# 4

# Organisational Appraisal

## *Learning Objectives*

- Explain the manner in which strategic and competitive advantage is developed
- Describe and exemplify six factors of organisational capability
- Explain the process of conducting organisational appraisal
- Describe the major methods and techniques used for organisational appraisal
- Prepare Strategic Advantages Profile (SAP) for an organisation

1) St. Advantage
2) Capability factors
3) Techniques
4) Structuring

## *Chapter Outline*

4.1 Dynamics of internal environment
Organisational resources/Organisational behaviour/Strengths and weaknesses/Synergistic effects/Competencies/Organisational capability/Strategic and competitive advantage

4.2 Organisational capability factors
Financial capability/Marketing capability/Operations capability/Personnel capability/Information Management capability/General management capability

4.3 Considerations in organisational appraisal
Factors affecting organisational appraisal/Approaches to organisational appraisal/Sources of information for organisational appraisal

4.4 Methods and techniques used for organisational appraisal
Internal analysis/Comparative analysis/Comprehensive analysis

4.5 Structuring organisational appraisal
Preparing the organisational capability profile/Preparing the strategic advantages profile

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Like individuals, all organisations such as the State Bank of India we described here, have strengths and weaknesses that lead to their having capabilities. These capabilities stand the organisations in good stead when they compete for resources, customers and market share. In strategic management, we give a lot of importance to an organisation's capabilities as these are central to their achieving strategic advantage for gaining long-term success.

The appraisal of the external environment of a firm helps it to think of what it *might choose to do*. The appraisal of the internal environment, on the other hand, enables a firm to decide about what *it can do*. We attempt to understand the internal environment of an organisation in terms of the organisational resources and behaviour, strengths and weaknesses, synergistic effects and the competencies that create strategic advantage.

## 4.1 DYNAMICS OF INTERNAL ENVIRONMENT

An organisation uses different types of resources and exhibits a certain type of behaviour. The interplay of these different resources along with the prevalent behaviour produces synergy or dysergy within an organisation, which leads to the development of strengths or weaknesses over a period of time. Some of these strengths make an organisation especially competent in a particular area of its activity causing it to develop competencies. Organisational capability rests on an organisation's capacity and the ability to use its competencies to excel in a particular field, thereby giving it strategic advantage.

The resources, behaviour, strengths and weaknesses, synergistic effects and competencies of an organisation determine the nature of its internal environment. Exhibit 4.1 depicts a diagram showing the framework that we adopt for an explanation of the process of development of strategic advantage by an organisation. It is expected that readers of this book are aware of these terms in general. However, we explain each of these terms here to place them in the specific context of strategic management and business policy.

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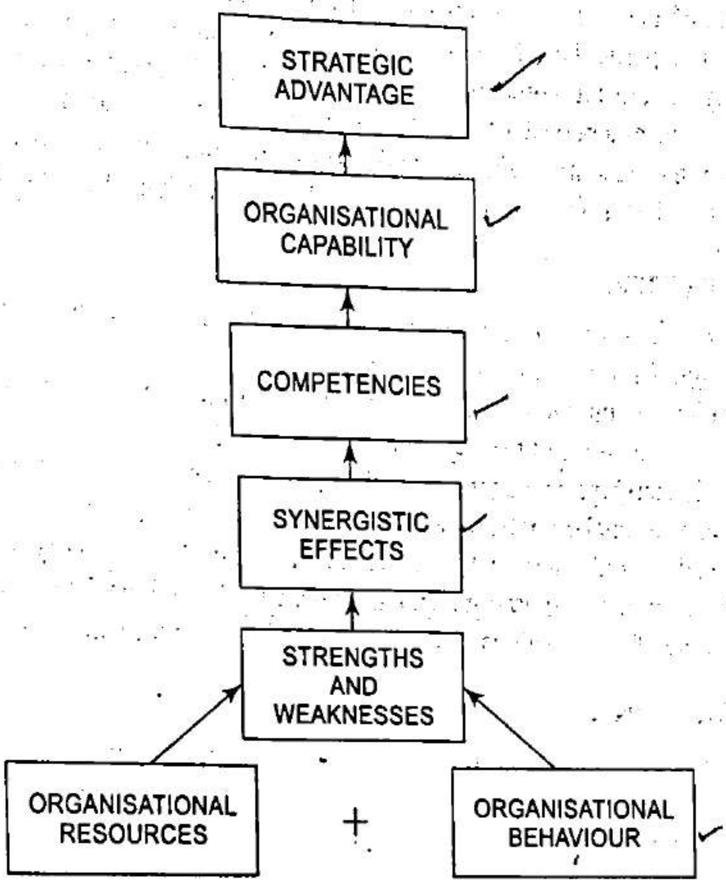
**Exhibit 4.1** Framework for the development of strategic advantage by an organisation




