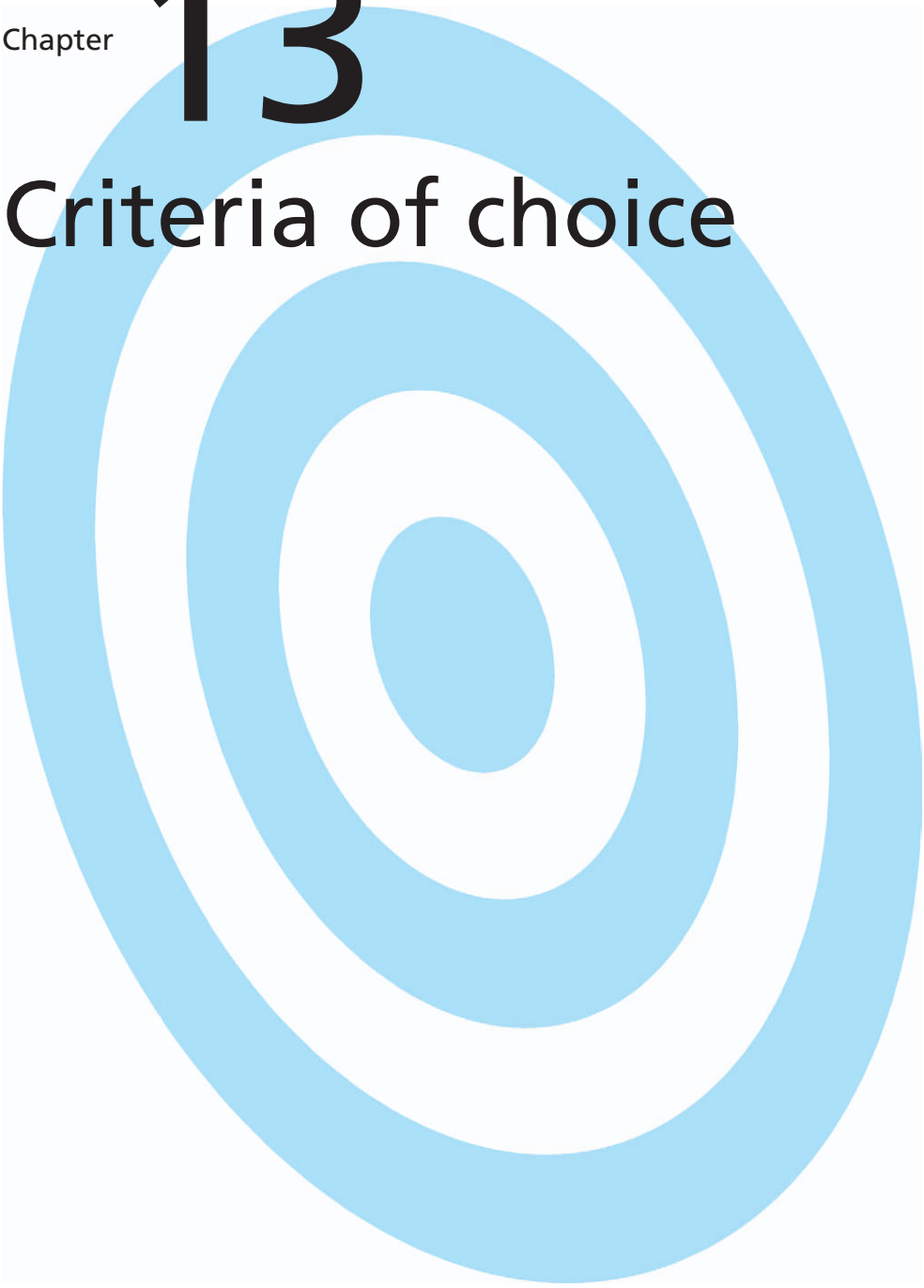
Chapter 13

Criteria of choice



13.1 Learning objectives

When you have read this chapter you should be able to:

(a) understand the role of criteria of choice in the decision-making process;
(b) distinguish between financial and non-financial criteria;
(c) recognize the limitations of using single criteria for making strategic choices;
(d) appreciate the relevance of multiple criteria approaches to strategic choice.

13.2 Introduction

In 1993 a group of chairmen, chief executives and other senior executives from twenty-five of Britain's top businesses came together to form the Royal Society of Arts (RSA) Inquiry 'Tomorrow's Company'. This inquiry was prompted by the recognition that Britain has a long tail of underperforming companies and that the prime responsibility for correcting this situation lay with the business community. The inquiry team has now reported, and a summary of its Inclusive Approach is shown in Illustration 13.1. This contrasts 'tomorrow's company' with 'yesterday's companies'. One of the key means of moving forward successfully is to improve the way in which strategic decisions are made.

Tomorrow's companies (or new products, new markets, new competitors and new ways of thinking)

In his book *Thriving on Chaos*, Peters (1988) argues that at least ten major forces are at work that are influencing how managers think and how they need to behave. By themselves, each of these forces represents a powerful agent for change. Together, he suggests, they are overturning virtually every well-known precept of corporate management. The ten forces that he highlights are:

1 *Unprecedented uncertainty*. Despite the attention that has seemingly been paid to environmental flux over the past 10 years, the majority of the managerial tools – basic accounting practice, patterns of organization, and approaches to the formulation of strategy – are, he suggests, still predicated on stability.
2 *Time* will increasingly be the main weapon of competition, with speed, flexibility, adaptiveness and information technologies providing enormous scope for the exploitation of opportunities.
3 *The fragmentation of markets* and the consequent need to customize products, services and the marketing effort negates the old ideas of niche markets. Niche marketing is, Peters argues, no longer meaningful, since there are no non-niche markets any more.
4 *Quality, design and service* are the fundamental expectations of customers in virtually all markets. Yet in far too few companies are these areas obsessions.

5 *Giant firms can no longer behave as they used to*. In *Time, Chance and Organization*, Herbert Kaufman argues that 'the survival of some organizations for great lengths of time is largely a matter of luck'. Skill plays a minor role and attempts to induce flexibility are often in vain – the ravages of time that beset large organizations are generally irreversible. The only hope is to create brand-new autonomous units with very different cultures from the parent.

6 *New organizational configurations* based on local networks inside the firm and electronic data interchange outside it becoming the keys to success. The flattening of hierarchical pyramids is simply a belt-tightening exercise and only a partial – and temporary – solution.

7 *Old ideas about economies of scale are no longer meaningful*. Scale, Peters suggests, needs to be redefined. Although size may well continue to be effective, it is more likely in the future to be based on the ideas of the collections of smaller firms in new organizational combinations rather than the monolithic ideas of the past.

8 *The growth of competitive networks*. Traditionally, organizations have operated at arm's length with their suppliers and forced one to bid against another in order to keep prices as low as possible. Such an approach is, however, incompatible with ideas of competing on time, constant innovation and improvement, and even simple efficiency. To overcome this, organizations need to develop partnership relationships with a smaller number of suppliers, with each side aiming to make the other profitable. These value-added partnerships (VAPs) are based on the idea that each player in the value-added chain has a stake in each other's success, and it is therefore the entire VAP – not just one part of it – that is the competitive unit.

9 *Internationalization for all*. Although tailoring products or services to local needs is vital, almost any national market today offers an opportunity for the enterprising firm of any size, irrespective of where it is located.

10 *The line worker committed to constant improvement and retraining* must become the chief agent for adding value and achieving continuous innovation.

Illustration 13.1 RSA Inquiry: 'Tomorrow's Company'

The inclusive approach

Some of the Inquiry's comparisons between tomorrow's company and yesterday's companies are:

Purpose and values

- ➡ Tomorrow's company clearly defines its purpose and values, and communicates them in a consistent manner to all those important to the company's success.
- ➡ Yesterday's companies do not see the need to have a distinctive purpose or values, and often confuse purpose with measures of success (for example, upper quartile earnings per share) or are content to leave the definition of their purpose to

habit or to others. Yesterday's companies have different messages for different audiences (for example, to providers of capital, employees are costs to be cut, while to the employees 'you are our greatest asset').

Measuring success

- Tomorrow's company uses its stated purpose and values, and its understanding of the importance of each relationship, to develop its own success model, from which it can generate a meaningful framework for performance measurement.
- Yesterday's companies take it for granted that 'everyone knows' what success is and allow existing systems of measurements to define it for them. They are content to measure returns. Because they have no measures of the value embedded in their relationships, when hard decisions have to be made they are taken in the dark. They risk destroying value rather than creating it. Yesterday's companies measure what they have always measured in the past.

Relationships

- Tomorrow's company values reciprocal relationships and works actively to build them with customers, suppliers and other key stakeholders through a partnership approach and, by focusing on and learning from all those who contribute to the business, will be best able to improve returns to shareholders.
- Yesterday's companies are locked in adversarial relationships. They think in terms of zero-sum, imagining that if they were to make customers, employees, suppliers or the community more important, the shareholders would be the losers.

13.3 Financial versus non-financial criteria; effectiveness versus efficiency

In choosing between alternative courses of action or strategies it is, of course, desirable to choose the best, but how is the 'best' to be recognized? The best from the viewpoint of one stakeholder may not be the best from another stakeholder's viewpoint. Similarly, what is best in the short term may not be best in the long term. Specifying the criteria by which choices are to be made among competing alternatives is a crucial step in working towards improved marketing performance.

It has traditionally been the case that financial criteria have dominated choice processes irrespective of the initial emphasis that may have been given to non-financial criteria. Changes in strategic thinking (as reported, for example, by Munro and Cooper, 1989) have suggested that the dominance of financial measures may no longer be appropriate. For instance, the emphasis placed by McDonald's on quality, service, cleanliness and value shows that a financial criterion is insufficient, although there will invariably be one or more financial measures within any enterprise's set of *critical success factors* (see pp. 576–85).

A selection of the most important financial and non-financial criteria is given in Figure 13.1, many of which will be discussed in this chapter.

