
- **Procurement** signifies purchasing, but not just materials.

Value Chain Analysis *is a process of identifying* ***Key Value Drivers*** *(can be referred to as equivalent to CSFs) that add substantial value and contribute most towards a firm's competitive advantage by categorizing the activities into* ***value-added*** *and* ***non-value-added activities****, with the objective of eliminating non-value-added activities to obtain* ***cost leadership*** *and focusing (by further resource deployment) on value-added-activities to improve* ***product differentiation***.

Note – Description of activities along with illustrations, in addition to value chain analysis, process, and tools thereof explained in detail under Chapter 1 of this material, students are advised to refer to the same for details.

3.2 How does an organisation use Value Chain to gain and sustain competitive advantage (desired performance)?

Following are the ways in which the value chain is helpful in presenting an integrated view of business activities to seize competitive advantage while focusing on the scope of improvement in performance.

3.2.1 Classification of value-added and non-value-added activity[6]

Classification of activities into value-added and non-value-added activities is helpful in devising appropriate strategies because the money saved by improving the efficiency of a value-added activity is as valuable as the money saved by reducing a non-value-added activity.

Classifying activities as value-added or non-value-added is problematic. People usually cannot consistently define what constitutes a value-added or non-value-added activity. Another major difficulty with this classification is employee reaction. Employees can be annoyed if informed that they are performing non-value-added activities which higher level managers have told them to perform.

An alternative to the dichotomous classification (which is difficult to make by drawing a clear line of distinction between value-added and non-value-added activities) into value-added or non-value-added activities is Kaplan and Cooper's (1998) suggestion of a classification into a four-category value-added scheme:

- An activity that is required to produce the product or improve the process; the activity cannot, on a cost-justification basis, be improved, simplified, or reduced in scope at this time.

  To illustrate, employing organic farming techniques as part of agribusiness can fall under this category. Farming is a necessary activity, and organic farming can be an improved (value-added) way to do it, but it is expensive currently, which may justify its application.

- An activity that is required to produce the product or improve the process; the activity can be improved, simplified, or reduced in scope.

  To illustrate, accepting online payment (POS)

- An activity that is not required to produce the product or improve the process; the activity can eventually be eliminated by changing a process or company procedure.

  To illustrate, time spent on the maintenance of machines is reduced to a certain level over a period of time as work experiences learning (effect of a learning curve). This applied to the elimination of waste as well.

- An activity that is not required to produce the product or improve the process; the activity can be eliminated in the short run by changing a process or a company procedure.

  To illustrate, an automobile company, after reverse engineering, instantly decided to remove certain features (such as the rear Windshield Wiper) after recognizing it as a non-essential requirement.

[6] Kaplan and Cooper, Cost and Effect (1998)

To summarise the above discussion, consider the following table to decide the course of action after classification.

Activity-Classification	Action to improve value
Necessary (essential) activity that can't be improved upon at this time (immediately)	None
Necessary (essential) activity that can be changed to improve the process	Modify the process to improve value
Unnecessary (non-essential) activity that can be eliminated eventually (but not now) by changing the process	Eventually, eliminate the unnecessary activity
Unnecessary (non-essential) activity that can be eliminated quickly (instantly) by changing the process	Immediately eliminate the unnecessary activity

To illustrate, United Parcel Services (UPS), a logistics company, implemented the wireless network. (Reduce paperwork and improve sorting and tracking; helps in resource planning in terms of capacity at hub provides timely information)[7].

Managers at Microsoft have chosen to outsource Xbox manufacturing to Flextronics to focus on core competencies[8].

3.2.2 Decision on Outsourcing

Undoubtedly, non-value-added activities that can't be eliminated will be outsourced (especially if they are non-core in nature). But a question arises here: can a value-added activity also be outsourced to enhance value? Answer depends on various quantitative and qualitative factors (cost effectiveness and core competencies).

3.2.3 Value Chain can make comparison easy[9]

A firm can evaluate its value chain relative to the value chains of its competitors or the industry. This will help in process mapping, gap analysis, and benchmarking.

3.2.4 Customer's Perspective

At each stage of the value chain, even inside the organisation, the next user shall be considered a customer. If each stage goes well, this will automatically generate value for the end consumer.

3.2.5 To look at Big Picture, 'Value System' (Wider Integration)

Extended value chain encompasses the customer's customers and the suppliers' suppliers. Because by creating an extended organisation a dynamic and hostile environment can respond in a better manner. A firm's value chain is connected to what Porter calls a **value system**.

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[7] https://www.zdnet.com/article/ups-takes-wireless-to-the-next-level/ http://www.mobileinfo.com/News_2002/Issue47/UPS_WiFi_Bluetooth.htm)

[8] https://www.termpaperwarehouse.com/essay-on/International-Business/171627

[9] Shank and Govindarajan (1992)

Do You Know?

Why is it necessary to consider the big picture (Value System)?

Because value chain recognises no organisation can operate in isolation from its supplier and customers, for example, the meal served to you at a restaurant drives its value from ingredients that are determined and impacted by the grower.

3.3 Linkage of Value Chain Analysis and Performance Management

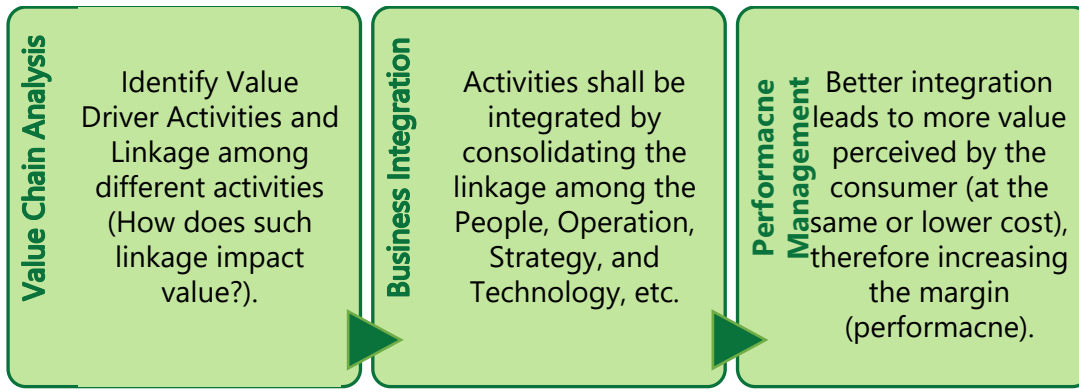

Figure B.2 – Linkage between Value Chain Analysis and Performance Management

All activities in the value chain **affect each other**. Together, these activities **generate value** that leads to competitive advantage. Value chain highlights such **linkages** between activities. **Linkage requires co-ordination**; hence –

- **Strategies** shall take an integrated view of organisation to focus on key value drivers (value generating, core activities).
- **Operation** shall be smoothed by eliminating or outsourcing of non-value-added or non-core activities, respectively, and by consolidating the linkage (enhancing co-ordination).
- To enhance co-ordination, Information system must use **technological** breakthroughs to ensure the free flow of information between different activities.
- Job descriptions must mention the activities to be performed by **people** and the relative importance of such jobs (or underlying activities), as well as the reporting hierarchy attached to it.

This will eventually ensure **sustainable competitive advantage**, i.e., increase in margin, which in turn will **improve performance**.

In the context of technology and people, the purpose of improving communication is to empower the individual in an organisation to start talking about their abilities, needs, and requirements with others (which helps in developing culture).

4. McKinsey's 7S

McKinsey's 7S[10] framework maps a constellation of interrelated factors (called Subsystems) that influence an organization's ability to change in order to attain its objectives. McKinsey's 7S is a consulting framework that guides the organisation to assist with organizational change, implementation of a new strategy, understanding the weaknesses (blind spots) of an organization; moreover, to understand how its sub-systems are interconnected and influence each other. Since sub-systems are interconnected, a change in one element will have repercussions on the others.

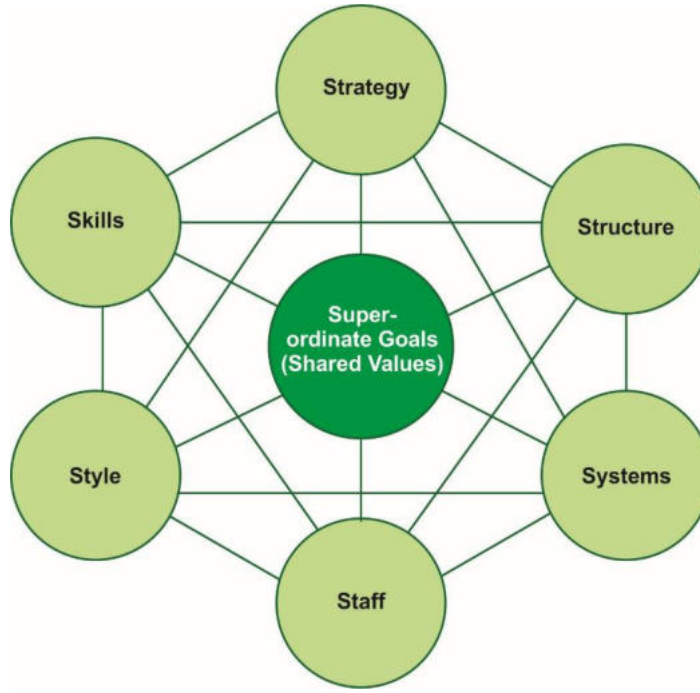

Figure B.3 - Constellation of the McKinsey 7s Framework

Do You Know?

There is **no hierarchy,** and all areas are of the same size in a **constellation (a constellation is a group of stars that forms a pattern and has a name)**. In other words, the 7S model considers all areas equally important, but Shared Values positioned in the centre to indicate that the organization's values are central to all elements.

McKinsey's 7S's model describes the **links** between the **organisation's behaviour** as a whole and the **behaviour of individuals** within it as a determining factor.

[10] McKinsey consultants Tom Peters, Robert Waterman, and Julien Philips, with help from Richard Pascale and Anthony G. Athos, developed the 7S model in the late 1970s. For the first time in 1982, it was featured in the book **'In Search of Excellence'** by former McKinsey consultants Thomas J. Peters and Robert H. Waterman.

4.1 Elements of 7S

The 7S framework is divided into two areas, i.e., **Hard S** and **Soft S**.

The **hard areas** comprise 3S, namely **Strategy, Structure and System**. It is **easy** for management to influence and change this area because these 'hard' elements are easily quantified and defined, **and** deal with facts and rules.

Whereas **soft areas** comprise 4S, namely **Style, Staff, Skills, and Shared values**. Since these are **influenced by the culture** of the organisation, hence more difficult to describe (less tangible), it is therefore **relatively difficult** for management to make change.

4.1.1 Strategy

It is a plan or method put in place, specific to the organisation, to achieve its goals with an available set of resources (usually scarce). This is helpful to attain a competitive advantage over the other firms. A sound strategy is one that is:

- Clearly articulated.
- With a long-term orientation.
- Helps achieve competitive advantage, and
- Reinforced by a strong mission.
- Vision and values.

To illustrate, Strategy of a premium *phone* manufacturer may be differentiation or differentiation with focus. Strategy of a *hospital* can be to provide cost effective treatment to its patients, while the strategy of another hospital may be to provide all treatment under a single roof.