## Organisational Resources

The dynamics of the internal environment of an organisation can be best understood in the context of the resource-based view of firms or the resource-based theory of strategy. According to Barney (1991), who is credited with developing this view of strategy as a theory, a firm is a bundle of resources—tangible and intangible—that include all assets, capabilities, organisational processes, information, knowledge, etc. These resources could be classified as physical, human and organisational resources. The physical resources are the technology, plant and equipment, geographic location, access to raw materials, etc. The human resources are the training, experience, judgement, intelligence, relationships, etc. present in an organisation. The organisational resources are the formal systems and structures as well as informal relations among groups.[2] Elsewhere, Barney says that resources of an organisation can ultimately lead to strategic advantage for it if they possess four characteristics, i.e., if these resources are valuable, rare, costly to imitate and nonsubstitutable. The resource-based theory of strategic management holds that firms possess resources of which those that are valuable and rare enable them to achieve strategic advantage. Other resources that cannot be imitated or substituted lead to superior long-term performance and a sustainable strategic advantage.[3] Empirical studies over the years have generally supported the resource-based theory.[4]

We observe here that the resource-based theory is concerned with the efficiency of resource utilisation. It clearly focuses on the internal environment of the firm and postulates that the strategic advantage would flow from the efficiency with which the resources would be utilised. When firms possess superior resources, they enable them to produce more efficiently and better satisfy customer needs, delivering better value for a given cost and yielding a superior strategic advantage to them.

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Very few organisations, like individuals, are born with a silver spoon in the mouth; most organisations have to acquire resources the hard way. The cost and availability of resources are the most important factors on which the success of an organisation depends. If an organisation is favourably placed with respect to the cost and availability of a particular type of resource, it possesses an enduring strength which may be used as a strategic weapon by it against its competitors. Conversely, the high cost and scarce availability of a resource are a handicap which causes a persistent strategic weakness in an organisation.

But mere possession of resources does not make an organisation capable. Much depends on their usage within the organisation. The usage, in turn, is based on the organisational behaviour that we study next.

## Organisational Behaviour

*Organisational behaviour is the manifestation of the various forces and influences operating in the internal environment of an organisation that create the ability for, or place constraints on, the usage of resources.* Organisational behaviour is unique in the sense that it leads to the development of a special identity and character of an organisation. Some of the important forces and influences that affect organisational behaviour are: the quality of leadership, management philosophy, shared values and culture, quality of work environment and organisational climate, organisational politics, use of power, etc.

The perceptive reader would note that what we are proposing here is marrying of the hard side of an organisation, i.e., its resource configuration, with the soft side of behaviour. The resources and the behaviour are thus the yin and yang of organisations. What they collectively produce are the strengths and weaknesses.

## Strengths and Weaknesses

Organisational resources and behaviour do not exist in isolation. They combine in a complex fashion to create strengths and weaknesses within the internal environment of an organisation. *Strength is an inherent capability which an organisation can use to gain strategic advantage. A weakness, on the other hand, is an inherent limitation or constraint which creates a strategic disadvantage for an organisation.* Financial strength, for example, is a result of the availability of sources of finances, low cost of capital, efficient use of funds, etc. Another example is of a weakness in the operations area which results due to inappropriate plant location and layout, obsolete plants and machinery, uneconomical operations, etc. In the following sections, we will take up a comprehensive discussion of possible strengths and weaknesses in different functional areas within an organisation.

Strengths and weaknesses do not exist in isolation but combine within a functional area, and also across different functional areas, to create synergistic effects.

## Synergistic Effects

marketing
Investment
Operation

It is the inherent nature of organisations that strengths and weaknesses, like resources and behaviour, do not exist individually, but combine in a variety of ways. For instance, two strong points in a particular functional area add up to something more than double the strength. Likewise, two weaknesses acting in tandem result in more than double the damage. In effect, what we have is a situation where attributes do not add mathematically, but combine to produce an enhanced or a reduced impact. Such a phenomenon is known as the synergistic effect. *Synergy is an idea that the whole is greater or lesser than the sum of its parts.* It is also expressed as 'the two plus two is equal to five or three effect'.