Financial	Non-financial
Liquidity	Sales volume
Cash generation	Market share
Value added	Growth rate
Earnings per share	Competitive position
Shareholders' value	Consumer franchise
Share price	Risk exposure
Profit	Reliance on new products
Profitability	Customer satisfaction
Cost leadership	Sustainable competitive advantage

Figure 13.1 Financial and non-financial criteria

Within the marketing literature there is surprisingly little coverage of effectiveness (i.e. doing the right things) as opposed to efficiency (i.e. doing things right). However, it is implicit in the extensive coverage of efficiency that the results of marketing activities are effective: it is not suggested that effectiveness should be traded off for greater efficiency. Nevertheless, the preoccupation that has existed with inputs rather than outputs tends to mean that outputs such as increased sales revenue, greater market share or higher profits are taken as being self-evident measures of effectiveness.

The various inputs and outputs cited in the literature on marketing efficiency include those shown in Figure 13.2.

If we consider market share to be an appropriate output measure we can relate this back to the discussions of the BCG growth–share matrix and the PIMS approach (see Chapter 9, pp. 367–74 and Chapter 11, pp. 432–7).

The growth–share matrix was developed for use in portfolio planning (i.e. to generate a balanced portfolio of business activities with reference to cash generation and cash use). Relative market share serves as a proxy for cash generation, with market growth acting as a proxy for cash use.

Figure 13.2 Marketing efficiency criteria

Market share as an output measure also features prominently in the PIMS approach (see Abell and Hammond, 1979; Buzzell and Gale, 1987; Day, 1990). ROI is the dependent variable in the PIMS approach (see p. 434), with market share playing a key role in the following sequence:

1 Superior relative quality is established by a business for its products
2 This superiority facilitates the building of market share
3 Greater share brings with it cost advantages due to higher volume and experience curve effects
4 Superior quality allows premium prices to be charged, which, in association with lower costs, ensures higher profits.

Whatever measures of input and output are used in an attempt to assess efficiency – and Figure 13.2 offers only a limited number of each – the overriding emphasis is typically on readily quantifiable factors. This gives a means of both asking and answering the question as to whether the enterprise is getting as much output per unit of input as it should, or whether the efficiency of marketing activities might be improved. As we have seen, however, this concern with 'doing things right' begs the question of whether the right things are being done, which requires a fuller consideration of marketing effectiveness. This is provided in Chapter 14, where we deal with such approaches as the marketing audit (which was also covered in Chapter 2) and Bonoma's approach to assessing marketing programmes.

We will proceed through this chapter by examining a range of individual criteria from both the financial and non-financial categories, and then look at more broadly-based, multiple-criteria approaches to evaluating alternatives.

13.4 Financial criteria

Cash generation

Poor liquidity is a greater threat to the survival prospects of an enterprise than poor profitability; hence it is vitally important in choosing a marketing strategy to consider carefully the cash flow implications of available alternatives. This can be vividly illustrated via the BCG growth–share matrix (as discussed in Chapter 9), which classifies products into four categories (see Figures 9.2 and 9.3):

- Stars
- Question marks (or wildcats)
- Dogs
- Cash cows.

Use of the product portfolio as a frame of reference should ensure that all products, business units or profit centres are not treated alike, and that investment decisions are

not seen as being independent of continuing business activities. Nevertheless, a strategic success sequence is likely to emerge through following these steps:

1 The cash generated by cash cows (high market share, low market growth) should be invested in building the market share of question marks. If this is done well, sustainable advantage will be provided by which question marks will become stars and then cash cows, and will thereby become capable of financing subsequent strategies.
2 To be avoided is the sequence by which question marks are not supported so that they become dogs when the market matures – low relative share in a low growth market is not the place to find oneself.
3 Also to be avoided is the sequence by which stars lose position and become question marks as market growth slows, with the risk of their becoming dogs.

It should be mentioned that, in focusing on the balancing of operating cash flows, the BCG matrix ignores the existence of capital markets, which also have a role to play in balancing cash flows. Moreover, the BCG matrix fails to allow for differential risk.

Cost leadership

A particular strategy may be more desirable than others if it is likely to secure cost leadership (which is one of Porter's key generic strategies). This notion can be illustrated through the *experience curve*.

In Figure 13.3, the three most offensive price/quality positioning strategies are 4, 7 and 8; it is these that provide the strongest basis for an attack, since each one offers the buyer above-average value for money. By contrast, strategies 2, 3 and 6 all involve

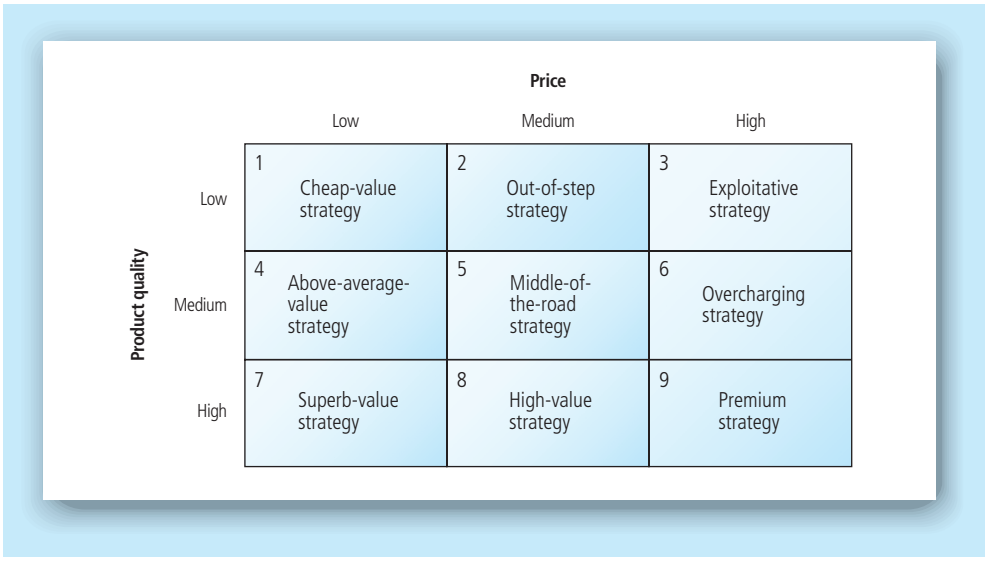


Figure 13.3 The nine price/quality strategies

setting the price above its real value and, particularly in the medium and long term, are unlikely to succeed.

Illustration 13.2 Price cuts and zero-sum games

At the beginning of 1996, Procter & Gamble launched its 'Every Day Low Pricing Strategy', which saw the prices of many of its brands cut by up to 17 per cent. The strategy, which was led by Pampers and Lenor, had a dramatic effect upon the market, forcing competitors such as Kimberly-Clark and Lever Brothers to match Procter & Gamble's lower prices. However, 12 months later, faced with static market share figures and squeezed profit margins, Procter & Gamble made a dramatic U-turn and began raising prices. Within days, its competitors followed suit.

In commenting on the price war in just one of Procter & Gamble's markets, the disposable nappy sector, a trade buyer commented: 'You cannot grow volumes in the nappy market. The cuts did not help anyone.'

Source: *Marketing*, 13 February 1997, p. 1.

Pricing decisions and portfolio analysis

In our discussion of portfolio analysis in Chapter 9, we commented that cash flow and profitability are both closely related to sales volume. Recognizing, therefore, that products typically follow a well-trodden path through the matrix, portfolio analysis is capable of providing a series of general pricing guidelines. *Question marks*, for example, offer scope either for skimming in order to quickly regain investment (this would be appropriate if the strategist sees the market as having only a limited life), or rapid penetration by means of low prices in order to build share and keep competitors at bay.

In the *star* stage, high prices are appropriate when buyer loyalty is high and/or if a high level of development costs still needs to be recovered. In other markets, a low price may be needed in order to retain share. In the *cash cow* stage, prices are likely to drift down partly because of a general increase in competition as late entrants to the market appear, and partly because the significance of differentiation is often reduced.

For a *dog*, the pricing choice is straightforward. Either price aggressively in order to build share, or where this is felt either not to be possible or worthwhile, raise prices in order to maximize very-short-term profits as far as possible and then withdraw.

The behaviour of costs over time

It has long been recognized that size and market share are primary determinants of profitability. The principal reason for this is that large firms usually have a lower unit cost base. These lower costs are due partly to *economies of scale* in manufacturing, distribution,

purchasing and administration, and partly to the *experience effect*, whereby the costs of most products decline by a fixed percentage each time an organization's experience of producing and selling them doubles.

Of the two, the nature and sources of economies of scale are by far the best known, and it is therefore not our intention to do anything more than draw the reader's attention to its significance and to emphasize that these economies can provide a significant input to the pricing decision.

The less well-known *experience effect*, however, is of equal, and in some instances of even greater, strategic significance. The concept is based on the discovery that costs decline with cumulative production and that this decline is measurable and predictable. The origins of the effect can be traced to the idea of the *learning curve*, which recognizes that the time needed to perform a task decreases as workers become more familiar with it. In the 1960s, however, evidence emerged to suggest that this phenomenon was limited not just to labour costs, but applied also to all total value-added costs, including administration, sales, marketing, distribution, and so on. A series of studies by the Boston Consulting Group then found evidence of what was subsequently labelled the *experience effect* in a wide variety of industries covering high-technology to low-technology products, service to manufacturing, consumer to industrial products, new to mature products, and process to assembly plants. The key feature in each case was, as Abell and Hammond (1979, p. 107) have pointed out:

> "That each time cumulative volume of a product doubled, total value-added costs . . . fell by a constant and predictable percentage. In addition, the costs of purchased items usually fell as suppliers reduced prices as their costs fell, due also to the experience effect. The relationship between costs and experience was called the experience curve."

Sources of the experience effect

The experience effect has a variety of sources, the seven most significant of which have been identified as:

1. Greater labour efficiency
2. Work specialization and methods improvement
3. New production processes
4. Obtaining better performance from existing equipment
5. Changes to the resource mix
6. Greater product standardization
7. Product redesigns.

While these are the principal sources of experience, they do not emerge naturally but are instead, as Abell and Hammond (1979, p. 113) point out:

> ". . . the results of substantial, concerted effort and pressure to lower costs. In fact, if left unmanaged, costs rise. Thus experience does not *cause* reductions but rather provides an

opportunity that alert managements can exploit. Consequently strategies resulting from market planning should explicitly address how cost reductions are to be achieved."

