A FRAMEWORK FOR WRITTEN

COMPREHENSIVE STRATEGIC ANALYSIS

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INTRODUCTION: FRAMEWORK OVERVIEW

This paper presents the basic framework for written comprehensive strategic analysis. The framework describes the major elements of a strategic analysis, and suggests an order in which major components (sections) should be covered in a write-up, therefore, it consists of a logically-sequenced, coherent "skeleton" of a comprehensive strategic analysis. Naturally, you have to know what many of the terms mean and understand their purpose in order to benefit from it. It is not a substitute for class!

In most circumstances, the purpose of strategic analysis is to help analyze how the firm can generate returns in excess of the firm's opportunity costs (rents). This can only be done successfully if the firm can deploy valuable resources: "To the scare resource, goes the rent".

Of course, given the overview nature of the framework, you will have to adapt it to meet the specific needs and circumstances of the case or firm strategic analysis you are dealing with. For example, as we will see, corporate level analysis for firms with multiple business units is different (and considerably more complex) than an analysis of a single business unit or analysis of a corporation in a single line of business. Naturally, some sections of the framework simply do not belong in short "back of the envelope" analyses. Much will depend on data availability and other constraints. The framework works best where there are few such limitations: the aim is to be comprehensive.

Usually, a written comprehensive strategic analysis contains three major parts:

- **Analysis of the current situation**. Here the critical questions are: What are the client firm's products? Who are the customers? What business is the client firm in? How competitive is the industry? What changes are taking place in the industry environment? What is the client firm's strategy? What are the firm's sources of competitive advantage/disadvantage? How well is the company performing from a financial perspective?
- **Assessment of current situation analysis (fulcrum)**. Here the critical questions are: What will happen if the existing strategy continues? Why or why not is the current strategy inadequate? What is the real problem? What is the rationale for action? In which broad strategic direction

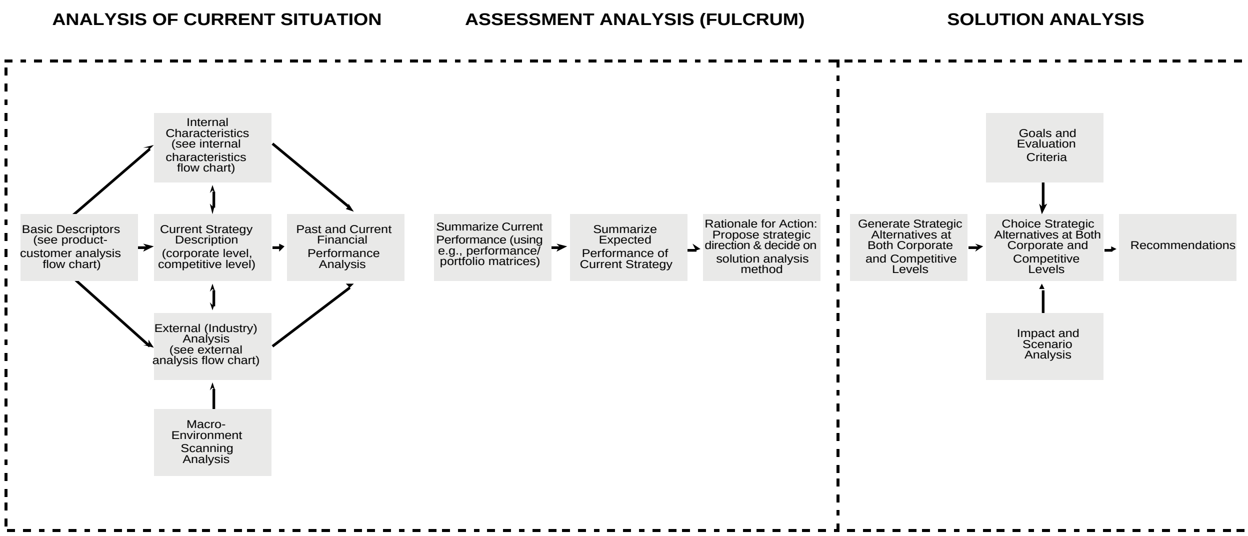
should the firm move? What type of choice method will be used to evaluate the strategic alternatives?

- **Solution analysis**. Here the key questions are: Are there any potentially better strategic alternatives? What should the firm's strategic goals be? Are there goals apart from profit maximization? How do the strategic alternatives do in terms of company goals? Are these good or bad? Which alternative is preferred? How sensitive is it to different "states of the world"?

Why three parts? Doing the major parts of strategic analysis is somewhat like trying to walk along a see-saw. Waling up one side of the see-saw is current situation analysis. Tipping the see-saw is assessment analysis (the fulcrum: this is usually the point where one is most likely to fall off!). Walking down the other side is solution analysis. (We do not mean to imply that it is easy because it's downhill.) This metaphor should convey the belief that fulcrum assessment analysis is the most difficult part of strategic analysis. In practice, students (and analysts) are often unprepared to pull everything together and succinctly tell the client what the real problem is. Students, like everyone else, have a tendency to want to avoid answering this big, unpleasant question. They may try to dodge the real issue by presenting laundry lists of problems or solutions, presenting a mass of different strategic planning techniques, or by providing no comprehensible structure — the proverbial "dog's dinner". The fulcrum requires a short statement of what will happen if we continue as we are doing, combined with a brief explanation about why. These statements may be no longer than a few sentences, because the fulcrum only summarizes information that has already been analyzed in the current situation analysis.

Each of the three parts can be divided into components (sections). These parts and their components are summarized in Figure 1. This paper expands on these three parts in turn.