When strategy is examined in isolation, it is difficult to determine whether it is well-aligned with other elements of 7S. The 7S model does not look at organizations and its elements to find great strategies, structures, systems, and so on, but rather to look in and ensure that they are aligned with other elements. To illustrate, a company's strategy with a short-term orientation is usually a poor choice, but if it is aligned with the other six elements, it can produce excellent results.

Students are advised to take note that generic strategies and means to apply them are already discussed in detail in Chapter 1 of this course.

4.1.2 Structure

It is the formal framework by which job tasks are divided, grouped, and coordinated. It is the formal pattern of interactions and coordination designed by management to link the tasks of individuals and groups towards achieving organizational goals.

To illustrate, a hospital is usually having divisional structure, while a construction company has a matrix structure (project oriented), and start-ups used to have a flexible structure.

Organisational structure outlines the roles of individuals in the organisation and decides the way in which authority and responsibility are allocated among them and how they are coordinating with each other to attain organisational objectives.

Organisation structure is a critical aspect of performance management, especially in determining the nature of the responsibility centre (classification into cost, revenue, profit, or investment centres) based upon the responsibilities and authority assigned.

What does it entail, and why?

When it comes to organisational structure, it includes both the formal structure defined by the organization chart and the unwritten lines of power and influence that indicate whose contributions are most valued. Hence, organisational structures are likely to reflect power and show important roles and relationships. The need for a well-defined organizational structure includes–

- To link individuals in an established network of relationships.
- To group together the tasks required to fulfil the organization's objectives as a whole.
- Allocate people to suitable individuals and groups.
- Allocate authority to the suitable individuals or groups.
- To coordinate the objectives and activities of separate units.
- Enable the flow of work, information, and other resources (communication and co-operation).

Do You Know?

What are the underlying principles of organising (defining organisational structure)?

1. Functional definition – Different duties, responsibilities, authority, and relationships need to be identified clearly and also need to be allocated to people in a systematic fashion.

2. Supervision (Span of Control, i.e., number of employees/ number of managers) – Guidelines as to how many subordinates or junior employees can be handled or supervised by a single manager. The span of control can be wide or narrow, resulting in wide and tall organisations, respectively.

The span of control determines the number of relations, in turn the cost of communication, reporting, etc. The formula used to calculate cross-relationship under the span of control is n (n–1), and relations will be [n (n-1)]/2. Therefore, cross-relationship will always be double the number of relations.

Illustration – A is the reporting manager to B and C. Here, the value of 'n' that superior along with subordinates is 3, i.e. A, B, and C.

The number of relations will be 3, i.e. [3(3-1)]/2 → A-B, A-C, and B-C

Cross relations will be 6, i.e., 3(3-1) → A-B, B-A, A-C, C-A, B-C, and C-B

The span of two results in 3 relations and 6 cross relations.

Task for you – Mr. Amar has reported on Mr. Akbar, Ms. Arman, and Mr. Anthony, find relations and cross-relations.

Hint – Relations will be 6 and cross relation will be 12, if the controlling span is 3.

3. Specialization (leads to delegations) – To ensure that maximum efficiency is achieved. The basis of division or delegation shall be the skills, qualifications, and abilities of the subordinates.

Organisations where authorities are delegated to subordinates are called decentralised organisations, whereas they are otherwise centralised. The level of delegations is a critical consideration in determining organisational structure.

Centralisation offers control and standardisation. It describes the degree where decision making is concentrated at a single point in the organization. Power and authority are retained at the top organizational levels; therefore, benefits include coordinated decision making, better management control, conformity with overall objectives, goal congruence that is likely to be achieved, standardization, balance of power, use of experience in decision making, lower overheads, and leadership to ease the growth for the company, etc., while limitations include reduced job satisfaction, a narrowed ability to make decisions (vested with top management only), stress for top management, subordinates experiencing restricted, less flexible, and possible communication problems, etc.

Decentralisation utilizes talent and local knowledge. It describes the degree to which lower-level employees provide input or make decisions. Power and authority are delegated to lower-level management and staffs. Benefits include reducing the workload and stress of top management, allowing them to focus on strategic matters, higher job satisfaction, better application of local knowledge, more flexibility, and speedy responses, while limitation include dilution in control, individual decisions that may not be aligned with the objectives of the organisation as a whole, higher overhead costs, organisation may become fragmented and may face agency problems among others.

4. Scalar chain – The chain of command to ease organization through minimization of waste and avoidance of duplication, etc.

5. Unity of command - Subordinates shall be answerable or accountable to one reporting manager at a time to best use resources, ensure clear communication and stability in the organization, etc.

Types of Organisational Structure

Post entrepreneurial structure, the next fundamental forms of organisation structure were line and staff (functional) organisations initially, but dynamics changed during the latter half of the 20th century when divisional, matrix, and project structure evolved; undoubtedly, divisional structure has dominance over others. The trend toward network or virtual organisations emerged recently. Each one of these structures has its own set of pros and cons.

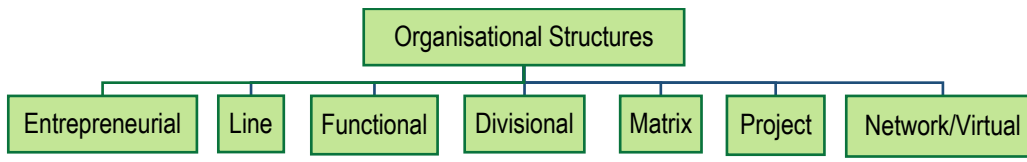

Figure B.4 *– Types of Organisational Structures*

Entrepreneurial - In such an organisation, management and control revolve around the proprietor (entrepreneur), who acts in a dual capacity, both as owner and manager.

Line - In a line organization, a supervisor exercises direct control over a subordinate, and authority flows from the top-most position to the lowest. It is straight and vertical. The top-level management takes all major decisions and issues directions for actual execution. It is also called a military or scalar-type organization.

Functional - It is a type of departmentalization in which positions are grouped according to their main functional or specialized area; in other words, positions are combined into units on the basis of similarity of expertise, skills, and work activities.

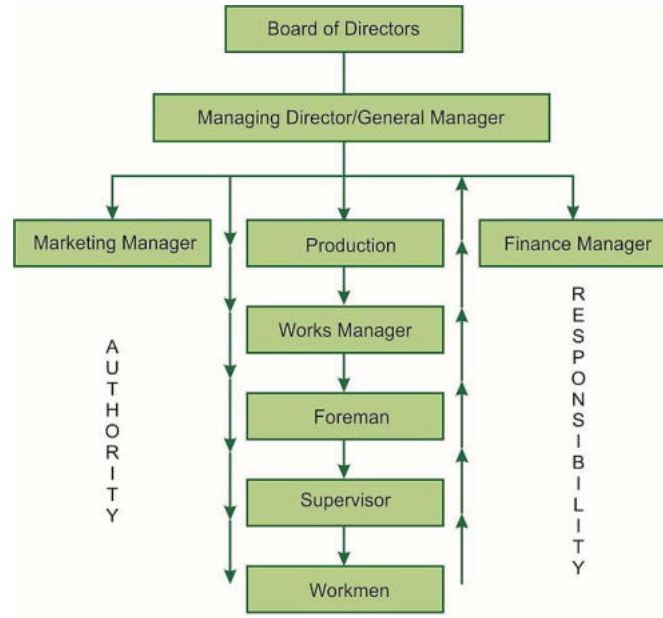

Figure B.5 – Line Organisation Structure

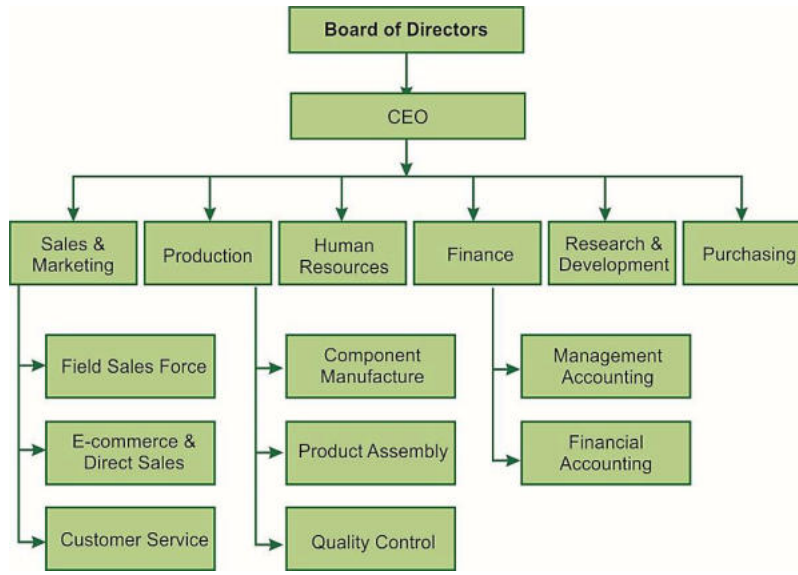

Figure B.6– Functional Structure

Advantages include pooling of expertise, no duplication of functions, in-depth specialization, senior managers being close to the operation, while limitations include poor communication across functional areas, etc.

Divisional - This is where the functionally structured business grows through diversification; a functional structure will be inappropriate, and a divisional structure based on Products/ Services or Geographical areas is likely to be adopted. Each division may be regarded as a Strategic Business Unit.

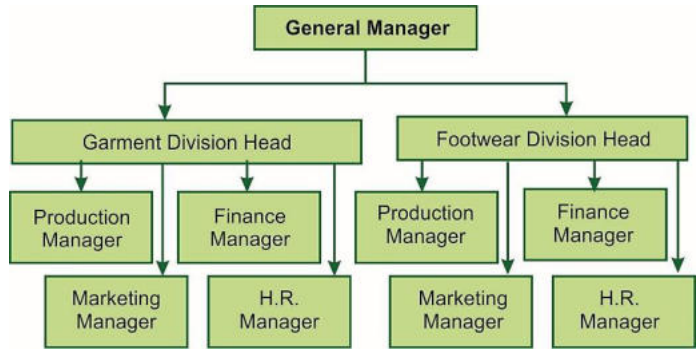

Figure B.7– Divisional Structure

Advantages include enhanced flexibility, specialist expertise is built up relating to particular product or market segment, and managers of divisions have greater personal interest in the strategy for their own division, etc. Limitations include duplication of efforts for all functions represented within divisions, barriers between divisions that may prevent information sharing and cooperation between divisions, etc.

***Note** - In the divisional structure too, some functional departments are working horizontally throughout the organisation (known as centralized/ corporate functions or shared/ support services), for example Legal, HR & Payroll etc. This saves cost and brings uniformity.*

Matrix Organisations - This is a type of departmentalization that superimposes a horizontal set of divisional reporting relationships onto a hierarchical functional structure. Thus, the structure is both a function and a divisional organization at the same time. Employees will have two bosses to report to: project manager and the functional manager. However, decisions such as promotions, salary recommendations, and annual reviews remain the functional manager's responsibility. To be effective, both the functional manager and the project manager must communicate regularly, coordinate work demands on employees, and resolve conflicts together. If not, employees will be in a position of dilemma where they will be confused and demotivated when the two bosses seem to hate each other.