The strategic implications of the experience curve are potentially significant, since by pursuing a strategy to gain experience faster than competitors (this would normally mean high market share), an organization lowers its cost base and has a greater scope for adopting an aggressive and offensive pricing strategy. This is illustrated in Figure 13.4, in which three organizations are competing.

In this example, Firm A has the greatest experience and Firm C the least. Firm A therefore has a choice of strategies open to it. By setting the price at level 1, all three firms make a profit. However, by forcing the price down initially to level 2 and subsequently to level 3, Firm A puts ever greater pressure on its two competitors, and forces firstly Firm C and then Firm B into making a loss. Faced with this, the two firms either make a loss that has to be absorbed or they withdraw from the market.

Although the industry prices are shown in Figure 13.4 to fall steadily, in practice they tend to follow a somewhat different pattern. This is illustrated in Figure 13.5.

The essence of the experience curve is that the real costs of generating products and services decline by 20–30 per cent whenever cumulative experience doubles.

The experience curve is derived not from accounting costs but by dividing the cumulative cash inputs by the cumulative output of end products, and the cost decline is shown by the rate of change in this ratio over time. From this rate of change, managers can see how – and why – their competitive costs are shifting. If estimates can be

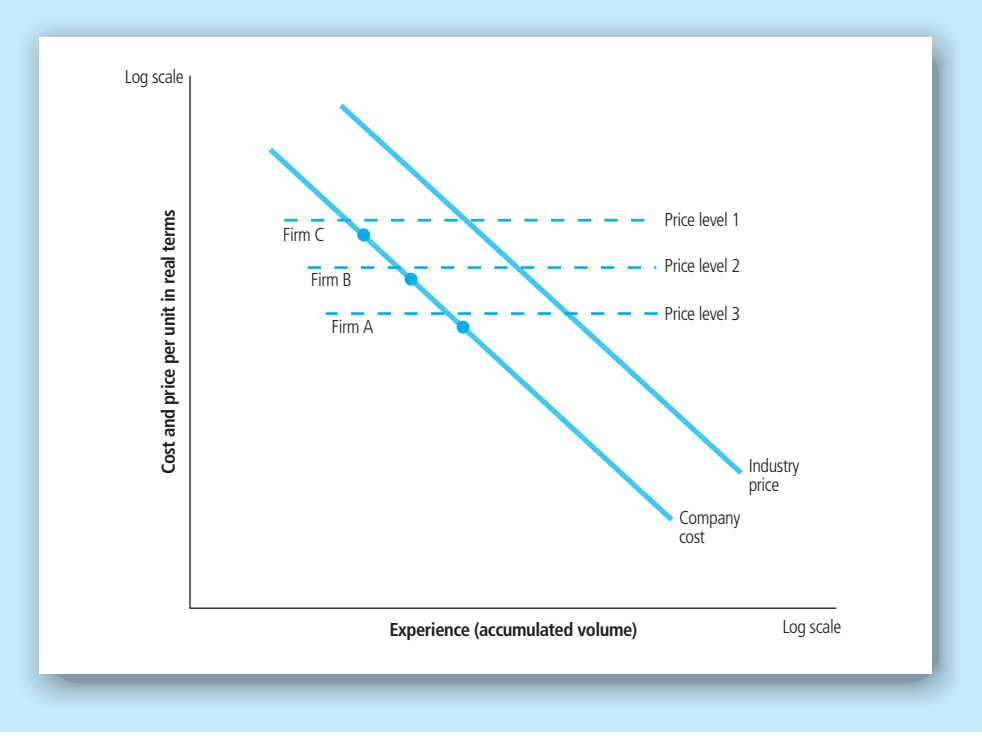


Figure 13.4 The implications of experience for pricing and profitability

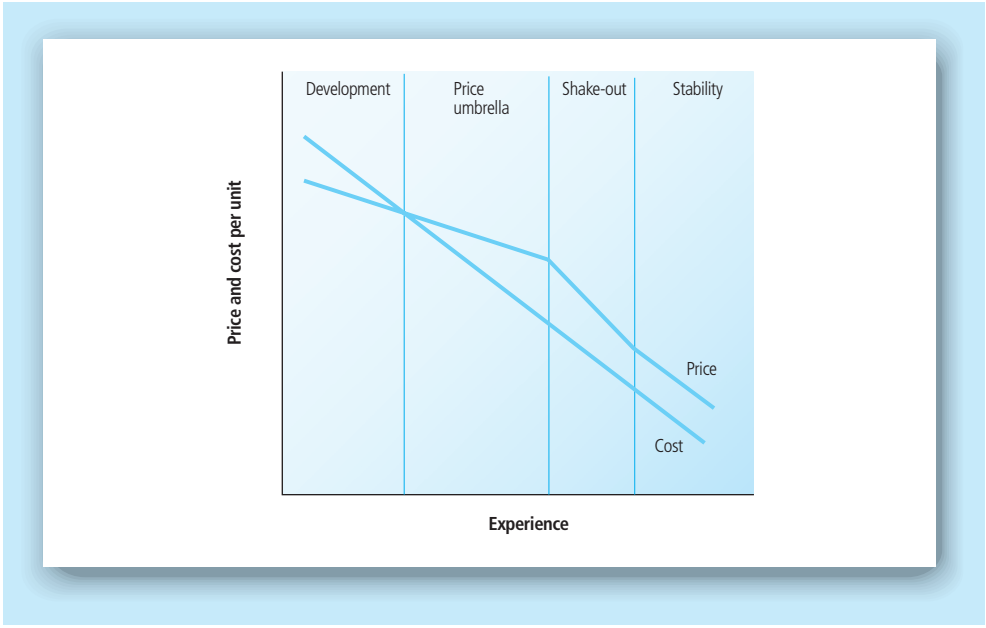


Figure 13.5 The development costs over time (adapted from Boston Consulting Group, 1971, p. 21)

made of competitors' experience curve effects, this should reveal which are the low-cost competitors and which are not, hence which are at risk and from whom.

The main strategic message from the experience curve is that if costs per unit in real terms decrease predictably with cumulative output, then the market leader has the potential to achieve the lowest costs and the highest profits. This is illustrated in Figure 13.4.

Given the empirical existence of the experience curve, it is apparent that the use of cash will be less than directly proportional to a product's rate of growth. Similarly, the generation of cash will be a function of the product's market share, which links back to the BCG product portfolio matrix.

Profitability analysis

Profitability can be defined as the rate at which profit is generated. This may be expressed as profit (i.e. an output measure) per unit of input (e.g. investment, or some measure of effort such as sales calls). Apart from limiting our focus to one output measure (profit) to represent effectiveness, this approach also overlooks such issues as the quality of services rendered, hence its partiality needs to be kept in mind.

As a criterion for strategic decision-making, profitability has been criticized by Robinson et al. (1978) as being insufficient in:

- Failing to provide a systematic explanation as to why one business sector has more favourable prospects than another and why one enterprise's position in a particular sector is strong or weak
- Not providing enough insight into the underlying dynamics and balance of an enterprise's individual business units and the balance among them.

Other writers (e.g. Chakravarthy, 1986; Day, 1990) have also criticized profitability as a performance criterion due to its remoteness from the actions that actually create value: it represents an outcome rather than a determinant of performance and cannot be managed directly, hence employees are likely to attach limited importance to it on the grounds that their day-to-day actions would appear to have little impact on profitability.

Feder (1965) has defined good marketing performance as existing when investment in each market segment is made to the point where the expenditure of an additional $1 or £1 would produce greater immediate profits if spent elsewhere. This approach reflects the *marginal responsiveness* that is characteristic of marketing experimentation (i.e. where can the greatest response in terms of improved profit be achieved for a marginal increase in effort?). To take an example, if investment of £1 million in advertising within a given market produces sales of £20 million and a gross margin of £10 million, then the *average* response of profit to advertising is 10:1. If an increase in advertising expenditure of £100 000 produced additional sales of £3 million and a gross margin of £1.5 million, then the *marginal* response would be 15:1.

In assessing marketing performance using this approach it would be logical to determine the average response for the existing allocation of marketing effort, segment by segment, which would highlight those areas in which the company has underspent or overspent relative to their profit potential. Improvements can be made by allocating additional effort in accordance with the anticipated marginal response: the greater the anticipated marginal response the more efficient will be the allocation of effort. In considering whether additional effort might be exerted through direct selling, advertising, or improved terms for intermediaries within distribution channels, for example, the need exists to consider the timing factor, since different actions bring results over different time scales.

A less dynamic approach emphasizing profit (rather than profitability) has been suggested by a number of writers. Goodman (1970) and Pyne (1984) both offer modified versions of financial operating statements as bases for assessing marketing performance. These are illustrated in Figures 13.6 and 13.7.

In Figure 13.6, Goodman distinguishes carefully between direct and apportioned costs, which is a more relevant distinction than, say, that between fixed and variable costs if one is concerned to identify the performance of a marketing segment: relevance is given priority over the question of cost behaviour. In principle it makes sense to separate the profit attributable to manufacturing, distribution, and so forth, on a direct cost basis. The operational difficulty in doing this stems from the problems associated with identifying the direct costs of Product 123 within a product range of 10 000 items.

Apart from the quantity of profits as a measure of performance, we might also consider the quality of profits. This depends upon the position of a particular product within its life cycle. It is evident that the profits from products in the growth phase of the cycle are likely to be more valuable than those in the decline phase, since the former have a more promising future.