Figure 1: COMPONENTS OF A COMPREHENSIVE STRATEGIC ANALYSIS

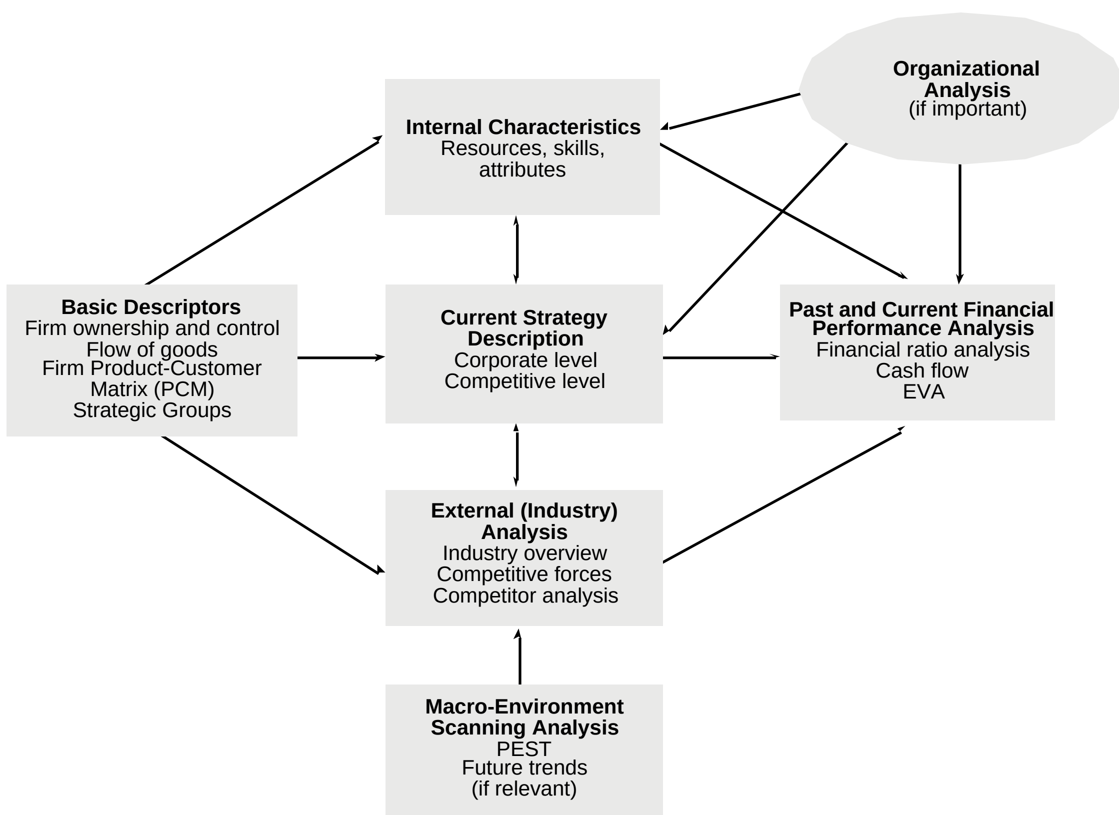


ANALYSIS OF THE CURRENT SITUATION

Figure 2 contains the main components of the current situation analysis. A description of the firm's basic facts appears on the far left hand side because this material provides a context for any strategic analysis and should be understood first. The position of the other components on this diagram and the lines between them emphasizes that the major purpose of strategic analysis is to improve the company's performance, and that the major components of strategic analysis are jointly determined: strategy affects structure and other internal characteristics (and vice versa), strategy affects the industry environment (and vice versa), strategy affects performance (and vice versa), etc. Focus here on the main elements of Figure 2 at the current moment (at "time t"). The causal relationships among the elements will come together in fulcrum assessment analysis and in solution analysis.

For the reasons stated above, the order in which components are discussed can be based simply on what works best in a particular situation. This varies somewhat. For a company in a single line of business, "tradition" suggests that one should analyze the industry first, followed by internal characteristics of the firm, followed by current strategy, and then performance. This order works well for relatively narrow strategic issues (i.e., at the business strategy level for firms in well-defined industries). For corporate level strategic analysis, it is sometimes better to at least describe the overall strategy first. If the client-firm is a duopolist or oligopolist, then industry analysis may merge with a discussion of the client-firm's competitive strategy. Sometimes it will make sense to discuss strategy and internal characteristics in the same section. Competitor analysis is often difficult to position: usually it forms part of the rivalry discussion in industry analysis; but sometimes aspects can form part of internal characteristics analysis (when discussing differences in value chain or key success factors); other times it makes sense to discuss it in a separate section just before the fulcrum.

Figure 2: MAIN COMPONENTS OF AN ANALYSIS OF THE CURRENT SITUATION



Framing the Problem and Basic Description of the Firm

Do not try to summarize your analysis in an executive summary. Remember, you have a page limit for cases. Usually this section consists of two sub-sections:

(a) Introduction (Framing the Problem). This sub-section offers an opportunity to provide a brief historical overview and to describe the problem as perceived by the client firm. This is useful because most strategy is path-dependent: the firm's strategic alternatives, at least in the short run, are constrained by its resources, industry position and strategy. You may begin with a concise explanation of how the company got to where it is now, including a chronology of the different businesses the company is in. This is particularly useful in corporate level analysis. However, for a "4-5 page" case analysis of a company in a single line of business, this sub-section should be kept very short or, more often, omitted.

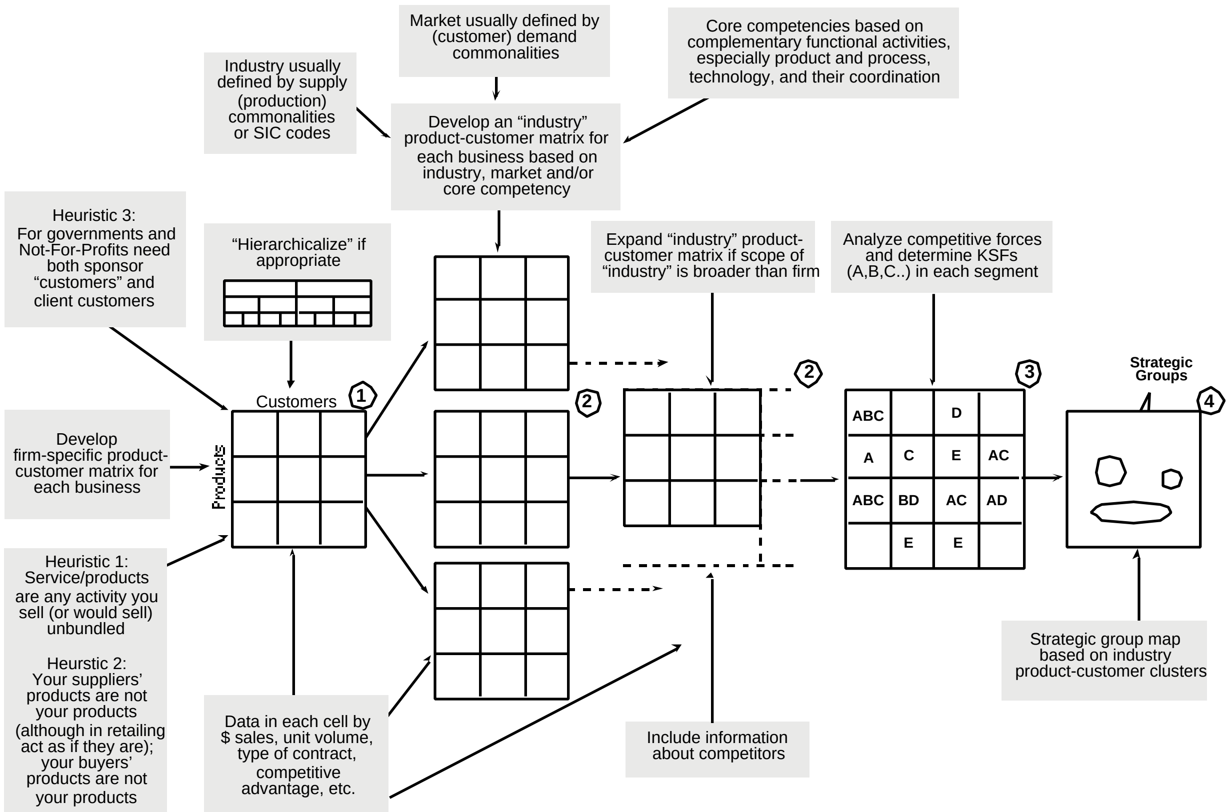
Each analysis should have a client-oriented focus, usually that of the CEO, but sometimes that of a major (external) shareholder. Usually, a strategic analysis is performed in response to some "cue to action" — a symptom. Sometimes the "cue" takes the form of a set of problems the client thinks the firm is facing or will face in the near future. Sometimes the client will go further and propose (or exhibit a preference for) a particular strategic alternative. You can give the case a focus by describing the client's perceived problems (issues) or the client's initial, proposed solutions at the time you were hired. (It is unnecessary to restrict yourself to exactly one key issue, but you should not muddle the analysis by listing every issue that comes to mind.) Sometimes, with highly successful firms, the major focus of the analysis is on opportunities. Where there is not real client but a surrogate — the business policy professor — you must address the strategic issue the professor wants answered.