Matrix structural organisation can be divided into weak and strong matrix structures. A weak matrix retains the management of the project in the hands of the functional managers instead of the project team.

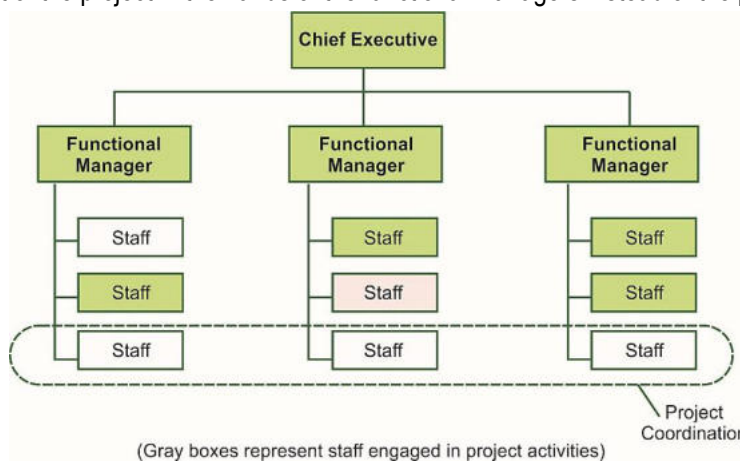

Figure B.8A– Weak Matrix Structure

On the other side, a strong matrix is still a functional organizational structure but has a completely separate project management arm. All of the project roles are still fulfilled within the functional departments, but the project manager is on the same level as the functional managers.

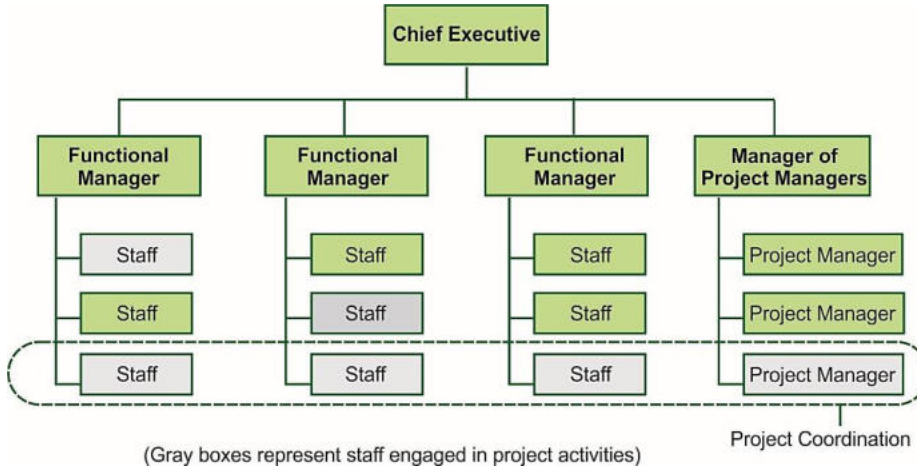

Figure B.8B– Strong Matrix Structure

Project Organisation – Each project may have a different sub-department, highly dependent on the nature of the project. Project managers are usually full time in the role, and for small projects, they might manage several projects at once. Project Manager has greater autonomy.

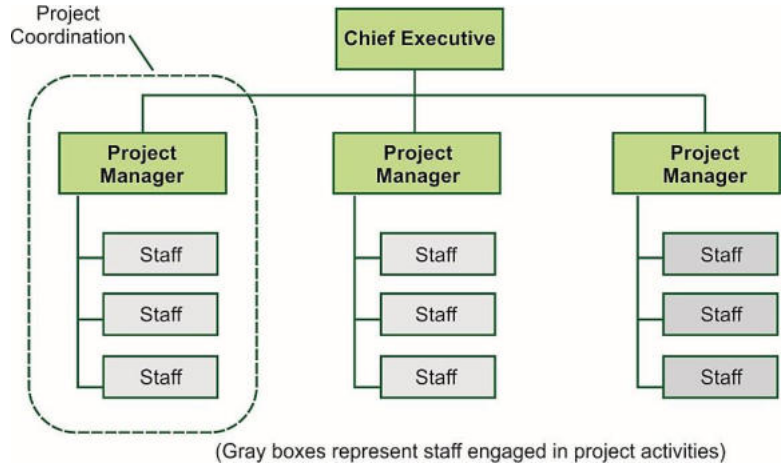

Figure B.9– Project Structure

Network or Virtual Organisation possesses features such as outsources major business functions, being highly centralized, networking done through electronic technology, less formal but more opportunistic, and creating the possibility to create the 'best of everything'. These allow someone who has an innovative idea but little money to compete with large companies. Limitations include reducing management's control, and the reliability of partners may be doubtful.

Do You Know?

Following is a list of the factors that influence the organisational structure (also referred to as drivers of structure):

- The types of problems the organization has when constructing strategies.
- Diversity of the organization, the needs of a multinational, multi-languages, and multi-currency.
- Adoption of technology for communication and control, apart from core operations.
- Type of ownership and involvement or influence of owners and other stakeholders.
- Size, Environment, Culture, Values, Objectives, and Future strategies of the organisation.
- People as well as skills and abilities they possess in reference to the task assigned to them and the complexity thereof.

4.1.3 Systems

These are the **processes and daily activities** undertaken by people who work in the organisation.

To illustrate, operations (processes) such as accounting, personnel, management information, and so forth. In a hospital, doctor's day includes largely three activities: IPD, OPD, and Operation Theatre.

All these daily activities and processes must be seen as system that are placed around an information system as the core, because executing all these activities involve some sort of processing of data that consumes and creates knowledge.

To illustrate, Accounting is an information system; it processes details pertaining to monetary transitions and provides knowledge about financial performance and position; similarly HR related system provide knowledge regarding intellectual health; while marketing and selling activities process the most critical data of customers' choices and behaviours to gain knowledge about consumer behaviour so that an appropriate strategy can be opted through decision making using such generated knowledge.

Hence, system signify knowledge management, seamless flow of information, defined process charts, and sequence of activities. Tools and techniques pertaining to analytics, technology, statistics, and POM (production and operations management) have proven to be handy for an efficient system.

4.1.4 Style

These are the informal rules of the organisation and include the culture of the organisation. It is the **way the organisation presents itself** to the outside world.

To illustrate, the ways of working, attitudes, and beliefs of organisation and people working therein.

Style is the combined outcome of the style of management adopted by the leader, prevailing stories and culture, usage of symbols and practices.

There are numerous leadership theories ranging from behavioural to great-man, transformational to transactional, and contingency to relationship that explain different leadership styles. Some of these are autocratic, while others are bureaucratic or democratic. Choice shall be based upon the size and life-cycle phase of the organisation, but it must be supported and integrated into strategy.

To illustrate, the style of the current leader to lead the organisation and make decisions in the process of same may be different from the style of earlier leaders.

4.1.5 Staff

These include the **intellect capital**, i.e., people, or the Human Resource of the organisation. Mind it, people are the resources that create organisation and culture thereat.

To illustrate, at the hospital, there are largely four different groups of staff, i.e., doctors, nurses, technician (lab, machine operators, etc.), support staff (cleaner, keeper, etc.)

Human Resource is no more a mere operation function; it has gained strategic importance because staff is the most precious resource that an organisation can have; more importantly, they are rational as well as emotional too, who carries perceptions; therefore, they have become the most significant factor in executing strategy to drive towards organisational success.

Do You Know?

Why is the integration of Staff (HR as a function) into strategy essential?

Though a satisfied and balanced workforce drives organisational productivity to higher levels, the most prominent are–

- Staff are your biggest resource and can affect public perception of your brand; they are indeed your brand ambassadors and the face of your company.
- Retraining, recruiting, and rehiring are expensive. Turnover is costly in terms of valuable resources, but it can also affect morale among both current employees and clients.
- Empowered (well-trained, participative, and motivated) staff become change agent rather than resisting factor.
- Culture and staff are often seen in a cyclic nature. A virtues cycle may have an empowering culture resulting in motivated and skilled staff that leads to higher productivity, which in turn leads to higher profitability and therefore better pay; ultimately, it enhances or maintains the motivation to remain or be more productive. The cycle may be vicious too if staff is not aligned with the rest of the 6 elements.

4.1.6 Skills

It involves identifying and getting insight into the **core competencies** of the organisation and working on them. The organisation must analyse the **skill gap** and work on filling it. It must also keep **outsourcing** as an option for **non-core skills**.

To illustrate, at hospital diagnosis, prescribing medicine, nursing, and performing surgery are core skills.

4.1.7 Shared Values

These are the values of the organisation that transverse through horizontal and vertical segments across different divisions. It is indeed **guiding the beliefs** of people in the organisation as to why it exists.

To illustrate, people (all the employees, be they doctors, nurses, or support staff) in a hospital seek to save lives.

Note: *Shared values were called "superordinate goals" when the McKinsey S7 model was first developed.*

Practical Insight

How does the fast-food chain, McDonalds leverages the 7S framework?[11]

McDonalds with 40,031 stores, is the globally largest fast-food restaurant chain in 2021, while second in terms of employees, employing around 2,00,000 people, and fifth in terms of revenue, with a total revenue of US$23.2 billion (out of which revenue from sales by company-operated restaurants is US$8.71 billion, whereas revenues from franchised restaurants is US$ 14.49 billion; remaining from other sources).

Strategy - Cost leadership has been the age-old strategy of McDonald's, striving to offer a wide range of products to its customers at the lowest possible price.

The company operated and franchised a total of 40,031 restaurants worldwide in 2021. This figure has seen a year-on-year increase for the last 16 years. McDonald's has implemented a growth strategy named "Velocity Growth Plan" for its emphasis on speed of expansion.

McDonald's sets **SMART** (Specific, Measurable, Achievable, Relevant, and Time-bound) and these goals are clearly communicated to all employees to ensure that everyone is on the same page.

Structure - McDonald's is present in multiple countries and owns a huge business, but rather than having a strict hierarchical structure, it has a flat structure, and the manager of each outlet usually manages assistants and employees.

All employees work as a team and have easy access to senior leadership if needed.

Systems - McDonald's has some of the most efficient sales, marketing, operations, and supply chain management systems in the world.

They constantly innovate to make their systems better. To illustrate, after introducing drive-through, they keep reducing order time. They multiple reduction targets of 30 seconds (this way reduces order time to the benchmark level).

Shared Values - McDonald's core values are Serve, Inclusion, Integrity, Community, and Family.

Here, Serve and Inclusion intended to cover a wide range of customers, while integrity highlights expectations from employees that they will showcase a high level of integrity.

Inclusion and Family together give stress on hiring employees from different backgrounds and encourage teamwork.

Community signifies giving back some profits to the community.

Skills - Skills are specially focused at McDonalds to ensure flawless service; hence, training and workshops are conducted regularly.

Style - McDonald's adopted a participative leadership style. Seniors engage the employees and consider their feedback to improve strategy and operations, as well as resolve conflicts.

Staff - Being the second-largest restaurant chain globally, employs a base of over 2,00,000 people worldwide. The McDonald's team is a global family.

People from different backgrounds work happily because McDonald indeed believes in diversity.