Pyne's approach is similar in some respects to that of Goodman. For instance, both authors emphasize the need for conventional operating statements (i.e. those having a

	£	£
Proceeds from sales		100.0
Variable cost of goods sold:		
Raw materials	10.0	
Packing	10.0	
Direct labour	5.0	
Variable gross profits (manufacturing contribution margin)		75.0
Other variable expenses:		
Freight	3.0	
Warehousing	2.0	
Spoilage	1.0	
Commissions	5.0	
Discounts	3.0	
Variable profit (distribution contribution margin)		61.0
Direct product costs:		
Advertising	9.0	
Promotion	3.0	
Direct product profits		49.0
Direct division costs:		
Sales management	12.0	
Product management	3.0	
Sales force	2.8	
Sales incentives	1.0	
Market research	0.2	
Division profit contribution (net contribution margin)		30.0
Allocated fixed expense:		
Factory indirect costs	21.0	
Supervision	4.0	
Other indirect costs	19.0	
Corporate administration	5.0	
Net division profit before taxes		(19.0)

Figure 13.6 Marketing-oriented income statement (adapted from Goodman, 1970, p. 38)

legalistic format) to be modified to reflect marketing's circumstances and, in so doing, to highlight direct costs.

In Figure 13.7 we can see that Pyne's approach differs in some significant ways from that of Goodman:

- ➡ Revenue is analysed more fully
- ➡ Marketing costs are analysed more fully, with headings that help in distinguishing operating from policy-related costs
- ➡ The orientation is more radical than that of Goodman in giving a basis for assessing marketing performance in strategic terms.

The amount of profit an enterprise earns is a measure of its effectiveness if that enterprise has a profit objective. (In this sense we can define effectiveness in terms of achieving that which one sought to achieve.) Since profit = revenue (output) − cost (input), it can be seen to be a measure of efficiency also in that it relates outputs to inputs. Thus,

Full revenue sales (at full sale price to end-user)	£
Lost revenue	
Distributors' mark-ups and margins	
Mark-downs, offers, deals and allowances	
Third-party costs of delivery to end-user paid by the purchaser	_____
Sales proceeds	£
Sales taxes and customs duties	_____
Net sales proceeds	£
Direct marketing expense	
Direct selling – field sales expenses	
Sales promotion – merchandising and display	
– samples, point of sales aids	
– cooperative allowances to distributors	
Product packaging and branding expense	
Product service – installation, warranty and returns	
Warehousing – storage, receiving and marking, shipping	
Transportation outward – truck, rail, air; cost, insurance, freight and delivery	
Direct marketing contribution	_____
Managed marketing expense	£
Order processing	
Sales and distribution management	
Brand and product management	
Marketing direction and administration	_____
Marketing policy costs	£
Advertising and publicity	
Market research and customer relations	
Product planning, design and development	
Marketing team training and development	_____
Committed marketing costs	£
Inventory carrying – expense and financing	
Cost of credit – collection and financing	
Marketing equipment – maintenance, insurance, financing	_____
Net marketing contribution	£

Note: where appropriate, lost revenue may be broken down by the marketing channels in use, e.g. wholesalers, stockists, retail chains, stores, direct vending outlets, etc.

Figure 13.7 Marketing-oriented profit statement (source: Pyne, 1984, p. 90)

an organization having revenues of £100 million and costs of £60 million is more efficient than one in the same industry having revenues of £100 million and costs of £70 million, since the former uses less input to produce a given output.

Despite its ability to act as a measure both of effectiveness and efficiency, profit is a less than perfect measure because:

1. It is a monetary measure, and monetary measures do not measure all aspects of either input or output
2. The standards against which profits are judged may themselves be less than perfect
3. At best, profits are a measure of what has happened in the short run, whereas we must also be interested in the long-run consequences of management actions.

Nevertheless, profit measures can still play a distinctly valuable role in the control effort. For example:

- A profit measure can provide a simple criterion for evaluating alternatives. (Although it will be necessary to take into account many factors other than profit in making a choice among alternative courses of action, on the face of it, option A is more attractive than option B if A will produce more profit than B.)
- A profit measure will permit a quantitative analysis of alternatives to be made in which benefits can be directly compared with costs. (Assuming a market exists for an enterprise's output, these benefits will be measured by the revenue flow from its sale.)
- A profit measure can provide a single, broad measure of performance in that it is arrived at after all financial costs and revenues have been taken into account, and it thus subsumes many other aspects of performance.
- Profit measures permit the comparison of performance to be made over time for one organization, or comparisons at a point in time to be made for a group of organizational units (e.g. divisions or competing enterprises within an industry), even if they are performing dissimilar functions. This is not possible with other measures, although it may be necessary to standardize accounting practices in measuring profits for this purpose and to ensure that the valuations of assets are made on the same bases.

This all sounds very promising, but we need to bear in mind the limitations of the profit measure. Among these are:

- Organizations have multiple objectives and will often forgo profit opportunities in order to avoid conflict over some other objective (or constraint), such as the desired image for the company or some ethical standard.
- Social costs and benefits are excluded from corporate profit figures. At best, profit is a measure of an enterprise's success as an economic entity, but this does not measure that enterprise's net contribution (or cost) to society, such as the training programmes it might offer or the pollution it might cause.
- As already mentioned, profit measures typically focus on current rather than long-run performance – actions can be taken to improve the former at the expense of the latter (e.g. by cutting advertising, R&D, training and maintenance budgets).
- Profit is an inadequate basis for comparing organizations' relative performance or for monitoring one organization's performance over time. The real test is actual versus target profit, but we are really unable to specify this latter figure in any sensible way because it should be based on *profit potential* and a company's profit opportunities are not all identified. It follows that an apparently high profit figure, even when this corresponds with the target figure, may in reality be poor when related to missed opportunities.
- Accounting rules are also inadequate, since they often do not permit the recording of economic reality. (Costs should reflect the use of resources, but accounting practice does not allow this to be measured when it values assets on the basis of historical

cost rather than their opportunity cost, i.e. current value in an alternative use, which has an impact on the depreciation charge, etc.)

➡ Profit measures are not applicable in certain segments of a business, notably those that incur costs but do not generate revenue (unless a transfer pricing system is introduced to impute revenue flows). Examples of these types of segment are R&D, the legal department, the personnel department and the accounting department.

Creating shareholder value

Perhaps the majority of evaluative criteria advocated in the literature and used in practice focus on the maximization of profit, profitability or sales rather than on the return to shareholders (see, for example, McGuire et al., 1986; Chakravarthy, 1986). The key idea behind *creating shareholder value* (e.g. Rappaport, 1986; Wenner and LeBer, 1989; Reimann, 1989) is that investors only willingly invest in an enterprise when they think that the managers of that enterprise will be able to secure a better return on their funds than they could on their own without additional risk. In contrast to ROI and other short-term measures, the creation of shareholder value emphasizes the market's assessment of the long-term health and wealth of the enterprise. Evidence exists to indicate that movements in an enterprise's share price are due (at least in part) to the impact of management's decisions on the long-term value of the enterprise. This is covered by the *efficient markets hypothesis*, which suggests that financial markets are adept at capturing information and reflecting the significance of that information in changes in share prices. It follows that decision-makers in enterprises having listed shares (which only applies to some 2200 of more than 1 million companies incorporated in the UK) should pay due attention to the impacts of their decisions on share prices.

Day and Fahey (1988) have sought to demonstrate how a value-based approach can be applied to the evaluation of marketing strategies. The starting point is the recognition that value is only created when the financial benefits of a strategic activity exceed its costs. Since strategic activities are carried out over time – often involving several years – it is necessary to apply discounting methods to the relevant cash inflows and outflows. This is equivalent to the long-established practice of applying discounting techniques to new investments in plant and equipment: the extension of the practice to marketing strategies involves dealing with more intangible elements and embracing a series of issues rather than simply the investment in a single item of plant. We will return to this approach in Chapter 16.

13.5 Non-financial criteria

Growth

The importance of growth as a criterion of choice stems from the following:

1 Its relationship to gaining market share. Consider, for example, the sad case of the motorcycle industry in Britain. During the 1960s the level of output of British

motorcycles was fairly constant (at 80 000 units per annum) whereas the exports from Japan increased from 60 000 in 1960 to 2.5 million in 1973, with their production volumes tripling over this period. The British manufacturers failed to recognize the strategic importance of market share *on a worldwide basis* for long-term profitability related to the experience curve effect. While UK production during the 1960s ensured that manufacturing facilities were being adequately employed, the significant strategic issue was that Japanese manufacturers' costs were falling whereas those of British manufacturers were not, hence the collapse of the UK motorcycle industry in the early 1970s.

2 The opportunities it provides for investment – as funds are generated they can be reinvested to produce a compound return.

Growth has a significant relevance to an enterprise's relative competitive position. This is most readily measured by relative market share, which is defined as the enterprise's market share divided by that of its largest competitor. Since the stronger the relative competitive position the higher the margins should be (due to the effect of the experience curve), this measure has a strategic importance.

The need for growth is shown in Figure 13.8, in which a gap can be discerned between the enterprise's present position and its preferred future position. (Figure 13.8 is a variation on Figure 7.13.) By continuing with current activities on the same scale, the level of profits will decline (e.g. due to increasing competition, product obsolescence, etc.). By expanding in either existing markets (i.e. larger market share) or by entering new markets with existing products, or by improving existing

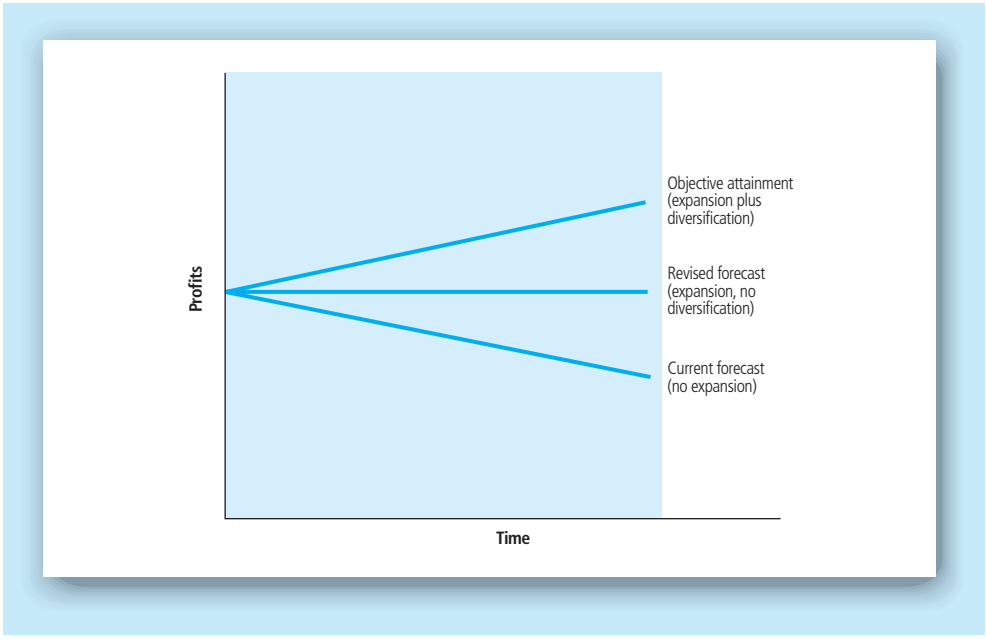


Figure 13.8 Gap analysis

products, it may be possible to maintain the level of profits into the future. (Note: these alternatives employ known technology and, in two out of three cases, known markets.)