(b) Description of Basic Firm Facts. Provide some context about each business of the firm, for example, its ownership, where the firm is located in the flow of goods from basic inputs to final consumers, the products or services, customers, and the products/services of other firms in the same business.

- **Ownership and Control**. Is the company privately owned, state owned, mixed (public and private ownership), owned by members (a co-operative), or a not-for-profit? Who has control? Is the organization managerially-controlled (share ownership widely dispersed) or owner-controlled (concentrated share ownership)? You do not need to write about his at great length (if at all), but you do need to understand the implications of these issues for strategy (see class notes on this topic).

- **Flow of Goods Analysis (Vertical Chain)**. What industrial ballpark is the client firm in? Sometimes it is useful to present a "flow of goods" diagram which shows the interrelationships among important sectors, organizations or groups. A "flow of goods" diagram may show the "vertical chain" across industries, from the initial upstream activities, through intermediate product industries, to final consumption goods. Remember, a multi-business firm is in multiple industries. It may be vertically or horizontally integrated, and/or be involved in related or unrelated diversification.
- **Construct a Product-Customer Matrix for Each Business**. The purpose of this component is to understand the client's products and customers, and the interaction between them. For each business, develop appropriate "product-customer" matrices (PCMs) and enter information about the client's products or services in the appropriate cells. The main purpose here is to discover which are the most important products or services, and the most important customer segments. (This is explained in Boardman and Vining, "Defining Your Business Using Product-Customer Matrices".) Figure 3 summarizes the development of PCMs.
- **Industry Product-Customer Matrices**. Add "competitors" defined in terms of industry (the traditional method), market (substitutes) or core competencies, expanding the matrix as necessary. What business is the client really in? What are its borders?
- **Strategic Group Maps**. If possible, use PCMs to construct a strategic group map. A strategic group is a group of firms that compete in similar ways; therefore, rivalry is likely to be greater within, as against across, strategic groups. The analyst may make a preliminary assessment of the key success factors for each segment or each strategic group.

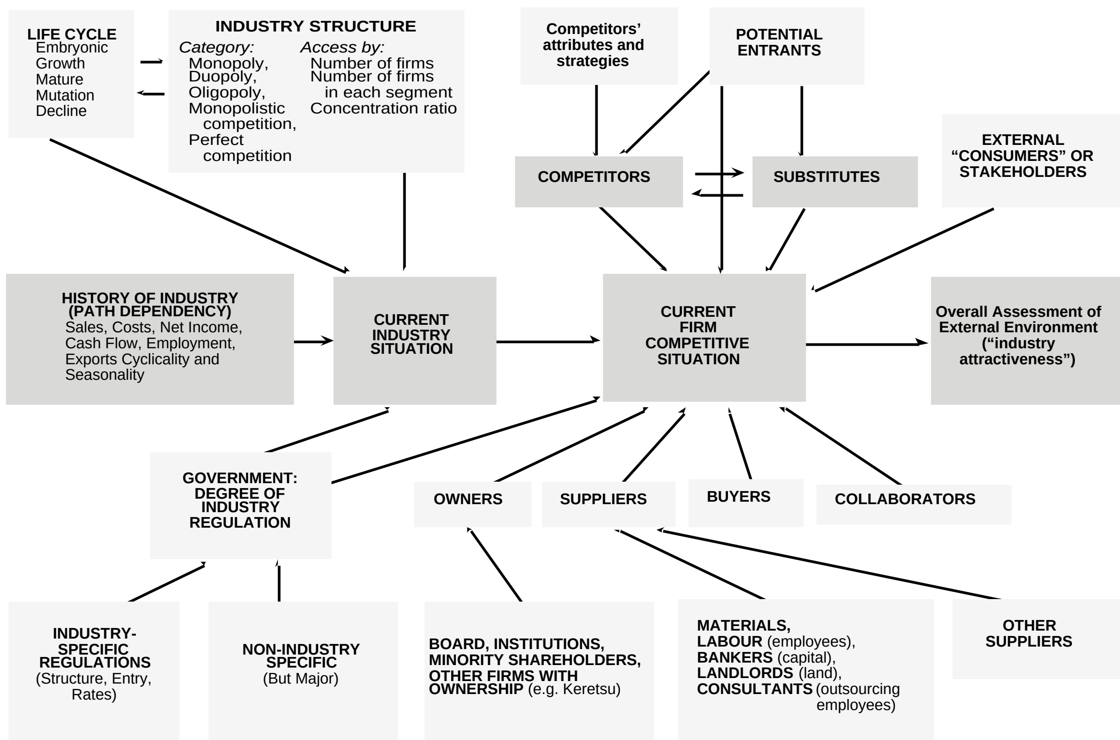
Figure 3: AN OVERVIEW OF THE USES OF PRODUCT-CUSTOMER MATRICES



Industry (External) Analysis

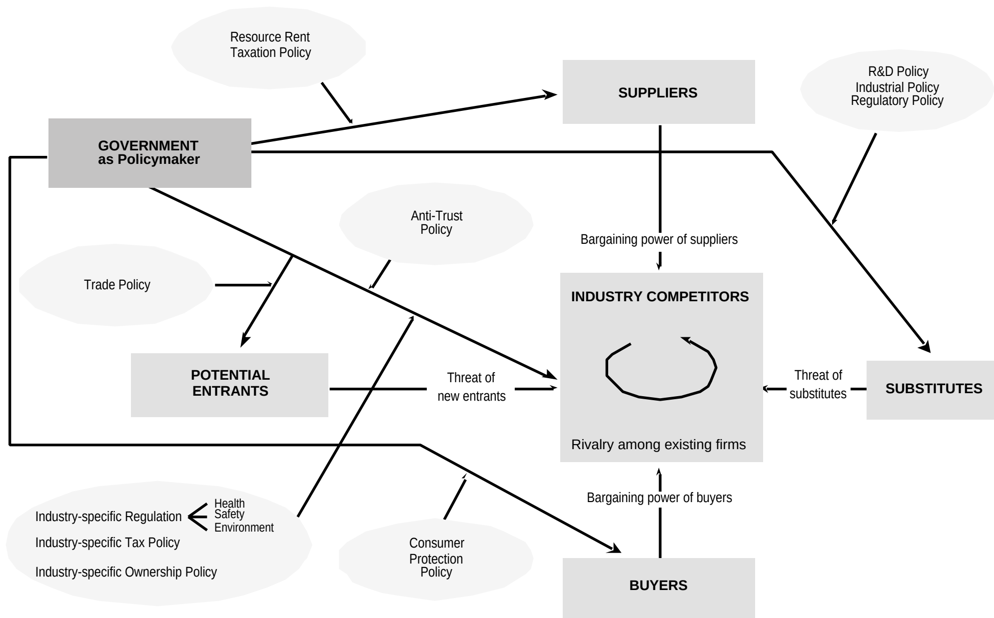
First define the industry. Remember, industries are constructed, not discovered! For each business, analyze the external environment and reach a preliminary assessment about the attractiveness of the industry. The analyst should focus on the external competitive forces — positive and negative — that affect the client firm's ability to earn "rents". The factors relevant to industry analysis are shown in detail in Figure 4.

