assessment of their organisational capability to compete in the markets. There are a number of considerations in organisational appraisal.

The various considerations involved in an organisational appraisal relate to the factors that affect appraisal, the approaches that can be adopted to appraise them and the sources of information available to perform the appraisal. In the previous chapter, we have dealt with these issues as they pertain to the appraisal of the external environment. Much of what we said there is relevant here too and, therefore, the discussion is limited only to the main points.

Factors Affecting Organisational Appraisal

The factors that affect organisational appraisal relate to the strategists, the organisation and to the internal environment. The various characteristics of the strategists—as they matter so far as their general management capability is concerned—affect the manner in which organisational appraisal would be done. The nature of organisation and the internal environment—its complexity and diversity—determine how well the appraisal can be done. To understand how these factors affect organisational appraisal, consider a few situations.

- The ability of the strategists to comprehend complexity determines how well the different forces and influences, operating within the internal environment, are analysed.
- The size of the organisation affects the quality of appraisal. Larger organisations are usually more difficult to appraise than smaller ones.
- If the internal environment of an organisation is vitiated owing to opposing political forces and power games, the quality of appraisal is likely to suffer. A cohesive management team, on the other hand, is more likely to appraise the organisation better.

Approaches to Organisational Appraisal

The approaches adopted for preparing an organisational appraisal may range from a highly systematic to an *ad hoc* one. A systematic approach is adopted as a proactive measure to appraise the organisation and is used when the strategists opt for formal strategic planning systems. An *ad hoc* approach is generally used as a reactive measure, in response to a crisis. In this approach, occasional organisational studies may be undertaken, whenever required, to determine capability. It is true that not all organisations have a formal or even an *ad hoc* system to appraise their internal environment. For instance, in smaller organisations which operate under the entrepreneurial mode, the chief executive may do the appraisal by himself, without the aid of formal systems, or by conducting *ad hoc* studies. Overall, the appraisal of organisations is an essential prerequisite to strategy formulation.

Sources of Information for Organisational Appraisal

The strategists need to tap different types of information sources for organisational appraisal. These sources may be verbal as well as written. They may also be internal as well as external sources. The assessment of organisational capability may rely on employees' opinion, company files and documents, financial statements, the management information system, and other internal sources. In a way, we could say that, the effectiveness of tapping the sources would largely depend on the information capability of an organisation.

For a comparative appraisal with similar organisations in the industry and across industries, it may be necessary to have access to external sources of information like company reports, magazines and journals. For systematic, as well as *ad hoc* studies, help may be sought from consultants. In sum, we could say that the sources of information used for environmental appraisal could be partially used for organisational appraisal as well.

Having dealt with the three considerations involved in an organisational appraisal, we describe further, the methods and techniques used for appraising an organisation.

4.4 METHODS AND TECHNIQUES USED FOR ORGANISATIONAL APPRAISAL

The methods and techniques used for organisational appraisal can be identical to those used for the performance evaluation of an organisation. But there is an important difference between performance evaluation and organisation appraisal. The emphasis in evaluating performance is on assessing the current behaviour of the organisation with respect to its efficiency and effectiveness and such an assessment is generally of a short-term nature. On the other hand, organisational appraisal is of a comprehensive and long-term nature and the emphasis is not on current behaviour, but also on what the organisation needs to do in order to gain the capability to compete in the market, take advantages of the available opportunities and overcome the threats operating in its relevant environment.

Keeping in view the differences between performance evaluation and organisational appraisal, the methods and techniques used could be classified as broadly in three parts as below.

Internal Analysis

1. VRIO framework — Barney
2. Value chain analysis — Porter 1985 + fig + drawbacks
3. Quantitative analysis
   (i) Financial analysis ratio, EVA, ABC
   (ii) Non-financial analysis goodwill, morale, absenteeism
4. Qualitative analysis

Comparative Analysis

1. Historical analysis
2. Industry norms
3. Benchmarking — Performance, process, strategic, Internal, competitive, Functional

Comprehensive Analysis

1. Key factor rating + in association financial analysis — Questions
2. Business intelligence systems Use of IT tools
3. Balanced scorecard 4 key performance measure

We now proceed to explain the methods and techniques of organisational appraisal.

Internal Analysis

The internal analysis of an organisation deals with an investigation into its strengths and weaknesses by focussing on factors that are specific to it. In contrast, as we will see a bit later, comparative analysis deals with an examination of strengths and weaknesses of an organisation in relation to its own past record or with reference to its competitors.