By expanding the scale of activity within existing markets, improving existing products *and* diversifying into new markets with new products, a much higher level of profit may result, thereby meeting the desired profit target. The choice of strategy, therefore, will be that by which the gaps in Figure 13.8 might be closed.

Growth will usually involve a move outside the enterprise's existing range of activities. Alternative paths for expansion are shown in Figure 7.10.

- *Market penetration* entails an increasing share of existing markets with existing products – this would involve more aggressive promotion and distribution
- *Market extension* results from taking existing products into new markets
- *Product development* requires that new products be created to replace existing products in present markets
- *Diversification* involves the development (or acquisition) of new products for new markets.

The risk levels associated with these strategies tend to increase in the sequence in which they are listed above, so a change in product technology is likely to be riskier than a change in target markets, and a change in markets and products will be riskier than a change in only one of these (see Figures 7.14 and 7.15).

Sustainable competitive advantage (see also Chapter 10)

Wensley (1981), Cravens (1988), and Day and Wensley (1988) argue that the most meaningful guidance for strategic decision-makers is to be found in returning to basics and focusing on the search for *sustainable competitive advantage*. This focus implies that strategic alternatives should be evaluated in terms of the organization's strengths and weaknesses. Sustainable competitive advantage will be found when opportunities are taken to build on an enterprise's unique capabilities. These capabilities reflect the adequacy of the match between the current core activities of an enterprise and the strategic alternatives under consideration. Thus, for example, if we consider Ansoff's growth matrix (see Figure 7.10), an enterprise's greatest competitive advantage is likely to be found in product–market situations that are similar to those of its core activities (i.e. in cell 1).

A clear example is that of Gillette. Razors for men were followed by shaving cream for men and razors for women. Razors – whether for men or women – can be manufactured using the same facilities and the marketing has similarities whether it is razors or shaving cream one is considering. A common brand name helps develop a consumer franchise. The distribution system in use for razors can also be used for shaving cream – the products are bought in the same outlets.

At first sight it may appear odd that Gillette ventured into disposable lighters, since they do not fit synergistically with the marketing of razors, etc. However, Gillette's special capabilities include:

- Mass production of low-cost products
- Utilization of precision plastic moulded parts
- Use of mass distribution
- Marketing of low-cost, disposable consumer products under the Gillette brand name.

The manufacturing and marketing capabilities ensured Gillette secured competitive advantage in disposable lighters even if the brand name itself was not particularly useful.

Competitive position

In considering financial criteria it is usually found that a rather introspective approach is adopted (i.e. *this* enterprise's profit or *this* enterprise's cash flow). There is a need to adopt a more strategic perspective in dealing with an enterprise's competitive position.

The strategic dimension emerges when the performance of the business in question is compared with that of its competitors. Viewing the business within its competitive context is possible within the framework suggested by Figure 13.9.

The details from Figure 13.7 would be entered in the rows of Figure 13.9 under the given headings.

A variation on this theme, focusing on the notion of competitive position, has been developed by Simmonds (1986). This is covered in some detail in the following discussion.

The key notion here is that of an enterprise's position *relative to* competitors' positions. In so far as strategy is concerned with competitive position, it has been largely ignored by management accountants, but in a number of papers Simmonds (1981, 1982, 1985, 1986) has proposed how this failing might be overcome. A basic plank in

	Economic performance of competitive units				
	Market leader	Dominant challenger	Own business unit	Closest competitor	
				A	B
Revenues **Resource costs**					

Figure 13.9 Strategic comparisons (adapted from Pyne, 1984, p. 90)

his argument is the preoccupation that accountants have with the recording, analysing and presentation of cost data relating to existing activities. This 'data orientation' begs some fundamental questions, such as why the data is being collected in the first place. An alternative and preferable approach is one of 'information orientation', which starts with the diagnosis of problems, leading to the structuring of decisions, and thence to the specification of information that will help in making appropriate decisions. The focus shifts from the analysis of costs per se to the value of information.

Managers wishing to make decisions that will safeguard their organization's strategic position must know by whom, by how much, and why they are gaining or being beaten. In other words, strategic indicators of performance are required. Conventional measures, such as profit, will not suffice.

Let us take comparative costs as a starting point. It is intuitively the case that organizations having a cost advantage (i.e. lower unit cost for a product of comparable specification) are strong and those having a cost disadvantage are weak. If we relate this to the idea of the experience curve (which was introduced above), it will be appreciated that, if costs can be made to decline predictably with cumulative output, then the enterprise that has produced most should have the lowest unit cost and therefore the highest profits.

Apart from cost, an enterprise may seek to gain strategic advantage via its pricing policy. In this setting, the management accountant can attempt to assess each major competitor's cost structure and relate this to their prices, taking care to eliminate the effects of inflation from the figures being used. Applying cost–volume–profit analysis to one's competitors is likely to be more fruitful than simply applying it internally. As Simmonds (1982, p. 207) states:

> "Clearly, competitor reactions can substantially influence the outcome of a price move. Moreover, likely reactions may not be self-evident when each competitor faces a different cost–volume–profit situation. Competitors may not follow a price lead nor even march in perfect step as they each act to defend or build their own positions. For an adequate assessment of the likelihood of competitor price reactions, then, some calculation is needed of the impact of possible price moves on the performance of individual competitors. Such an assessment in turn requires an accounting approach that can depict both competitor cost–volume–profit situations and their financial resources."

After dealing with costs and prices, the next important (and related) variable to consider is volume – especially market share. By monitoring movements in market share, an enterprise can see whether it is gaining or losing position, and an examination of relative market shares will indicate the strength of different competitors. Reporting market share details along with financial details can help in making managerial accounting reports more strategically relevant.

The significance of competitive position has been highlighted by Simmonds (1986) as being the basic determinant of future profits and of the business's value. Moreover,

since competitive position can change over time, so can profits and value, but it should not be assumed that an improvement in competitive position will be associated with an improvement in short-run profits. In fact, the opposite is likely to be the case due to the need to incur costs in building up a competitive position, which has the effect of depressing current profits in favour of future profits. This raises the question as to whether competitive position can be measured in accounting terms – not just for a given business, but also for its main competitors, and not just at a point in time, but also over time. Simmonds has attempted to do this by applying strategic management accounting. He makes it clear, however, that it is not possible to express competitive position as a single figure. Instead, it is possible to offer an array of indicators relating to the competitive situation. From these indicators managers can gain insights into the competitive position of a business, which will help them in judging whether or not things are moving in their favour.

Simmonds recommends that competitive data be built up for the market leader, close competitors and laggards rather than for all competitors. The following data (derived from that given in Simmonds (1986) and used with permission) might most usefully be developed.

1 Sales and market share

The sales revenue of each firm relative to the total market is a cornerstone, and changes in market share should be closely monitored. A decrease in market share suggests a loss of competitive position, with unfortunate implications for future profits. Conversely, an increase in market share suggests an improved competitive position, with the prospect of improved future profits. By adding market share details to management accounting reports, managers are able to make much more sense of what is happening.

Figure 13.10 gives sales and market share data for Firm A and the total market for Product X. We can see from Figure 13.10 that, despite an increase in sales revenue of 20 per cent for Firm A, the market share has slipped from 19 to 16 per cent. This is

	Firm A	Total market
Sales (£'000)		
Last year	1,000	5,200
This year	1,200	7,500
% change	+20	+44
Market share (%)		
Last year	19	100
This year	16	100

Figure 13.10 Sales and market share data, Product X

	Sales (£'000s)	Market share (%)	Relative market share
Total market:			
Last year	5,200		
This year	7,500		
Firm A:			
Last year	1,000	19	
This year	1,200	16	
Leading competitor:			
Last year	2,200	42	2.20
This year	3,600	48	3.00
Close competitor:			
Last year	1,200	23	1.20
This year	2,200	27	1.67

Figure 13.11 Relative market shares

explained by the growth in the total market of 44 per cent. It seems probable that the firm's failure to keep pace with the overall market growth will be reflected in a poorer competitive position: not only might competitors have gained market share at the firm's expense, but this is likely to be accompanied by cost advantages – hence improved profits. Some details are given in Figure 13.11.

Relative market share is calculated by dividing each competitor's market share by that of one's own firm, and it indicates any gains or losses. As Figure 13.11 makes clear, Firm A has slipped relative to both the market leader and its closest competitor. The leader's market share has increased to three times that of Firm A, and it will almost certainly have lowered its unit costs.

2 Profits and return on sales

If a competitor has a higher return on sales than Firm A it may well reduce price, or improve quality, or increase its marketing efforts in order to improve its competitive position further.

The data in Figure 13.12 shows sales, market share, relative market share and profit (before tax but after interest) over the last three years for all firms supplying Product X. Over that period the market leader's profit has quadrupled, the closest competitor's has more than doubled, and Firm A's has not quite doubled. In absolute terms, the market leader's profit in Year 3 is almost five times that of Firm A, giving a huge source of funds for expansion, R&D, etc., while in relative terms the leader's return on sales of 22.2 per cent in Year 3 is well ahead of any other competitor.

Firm A's task seems to be to reinforce its competitive position relative to both laggard firms on the one hand, and to develop a defence against the strong competitors on the other.