Figure 4: EXTERNAL (INDUSTRY) ANALYSIS



Alternatively, they can be grouped into six sub-sections (rivalry, buyer power, supplier power, threat of entry, substitutes and government), assuming that competitor analysis is performed in this section (Figure 5).

Figure 5: THE ROLE OF GOVERNMENT AS POLICYMAKER



(a) Nature of Rivalry in the Industry. What is the overall competitive "state" of the industry or industries (for firms in multiple industries)? What's happening to overall sales, margins, profits, cash flow? Stage of life cycle of the industry. Structure of the industry (monopoly, duopoly, …., perfect competition). Industry (market) concentration at the international, national and regional levels. Presence of significant differentiation, economies of scale, learning curve.

Competitor analysis should focus on the effect of competitors, individually and collectively, on the client firm's ability to earn rents. An in-depth comprehensive competitor analysis describes competitors' strategies, internal characteristics and performance. Sometimes competitors can be placed in industry segments or "strategic groups". Also, competitive analysis considers how competitors are changing their strategies and their internal characteristics.. Sometimes there is no need for a separate section on competitor analysis because so much of strategic analysis is relative to the competition and the material is better covered elsewhere. Possibly repeat some or all of this overview or perform simultaneously for each product or product-customer segment (when dealing with a single business). Consider, for example, whether there are any product-customer segments that differ from the industry as a whole in terms of the product life cycle.

(b) Buyer Bargaining Power and Supplier Bargaining Power. Assess the bargaining power of buyers. This depends on the buyer's price sensitivity and relative bargaining power. In turn, price sensitivity depends on: proportion of the cost of the client's product to the buyer's total product cost; homogeneity of the client firm's product; competitiveness in the buyer's industry (requires a mini-analysis of the competitive forces in the buyer's industry, but remember — your customer's industry is not your industry!); and importance of the client firm's product to the buyer's product quality. Relative bargaining power depends on: the size and concentration of buyers relative to sellers; buyer's information about seller's quality, prices and costs; the buyer's switching costs; and the buyer's ability to backward integrate. Usually, individual buyers have must less bargaining power than intermediate (industry) buyers.

Supplier bargaining power can be analyzed in the same manner. Firms that produce manufactured products often derive supply from commodity producers or small scale component producers that have relatively little bargaining power.

(c) Threat of Entry. Entry threat is driven by: the amount of capital required to enter the industry (but given the sophistication of capital markets, only very large capital requirements represent a significant barrier to entry); the extent of economies of scale (and the extent of sunkness); absolute cost (first-mover) advantages; extent of brand recognition and loyalty; access to distribution channels; and ability and willingness of firms currently in the industry to retaliate against entrants.

(d) Competition From Substitutes. This depends on the propensity of buyers to substitute the product of he substitute industry for those of another industry that meets the same consumer need. Given that the substitute does not usually meet the need in exactly the same way as products of the incumbent industry, the price <u>and</u> performance (the price-performance characteristic) is crucial. The relationship may often be driven by changes in the social and cultural environment — the emergence of coffee bars as substitutes for bars or the increase in cremation rather than burial.

(e) Government: The "Sixth Force". In many industries, government through its many policymaking roles has more influence on firm profits than other competitive forces (if government is a supplier or buyer or the provider of a substitute, it should be analyzed under the relevant category). Figure 5 illustrates some of the policy arenas wherein government can influence firm profitability. Strategies to influence government (political strategy) must be analyzed separately from competitive and corporate-level market strategies.

Macro-Environment Analysis

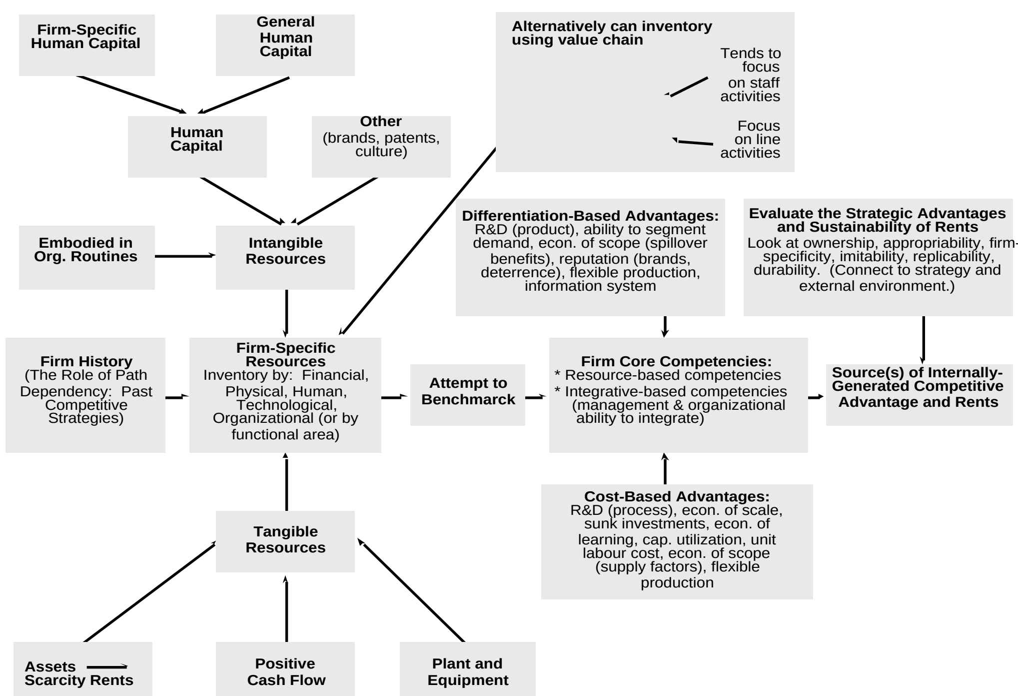
Sometimes it is useful to scan the broader Political, Economic, Social and Technological (PEST) factors and how they are changing. Predict future trends and consider possible impacts of these changes on the client firm. This section may discuss important demographic and environmental (e.g. climate) changes and their consequences for the firm. Decide what is potentially important; that is, those factors likely to enter the industry environment in the near future and have an important impact in the medium run. Do not discuss categories simply for the sake of discussing them. Useful macro-environmental analysis is difficult to do, and "more honor'd in the breach than in the observance".