It is important to note that, the household name McDonald's accounted for around 2,00,000 employees in 2021. This figure remained consistent with the previous year's total in 2020. Overall, the number of McDonald's employees has more than halved in the past six years. Technological innovation is the reason for the same.

[11]Source for quantitative facts: https://www.globaldata.com/data-insights/foodservice/mcdonalds-number-of-restaurants-globally/; https://corporate.mcdonalds.com/corpmcd/investors/financial-information.html
https://consultport.com/consulting-academy/the-mckinsey-7s-model-explained-with-a-practical-example/

Do You Know?

Symbols are virtual representation of organisation including logos, titles, dress code, types of language, and terminology. To illustrate, does organisation parking have a designated space for directors and c-suites, or can anyone park in any space? Both have own pros and cons. Another illustration, the colour of the belt and the designated names show the expertise and role one can play in a six-sigma project/ organisation.

4.2 Effective use of the 7S Framework for Business Integration

In order to make effective use of this model, the following steps shall be followed –

Step 1: Start with your shared values. Evaluate whether shared values are consistent with your structure, strategy, and systems. If not, what changes need to be made to align them or integrate them?

Step 2: Then look at the hard elements, i.e., strategy, structure, and systems. How well does each one support the others? Identify where changes need to be made in order to consolidate integration.

Step 3: Next, look at the soft elements, i.e., shared values, skills, style (leadership), and staff. Do they support the desired hard elements? Do they support each other? If not, then assess the changes that need to be made.

Concept Insight

Organisation as a whole needs to answer the following questions pertaining to each of S.

Strategy - What will the company do? How does the organisation plan to outperform its competitors, or how does it intend to achieve its objectives?

Structure - How should it be organised? How are departments and teams structured, including who reports to whom?

Systems - What procedures need to be in place? Too many or limited procedures in place?

Style - What management style will work best?

Staff - What staff will we require?

Skills - What skills will our staff/ company need?

Shared Value - What culture (attitudes) will be most suitable?

Above stated list of questions is illustrative, not exhaustive.

Step 4: Review the changes. As you adjust and align the elements, you'll need to use an iterative (and often time-consuming) process of making adjustments and then re-analysing how that impacts other elements and their alignment.

***All elements**, both hard and soft, **must pull in the same direction** for the organisation to be **effective**. Indeed, if all elements move in the same direction, it means the organisation is striving for a greater level of business integration.*

Do You Know?

Change Management and Gap Analysis run parallel with the 7S framework

In Steps 1 to 3, as stated above, changes are required to be made; hence, first there is a need to identify such changes, then implementation thereof; therefore, *change management* is helpful in implementing changes (especially in countering resistance). Every change is an attempt to move from an existing situation to a desired position; hence, *gap analysis* is useful.

After accepting or rejecting the proposal (requests for change) based upon the Stakeholder Impact Assessment, following steps of the *Change Management* can be handy–

- Prepare the organization for change.
- Craft a vision and plan for change.
- Implement the changes.
- Embed changes within company culture and practices.
- Review progress and analyze results.

It is worth noting for students that the three-C principle can help you overcome this change management challenge. Managers should ensure the changes they are communicating are *clear*, *compelling*, and *credible*.

The steps involved in *gap analysis* are specified below–

- Understanding the current situation (position).
- Determining the desired position.
- Determining the action plan to reach the desired situation.
- Execute the action plan.
- Perform a periodic review of the situation.

It is worth noting for students that, gap analysis is a way to enter the next level; hence, tools or models such as SWOT Analysis, McKinsey 7s Model, Fishbone Diagram, Burke-Litwin Change Model, Nadler-Tushman's Congruence Model and PERT Technique can prove handy.

4.3 McKinsey's 7S Model and Performance Management

If an organisation desires to be effective in terms of attaining the objective through devising and implementing an appropriate strategy, then all the 7S needs to be aligned; this means that the 7S's model could have important implications for performance management, as highlighted in figure B.10 on the next page.

Referring to heading 4.2, we already know that 7S's model is helpful in identifying whether its 'S' elements are **properly aligned** and supporting each other or not. If the organisation identifies that some of the elements are not properly aligned, it can then assess the change to be made to **realign and integrate all 7S**.

This realignment leads to **improved performance**, therefore attaining the objective of performance management.

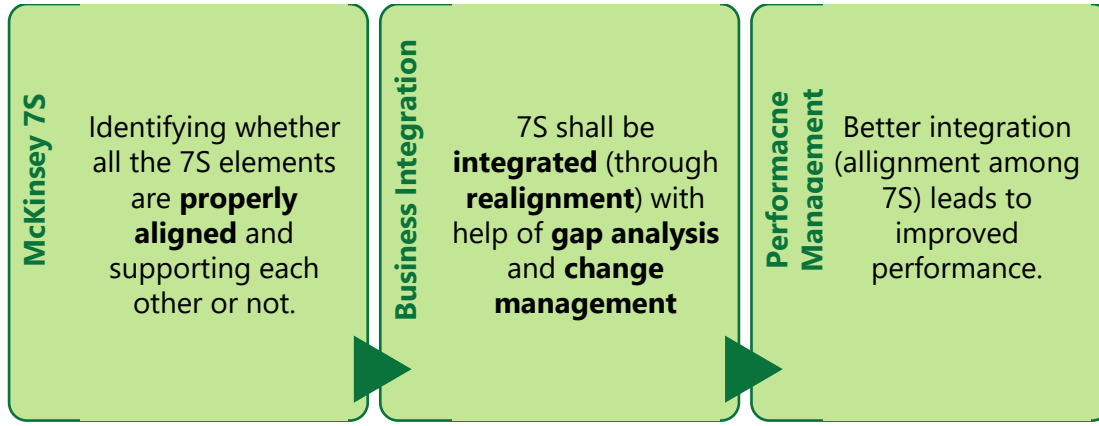

***Figure B.10** – Linkage between McKinsey 7S and Performance Management*

C. THE EFFECT OF ORGANIZATION STRUCTURE, CULTURE, AND STRATEGY ON PERFORMANCE MEASUREMENT

Despite two businesses operating in the same industry, even at the same level and with the same set of resources, there is surely a difference in their performance level. The reason behind such a difference is the structure, culture, and strategy of said businesses.

Hence one can say than an organisation's structure, culture and strategy have implications for performance; therefore, the selection of techniques and methods of performance measurement also depends upon the structure, culture, and strategy adopted by the business.

A change in organisational structure, culture, or strategy may result in a requirement for new performance measurement techniques and methods.

To illustrate, businesses with a **cost leadership strategy**, the financial indicators (e.g., profit, sales) based performance measures (e.g., ROI, RI) may be used, whereas for businesses with a **strategy to be quality leaders**, non-financial indictors (e.g., flexibility, lead time, skill level of employees) based performance measures (e.g., Performance Pyramid, Balance Scorecard) shall also be used in addition to financial indicators.

Further, from a **structural preview**, in the case of a divisional organisation, RI may be misleading due to the difference in size of divisions while comparing the performance of various divisions. ROI is a better measure in such organisations (subject to the transfer pricing method in the application for transfer among divisions).

1. The Influence of Structure

Traditionally, there are two types of organisational structures prevalent, i.e., **functional,** and **divisional,** which may be seen as organisations with **centralised** and **decentralised** control.

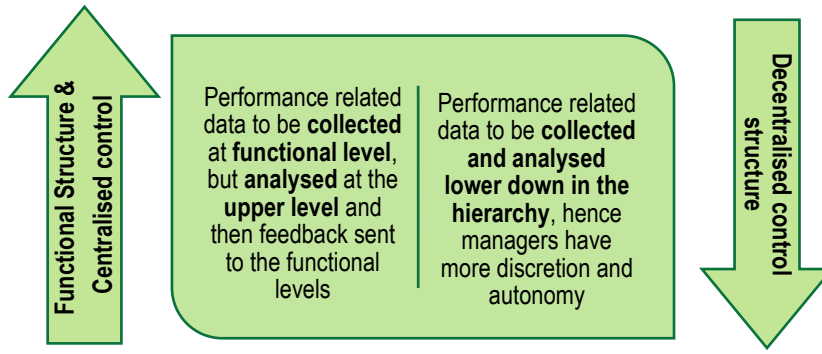

Figure C.1 *– Influence of structure on performance measures*

The changing business environment warrants **flexibility, innovation,** and **adaptability** in organisational structure; hence, new forms of organisation emerged that are **task oriented** and **multi-disciplinary**. Project team and matrix organisation are examples of these new forms. For such new forms/ structures, a performance measurement system shall also be appropriate. **To illustrate**, under the matrix form of organisation, performance of an individual is measured by both the functional and project heads. Hence, the structure of a business organisation has an influence on the selection of performance measures for performance management.

2. The Influence of Culture

Culture has a significant impact on the choice of performance measure, apart from the willingness it has to introduce new methods and techniques.

To Illustrate, an **innovative or creative** culture will introduce new performance measurement techniques that measure the performance of innovation, whereas resistive, traditional, **bureaucratic cultures** will be less open to change the measure of performance.

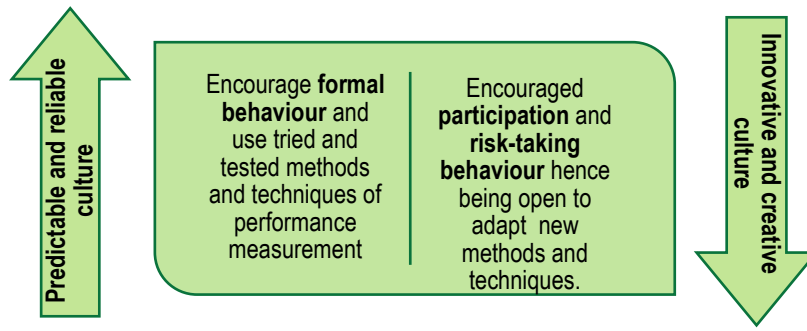

Figure C.2 *– Influence of culture on performance measures*

Influence of culture on performance measures can be understood by comparing the Japanese culture and commitment to quality vis-à-vis any other country.

3. The Influence of Strategy

The performance measurement techniques adopted should be aligned to the strategy the organisation is pursuing.

Organisations that are competing effectively in today's competitive market need to adopt **strategies** that aim at **satisfying customers**. These have to focus on **quality**, **time,** and **innovation**, in short, there is a need to consider non-financial aspects of performance in addition to the financial aspects.

D. STRATEGIC PERFORMANCE ISSUES IN COMPLEX BUSINESS STRUCTURES

Traditionally, businesses used to follow either a functional or line structure, but with the development of multi-product and multi-brand businesses, divisional structures have become popular. The business environment is too dynamic and keeps evolving, which warrants businesses to **rely on relationships with external partners** to perform critical business processes. Such relationships result in **complex business structures**.

1. What is a complex business structure?

Though there is no universally acceptable definition of complex business structure or list thereof, but any business structure is said to be complex business structure if one or combination of the following **features** exist –

- Diluted control; or
- Shared objectives; or
- Pooled resources; or
- Connected virtually; or
- Collaboration of different cultures, interests; or
- Diverse business environment.

Prominent complex business structures are shown in figure D.1 below.