	Sales (£'000s)	Market share (%)	Relative market share	Profit (£'000s)	(%)
Firm A:					
Year 1	700	17.5		90	12.8
Year 2	1,000	19.2		130	13.0
Year 3	1,200	16.0		170	14.2
Leading competitor:					
Year 1	1,400	35.0	2.0	200	14.3
Year 2	2,200	42.3	2.2	400	18.2
Year 3	3,600	48.0	3.0	800	22.2
Close competitor:					
Year 1	1,000	25.0	1.4	120	12.0
Year 2	1,200	23.1	1.2	170	14.2
Year 3	2,000	26.6	1.7	260	13.0
Laggard 1:					
Year 1	500	12.5	0.71	55	11.0
Year 2	500	9.6	0.50	60	12.0
Year 3	500	6.7	0.42	50	10.0
Laggard 2:					
Year 1	400	10.0	0.57	40	10.0
Year 2	300	5.8	0.30	20	6.7
Year 3	200	2.7	0.17	5	2.5
Total market:					
Year 1	4,000	100.0		505	12.6
Year 2	5,200	100.0		780	15.0
Year 3	7,500	100.0		1,285	17.1

Figure 13.12 Sales, market shares and profits for all suppliers of Product X

3 Volume and unit cost

Details of volume and costs are given in Figure 13.13. Changes in unit costs reveal each firm's relative efficiency: the further a competitor's relative cost falls below unity, the more of a threat this becomes, and vice versa. (Costs are calculated by subtracting profit from sales revenue, and unit costs are obtained by dividing the costs by volume, year by year.)

The market leader has a cost advantage in Year 3 of 69p per unit relative to Firm A, whereas Laggard 2 has a cost disadvantage relative to Firm A of 73p per unit. Perhaps more significant than these figures are those that compare volume and cost changes. Thus, for example, Firm A's two main competitors both increased volume between Years 2 and 3 by more than 70 per cent, yet the close competitor's cost per unit only fell by 3 per cent or so while the market leader's cost per unit fell by more than 9 per cent. Is the explanation to be found in the close competitor's investment in competitive position – such as in R&D, marketing programmes or new plant?

4 Unit prices

Figure 13.14 shows the unit prices charged for Product X by each competitor over the last three years, along with costs and the profits and market shares that

	Volume in units (000s)	Increase (%)	Cost (£'000s)	Cost per unit (£)	Relative cost per unit
Firm A:					
Year 1	100		610	6.10	
Year 2	156	56	870	5.58	
Year 3	192	23	1,030	5.36	
Leading competitor:					
Year 1	200		1,200	6.00	0.98
Year 2	350	75	1,800	5.14	0.92
Year 3	600	71	2,800	4.67	0.87
Close competitor:					
Year 1	140		880	6.29	1.03
Year 2	190	36	1,030	5.42	0.97
Year 3	330	74	1,740	5.27	0.98
Laggard 1:					
Year 1	70		445	6.36	1.04
Year 2	75	7	440	5.86	1.05
Year 3	80	7	450	5.62	1.05
Laggard 2:					
Year 1	56		360	6.42	1.05
Year 2	45	(20)	280	6.22	1.16
Year 3	32	(29)	195	6.09	1.14
Total:					
Year 1	566				
Year 2	816	44			
Year 3	1,234	51			

Figure 13.13 Volume, costs and unit costs

have resulted. (Unit prices are simply calculated by dividing sales revenue by units sold.)

The pattern of price changes reflects the use of price as a competitive variable, and this can be related to cost and market share data to see how competitive positions are changing. For example, the market leader has reduced the price by more than any other firm, but its price reductions have not been as great as its cost reductions, hence profit per unit has increased each year – as has the number of units. This places that firm in a very strong competitive position.

Patterns of price, cost, profit and volume change for Firm A and its closest competitor are less clear, but for the laggards the picture of a downward spiral is clear enough.

5 Cash flow, liquidity and resource availability

Competitive gains and losses will arise over longer periods than the financial year, and the capacity of a competitor to continue in the fray is a function of more than simply profit or market share at a particular point in time. A firm's ability to continue to compete will also depend on its liquidity position and the availability of other resources

	Average price per unit (£)	Average cost per unit (£)	Profit per unit (£)	Market share (%)
Firm A:				
Year 1	7.00	6.10	0.90	17.5
Year 2	6.41	5.58	0.83	19.2
Year 3	6.25	5.36	0.89	16.0
Leading competitor:				
Year 1	7.00	6.00	1.00	35.0
Year 2	6.29	5.14	1.15	42.3
Year 3	6.00	4.67	1.33	48.0
Close competitor:				
Year 1	7.14	6.29	0.85	25.0
Year 2	6.31	5.42	0.89	23.1
Year 3	6.06	5.27	0.79	26.6
Laggard 1:				
Year 1	7.14	6.36	0.78	12.5
Year 2	6.66	5.86	0.80	9.6
Year 3	6.25	5.62	0.63	6.7
Laggard 2:				
Year 1	7.14	6.42	0.72	10.0
Year 2	6.66	6.22	0.44	5.8
Year 3	6.25	6.09	0.16	2.7

Figure 13.14 Unit prices, profits and market shares

over time. For example, a firm with poor cash flow, a high level of debt and out-of-date production facilities is not likely to be able to compete for long.

6 The future

Having analysed the relative positions of each firm supplying Product X over the past three years, the real challenge comes in attempting to make the next move.

The management of Firm A will be able to see that the market leader is controlling the competitive situation with the highest volume and profits, plus the lowest unit costs and price. If that firm reduced its price by, say, 10 per cent, it would force the laggards out of the market and limit the close competitor's profit (assuming it followed suit and reduced its own price). Firm A needs to reduce its costs and strengthen its position against its two main competitors while there is scope for growth in the overall market for Product X.

Using Figures 13.11–13.14 as a basis, various possibilities can be projected for the future, each building on explicit assumptions regarding:

- Future market demand
- Likely competitive actions
- Likely competitive reactions
- Competitors' liquidity and solvency.

This takes us a long way from conventional single-entity, single-period management accounting, yet the adaptations that need to be made are not so difficult to comprehend – but the benefits from gaining a clearer picture of one's competitive position and how this is changing should be enormous. Strategic management accounting can help realize these benefits.

After seeing the appeal of the approaches suggested by Pyne and Simmonds, one might wonder how the necessary competitive information might be gathered. Brock (1984), Pyne (1985), Beerel (1986), Jones (1988), Robert (1990) and others offer a variety of ways forward. We will return to this theme in Chapter 18.

Consumer franchise

It has been argued by Mehotra (1984) that market share and profit measures are unsatisfactory for gauging efficiency since they ignore the purpose of marketing, which he sees as being the identification of, and meeting, the needs and wants of end-users. His proposed measure is *consumer franchise*, which he has developed from an approach within General Electric. The basis of this approach is to be found in a continuum, with consumers being arrayed along it in accordance with the probability of their buying a particular brand. An enterprise's core consumer franchise for its brand is represented by consumers having a consistently high probability of buying that brand. Those consumers with a low probability of buying that brand are likely to be either committed to another brand or uncommitted to any brand. It is apparent, therefore, that a brand's sales can be represented by the following equation:

$$\text{Sales} = (P_1 \times N_1) + (P_2 \times N_2)$$

where:

P_1 is probability of buying if committed;
N_1 is number of committed buyers;
P_2 is probability of buying if uncommitted;
N_2 is number of uncommitted buyers.

The level of sales can be increased by increasing the probability of purchasing by a given consumer or by increasing the proportion of high-probability buyers, i.e. the consumer franchise. To achieve the former it is likely that sales promotion methods will be used, whereas advertising and product improvements are more likely for the latter. It can be argued that the use of sales promotions (as inputs) is likely to influence market share, but this may only be temporary. On the other hand, improvements in the consumer franchise are more likely to be lasting, a more desirable output. There is always a risk that some approaches to increasing market share (or sales or profit) may only achieve this in the short term and thereafter actually erode the consumer franchise – this would be reflected in a temporary improvement in efficiency but a reduction in effectiveness. In contrast, a brand's consumer franchise might be enhanced by a more substantive and coordinated improvement in the market offering.

13.6 Multiple criteria

Let us broaden our perspective and consider criteria that go beyond the single-criterion approach we have been focusing on so far in this chapter. The use of a single criterion is inadequate because:

- Organizations behave ineffectively from some points of view if a single criterion is used.
- Organizations fulfil multiple functions and have multiple goals, some of which may be in conflict. It would be inappropriate to assess strategies purely on the basis of any one criterion.

The difficulty, as will be apparent, lies in identifying those multiple criteria that are necessary and sufficient to ensure corporate well-being and survival. One way is via the application of *Pareto's law*.

Pareto's law (or the 80/20 rule) is widely thought to apply to a range of situations in which most of the behaviour or value of one factor is deemed to depend on only a little of another factor. For example, it is often asserted that 80 per cent of inventory movements within an organization are attributable to 20 per cent of items stocked, 80 per cent of sales volume comes from 20 per cent of customers, or 80 per cent of profits are derived from 20 per cent of product lines. The main point here, of course, is that one can effectively control an inventory if one can focus attention on the critical 20 per cent of active items, or one can control the level of sales if the key customers are properly serviced. This can be greatly beneficial both in terms of cost savings (through eliminating unnecessary control effort on the 'insignificant' 80 per cent of items that only make up 20 per cent of stock issues) and in terms of improved organizational effectiveness (due to better control of the key elements).

The application of Pareto's law is known by a number of different names. Perhaps the most frequently encountered are: key variables, critical success factors (CSFs) and key result areas.

To illustrate the idea further we can consider a generalized example, and then a number of specific industry examples (see Rockart, 1979). Figure 13.15 identifies, for each main sphere of activity, the factors that are likely to be of some major significance to corporate performance. Each factor has financial implications, and if they can be controlled it is probable that the overall company can be controlled.

Within specific industries there is likely to be considerable variation in key variables, as Figure 13.16 illustrates. Johnson (1967), for example, looks in more detail at this key question.