Internal Characteristics

The first sub-section concerning the internal characteristics always appears in a strategic analysis; see Figure 6. The purpose of internal analysis is to identify the existing and potential sources of rents and impediments to rents. That is, what are the client's competitive advantages (core competencies) and disadvantages? How sustainable are they (durability)? How firm-specific are they? Can they be imitated by others? Can they be replicated by the client? Are they complementary? For multiple business or multiple "product-customer" segments firms, is there synergy among the segments or businesses? If so, what is the source of the synergy? The second sub-section on organizational analysis (shown in Figure 2) may be very short, discussed elsewhere or omitted from a strategic analysis.

(a) Resources, Skills, and Attributes. List resources, skills and attributes by using a resource inventory: financial (cash, capital, borrowing capacity); fixed (physical: land, plant and equipment — quality and quantity); human (labour skill and loyalty); intangible (reputation: brand names, financial reputation, strategic reputation, corporate culture); technological (patents); long-term contracts (e.g., guaranteed source of supply). Alternatively, inventory resources, skills and attributes by functional area or by using the value chain as an organizing guide. It is often useful to construct multiple versions of the value chain: (1) a description of the specific activities that make up the client firm's value chain; (2) a description of the firm's competitive stance (cost vs. differentiation) at each stage of the value chain; (3) benchmarking and evaluation of each activity). Evaluate resources by benchmarking, if possible. Consider both resource-based competencies and integrative-based competencies (managerial and organizational skills). For multi-business corporations, examine the links between the value chains of different businesses.

Figure 6: INTERNAL CHARACTERISTICS ANALYSIS



(b) Organizational Analysis. The purpose is to inventory organizational attributes and to describe how such characteristics affect core competencies. Describe the organizational structure (Senior positions and reporting relationships — the internal architecture and lines of authority); assignment/delegation of responsibility, centralization and degree of autonomy (control) of businesses/divisions ("style"); organizational systems: MIS, budgeting, strategic planning (control systems), and incentive and reward systems. Incentives are critical, but capacity and resources are also important (this sub-section may raise the same issue as strategy implementation).

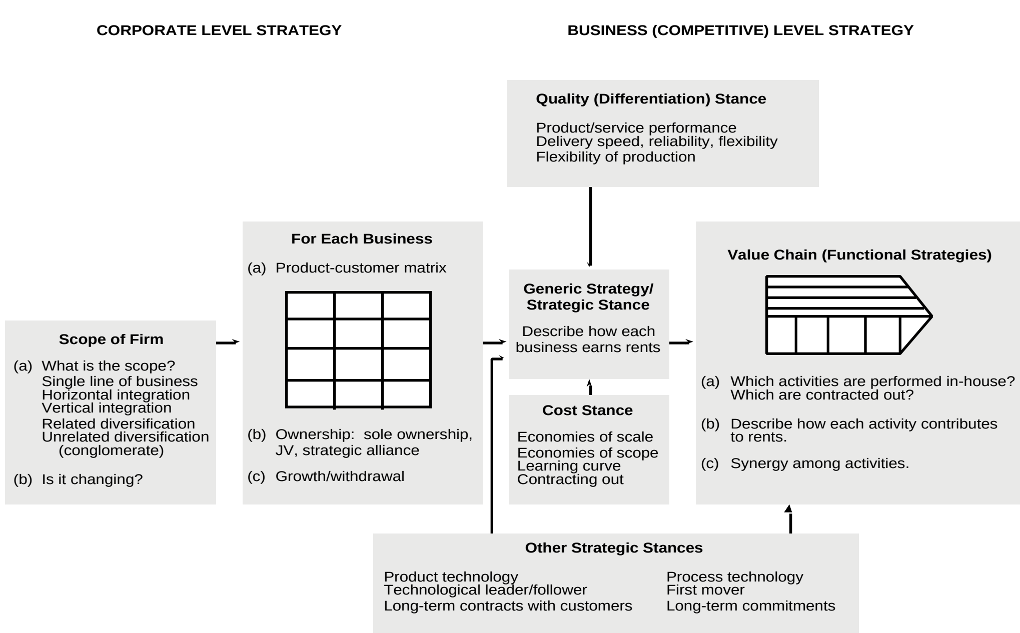
Describe the Firm's Strategy

Here the analyst briefly summarizes the two main levels of current strategy: corporate level strategy and competitive (business) level strategy; see Figure 7. Both concern allocation of resources.

(a) Corporate Level Strategy. Corporate strategy concerns the scope of the firm. In order to understand the client' s corporate strategy, the analyst needs to consider:

- **What business(es) is the firm currently in?** Is it a single line of business, horizontally integrated, vertically integrated, or diversified? If diversified, are the businesses related or unrelated (a conglomerate); if related, how? How is the scope changing, that is, which new business(es) is the company moving into, which current businesses are expanding, which are being withdrawn from?

Figure 7: IDENTIFYING CURRENT STRATEGIES OF THE FIRM



- **For each business, amplify on the firm's product-customer segments** (see product-customer matrices above). Is it broad or focused? Does it have sole ownership of each business or does it have a joint venture or a strategic alliance? Is it entering new segments, expanding existing segments or withdrawing from segments? If it is growing, is this through internal development or through acquisition? If withdrawing, by sale or walk away?

(b) Competitive (Business) Level Strategy. Competitive level strategy concerns how well business (or each product-customer segment) competes, that is, how it makes money. Here it is useful to describe the firm's strategic stance and its value chain. At the same time, consideration should also be given to the dynamic element of strategy, that is, changes in strategy.

- **Strategic Stance.** Does the firm focus on pushing out the demand curve (differentiation strategy), pushing down the cost curve (low-cost producer strategy), or both (or neither)? How does it increase demand? Does it focus on adding quality (vertical differentiation) via advanced product technology, process technology (e.g., JIT), superior inputs, speed and reliability of delivery, or product reliability? Does it try to obtain low costs via economies of scale, economies of scope, learning curve, product technology, or process technology? Are there other ways it earns rents? Other questions to consider are: What type of company is it? How has it traditionally obtained a competitive advantage? Is it production-oriented or marketing-oriented? Product or process oriented? Is it a technological leader or follower? Does it fight with competitors or cooperate? Does it commit resources to the future, for example, to establish a good reputation? In this sub-section, the idea is not to go into too much detail, which can be done in the immediately following sub-section, but to describe the key strategic stance — how the fir usually competes.
- **Value Chain Strategy.** What (functional) activities does the firm perform individually, which in collaboration (joint venture), which does it contract out, and, by implication, which are not relevant? (In essence, discuss "vertical integration" within the firm.) Preliminary assessment of which activities particularly contribute to profits. What are the important functional strategies? The most important activities are often those that receive the largest resource allocations. Which activities have recently received larger "investments" <u>or</u> have obtained commitments of larger

future resource allocations? For a multi-business corporation, describe how the value chain activities of one business relate to those of the other business(es). Which specific activities generate synergistic benefits?

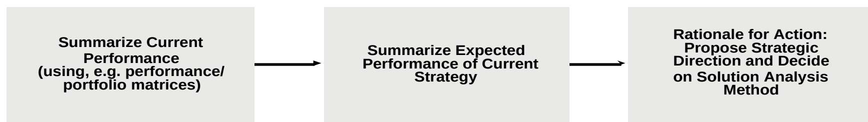
Financial Performance Analysis

Perform financial ratio analysis and cash flow analysis. Ratio analysis should cover the four major categories of ratios: profitability, liquidity, leverage and activity (operational efficiency). Is the client earning rents? Does the firm have the ability to finance future alternatives out of current cash flow or by borrowing? This section is based primarily on historical data. It might include future-oriented pro-formas based on a simple projection (i.e., under a broadly-defined “no change” scenario). Not-for-profit organizations should be judged by different criteria.