Within an organisation, synergistic effects occur in a number of ways. For example, within a functional area, say of marketing, the synergistic effect may occur when the product, pricing, distribution and promotion aspects support each other, resulting in a high level of marketing synergy. At a higher level, the marketing and production areas may support each other leading to operating synergy. On the other hand, a marketing

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inefficiency reduces productions efficiency, the overall impact being negative, in which case dysergy (or negative synergy) occurs. In this manner, synergistic effects are an important determinant of the quality and type of the internal environment existing within an organisation and may lead to the development of competencies.

## Competencies

On the basis of its resources and behaviour, an organisation develops certain strengths and weaknesses which when combined lead to synergistic effects. Such effects manifest themselves in terms of organisational competencies. *Competencies are special qualities possessed by an organisation that make them withstand the pressures of competition in the marketplace*. In other words, the net results of the strategic advantages and disadvantages that exist for an organisation determines its ability to compete with its rivals. Other terms frequently used as being synonymous to competencies are unique resources, core capabilities, invisible assets, embedded knowledge, etc.

When an organisation develops its competencies over a period of time and hones them into a fine art of competing with its rivals, it tends to use these competencies exceedingly well. The capability to use the competencies exceedingly well turns them into core competencies.

*When a specific ability is possessed by a particular organisation exclusively or relatively in large measure, it is called a distinctive competence.*

Many organisations achieve strategic success by building distinctive competencies around the critical success factors. Recall that critical success factors are those which are crucial for organisational success (for a detailed discussion, refer to section 2.5). A few examples of distinctive competencies are given below.

- Superior product quality on a particular attribute, say, a two-wheeler, which is more fuel efficient than its competitor products.
- Creation of a marketing niche by supplying highly specialised products to a particular market segment.
- Differential advantage based on superior research and development skills of an organisation, not possessed by its competitors.
- Access to a low-cost financial source, like equity shareholders, not available to its competitors.

A distinctive competence is 'any advantage a company has over its competitors because it can do something which they cannot or it can do something better than they can'.[5] It is not necessary, of course, for all organisations to possess a distinctive competence. Neither do all organisations, which possess certain distinctive competencies, use them for strategic purposes. Nevertheless, the concept of distinctive competence is useful for the purpose of strategy formulation. The importance of distinctive competence to strategy formulation rests with 'the unique capability it gives an organisation in capitalising upon a particular opportunity; the competitive edge it may give a firm in the market place; and the potential for building a distinctive competence and making it the cornerstone of strategy'.[6]

To some of you, we may seem to be making a hairline distinction here between the three terms: competencies, core competencies and distinctive competencies. The difference, as you must have noted, lies in the degree of uniqueness associated with the net synergistic effects occurring within an organisation. You could think of them as being synonymous so long as you are able to make a distinction among them when necessary. Among the three, it is the term 'core competence' that has gained greater currency and popularity. The term 'core competence' has been popularised by Prahalad and Hamel as an idea around which strategies could be formulated by an organisation. Exhibit 4.2 presents an understanding of the idea of core competence.

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**Exhibit 4.2** Understanding the idea of 'core competence'

C. K. Prahalad and Gary Hamel are mainly credited for the dynamic capabilities approach that considers strategic management as a collective learning process aimed at developing and then exploiting distinctive competencies by an organisation that are difficult to replicate by their rivals. Through a series of publications such as 'The Core Competence of the Corporation' (1990) and 'Strategy as Stretch and Leverage' (1993) in the *Harvard Business Review*, and a book *Competing for the Future* (1994), they have sought to propagate the idea of dynamic capabilities. This idea rests on the thinking that strategy depends on learning, and learning depends on the capabilities of an organisation.

According to Prahalad and Hamel, the competitive (or strategic, as we call it here) advantage can be traced to the core competencies of an organisation. They take the analogy of a tree in describing core competence. 'The diversified corporation is a large tree. The trunk and major limbs are core products, the smaller branches are business units; the leaves, flowers, and fruit are end products. The root system that provides nourishment, sustenance, and stability is the core competence.'