The variables that are critical are those that are causally related to desired outcomes. In seeking to measure the values of variables, great care must be taken to avoid the trap of giving attention to variables that are amenable to measurement and overlooking more important variables that are not amenable to measurement (e.g. quantities are more readily measured than qualities, but it does not follow that the latter are less important than the former). Similarly, variables that reflect a short-run focus, such as reported profit or EPS (earnings per share), should not be allowed to dominate the

Sphere of activity	Critical factors
Environment	Economic – interest rates inflation rates concentration Political stability
Marketing	Sales volume Market share Gross margins
Production	Capacity utilization Quality standards
Logistics	Capacity utilization Level of service
Asset management	Return on investment Accounts receivable balance

Figure 13.15 A general example of key variables

measurement process when variables with a longer-run focus, such as competitive position, are being ignored in that process.

In a study of more than 250 US organizations, Steiner (1969) sought to determine the factors most likely to influence future success. He did this by asking the senior managers in the chosen companies to rank eighty-five factors. The top ten are shown below:

1. Attract and maintain high-quality top management
2. Develop future managers for domestic operations
3. Motivate sufficient managerial drive for profits

Food processing:
- new product development
- good distribution
- effective advertising

Motor vehicles:
- styling
- efficient dealer networks
- tight control over manufacturing costs

Life assurance:
- development of agency managerial personnel
- effective control of clerical staff
- innovation in creating new types of policies

Oil:
- decentralization
- liquidity
- government business relationships
- societal image
- new ventures (to broaden its base)

Figure 13.16 Specific industry examples of key variables (adapted from Rockart, 1979)

4 Assure better judgement, creativity and imagination in decision-making at top management levels
5 Perceive new needs and opportunities for products
6 Develop a better long-range planning programme
7 Improve service to customers
8 Provide a competitive return to shareholders
9 Maximize the value of shareholders' investment
10 Develop a better willingness to take risks with commensurate returns in what appear to be excellent new business opportunities in order to achieve growth objectives.

A variety of alternative approaches have been put forward for identifying key variables or critical success factors (see, for example, Leidecker and Bruno, 1984; Hitt and Ireland, 1985; Jenster, 1987; Freund, 1988; De Vasconcellos and Hambrick, 1989; Dace, 1990). Such approaches usually rely on the views of managers and other experts within the particular industries. It is inherent in these approaches that their validity is questionable and that they do not constitute a clear basis for action. Is it helpful in the food processing industry, from the viewpoint of formulating action plans, to know that NPD, good distribution and effective advertising are the prescribed critical success factors (as in Figure 13.16)? However plausible the CSFs might be, it is difficult to know how they will impact upon an enterprise's competitive position.

An alternative approach that Day and Wensley (1988) argue gives more defensible insights is one that relates current *sources* of advantage to the achievement of advantageous competitive *positions* and hence superior *performance*. By relating causes (i.e. sources) to effects (i.e. performance), this approach emphasizes linkages in a more explicit way (see Figure 13.17).

An example of operational linkages between CSFs and actions (in the form of specified strategies) is given by Freund (1988) for a life insurance company. These emerged from a process in which:

1 Top management identified what it considered were the company's CSFs
2 Departmental managers then identified financial strategies that would allow the CSFs to be achieved.

While CSFs can serve as criteria for choosing among competing strategies, they are not equivalent to performance indicators. Figure 13.18 shows CSFs, a selection of strategies and some performance indicators. The performance indicators are designed to show when – and by how much – strategies are not being achieved once they have been implemented.

In a study of US companies, D'Aveni and MacMillan (1991) found that, under normal circumstances, managers in successful enterprises pay equal attention to their internal and external environments, but pay more attention to their output environment than to their input environment. When crises relating to demand decline arise, they focus their attention on the critical aspects of their external environments.

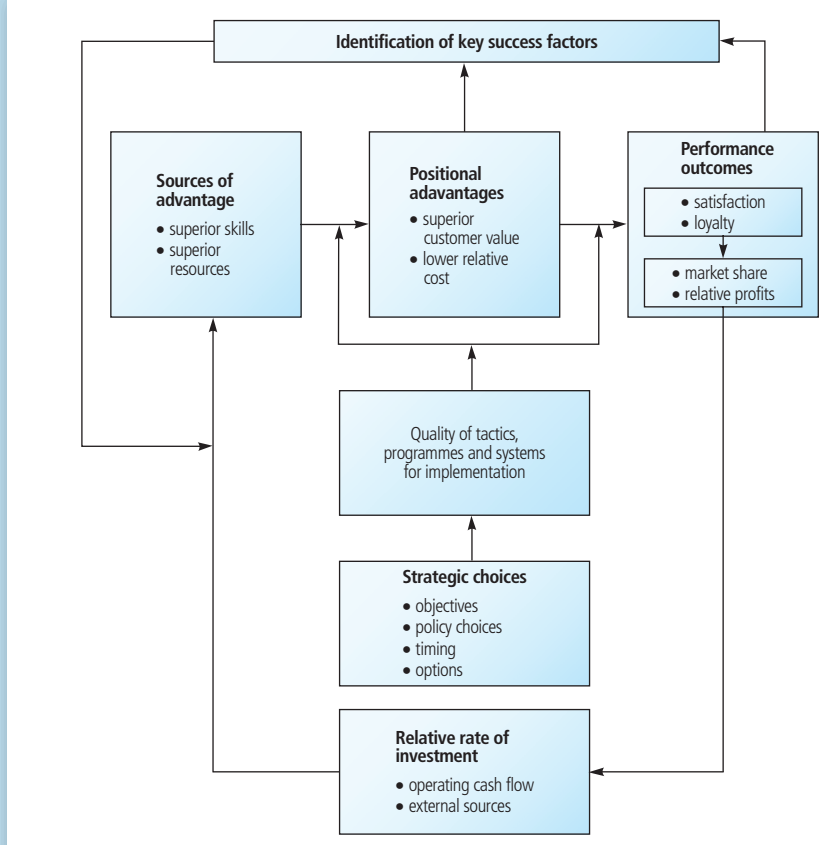


Figure 13.17 Comparing competitors (source: Day and Wensley, 1988, p. 13)

Critical success factor	Strategies	Performance indicators
Ability to achieve critical mass volumes through existing brokers and agents	➡ Develop closer ties with agents ➡ Telemarket to brokers ➡ Realign agents' compensation	➡ Policies in force ➡ New business written ➡ Per cent of business with existing brokers
Be able to introduce new products within six months of industry leaders	➡ Underwrite strategic joint ventures ➡ Copy leader's products ➡ Improve underwriting skills	➡ Elapsed time to introduce ➡ Per cent of products introduced within six months ➡ Per cent underwriters having additional certification
Be able to manage product and product line profitability	➡ Segment investment portfolio ➡ Improve cost accounting ➡ Closely manage loss ratio	➡ Return on portfolio segments ➡ Actual product cost/revenue versus plan ➡ Loss ratio relative to competitors

Figure 13.18 Critical success factors in action (adapted from Freund, 1988, pp. 22–3)

In contrast, the managers of enterprises that subsequently fail tend to ignore output factors during crises and pay more attention to their input and internal environments.

These results accord with the view that successful enterprises attend to critical success factors that relate to their output environments (e.g. customers' needs and demand growth).

Relationships between CSFs (described as *corporate distinctive competencies*) and overall performance were examined by Hitt and Ireland (1985) in 185 US industrial enterprises. Their results suggest that distinctive competencies associated with performance vary according to the 'grand strategy' used on the one hand, and on the industry in which the enterprise is based on the other. A grand strategy refers to a predominant strategy covering the whole enterprise, and the view put forward by Hitt and Ireland for testing was that an enterprise should develop distinctive competencies in activities that are important from the point of view of implementing the grand strategy. They distinguish four industry types:

1. Consumer durables
2. Consumer non-durables
3. Capital goods
4. Producer goods (e.g. raw materials).

The message that emerges from this work is that managers should be concerned to develop distinctive competencies that are appropriate for implementing their grand strategies within the context of their particular industries. It is important to match these matters in a balanced way.

A particular approach to balance that has been enthusiastically received in recent years is Kaplan and Norton's *balanced scorecard framework* (1992, 1993), which 'provides executives with a comprehensive framework that translates a company's strategic objectives into a coherent set of performance measures, thereby providing a powerful tool for decision-making'.

Within their framework, Kaplan and Norton specify four sets of goals and associated performance measures that focus attention on the following basic questions:

1. How do customers see us? (i.e. customer perspective)
2. At what must we excel? (i.e. internal business perspective)
3. Can we continue to improve and create value? (i.e. innovation and learning perspective)
4. How do we look to our shareholders? (i.e. financial perspective).

These elements of the scorecard are illustrated in Figure 13.19, from which it will be apparent that this approach has the potential to overcome two of the most pervasive problems associated with, on the one hand, univariate performance measures and, on the other, linking goals and measures of performance.

	Goals	Measures
How do we look to our shareholders? *Financial perspective*	• survive • succeed • prosper	• cash flow • sales growth and operating income at division level • ROE, share of market
How do customers see us? *Customer perspective*	• new products • responsiveness • preference • partnership	• new products as % sales • OTIF delivery • % key account purchases • no. of joint projects
What must we excel at? *Internal business perspective*	• technology ability • operations excellence • R&D productivity • NPD activity	• application turnaround • yield % • fastest output • introduction schedule vs plan
Can we continue to improve and create value? *Innovation and learning perspective*	• technology leadership • process improvement • time to market	• first with next generation • downtime % • cycle time vs industry norm

Figure 13.19 The balanced scorecard (adapted from Kaplan and Norton, 1992, p. 76)

To implement the balanced scorecard approach it is necessary that senior managers address four further questions regarding:

1. Their vision of the future
2. The ways in which they will be seen to differ in shareholders' perceptions, customers' perceptions, internal management activities, and their ability to innovate and grow if their vision succeeds
3. The specification of CSFs from financial, customer, internal and innovating perspectives
4. The critical measurements that should be used for each of the four goal and performance areas shown in Figure 13.19.