FULCRUM ASSESSMENT ANALYSIS

On the basis of the analysis of the current situation, the analyst should reach a conclusion about whether the client’s currently proposed strategy is appropriate for the future. There are three main steps in addressing this issue, as shown in Figure 8.

Figure 8: FULCRUM ASSESSMENT ANALYSIS

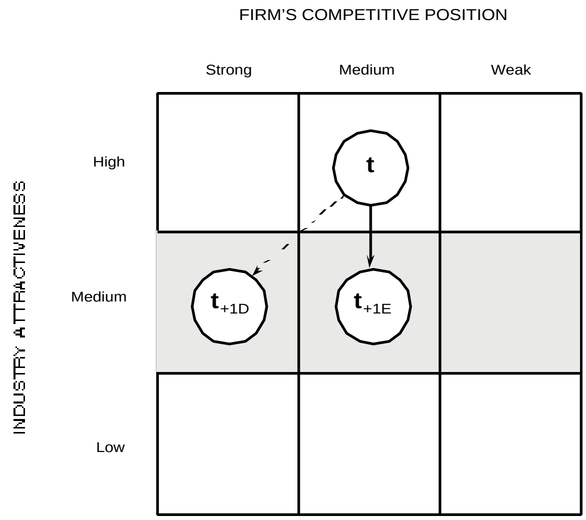


- The first step is to summarize current performance (at "time t") and determine whether the client has a problem and, if so, what is the nature of the real problem. Briefly summarize the key points from the preceding analysis of the current situation at time t. Some questions to consider are: Is this an attractive industry for the client? What are the key success factors? Does the client have them? Does the strategy fit the environment, or is it incongruent? Are the firm's characteristics appropriate? Does the client have a competitive advantage? Why or why not is it capturing rents? Why are there problems? (These questions are suggestions to help you describe briefly, but accurately and perceptively, the client's current situation. Do not answer all of them.) So-called "portfolio" matrices (e.g., the Boston Consulting Group Growth-Share Matrix or the General Electric [McKinsey] Industry Attractiveness/Business Strength Matrix) can be used to represent diagrammatically the client's current situation and future situation. Since the focus is on performance of a business (or group of businesses), the term "performance" matrix is more appropriate than portfolio matrix.

- The second step is to summarize expected performance in the future (at "time t+1") if the current strategy is maintained: will the client have a problem and, if so, what will it be? Based on the above analysis of the current situation, develop a "most" likely scenario for the industry, i.e. perform a dynamic industry analysis. What changes will take place, most likely, to the external environment? Then, considering also the client's current characteristics and currently-proposed strategy, predict its future performance. Is there a rationale for action? Is the proposed strategy inadequate for the future? Why/why not? Does the client have a sustainable competitive advantage? For how long? How long will it continue to earn rents?
- Third, given the above two steps, decide what broad strategic direction is suggested and decide what will be the solution analysis method (e.g., NPV or multi-goal). Solution analysis will then investigate how best to address this problem. This approach is summarized in Figures 9 through 13.

The fulcrum section serves as a bridge to solution analysis — where the analyst generates and evaluates alternatives. We suggest a detailed analysis of the current situation and a fulcrum assessment analysis for three reasons. First, they enable the analyst to narrow the range of reasonable alternatives. Ex ante, the range of potential alternatives is extremely large. Analysis of the current situation provides a picture of how the industry is changing, what competitors are up to, and, therefore, what strategic alternatives are reasonable, thereby eliminating totally inappropriate alternatives. Second, analysis of the current situation helps enormously with scenario development and evaluation of the proposed alternatives. Third, a separate fulcrum assessment analysis forces analysts to state what is conceptually most important.

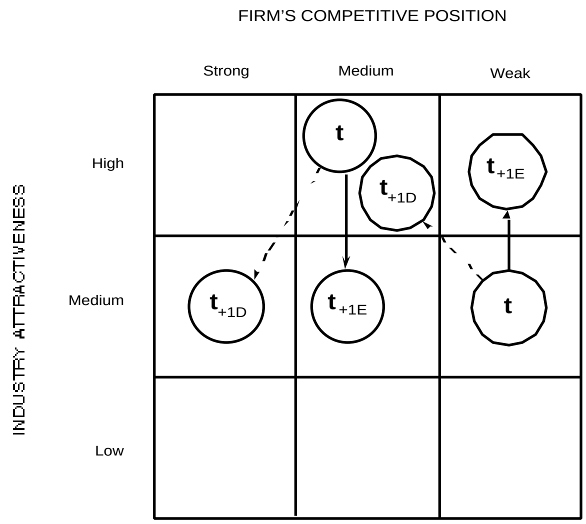
Figure 9: BASIC PERFORMANCE ASSESSMENT MODEL



E = Expected outcome if no change in strategy

D = Desired outcome

Figure 10: BASIC PORTFOLIO MATRIX



E = Expected outcome if no change in strategy

D = Desired outcome

Figure 11: GENERAL ELECTRIC MATRIX

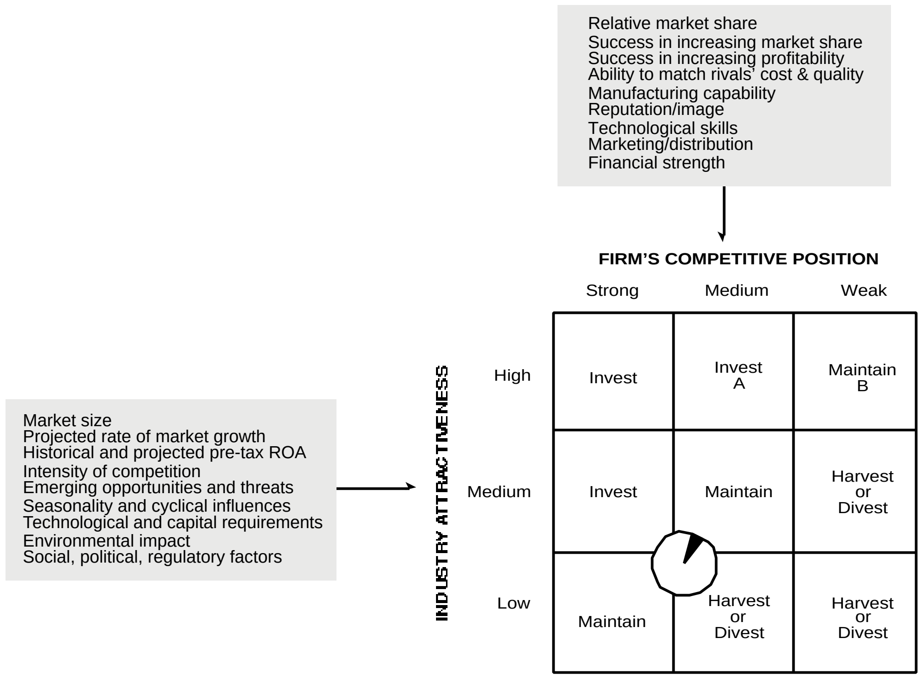
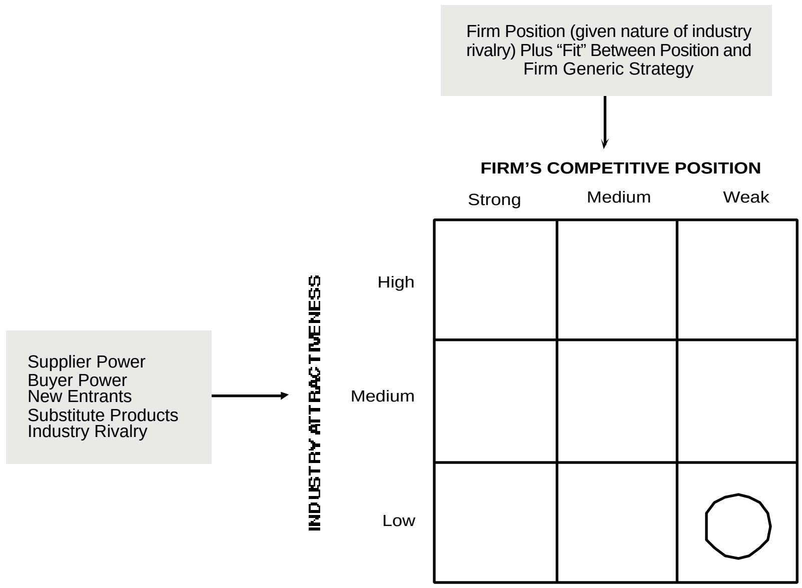