1. VRIO Framework The VRIO framework is the contribution of Barney, who is credited with the enunciation of the resource-based theory.[11] We explained the resource-based theory in Section 4.2.

The acronym VRIO stands for valuable, rare, inimitable and organised for usage. These terms are briefly described below.

- *Valuable*: The organisational capabilities possessed by the firm that help it to generate revenues by capitalising on opportunities and/or to reduce costs by neutralising threats. Examples of valuable capabilities are: the ability to generate an amicable relationship with the government or to provide high quality after-sale service to customers.

- *Rare*: The organisational capabilities that are possessed by the firm exclusively or just by a few other firms in the industry. Examples of rare capabilities are: capability derived out of an exclusive location or the presence of a highly satisfied and motivated workforce.
- *Inimitable*: The organisational capabilities possessed by the firm that are impossible, very difficult or not worthwhile to duplicate or substituted by the competitors. Examples of inimitable resources are: a favourable corporate image or the ability to acquire and integrate new businesses.
- *Organised for usage*: The organisational capabilities possessed by the firm that could be used through appropriate organisational structure, business processes, control systems and reward systems that are present in the firm. Examples of a firm organised for usage are: the availability of competent R & D personnel and research laboratories to innovate new and improved products continually or the availability of potential business partners who are competent and willing to integrate their information systems with that of the firm.

Exhibit 4.10 presents a table that shows how the four attributes of organisational capabilities can contribute to strengths and weaknesses in a firm.

Exhibit 4.10 How organisational capabilities contribute to strengths and weaknesses?

Are the capabilities valuable?	*Are the capabilities rare?*	*Are the capabilities costly to imitate?*	*Are the capabilities organised for usage?*	*Are the capabilities strengths or weaknesses?*
No	—	—	No	Weakness
Yes	No	—	Yes	Strength
Yes	Yes	No	Yes	Strength and distinctive competence
Yes	Yes	Yes	Yes	Strength and sustainable distinctive competence

Source: Adapted from J.B. Barney, *Gaining and Sustaining Competitive Advantage*, Reading, MA: Addison Wesley Publishing Company, 1997, Tables 5.2 and 5.3, p. 163.

To summarise the use of the VRIO framework for internal analysis, we note that sustainable strategic advantage results through the use of capabilities that are valuable, rare, inimitable and for which the firm is organised for usage. Exhibit 4.10 indicates that the consequences of combining the four criteria of the VRIO framework can help to determine the strategic significance of an organisation's capabilities. Capabilities that are not valuable, rare or that can be imitated should not be emphasised by the organisation. In fact, if the organisation puts in place systems and processes and attempts to organise the usage of such capabilities, this may lead to a strategic disadvantage. Capabilities that yield strengths need to be organised for usage by the organisation.

2. Value Chain Analysis This is a method for assessing the strengths and weaknesses of an organisation based on an understanding of the series of activities it performs. Porter (1985) is credited with the introduction of the framework called value chain.[12] *A value chain is a set of interlinked value-creating activities performed by an organisation.* These, activities may begin with the procurement of basic raw materials and go through processing in various stages right up to the end products marketed to the ultimate consumer. The value chain of a company may be linked to the value chain of its upstream supplier and downstream buyers, forming a series of chains that Porter terms as the *value system*.

Porter divided the value chain of a manufacturing organisation into primary and support activities. Primary activities are directly related to the flow of the product to the customer and include five sub-activities as listed below:

- *Inbound logistics*: All activities that an organisation uses for receiving, storing and transporting inputs going into the production process. Typical inbound logistics activities performed in organisations are materials handling, warehousing and inventory control.
- *Operations*: All activities required for transformation of raw materials to finished products. Typical operations activities performed in organisations are assembling, fabricating, machining, maintaining and packaging.
- *Outbound logistics*: All activities that an organisation uses for receiving, storing and transporting outputs going out of the production process. Typical outbound logistics activities performed in an organisation are of materials handling, order processing, physical distribution, and warehousing.
- *Marketing and sales*: All activities that an organisation uses to market and sell its products to customers. Typical marketing and sales activities performed by organisations are of pricing, developing products, advertising, promoting and distributing.
- *Service*: All activities that an organisation uses for enhancing and maintaining a product's value. Typical service activities performed by organisations are of installation, repair, maintenance and customer training.