Further they explain core competence as: '... the collective learning in the organisation, especially how to coordinate diverse production skills and integrate multiple streams of technologies..... it is also about the organisation of work and the delivery of value... (It) is communication, involvement and a deep commitment to working across organisational boundaries. It involves many levels of people and all functions... (and it) does not diminish with use.'

To identify a core competence, Prahalad and Hamel prescribe three tests:

- It should be able to provide potential access to a wide variety of markets;
- It should make a significant contribution to the perceived customer benefits of the end product; and
- It should be difficult for the competitors to imitate.

From the several examples of corporations that Prahalad and Hamel use to exemplify their concept of core competence, we quote here a few. Canon's core competence lies in optics, imaging and microprocessor controls, Sony's in miniaturisation, Philip's in optical-media, 3M's in stick tape and Honda's in engines and power trains. The core competencies of these corporations have enabled them to operate in diverse markets offering different products. For instance, Canon has entered, and even dominated, diverse markets such as copiers, laser printers, cameras and image scanners.

*Source:* C. K. Prahalad and Gary Hamel, "The Core Competence of the Corporation", *Harvard Business Review*, Vol. 68, No. 3, May-June 1990, pp. 79-91.

Several Indian companies took to the idea of core competence in right earnest in the 1990s. Examples abound of companies shedding businesses that are not in line with their perceived core competencies and focussing upon those that are. Nandas of Escorts may perceive their core competence in light engineering, NIIT in offering technology-based learning, Reliance Industries in skilful project management and execution and S. Kumar sees its core competence in textile processing.

The idea of core competence, presented in Exhibit 4.2, seems to be a brilliant way to focus upon the latent strength of an organisation. Yet there are pitfalls of which an organisation has to be aware of. Core competencies can be developed but so also, lost. They cannot be taken for granted. The ability of a core competence to provide strategic advantage can diminish over time as they do not exist perpetually. A dilemma associated with all core competencies is that they have the potential of turning into core rigidities.[7] External environment is responsible for this sad turn of events. New competitors may figure out a way to serve customers better or new technologies may emerge, causing the existing company to lose its strategic advantage. Over-reliance on core competencies to the extent of becoming prisoners of one's own excellence may result in strategic myopia.

Core competence acting as a double-edged sword is demonstrated by the concept of strategic commitment enunciated by Pankaj Ghemawat. This term refers to an organisation's commitment to a particular way of

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doing business, i.e., developing a particular set of resources and capabilities. Ghemawat's contention is that once a company has made a strategic commitment, it finds it difficult to respond to new competition if doing so requires a break with its commitment.[8]

The idea of a single core competence as the bedrock for strategy formulation has not gone unchallenged. Critics feel that a core competence, narrowly defined, may restrict an organisation's freedom to act when fresh opportunities in the business environment lure it towards a new direction. This is especially seen in the case of the Indian business environment where organisations need to be constantly on the look-out for new opportunities emerging and to be willing to act upon them despite the business's requiring them to move out of their core competence area. In a situation, where organised retail is just taking off, the country still remains under-insured, agriculture has not yet been exploited as an organised industry and the infrastructure sector needs overhauling, it would be imprudent for organisations to stick to a single core competence and deprive itself of taking advantage of the opportunities. There might be several different core competencies required. In one case, it may be the ability to raise and manage capital, in another, it might be the ability to manage the regulatory environment or simply, the ability to roll out operations quickly.[9] No wonder, when asked to define his group's core competence, Kumar Mangalam Birla, of the A.V. Birla group, perceived it in a wide array of skills related to process industries, project management, operations, raw material sourcing, distribution and logistics, setting up dealer networks, commodity branding and raising finance at a competitive cost.[10]

Core or distinctive competencies serve a useful purpose if they are used to develop a sustained strategic advantage through building up of organisational capability, which is the subject matter of the next sub-section.

## Organisational Capability

*Organisational capability is the inherent capacity or potential of an organisation to use its strengths and overcome its weaknesses in order to exploit the opportunities and face the threats in its external environment.* It is also viewed as a skill for coordinating resources and putting them to productive use. Without capability, resources—even though valuable and unique—may be worthless. Since organisational capability is the capacity or potential of an organisation, it means that it is a measurable attribute. And since it can be measured, it follows that organisational capability can be compared. Yet, it is very difficult to measure organisational capability as it is, in the ultimate analysis, a subjective attribute. As an attribute, it is the sum total of resources and behaviour, strengths and weaknesses, synergistic effects occurring in and the competencies of, any organisation.