Figure 12: THE LIFE CYCLE PORTFOLIO MATRIX

COMPETITIVE POSITION

INDUSTRY MATURITY	Dominant	Strong	Favorable	Tenable	Weak
Embryonic	Probably profitable, but not necessary Net cash borrower	May be unprofitable Net cash borrower	Probably unprofitable Net cash borrower	Unprofitable Net cash borrower	Unprofitable Net cash borrower
Growth	Profitable Probably net cash producer (but not necessary)	Probably profitable Probably net cash borrower	Marginally profitable Net cash borrower	Unprofitable Net cash borrower or cash flow balance	Unprofitable Net cash borrower or cash flow balance
Mature	Profitable Net cash producer	Profitable Net cash producer	Moderately profitable Net cash producer	Minimally profitable Cash flow balance	Unprofitable Possibly net cash borrower or net cash producer
Aging	Profitable Net cash producer	Profitable Net cash producer	Moderately profitable Cash flow balance	Minimally profitable Cash flow balance	Unprofitable (Write-off)

Figure 13: ADAPTING PORTER'S "FIVE FORCES" TO A PERFORMANCE MATRIX FORMAT



Something to keep in mind: Porter's generic strategies are not strategic alternatives. They can be used in fulcrum analysis to consider the broad strategic stance of the firm. Most strategic alternatives are within a generic strategic type.

SOLUTION ANALYSIS

Even if the current strategy looks great, one may want to move to this part for contingency planning purposes. It consists of five major sections; see Figure 14.

Generate Alternatives

For clients in many businesses, you may generate both corporate level alternatives and business level alternatives. For strategic issues involving governments, you may also need to develop political strategic alternatives (see Figure 15). Make sure, however, you group the corporate level alternatives separately from the business level alternatives. When making comparisons among strategic alternatives, ensure that they are all at the same level of analysis: don't mix corporate, competitive and functional level alternatives.

Propose a number (at least three, preferably four) of reasonable, mutually exclusive strategic alternatives at each level. The current strategy — the status quo — is usually a reasonable alternative. This does not mean "do nothing"; it means continue to do what you were doing before: if the client is investing, then the status quo means continue to invest at roughly the same rate. Try to avoid "straw men" alternatives. As indicated above, a good analysis of the current situation should help you to come up with some interesting and appropriate alternatives.

Figure 14: SOLUTION ANALYSIS

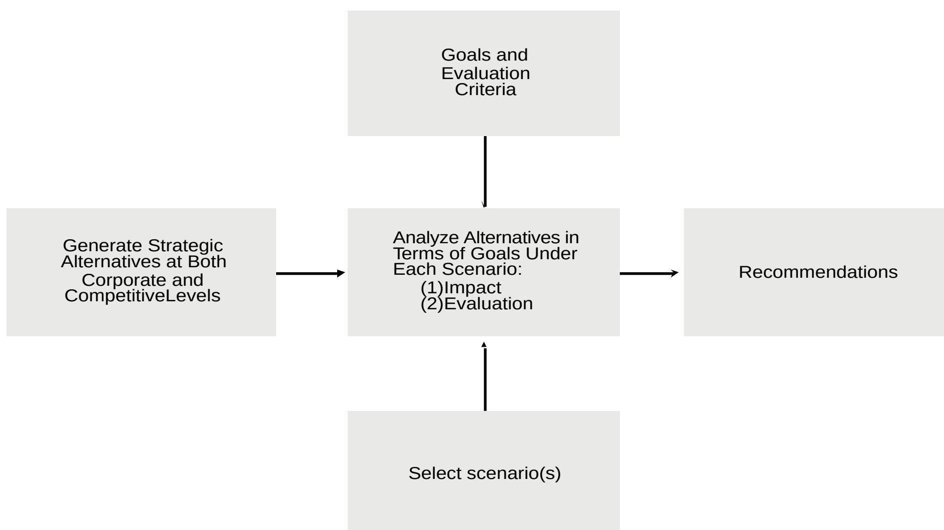
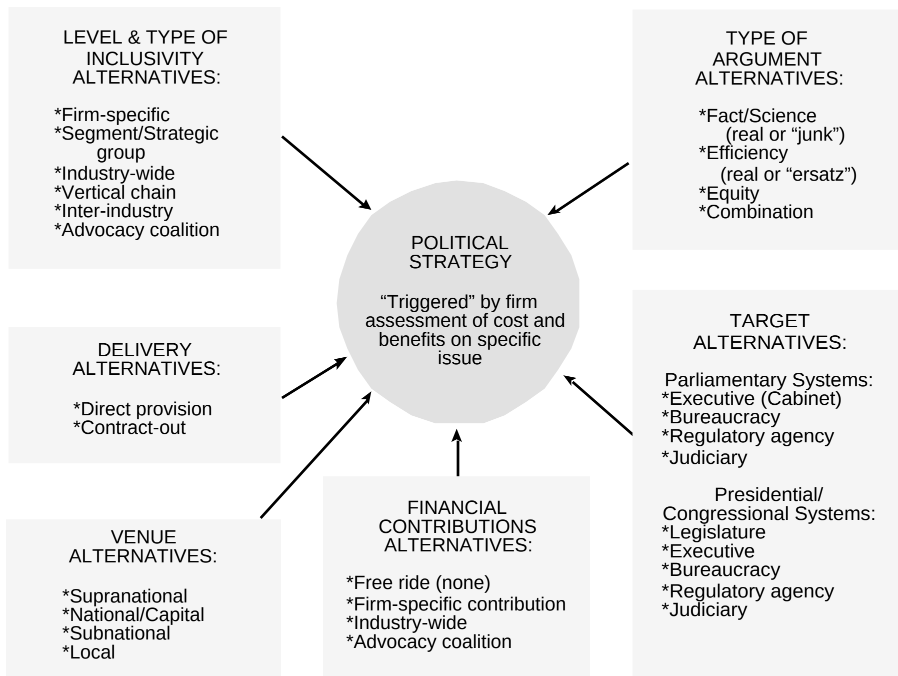


Figure 15: ELEMENTS OF POLITICAL STRATEGY



Select and Develop Scenario(s)

For some analyses, consider a couple of possible scenarios for each business. Ideally, this should consider simultaneously all the key external competitive forces (Figure 4). At a minimum, think through a "crash" scenario, a "most likely" scenario and an "optimistic" scenario. Attach probabilities to the predicted state variables, if possible.