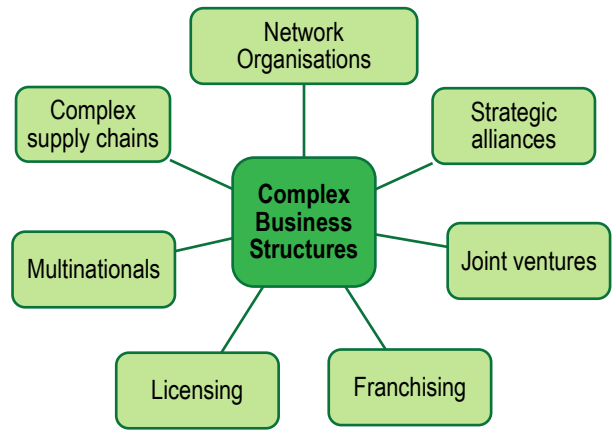

Figure D.1 – Complex Business Structure

Why has a complex business structure evolved?

A complex business structure allows business processes to be performed better or more cost effectively, without the need for investment in expensive production capacity.

Do You Know?

A virtual organisation is also considered as a complex business structure.

A virtual organisation that works on the Assets Lite Model which means there are little or no physical premises but where employees and managers work remotely (typically from their own location) and are connected using IT. These are sometimes also called hollow or network organisations, especially where people are connected to each other through some common platform such as online trading or retail platforms.

To illustrate, App-based platforms that provide services related to mobility, etc. The presence of these is largely virtual.

Online retail platforms (or even product specific online platforms) are also a sort of virtual organisation.

To illustrate, a large number of orders placed on online retail platforms are forwarded to suppliers, who then send the goods directly to the customer.

2. Complex Business Structures - Problems and Solutions thereto

Due to the inherent features of business structure (some of which are specified in the previous section), the **task of planning, controlling, and measuring performance** is not as easy as it is in the case of more common business structures. There are a number of problems in planning, controlling, and measuring performance in these complex business structures. The **root causes of these problems** are highlighted below, **along with possible solutions** –

- **Establishing objectives** is never easy because the parties involved in complex business structures may have different values, vision, risk appetites, and timescales. This shortcoming highlights the inevitable need for **goal congruence**.
- **The approaches and attitude** of parties towards factors that are critical for performance, such as **quality, control, and risk**, **etc.** may be different; hence, a **common minimum programme** needs to be devised.
- Since different sets of resources, skills, and knowledge are contributed by parties, assigning **accountability** for performance is a key issue. Accountability shall be clearly established and communicated **at the outset.**
- **Lack of trust** is a critical aspect because, for performance measurement and evaluation, detailed information is required, whereas parties in complex business structures may be hesitant to share information freely if they lack trust in each other. Control and reporting framework shall be **mutually decided,** and a **climate of trust** shall be fostered by opting for a compatible **management style.**
- **Cultural conflicts** may result in poor performance; hence, **shared values** shall be redefined so that they may be **more liberal** and serve the purpose.

Now we will look at specific issues pertaining to particular form of complex business structures.

2.1 In Case of Strategic Alliance

*A strategic alliance is an arrangement between two or more enterprises to undertake a **mutually beneficial project** while each **retaining its independence**.*

Since independence is retained, it is difficult to put common performance measures in place and to collect and analyse management information for the same because the security of confidential information is a concern.

2.2 In Case of Joint Venture

*A joint venture is a combination of two or more parties that seek the development of a single enterprise or project **for profit and share the risks** associated with its development.*

Therefore, in simple words, a joint venture is a **separate business entity** whose shares are owned by two or more business entities; this results in the following specific difficulties apart from those stated above.

Joint Venture are of different types, such as Project based, Vertical, Horizontal, and Functional, since the purpose of each sort of joint venture is different, hence assigning **accountability for performance** to joint venture partners in light of the distribution of resources and work (which is usually not equal) is always a critical aspect.

Do You Know?

How is a Joint Venture different from a Strategic Alliance?

A Strategic Alliance agreement is less complex and less binding than a joint venture. In a joint venture, two businesses pool resources to create a separate business entity, whereas in a strategic alliance, they retain their independence.

Despite this major difference, both forms are useful for sharing costs, risks, and expertise.

2.3 In Case of Multinationals

*Multinationals are enterprises that have **subsidiaries or operations in a number of countries**.*

Places (countries) have their own culture, language, precedents, notions, conventions, apart from differences in time zone, legal and reporting framework, and more importantly, currency; hence, the co-ordination of subsidiaries or operations to ensure they are working towards the overall mission and objectives can be difficult. This difficulty further multiplies due to greater levels of uncertainty on account of exchange rate movements, changes in government taxation, or foreign trade policy.

To illustrate, Windfall tax on export of refined crude-imposed w.e.f. 1st of July 2022; impact of policy rates decided by the central bank's Monetary Policy Committee on Exchange Rates; etc.

Measuring and reporting performance may become more difficult if common systems don't exist at all the subsidiaries or offices.

2.4 In Case of Complex Supply Chain

*A supply chain is a **network of enterprises** which are **connected to each other** while involved in **creating a product and delivering it to the consumer**.*

In the dynamic modern business environment, the supply chain is becoming more complex than earlier. Issues including logistical communication barriers, incompatible technology, and high levels of pressure in modern supply chains can prevent the **trust and efficiencies** on which effective trading partner relationships should ideally rest, which in turn leads to poor performance management.

Collaboration among supply chain partners can only be a solution to the above issues. Coordination among the supply chain partners can be ensured and enhanced through the **free flow of information**.

2.5 In Case of Virtual Organisations

*A virtual organisation is one that has **little or no physical premises** but where employees and managers work remotely and are connected using IT.*

Collecting reliable **performance related data** from widespread sources is difficult, especially where the control that can be exercised over these sources is limited.

Do You Know?

Information Technology breakthroughs can be game changer for complex business structure –

Accurate, Reliable, and Timely information can be the answer to the majority of issues that performance management may face in complex business structure. Hence, information systems often play a crucial role in complex business structure.

The core organisation may invest in the development of an information system, which is required to be used by all partners. Having one system used by all partners means that everyone is using the same data. There should be less difficulty collecting information about the performance of partners since the information will all be stored on one system.

In order to cut a long story short, the greater use of business partners to perform crucial business processes may lead to lower costs and greater specialization. However, the reliance on external partners can lead to additional challenges for performance management. These must be considered in drafting contracts with the partners. The use of shared IT systems can also assist in many of the challenges.

E. BEHAVIOURAL ASPECTS

As specified earlier in Section B of this chapter, human resources are the deciding factor that makes an organisation different and better from the rest. Since an organisation's performance as a whole is the sum of the people's performance who are working in it, it is important to consider the behavioural aspect(s) of humans in the context of the Performance Management System and the impact of the same on strategic decisions pertaining to performance measurement and evaluation thereof.

Do You Know?

Behavioural aspects are one of the 7 human attributes that the life wheel encompasses.

The 7 human attributes are: self-aspect, behavioral aspect, social aspect, physical aspect, emotional aspect, mental aspect, and spiritual aspect.

The behaviour of executives can be understood and controlled through the principle of accountability using control mechanism; performance measures also act as a stimulus to mend the behaviour in a particular way, whereas the behaviour of management (and the responses thereto by staff) can be seen through the management style chosen.

1. Accountability

When humans are made accountable for their actions and decisions, they become more conscious and strive for better performance.

Accountability for business managers' (i.e., Directors) who are acting as agent of shareholders under fiduciary relations instilled through agency theory, whereas for the rest of people working in organisation, accountability is instilled though accounting and management control system as discussed below–

1.1 Accountability and Accounting

The effectiveness of an accounting system (especially management accounting) is essential for an efficient performance management system. From an accounting angle there are two categories of accountability: hard and soft accountability.

1.1.1 Hard Accountability involves consideration of financial and quantitative information and covers aspects such as converting activities and outcomes into numbers and further reporting those numbers with underlying reasons.

1.1.2 Soft Accountability involves consideration of the human input to the system and its role in shaping, evaluating, and implementing goals.

1.2 Accountability and Control

Management control systems have an important role to play in developing accountability, and in turn, accountability leads to better performance. There are three broad categories of control mechanism which any business can use-

1.2.1 Behavioural Control – to ensure only desired actions take place.

1.2.2 Personnel and Cultural Control – for every job, a person with appropriate skills and a conducive environment is provided.

1.2.3 Reporting Control – to control the collection and reporting of information pertaining to performance (basically to ensure the outcome of efforts must be reported fairly).

Do You Know?

Ethical behaviour supports performance management.

Apart from any moral duty to be ethical, the prime purpose of a business is to maximise shareholder wealth, and the chance of this happening is increased by the adoption of ethical behaviour.

2. Performance Measures (CSFs & KPIs thereto) Act as Stiumli

Since people are conscious of the activities wherein their performance is being measured, especially if they know that after being measured, their performance will be evaluated as well, we can say that clearly communicated performance measures (CSFs and KPIs thereof) act as stimuli (stimuli means a force that either promotes or prevents a person from doing a particular act) that mend the way people behave, therefore in turn influencing performance.

Berry, Broadbent, and Otley rely on the principle that 'what gets measured, gets done' while suggesting the benefits and problems of using performance measures.

Do You Know?

What gets measured, gets done.

People will make a greater effort to perform well in aspects of their roles which they know are being measured, compared to those which are not.

3. Management Styles & Culture Modify Behaviour, therefore Influence Performance

It is essential to ensure that the management style employed is appropriate to the organisational context.

To illustrate, budget-constrained style of management is appropriate for businesses working in the maturity phase, where cost control is of significant importance, whereas a profit-conscious style is highly recommended when businesses are in the growth phase.

Note –The maturity and growth phases are referred to here as stages of the business or product life cycle. Further students are advised to refer to Hopwood's three distinct management styles (budget-constrained style, profit-conscious style, and non-accounting style) for better understanding.

Management must ensure that the overall culture prevailing in the organisation is aligned with its strategy.

To illustrate, organisations that are pursuing cost leadership strategies would be expected to have elements of Financial Control Cultures, while organisations that are pursuing differentiation strategies would be expected to be more aligned with Excellence/ Service Cultures.

F. PREDICTING AND PREVENTING CORPORATE FAILURE

1. Introduction

Around 90% of Fortune 500 firms that were in full swing to be part of this elite bunch in 1955 are replaced. They have gone either bankrupt, merged, or are in a state of gloom. Basically, they not only failed to perform but also failed to survive. How did a giant, struggle to survive? What are the leading reasons behind the corporate failure? Is it financial mismanagement only? Are they too late when they come to know they will be wiped off from market? What if they come to know about dwelling performance at some earlier stage?

This chapter will address the issue of corporate failure in a generic way, with a focus on predicting and preventing corporate failure while highlighting the reasons for it, in the context of Strategic Performance Management.