Several thinkers in the field of strategy favour the line that capabilities are the outcomes of an organisation's knowledge base, i.e., the skill and knowledge of its employees. There is a growing body of opinion that considers organisations as reservoirs of knowledge, in which case they are all learning organisations. In fact, the concept of organisational learning has spawned a whole school of strategy thought. Readers are advised to refer to Exhibit 4.3 that provides some basic understanding of the learning organisation. It is to be noted that while the concept of a learning organisation is applicable to strategic management in a wider sense at several places, here we are referring to it in the specific context of a capability that is seen as an outcome of organisational learning.

Strategists are primarily interested in organisational capability because of two reasons. First, they wish to know what capacity exists within the organisation to exploit opportunities or face threats in its environment. Secondly, they are interested in knowing what potential should be developed within the organisation so that opportunities could be exploited and threats could be faced in future.

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**Exhibit 4.3** Understanding organisational learning

Crossan, Lane and White (1997) define organisational learning as 'the process of change in individual and shared thought and action, which is affected by and embedded in the institutions of the organisation'. Four basic processes of organisational learning are: *intuiting* (subconscious process of learning that occurs at the individual level); *interpreting* (sharing learning at the group level); *integrating* (collective understanding at the group level and taking it to the level of organisation); and *institutionalising* (incorporating learning across the organisation by embedding it in systems, structures, routines and practices).

Nonaka and Takeuchi (1995) place value on knowledge creation within organisations through focussing on insight, intuition and hunch that are gained through experience. Chris Argyris (1977) earlier, and later Garratt (1987), differentiated single-loop learning, which is a simple case about reviewing performance against targets and taking corrective action, from double-loop learning that questions the existing framework in which decisions take place. Organisations that engage in double-loop learning are able to discover new things and act in novel ways that enable them to adapt to changes and sustain and improve their capability and competitiveness.

Peter Senge (1990) popularised the concept of a learning organisation which could be explained as an organisation skilled at creating, acquiring and transferring knowledge, and at modifying its behaviour to reflect new knowledge and insights. From the classic term of Peter Drucker: the knowledge worker down to the emerging discipline of knowledge management—which is considered as gathering and managing intellectual capital that can be leveraged for generating internal responsiveness of organisation—the focus is clearly on the capability of an organisation for developing and sustaining strategic advantage.

*Sources:* C. Argyris, "Double Loop Learning in Organisations", in *Harvard Business Review*, Sept-Oct 1977, pp. 115-125; B. Garratt, *The Learning Organisation*, Fontana, 1987; P. M. Senge, *The Fifth Discipline: The Art and Practice of the Learning Organisation*, New York: Doubleday, Currency, 1990; I. Nonaka & H. Takeuchi, *The Knowledge-creating Company: How Japanese Companies Create the Dynamics of Innovation*, New York, Oxford University Press, 1995; M. Crossan, H. Lane & R. White, "Organisational Learning: Toward Theory", Working Paper, London, Ontario: Richard Ivey School of Business, University of Western Ontario, 1997.

Organisational capability is measured and compared through the process of organisational appraisal which is the subject matter of this chapter. A feasible approach to appraising the organisation is to start with the factors and influences operating within the organisation. These could be called the organisational capability factors.

But before we move on to a substantive description of the capability factors, the last component of organisational appraisal, strategic advantage, has to be understood. This we do in the next sub-section.

## Strategic and Competitive Advantage

Strategic advantages are the outcomes of organisational capabilities. They are the results of organisational activities leading to rewards in terms of financial parameters, such as profit or shareholder value and/or non-financial parameters, such as market share or reputation. In contrast, strategic disadvantages are penalties in the form of financial loss or damage to market share. Clearly, such advantages or disadvantages are the outcomes of the presence or absence of organisational capabilities. Strategic advantages are measurable in absolute terms using the parameters in which they are expressed. So, profitability could be used to measure strategic advantage: higher the profitability better is the strategic advantage. They are comparable in terms of the historical performance of an organisation over a period of time or its current performance with respect to its competitors in the industry.

• Competitive advantage is a special case of strategic advantage where there is one or more identified rivals against whom the rewards or penalties could be measured. So, outperforming rivals in profitability or market

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