If you are going to conduct an in-depth dynamic industry analysis, then this is the appropriate section. You could consider how competitors are likely to react under each alternative scenario and to each of the client firm's strategic alternatives. In oligopolistic industries, the scenarios may become quite complicated, involving exogenous shocks, strategic choices by one or more firms and subsequent strategic responses by competitors.

Goals and Evaluation Criteria

What are the goals of the client? Do they differ from shareholder value maximization? Tightly-held, privately-owned firms may not maximize profits (to the exclusion of all other goals)! Not-for-profit firms may have cash flow satisficing goals and distributional goals.

How are the goals translated into specific performance evaluation criteria? Goals should be transformed into objectives, that is, specific, measurable, operational criteria with a time frame. Common criteria related to profitability include relative or absolute expected profit, cash flow, ROA or ROI, ROE, market share and sales growth. Reducing both systematic risk and total risk are likely to be important goals, so one might consider measures of “downside” risk (minimum gain, maximum loss). When business level decisions affect other parts of the corporation, these interdependencies should be considered in order to maximize global (i.e. corporate) objectives rather than local (business level) objectives. Synergy may be an appropriate goal.

Analyze the Alternatives in Terms of the Goals

Evaluate the alternatives in light of the performance criteria (goals) for each scenario. There are two steps:

(a) Predict Impacts. Determine the expected impact of each strategic alternative (columns) on each performance measure/goal (rows) and present the results in an impact matrix — see Table 1. The cells in the matrix describe the impacts of each alternative in qualitative or quantitative terms. The matrix format ensures that all alternatives are evaluated according to all criteria. Not all impacts are necessarily positive. Do not intentionally suppress real ambiguity: as an analyst, you must point out all the nasty trade-offs. Repeat for the other scenarios, if appropriate.

Strategic alternatives may differ considerably in terms of their expected effects on some performance measure that, initially, was not considered to be a relevant goal. If so, the impacts should be noted so that the client may add the new performance criteria to the set of goals. Indeed, goals are often not clearly specified until after the impacts of the alternatives have been examined — often you don’t really know what you want until after you find out what you can have.

(b) Value Impacts. Evaluate the alternatives in light of the goals and state the preferred strategic alternative for each scenario. First, transform the impact matrix into a valuation matrix by assigning a "value" to each cell, depending on the magnitude of the impact in each cell. For example, on a scale of 1 through 5, an impact of "10,000 units sold" may be assigned the value of 1 and an impact of "1,000,000 units sold" may be assigned the value of 5. In effect, the impact of each alternative on each criterion (goal) is assigned a "z score". Some clients prefer verbal valuations, in which case "10,000 units sold" may be assigned the value of "insignificant" and an impact of "1,000,000 units sold" may be assigned the value of "very high". Valuation requires judgement on the part of the analyst and would benefit from advice from the client. Conceptually, however, it is <u>no</u>t based on the client's utility function and differences or opinion could be resolved by further analysis.

Second, attach weights to the goals. Weights should be based on the analyst's perception of the client firm's goals: What goals does the client really care about? How much? What is the client's willingness to trade off one goal against another? After the analyst has "valued" the impact of each alternative on each goal and has weighted the goals, then the most preferred strategic alternative "Drops out" under each scenario. Some samples are shown in Tables 2 and 3.

Table 1: A GENERIC IMPACT MATRIX

Goals (Criteria)	Strategic Alternatives			
	S1	S2	S3	S4
G1				
G2				
G3				
G4				
G5				

Table 2A: SAMPLE GOALS/CRITERIA FOR METACHOICE ALTERNATIVES

	Single Goal of Profitability	Multiple Goals (including profitability)
"Monetized" Data on Profitability	**1** **DCF Analysis** Discounted Cash Flow Analysis NPV IRR Payback Period	**3** **Modified DCF Analysis** Core DCF + Other Goals: Employee Impacts Environmental Impacts Social Responsibility
Not All Dimensions of Profitability "Monetized"	**2** **Profitability Analysis** Direct Profitability Criteria: ROI ROE ROS Net Income Residual Income (RI) Payback Reciprocal B/E Analysis Contribution Margin "Short-Run Profit" "Long-Run Profit" Indirect Profitability Criteria: % Sales Growth % Market Share Change % Synergy (Qualitative) Margin Change (Low Cost) Experience Curve Change Public Image Acceptability to Government	**4** **Multiple Goal Analysis** Profitability Criteria (Direct and Indirect) + Other Goals: Employee Impacts Environmental Impacts Social Responsibility

Table 2B: ECI's BALANCED BUSINESS SCORECARD

FINANCIAL PERSPECTIVE

Goals	Measures
Survive	Cash flow
Succeed	Quarterly sales growth and operating income by division
Prosper	Increased market share and ROE

CUSTOMER PERSPECTIVE

Goals	Measures
New products	Percent of sales from new products
	Percent of sales from proprietary products
Responsive supply	On-time delivery (defined by customer)
Preferred supplier	Share of key accounts' purchases
	Ranking by key accounts
Customer partnership	Number of cooperative engineering efforts

INTERNAL BUSINESS PERSPECTIVE

Goals	Measures
Technology capability	Manufacturing geometry vs. competition
Manufacturing excellence	Cycle time Unit cost Yield
Design productivity	Silicon efficiency Engineering efficiency
New product introduction	Actual introduction schedule vs. plan

INNOVATION AND LEARNING PERSPECTIVE

Goals	Measures
Technology leadership	Time to develop next generation
Manufacturing learning	Process time to maturity
Product focus	Percent of products that equal 80% sales
Time to market	New product introduction vs. competition

(Source: Kaplan and Norton)

Table 3A: AN EXAMPLE OF MULTIPLE GOAL PREDICTION MATRIX

STRATEGIC ALTERNATIVES

		Alternative A	Alternative B	Alternative C
	Short-Run Profitability (3 Years)	$30M	$43M	$60M
	Longer-Run Profit (4-10 Years)	High	High	Low
GOALS	Synergy	Medium	Low	High
	Market Share	30% (by Year 5)	26% (by Year 5)	24% (current) (by Year 5)
	Impact on Employees	Increased Workloads, No Layoffs	10% Layoff	No Change