2. Why do companies fail?

Corporate failure is normally a reflection of deep-seated corporate shortcomings (Hopkin, 2012). The underlying reasons (and their intensity) for the corporate failure are often specific to the environment (both micro and macro) in which the organisation is operating, apart from the nature of its business, the decision-making process, and organisational structure it follows. The prominent reasons for corporate failure are listed below –

- **Fail to innovate and adapt to changes.** To illustrate, A reputed cell phone manufacturer failed to innovate in line with changing needs and expectations.
- **Too much hostile business environment, which is beyond control.** To illustrate, UPI payment gave a bad jolt to the candy market. It is worth noting here that Johnson (1998) propounded the term '**Strategic drift**' to describe this effect.
- **Too many changes** or **restructuring** in quick successions, especially in a time when the environment is too dynamic to handle.
- **Financial misappropriations.** Satyam, from being the 4th largest ITeS giant, became a corporate blemish on account of financial irregularities and misappropriations.
- **Power-tussle** in the promoter group and/or **inefficiency** of management.
- **Failure of strategy or strategic decision** (especially investment decisions). A reputed company, which was a retail chain with 1,600 outlets selling groceries, fruits, vegetables, medicines, and mobile phones, began its operations in the late 1990s and was closed in 2009 owing to a severe cash crunch because it decided (strategic decision) to expand without adequate system control and support. Moreover, it expanded so fast that it became debt ridden and fell into a debt trap.

Note – The above list is illustrative only not, exhaustive.

The triggering factor, which prime facie may seem to be the cause of corporate failure, may or may not be the root cause; even if it is, then also not necessary to be the only cause. Multiple reasons may coexist.

3. Need for Predicting Corporate Failure

For businesses, survival is essential to perform and then sustain the same level of performance or keep growing. Hence, the need to eliminate the threat of failure is inevitable; therefore, predicting the possibility of corporate failure is of strategic significance.

In the context of Strategic Performance Management, it is of significant importance to detect the signs of corporate failure to take corrective measures to control the damage that has already taken place, in addition to applying preventive measures for the future.

4. Predicting Corporate Failure

There are two types of models available to predict corporate failure, the **Quantitative** and the **Qualitative** models.

The quantitative models either compute score or assign rank based on **ratios and values** to classify the companies into categories of surviving or failing companies, whereas the qualitative models usually assign the score to **particular risk factors**.

Hence, quantitative models rely on monetary information such as financial ratios pertaining to gearing, profitability, liquidity, and solvency coverage, apart from major changes in values observed through analysis of comparative and common size financial statements and flow of cash and funds.

On the contrary, qualitative models rely on information like chairpersons' address to shareholders, directors' report, regulatory filings, brand equity, etc.

4.1 Quantitative Models

The most prevalent quantitative model is the Altman Z score, though a couple of years prior to when Altman suggested the Z score model, a univariate model was suggested by Beaver, which was the first and foremost model for predicting corporate failure.

Later, many authors either try to improve the Z score model by responding to or eliminating its limitations or develop their own version of Z score, whereas only a few others give their Models.

Hence, this section of the chapter will list the relevant set of quantitative models but discuss the Altman Z score model in detail (as other models are largely based upon this), apart from highlighting the limitations of quantitative models.

4.1.1 Altman Z score (1968)

Publicly Held Manufacturing Firms

In 1968, Edward I. Altman suggested the Z score model to predict the probability that a firm will go into bankruptcy within the next two years, when he was an Assistant Professor of Finance at New York University.

It is worth noting that the Altman Z score is a customised version of the discriminant analysis technique of R. A. Fisher (1936), meaning the Z score model is capable of considering multiple factors at a single point of time for analysis; this feature makes Altman's Z score a sophisticated model that combines key five ratios into a single discriminate score called the Z score.

Z score is generated by calculating five key ratios, which are then multiplied by coefficients (pre-determined allocated weight) and added together to reach a single discriminate score. The equation to compute the Z score is –

$$\textbf{Z Score} = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

Wherein,

X_1 = working capital/total assets

X_2 = retained earnings/total assets

X_3 = earnings before interest and tax/total assets

X_4 = market value of equity/total liabilities

X_5 = sales/total assets

1.2, 1.4, 3.3, 0.6, and 1.0 are pre-defined weights (coefficients).

Mind it, there is ***no concept of an ideal score.*** The computed Z score indicates the likelihood of failure (bankruptcy) as per the table shown below –

Z-Score	Zone of discrimination	Prediction regarding corporate failure (due to bankruptcy)
Less than 1.81	Distress	Companies with a Z score of below 1.81 are in danger and possibly heading towards bankruptcy.
1.81 to 2.99	Grey	Companies with scores 1.81 to 2.99 need further investigation.
More than 2.99	Safe	Companies with a score more than 2.99 are financially sound.

Practical Insight

The original data sample used by Altman consisted of 66 firms (half of which had already filed for bankruptcy). All businesses in the database were manufacturers with assets base of $1 million or above. Altman found that the ratio profile for the bankrupt group fell at −0.25 average and for the non-bankrupt group at +4.48 average.

EXAMPLE

Numerical Application of the Altman Z score Model - Sigma Cast & Pig Moulder (SC&PM) Limited has been in the business of moulding cast and pig irons for more than a decade. SC&PM is listed on the National Stock Exchange, and its market value of equity is ₹7,000 crores.

Their total assets are worth ₹ 3,500 cores, while they have a working capital of ₹4,200 crores. SC&PM has Earnings before Interest and Tax of ₹6,500 crores, which is enough to employ more staff and increase installed capacity. Moreover, SC&PM is also enjoying stable revenue streams, i.e., top line with a total sale of ₹8,300 crores.

But with a recent loan taken to facilitate automation, the investors are sceptical about the sustainability of SC&PM and hence want to know how it is doing. Their liabilities stand at ₹5,000 crores, while retained earnings amount to ₹800 crores. To put an end to the haze among shareholders and fund providers regarding the possibility of bankruptcy, the BoD decided to report the Altman z-score along with financials. For the calculation of the same, they hire you –

Altman z-score can be computed as $\mathbf{1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5}$

Wherein,

X_1 = working capital/total assets

X_2 = retained earnings/total assets

X_3 = earnings before interest and tax/total assets

X_4 = market value of equity/total liabilities

X_5 = sales/total assets

Hence, the Z score will be equal to –

= {[1.2 × (4,200 / 3,500)] + [1.4 × (800 / 3,500)] + [3.3 × (6,500 / 3,500)] + [0.6 × (7,000 / 5,000)] + [1.0 × (8,300 / 3,500)]}

Therefore, the Altman Z-Score for SC&PM Limited is **11.097.**

Analysis of Computed Altman Z-Score - Companies with a Z-score of 3 or above are considered to be financially sound. With a score of 11.097, SC&PM is firmly in the safe zone; hence investors can comfortably toss away their fears regarding bankruptcy threat over SC&PM.

Practical Insight

Whether is the Z-score Model reliable for predicting corporate failure?

In its initial test, the Altman Z-score was found to be 72% accurate in predicting bankruptcy two years before the event, with a Type II error (classifying the firm as bankrupt when it does not go bankrupt) of only 6% (Altman, 1968).

In a series of subsequent tests covering three periods over the next 31 years (up until 1999), the model was found to be approximately 80%–90% accurate in predicting bankruptcy one year before the event (Altman, 2000).

4.1.2 Beaver's Univariate Model (1966)

William Beaver was the first to apply a statistical method (t-tests) to predict bankruptcy for a pair-matched sample of firms. Beaver's Univariate Model is simple because Beaver evaluates the importance of each of several accounting ratios based on univariate analysis (using each accounting ratio, but one at a time).

Practical Insight

Since only one ratio is reviewed at a time, Beaver's Univariate Model is considered to be a flawed one and was replaced by the Altman Z score later in 1968. Altman's primary improvement was to apply discriminant analysis as a statistical method that could take into account multiple variables simultaneously.

4.1.3 Taffler and Tishaw's Model (1977)

In the UK, Taffler and Tishaw in 1977 developed their own version of the Z score model based on a combination of four ratios (using a similar methodology) with a sample size of 92 listed manufacturing companies.

Later, both Altman and Taffler developed their models further to overcome the weaknesses and shortcomings it possessed.

Altman et al (1977) addressed the problem of the assumption regarding the normal distribution of ratios in their ZETA model, whereas Taffler then adapted the Z score technique to develop the Performance Analysis Score (PAS).

4.1.4 The ZETA Model (1977)

ZETA is a bankruptcy classification model that incorporates comprehensive inputs with respect to discriminant analysis and utilises a sample of bankrupt firms, essentially covering the period 1969–1975. As specified earlier, this model is also given by Altman in association with Haldeman and Narayanan as an improved version of the Z score model.

4.1.5 Altman Z Score for Private Firms, Non-manufacturers, and Emerging Markets (1983)

Private Firms

The Z score model discussed under 4.1.1 was originally suggested for manufacturing entities that're too listed and whose scripts are traded in the public domain because market value of equity is required. Hence, later in 1983, he advocated a complete re-estimation of the model, substituting the **book value of equity** for the market value in X_4. Using the same data and reaching out to

$$\textbf{Revised Z score} = 0.717X_1 + 0.847X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5$$

Wherein,

X_1 = working capital/total assets

X_2 = retained earnings/total assets

X_3 = earnings before interest and tax/total assets

X_4 = book value of equity/total liabilities

X_5 = sales/total assets

But we did not test the Z-Score model on a secondary sample due to a lack of a private firm data base; hence the above revised equation, which was suggested by Altman to be used for private firms, has less utility.

The computed Z score indicates the likelihood of failure (bankruptcy) as per the table shown below–

Z-Score	Zone of discrimination	Prediction regarding corporate failure (due to bankruptcy)
Less than 1.23	Distress	Companies with a Z score of below 1.23 are in danger and possibly heading towards bankruptcy.
1.23 to 2.99	Grey	Companies with scores 1.23 to 2.99 need further investigation.
More than 2.99	Safe	Companies with a score more than 2.99 are financially sound.

Nonmanufacturing firm operating in developed markets

He then further revised the Z score model and ran it only with four factors in order to minimise the potential industry effect. Hence, the Z score for non-manufacturer will be computed as

$$\textbf{Z score for Non-Manufacturer} = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$$

Non-manufacturing firm operating in emerging markets

Whereas for the entities operating in emerging markets, the Z score will be computed (Altman 1983: 124) as

$$\textbf{Z score for emerging markets' entities} = 3.25 + 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4$$

Wherein,

X_1 = working capital / total assets

X_2 = retained earnings / total assets

X_3 = earnings before interest and taxes / total assets

X_4 = book value of equity / total liabilities

Zones of discrimination for analysis (for both categories) will be–

Z-Score	Zone of discrimination	Prediction regarding corporate failure (due to bankruptcy)
Less than 1.1	Distress	Companies with a Z score of below 1.1 are in danger and possibly heading towards bankruptcy.
1.1 to 2.6	Grey	Companies with scores 1.1 to 2.6 need further investigation.
More than 2.6	Safe	Companies with a score more than 2.6 are financially sound.

The industry effect is more likely to take place when this kind of industry-sensitive variable (asset turnover) is included in the model.

4.1.6 Performance Analysis Score (PAS or Tafflers' PAS)

This is a relative measure that uses the Z score in percentile term. Under this, the Z score of all the companies is recorded in percentile term (from 0 to 100) to analyse the performance. Any downward trend in an individual company's performance over time should be investigated further.