As Murray and O'Driscoll (1996, p. 386) point out, the balanced scorecard framework improves on traditional approaches in some significant ways. For example:

- ➡ It is based on the company's strategic objectives and competitive demands; by demanding that managers select a small number of critical indicators, it promotes greater focus on strategic vision
- ➡ By including financial and non-financial measures, it provides a basis for managing both current and future success
- ➡ It balances external and internal goals, and measures and reveals trade-offs that managers should or should not make

- It facilitates coherence among various strategic initiatives and special projects (such as re-engineering, total quality and empowerment initiatives) by providing a goal-related context and an approach to integrated measurement.

It will be apparent that the choice of critical variables is neither neutral nor objective: in choosing what to measure, the manager is indicating his or her personal view regarding factors that are considered important in the control process. This can be illustrated via the well-documented case (e.g. Lewis, 1955; Greenwood, 1974) of the American company General Electric (GE).

GE set up a major measurement project that had three principal component parts:

1. Measures designed to assess the overall performance of a department or division as an economic entity
2. Measures designed to assess the performance of the functional activities within the organization (such as engineering, production, marketing, finance, employee relations and community relations)
3. Measures designed to assess the performance of departmental or divisional managers.

The overall measurement project was based on the following principles:

- Measures should be designed to provide factual inputs to support judgements in appraising the performance of departments or divisions
- Measures should be designed so as to provide performance indicators relating both to short-run and long-run goals
- A minimum number of measures should be used at each level within an organization.

In order to determine whether or not a variable qualified as a key success factor (which would require it to be measured), the following question was asked: 'Will continued failure in this area prevent the attainment of management's responsibility for advancing General Electric as a leader in a strong, competitive economy, even though results in all other key result areas are good?' A range of eight key success factors emerged from this project (see Figure 13.20).

Figure 13.20 General Electric's key results areas

While these eight factors might seem to be generally applicable, it is their precise definition within the context of a particular company's activities that determines how critical they are. This highlights a fundamental aspect of designing any control system: it must be highly 'situational' if it is to be effective. In other words, it must be tailored to the specific characteristics of the situation, which means *this* company's objectives, *this* company's operations, *this* company's managers and *this* company's environment.

The General Electric approach seeks to balance two conflicting tendencies: on the one hand, the diffusion of effort over multiple goals and the failure to perform as well as might be expected in any one area; and on the other hand, the tendency to emphasize one particular goal with the result that other goals are not attained.

The most common tendency in commercial enterprises is to focus on the short-run maximization of net profit (or sales) without considering the damage that this might do to the long-run position (e.g. by postponing repairs or maintenance work; by cutting back on advertising or on research, training or quality control expenditure; by deferring capital investment outlays; or through exhortations to employees to increase productivity). Short-term 'gains' achieved in this way tend to be illusory, because the subsequent need to make up lost ground (e.g. via heavier advertising or training in later periods) more than outweighs short-term gains.

Saunders (1987b) has observed that an enterprise only has two basic ways of increasing wealth: it can do this by innovating to increase its volume or by seeking to improve its productivity via production of the same output but at lower cost. It is much simpler to look inwards and seek to cut costs rather than to look outwards and seek to innovate, compete more effectively or increase margins through better marketing planning. Cost cutting is referred to by many Europeans as 'a British solution', since it is easy to do in the short term but with unfortunate long-term consequences (as suggested in the previous paragraph). Figure 13.21 summarizes the alternative approaches to improving long-run returns.

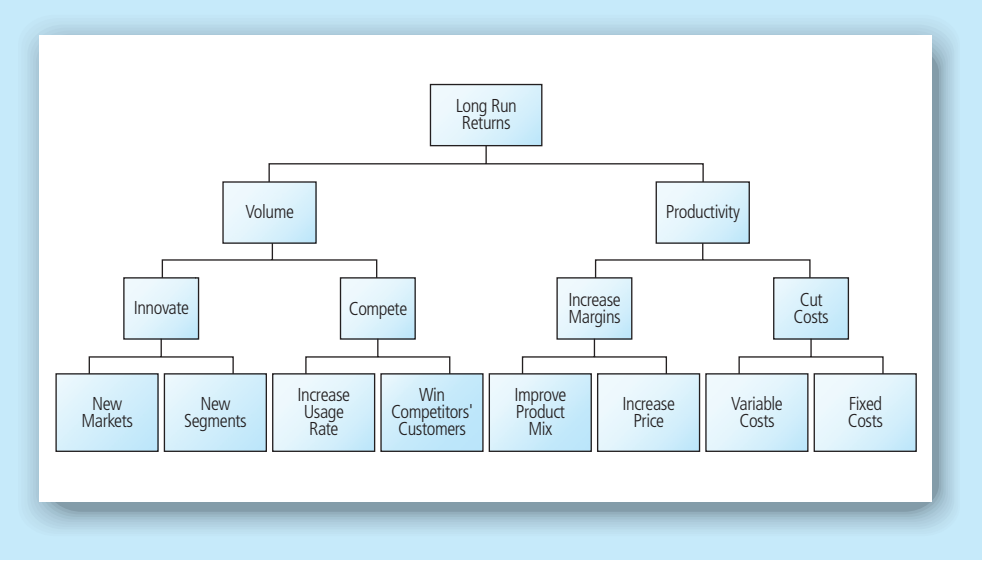


Figure 13.21 Strategic alternatives (source: Saunders, 1987b, p. 174)

Figure 13.22 Routes to success (source: Saunders, 1987b, p. 176)

As is apparent from Figure 13.22, a preoccupation with short-term profit reflects an introspective concern with aspects of productivity. A longer-term perspective requires a shift of focus from internal productivity improvement to external factors – such as beating the competition and innovating (by developing new markets, new products or both).

To the extent that effectiveness is a multifaceted criterion, we must avoid the trap of focusing too sharply on one contributing factor. It would be a mistake to assume that effectiveness would be assured simply through selecting and training the right people. Given our definition of effectiveness in Chapter 1, effectiveness may be assessed in terms of a system's capacity:

1 To survive, adapt, maintain itself and grow – regardless of the functions it fulfils
2 To achieve the aims in point 1 above through its bargaining position with its environment in relation to the acquisition of resources.

Against this background of criteria for effectiveness at an enterprise level, it can be argued that any attempt to deal with the effectiveness of individual elements of marketing, such as advertising or personal selling, is problematic for two major reasons:

1 It is not possible to separate the impact of, say, advertising on the attainment of goals from the impacts of other elements of the marketing mix. The interdependence of the elements of the mix ensures that the selling task is influenced by advertising and by the nature of the product, the price and the channel decisions, all on a *mutatis mutandis* basis. It would not be sensible, therefore, to attempt to consider marketing effectiveness at any level below that of the marketing programme (i.e. the integrated set of marketing activities embracing the entire mix formulated to pursue a given strategy directed at a particular segment).
2 Most criterion measures relating to individual elements of marketing are measures of efficiency rather than effectiveness, focusing on the maximization of output for a given input or the minimization of input to achieve a given level of output. One

Activity	Criteria
➡ New product programmes	Trial rate Repurchase rate
➡ Product programmes	Contribution margin Controllable margin as percentage of sales
➡ Sales programmes	Contribution by region, salesman Controllable margin as percentage of sales Number of new accounts Travel costs
➡ Advertising programmes	Awareness levels Attribute ratings Cost levels
➡ Promotion programmes	Redemption rates Displacement rates Stock-up rates
➡ Pricing programmes	Price relative to industry average Price elasticity of demand
➡ Distribution programmes	Number of distributors carrying the product

Figure 13.23 Criteria for functional activities

exception to this is the use of sales quotas, which represent output measures, performance being assessed by reviewing how close each salesperson came to achieving his or her quota. We can see that this is a measure of effectiveness, albeit on a small scale relative to the overall scheme of things.

With these caveats in mind it is possible to identify criteria that are regularly applied in choosing among alternative plans for specific elements of the mix (see, for example, Guiltinan and Paul, 1988, pp. 396–8; McNamee, 1988, pp. 131 and 143). Examples are given in Figure 13.23.

13.7 Summary

In this chapter we have looked at a range of possible criteria for assessing marketing strategies as a basis for making choices. Distinctions have been made among:

- Short-term versus long-term criteria
- Financial versus non-financial criteria
- Single versus multiple criteria
- Criteria focusing on overall strategies versus criteria focusing on specific activities
- Criteria focusing on efficiency versus criteria focusing on effectiveness.

Apart from the variety of input and output measures that have been discussed, there are additional approaches that deal with factors ranging from the degree of realism in the

assumptions underlying the strategy to the capacity of the enterprise to implement successfully the chosen strategy. To take specific examples, Tilles (1963) and Day (1990) both outline sets of criteria that might be applied in assessing strategies. These include:

- Is there an effective matching of the enterprise's competences with the threats and opportunities from the environment? (If not, then there is unlikely to be a basis for achieving sustainable competitive advantage.)
- Will the strategy place the enterprise in a position to counter known threats, exploit opportunities, enhance current advantages or provide new sources of advantage?
- Is the strategy robust enough to adapt to a broad range of anticipated environmental events or is it only likely to work under very specific conditions?
- Will it be difficult for competitors to deal with the expected advantages to be gained from the strategy?
- Are the assumptions underlying the formulation of competing strategies realistic? (Such assumptions might relate to price levels, relative market share, market growth, cost levels, timing aspects, competitive reactions, and so on.)
- What are the potential risks to which the strategy (hence the enterprise) may be vulnerable? (These may be internal – in the form of resource availability or implementation factors – as well as external.)
- Is the strategy feasible from the viewpoint of the enterprise having the necessary skills and resources? (These would include access to technology, markets and servicing facilities, as well as adequate managerial capabilities.)
- Is the strategy capable of being effectively communicated, so that those who will be responsible for its implementation can understand what is required of them?
- Will the strategy challenge and motivate key personnel? (This implies that strategies must be accepted by those who are charged with their implementation.)
- Are the elements within the strategy internally consistent, so that it hangs together in a coherent way?
- Will the expected results from the strategy be acceptable relative to the anticipated risks? (This will require evidence of a clear competitive advantage, from which enhanced value to shareholders and other stakeholders' gains will flow.)
- Does the strategy have an appropriate time frame? (Strategies cannot be achieved overnight, so sufficient time must be allowed for their effective implementation.)