It is worth noting here that Taffler uses the following equation to compute the Z score for Performance Analysis Score –

$$Z = 3.2 + 12.18X_1 + 2.50X_2 – 10.68X_3 + 0.029X_4$$

Wherein,

X_1 = profit before tax/current assets

X_2 = current assets/current liabilities

X_3 = current liabilities/total assets

X_4 = no credit interval

The negative Z-score means that the company is facing a potential bankruptcy.

4.1.7 H Score Model

The model was developed by **Company Watch**. It is similar to Taffler's PAS model. H score is basically a ranked percentile score taking a value between 0 and 100. The **threshold is kept at a score of 25**, meaning that companies with a lower percentile score are described as being in the **'Warning Area'**.

4.1.8 Shortcomings of using Quantitative Models to predict Corporate Failure

The major limitations of quantitative models are listed below –

- Since these models are largely based on financial numbers, which can be manipulated, hence, may fail to predict corporate failure efficiently, especially if window-dressing is present.
- These tend to have a short-term orientation or be able to forecast for the near future only. Utility is also reduced because it relies on historical data.
- Even the score estimated to predict corporate failure is only a snapshot. Neither the root cause nor the solution are highlighted. Hence, further analysis is essential to be sure about the prediction.
- These models use weights to arrive at a score, based upon which the possibility of corporate failure will be predicted. Undauntedly, using pre-defined weight has its own inherent limitations, which reduce the reliability of prediction.

4.2 Qualitative Models

The most prevailing and used qualitative model is Argenti's A score model, which suggests, the failure process follows a predictable sequence, **defects** turn into **mistakes** if not rectified, and further continuing mistakes warrant the **symptoms of failure**.

4.2.1 Argenti's A score

This model has three dimensions or groups – **defects, mistakes, and symptoms of failure**. These groups are further sub-grouped enumerating areas (negative aspects like high-gearing, Chief Executive is an autocrat, etc.). Score shall be marked by management for each such area (negative aspect), and then all such score shall be added. If the total score arrived is **more than 25**, then the company is likely to fail; hence, there is cause for concern and corrective measures need to be applied.

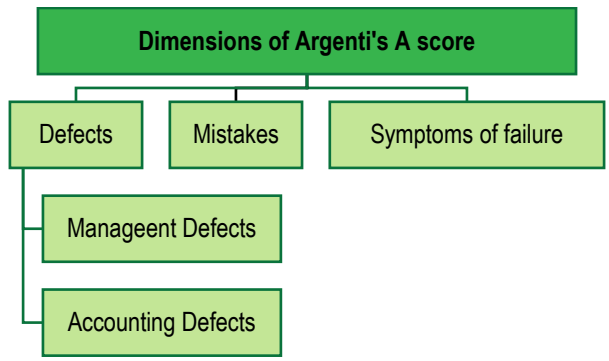

Figure F.1– Dimensions of Argenti's A Score

- **Defects** include management weaknesses (such as faulty organisation structure, an autocratic chief executive, the Chairman is the CEO of the company, etc.) and accounting deficiencies (such as a lack of budgetary control, a costing system, etc.).

- **Mistakes** will occur over time as a result of the defects. Defects and Mistakes are interconnected. **To illustrate,** if the management and accounting system are weak, then mistakes are bound to happen. A mistake includes high gearing, overtrading, or failure of a big project, etc.
- **Symptoms of failure** will surely be present if the mistakes identified above are of a continuing nature. Eventually, these symptoms will become visible. Symptoms of failure can be something like deteriorating ratios or creative accounting.

In addition to the total score, the scores of the three groups are also reviewed and evaluated to appraise the more about the performance, as group score are capable of revealing the root cause (which in turn makes the choice of corrective measures easy). For example, a high score in mistakes made, will reveal poor management.

Calculation of A score – Areas and Score

Source of problem	Observed variable	Score
Group A – Defects	**Management defects**	
	Chief Executive is an autocrat	8
	Chief Executive also holds the position of Chairman	4
	Passive board of directors	2
	Unbalanced board of directors, not representing all business functions, or dominated by directors whose background is in the same business function	2
	Weak Finance Director	2
	Lack of 'management in depth'	1
	Poor response to change: old-fashioned product or service, obsolete production facilities, out of date marketing methods; old directors	15
	Accounting defects	
	No budgets or budgetary controls	3
	No cash flow forecasts, or not up to date	3
	No costing system: costs and contribution of each product or service are not known	3
	Sub Total	**43**
Group B – Management mistakes	High gearing; inability to service debt	15
	Overtrading: company expanding faster than funding; capital base too small for level of activity; or capital base unbalanced for type and nature of the business	15
	A big project that has gone wrong; any obligation that the company will be unable to meet if something goes wrong	15
	Sub-Total	**45**
Group C – Symptoms of trouble	Financial analysis appears to indicate failure or difficulties (e.g., poor Z-score)	4
	Creative accounting (e.g., gaming; misrepresentation)	4
	Any non-financial signs of problems: unclean and untidy offices and factories, high staff turnover, low morale, rumours, and so on	4
	Sub-Total	**12**
	Grand Total	**100**

Interpretation of A Score

The maximum score allotted is 100 (43 from Group A, 45 from Group B, and 12 from Group C). For a firm to be cleared as healthy, its overall score must be less than the **maximum acceptable score of 25** (with 10 and 15 being the maximum acceptable scores in Group A (defects) and B (mistakes) respectively). If a firm scores anything in Group C, this is immediately seen as an indicator that the firm is at risk.

A firm that scores more than 25 overall, even if it scores below the individual thresholds in either Group A (10) or Group B (15), would still be considered at risk.

Example

Score under Argenti's A score Model and Interpretation thereof.

Sr. No.	Defects	Mistake	Symptoms of trouble	Overall Score	Remark
1	10	15	0	25	Healthy
2	2	15	0	17	Healthy
3	10	15	4	29	Risky
4	0	0	4	4	Risky
5	15	0	0	15	Risky
6	0	30	0	30	Risky

4.2.2 Shortcomings of using a qualitative model to predict corporate failure

Qualitative model also possesses certain shortcomings; the major among those are –

- Subjectively – The expert or user has to apply his or her judgement, that leads to subjectivity in results, which reduces the reliability of the same.
- Qualitative model, in addition to financial information, requires a large amount of non-financial information, which undoubtedly provides a more holistic picture and reliable result, but obtaining non-financial information is not easy.
- Results are only as good as the inputs into them. Since qualitative information is used, the reliability of such information and its relevance upon conversion into numbers is a critical affair.
- Qualitative model though able to identify the root-cause of the problem (corporate failure) as it lists out defects and mistakes, but it doesn't suggest a solution (corrective measures).

4.3 Preventing Corporate Failure

Since things that can be measured, can also be managed, hence if corporate failure is predicted, the same can be prevented by the spot-on warning signs early and taking corrective action quickly. The corrective action is more like performance improvement strategies; the major ones among these are –

- Once the signs of impending failure are seen, it is important to investigate and identify the causes. Sometimes it may be wise to seek external advice and help from technical experts to identify the problem.

  Note *- The causes may be related to a range of different functions within the business, such as financial management, marketing, or production. Hence, function expertise may help in detecting the causes and then preventing against the same.*

- It is important that the managers of the business accept that there is a problem, and that mistakes have been made, and to move on to a solution rather than apportioning blame.
- The actions needed will depend on the particular situation. Actions may involve major strategic change, such as getting out of a loss-making business, or making changes to the way operations are managed, such as changes to production management.
- To prevent failure, it is essential to have effective management systems in place, because sometimes the action needed may also include putting in controls to prevent further loss.

Summary

- Performance management is capable to bring ease in strategic planning and control for management of any business, while strategy acts a guiding force for establishing performance indicators and parameters thereof.
- Business integration is bringing all aspects of business in an alignment, so that business objectives can be achieved; by effective implementation of strategies while making efficient use of available set of resources. Four aspects in particular need to be linked as part of business integration effort i.e., people, operations, strategy, and technology.
- Value Chain is the sequential chain of activities which leads to delivery of final product to the customer, it also depicts how value (utility) accumulates to customer.
- McKinsey's 7S framework maps a constellation of interrelated factors (called Subsystem) that influence an organization's ability to change in order to attain its objectives. The 7S framework is divided into two areas i.e., Hard S and Soft S. The hard areas comprise 3S namely Strategy, Structure and System, whereas soft areas comprise 4S namely Style, Staff, Skills, and Shared values.
- Organisation's Structure, Culture and Strategy has implications on performance; therefore, selection of techniques and methods of performance measurement also depends upon the Structure, culture and strategy adopted by business.
- The greater use of business partners to perform crucial business processes may lead to lower costs and greater specialization. However, the reliance on external partners can lead to additional challenges for performance management. These must be considered in drafting of contracts with the partners. The use of shared IT systems can also assist in many of the challenges.

- Effectiveness of accounting system (especially management accounting) is essential for efficient performance management system. From an accounting angle there are two categories of accountability: hard and soft accountability.
- Management control systems have an important role to play in developing accountability and in turn accountability leads to better performance. There are three broad categories of control mechanism which any business can use are Behavioural control, Personnel and cultural control, and Reporting control.
- Clearly communicated performance measures (CSFs and KPIs thereof) acts as stimuli that mend the way people behave, therefore in turn influence performance.
- It is essential to ensure that the management style employed must be appropriate to an organisation context. Management must ensure that overall culture prevailing in the organisation is aligned to its strategy.
- There are two sorts of models available to predict corporate failure, the Quantitative and the Qualitative models. The quantitative models either compute score or assign ranks are based upon ratios and values, to classify the companies into category of surviving or failing companies, whereas the Qualitative models usually assign the score to particular risk factors.
- Once the signs of impending failure are seen, it is important to investigate and identify the causes; and provide suitable response to them.

TEST YOUR KNOWLEDGE - MCQS

MCQ 1

McKinsey's 7S framework divided 7S into two sets of areas i.e., soft and hard area. The hard S are easy to quantify (measure) hence changes can be made to these by management with greater ease. Which of following is not a hard S?

Options

a. Strategy

b. Structure

c. System

d. Style

Key – d

Reason – There are three hard S, Namely Strategy, Structure and System.

MCQ 2

Business integration brings all aspects of business in alignment, so that business objectives can be achieved; by effective implementation of strategies while making efficient use of available set of resources. There are four aspects that are essential to be integrated, namely people, operations, strategy and

Options

a. Finances

b. Logistics

c. Technology

d. Knowledge

Key – c

Reason – Four aspects in particular need to be linked as part of business integration effort i.e. **people, operations, strategy, and technology.** Performance management improves as result of integration of these four aspects.

MCQ 3

'A' Motors directed 'A' Steels to deliver a specific metal material for its upcoming e-vehicle considering the design. Engineers from Production and Operation division of 'A' Motors visited to 'A' Steel to explain the needs after deliberation decided some of process need to be performed in such metal while in process at 'A' Steel's plant only (even prior to bring to 'A' Motors' Plant). One of engineer from 'A' Motors placed at 'A' Steel till such metal prepared and deliver to keep check at specifications. Above facts highlights the concept of –

Options

a. Value Chain

b. Value System

c. Value Specification

d. Value Set

Key – b

Reason – Extended value chain encompasses the customer's customers and the suppliers' suppliers. Because by creating extended organisation, dynamic and hostile environment can respond in better manner. A firm's value chain is connected to what, Porter calls a value system.

MCQ 4

The new appointed top brass at Jim-Jam Limited give local manager greater autonomy for decision making, with intent to improve performance, in light of fact that company introduced a number of changes in recent past.

Because in past decisions are made at corporate level, local managers only execute them, hence despite power vested with local manager they didn't exercise the authority resultantly changes that were introduced recently failed to create any yield or impact.

Which one of the following elements of McKinsey's 7S's model best explains why the change initiatives have been unsuccessful at DJK Co?

Options

a. Shared values

b. Strategy

c. Structure

d. Systems

Key – c

Reason - The Jim-jam in past used to have centralised structure but sudden change in structure from centralised to decentralised make it difficult for staff to mend their ways. Nothing regarding Shared Values, Strategy and System is specified in facts of case.

MCQ 5

Which of following is not a limitation of complex business structure in measuring and evaluating performance?

Options

a. Lack of information

b. Disagreement on objectives

c. Legal aspects

d. Cultural conflicts

Key – c

Reason – The generic issues in complex business structure are -

- Establishing objective in is never easy, because the parties involved in complex business structures may have different values, vision, risk appetites and timescales.
- Approaches and attitude of parties towards factors that are critical for performance such as quality, control and risk, etc. may be different.
- Since different sets of resources, skills and knowledge contributed by parties, assigning accountability for performance is a key issue.
- Lack of trust is a critical aspect, because for performance measurement and evaluation detailed information is required, whereas parties of complex business structures may be hesitant to share information freely if they lack trust in each other.
- Cultural conflicts may result in poor performance.

MCQ 6

Which among the following is not a category of control mechanism that can be used as part of management control system.

Options

a. Behavioural Control

b. Reporting Control

c. Physical Control

d. Cultural Control

Key – c

Reason – Management control systems have an important role to play in developing accountability and in turn accountability leads to better performance. There are three broad categories of control mechanism which any business can use are Behavioural control, Personnel and cultural control, and Reporting control.

MCQ 7

Based upon the Z score the companies are classified into different zone of discriminations, which of following is not a Zone of discrimination?

Options

a. Distress

b. Grey

c. Safe

d. Warning

Key – d

Reason – There are three zones of discrimination -

Distress – Companies are in danger and possibly heading towards bankruptcy in upcoming two years.

Grey – Further investigation is required, especially in CSFs and KPIs.

Safe – Companies are financially sound.

MCQ 8

Skyway Airline Limited (SAL), an international carrier took series of loans to finance the M&A deals, but now observing the working capital crisis. CEO of SAL in response to a question at recent press-conference, reported the Z-score of 1.6 and assure the investors as well as stakeholders that thing are under control. In which of following zones, you place the SAL.

Options

a. Distress

b. Grey

c. Safe

d. Warning

Key – b

Reason – The classification criteria (into zones of discrimination) applicable to non-manufacturing entities, as per Z-score are-

Z-Score	Zone of discrimination	Prediction regarding corporate failure (due to bankruptcy)
Less than 1.1	Distress	Companies with a Z score of below 1.1 are in danger and possibly heading towards bankruptcy.
1.1 - 2.6	Grey	Companies with scores 1.1 to 2.6 need further investigation.
2.6 above	Safe	Companies with a score of 2.6 above are financially sound.

Mind-it, Skyway Airline Limited (SAL) is an international carrier, a non-manufacturing entity.

MCQ 9

Which of following statements are incorrect in regard to Argenti's A score model.

1. Mistakes and defects not inter-related.
2. Threshold is Kept at score of 45.
3. There are three underlying groups (dimensions) i.e., Mistakes, Defects and Symptoms of failure.

Options

a. Only 1

b. Only 1

c. Both 1 and 2 only

d. Both 1 and 3 only

Key – c

Reason – Mistake and defects are interrelated. To illustrate, if the management and accounting system is weak (defect) then mistakes are bound to happen. The threshold score to identify the corporate at risk of failure is 25.

MCQ 10

Following are the scores of six firms as per Argenti's A score model. You are required to identify healthy firms-

Firm	Defects	Mistake	Symptoms of trouble
1	10	0	4
2	2	15	0
3	10	15	0
4	15	0	0
5	0	30	0

Options

a. Only firm 1, 2, 3, and 4

b. Only firm 1 and 4

c. Only firm 2 and 3

d. Only firm 2, 3, 4, and 5

Key – c

Reason – The maximum score allotted is 100 (being 43 from **Defects**, 45 from **Mistake** and 12 from **Symptoms of trouble**). For a firm to be cleared as healthy, its overall score must be less than the **maximum acceptable score of 25** (with 10 and 15 being the maximum acceptable scores in defects and mistakes respectively). If a firm scores anything in **Symptoms of trouble** this is immediately seen as an indicator that the firm is at risk.

A firm that scores more than 25 overall, even if it scores below the individual thresholds in either of **Defects** (10) or **Mistake** (15), would still be considered at risk.

In case of 1st firm Symptoms of trouble score is 4, while in case 4th firm Defects score is more than 10 whereas in case of 5th firm Mistake scores are 30, which more than acceptable limit of 15, hence Firm 1, 4 and 5 are at risk. On contrary firm 2 and 3 are healthy.

MCQ 11

Consider the following categories of performance measures.

I.	Profitability measures.
II.	Customer-satisfaction measures.
III.	Efficiency, quality, and time measures.
IV.	Innovation measures.

A cruise line operates on a national scale in a very competitive marketplace. In view of this information, which measures should the company use in the evaluation of its managers?

Options

a. I

b. I and II

c. II and III

d. I, II, III and IV

Key – d

Reason – These categories of performance measures are all the things that a company needs in order to have a competitive advantage. Competitive advantage is an advantage that a company has over its competitors which it gains by offering consumers greater value than they can get from its competitors.

In a very competitive marketplace such as this cruise line is in, competitive advantage is essential. In order to have a competitive advantage, the company needs to excel in all of these performance measures. If managers are not evaluated on their performance in these areas, they will not work toward excelling in them, and the company will not have a competitive advantage. Therefore, the company should use all of these measures in its evaluation of its managers.

TEST YOUR KNOWLEDGE – CASE-LETS

Nova Automobile Limited (NAL) is a bike manufacturer that specializes in environmentally friendly 'hybrid' bikes. Its bikes are powered by both electric batteries and CNG. Despite being in its initial years, NAL has already earned a good reputation for the quality and dependability of its bikes.

NAL has made significant investments in the development of hybrid engines and is now looking to expand its market reach to nearby countries. The majority of shares in NAL are held by two venture capital firms that are supporting the company's growth plans ***……continue…….***

MCQ 1 – Which of the following option allow the Nova to expand its market reach without sparing any of its resources, rather it will be generating cash inflows –

Options

a. Joint venture

b. Strategic Alliance

c. Setting-up plant in those countries

d. Licensing

Key – d

Reason – Licensing involves obtaining permission from an entity (licensor) to manufacture and sell one or more of its products (or even rendering services on behalf of said licensor) within a defined market area for a set period in return for a royalty.

Hence if Nova decides to be licensor of their hybrid-bikes by allowing other automobile manufacturers to manufacture and sell its bikes, may expand its market reach without sparing any of its resources. Instead, they will get royalty payment (undoubtedly there will no control on quality directly and technology is also transferred to licensees).

MCQ 2 – Since brand is big resource to attain and sustain competitive advantage, hence Nova don't want to compromise with quality that may harm the repute which it earns; therefore, intended to keep control over quality through active participation while preserving it independence in addition to least possible resource application, then which form is best for Nova.

Options

a. Joint venture

b. Strategic Alliance

c. Setting-up plant in other countries

d. Licensing

Key – b

Reason - A strategic alliance is an arrangement between two or more enterprises to undertake a mutually beneficial project while each retains its independence.

A Strategic Alliance agreement is less complex and less binding than a joint venture. In joint venture two businesses pool resources to create a separate business entity, whereas in case strategic alliance they retain their independence. So, NAL through strategic alliance can control the quality while.

On the other hand, setting up plants in other countries would require huge capital outlay, whereas licensing lead not control of NAL over quality.

Note *- Since independence is retained under the Strategic Alliance, hence it become difficult to put common performance measures in place and to collect and analyse management information for same because security of confidential information is a concern.*

....continue..... *NAL's board of directors is considering a joint venture with Country B's Anumaj Automobiles Limited (AAL), because Country B, which is a neighbouring country has a rapidly growing market for environmentally friendly bikes. Though AAL does not currently produce hybrid vehicles, but it does have excess capacity in its factory.*

AAL is also interested in proposal because their sale during proceeding three years has been declining due to the safety issued in their bikes. Even couple of blast issues report in their bike in recent past, engine caught fire in both the cases; resultantly petrol tank bust results in blast.

MCQ 3 – Managing performance of Joint-venture is difficult due to which of the following limitations.

I. Difference in Culture and management styles in both the companies (JV partners)

II. Difference in financial reporting framework in both the countries

III. Difference in attitude towards risk and quality in both the companies (JV partners)

Options

a. I and II only

b. I and III only

c. II and III only

d. All I, II and III

Key – b

Reason – Limitations that become root cause of problems in measuring and managing the performance of JV.

- Establishing objective in is never easy, because the parties involved in complex business structures may have different values, vision, risk appetites and timescales. This shortcoming highlights the inevitable need of goal congruence.
- The approaches and attitude of parties towards factors that are critical for performance such as quality, control and risk, etc. may be different, hence a common minimum programme needs to be devised.
- Since different sets of resources, skills and knowledge contributed by parties, hence assigning accountability for performance is key issue. Accountability shall be clearly established and communicated at the outset.
- Lack of trust is a critical aspect, because for performance measurement and evaluation detailed information is required, whereas parties of complex business structures may be hesitant to share information freely if they lack trust in each other. Control and reporting framework shall be mutually decided and climate of trust shall be foster by opting compatible management style.
- Cultural conflicts may result in poor performance, hence shared values shall be redefined so that they may be more liberal and serve the purpose.

MCQ 4 – Which of the following primary activity shall be substantial source of enlarged value for proposed JV of Nova and AAL.

Options

a. Inbound logistics

b. Outbound logistics

c. Marketing and sales

d. After sale services

Key – c

Reason – Country B has a rapidly growing market for environmentally friendly bikes, hence managing marketing mix to drive higher margin (through high perceived value) will be easy for JV of PAL and AAL; therefore, marketing and sales activities shall be substantial source of enlarged value.

DESCRIPTIVE QUESTION

How can information technology breakthrough help Nova and AAL to overcome the limitation of complex business structure in managing performance of JV they are going to form?

Answer – Joint Venture is considered to be complex business structure; it faces a variety of issues in measuring and managing performance. Information Technology breakthroughs can be game-changer for such complex business structure though ensuring accurate, reliable and timely information.

All the JV parties must agree to use one uniform system for information exchange pertaining to shared interest. If such information system is separate from their core individual information system, then plug-in between common system and respective information systems of JV partner shall be used for real-time information sharing to ensure seamless flow of information.

Having one common system used by all partners' means that everyone is using the same data. This will also result in less difficulty collecting information about the performance of partners since the information will all be stored on one system.

NOTES