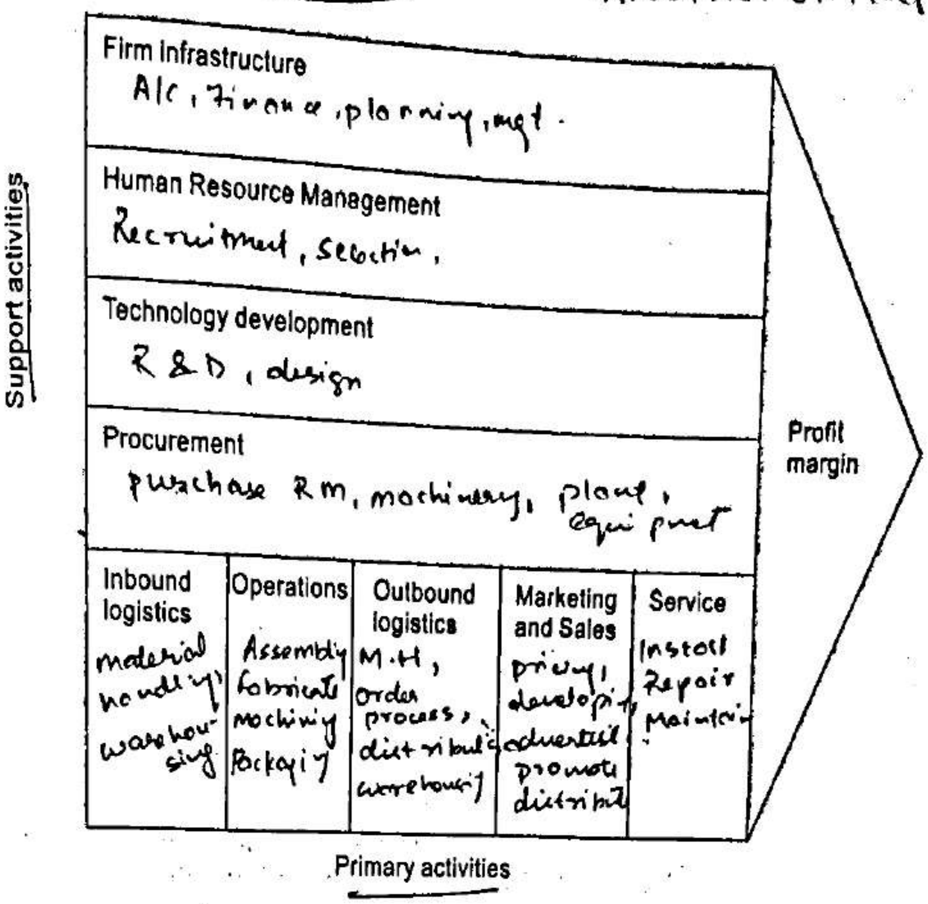
Support activities are provided to sustain the primary activities. These consist of:

- *Firm infrastructure*: All activities that an organisation uses for ascertaining the external opportunities and threats, identifying strengths and weaknesses and generally managing the organisation for achieving its objectives. Typical firm infrastructure activities performed by organisations are of accounting, finance, planning, general management, legal support and managing government relations.
- *Human resource management*: All activities that an organisation uses for managing human resources. Typical human resource management activities performed by organisations are of recruitment, selection and training, developing, appraising and compensating employees.
- *Technology development*: All activities that an organisation uses for creating, developing and improving products and services. Typical technology development activities performed by organisations are research and development, product design, process design, equipment design and servicing procedures.
- *Procurement*: All activities that an organisation uses for procuring inputs needed to produce products or provide services. Typical procurement activities performed by organisations are purchasing fixed assets such as machinery and equipments, raw materials and supplies.

Exhibit 4.11 provides a simplified depiction of the value chain. As you can observe, it is a representation of the interrelated chain of activities that are required to be undertaken for bringing the finished product to the doorstep of the customer. The profit margin that an organisation earns depends on how effectively the value chain is managed. The value chain provides a systematic view of examining all the activities performed by an organisation and how these activities interact and are interrelated.

An illustration of the value chain can be seen in the case of oil companies in India. Here the value chain is broken down into two parts of upstream and downstream activities. The upstream activities refer to oil exploration, drilling and transporting the crude oil to the refinery. The downstream activities start from refining and then transporting and marketing of oil and allied products through distributors and petrol pumps. Most integrated oil companies perform all the upstream and downstream activities, but they often vary in terms of the capability they possess in one or more of the activities in the value chain. The major global oil companies are highly integrated, covering the complete value chain, but ONGC is India's sole oil exploration and production company. IOC is in refining, transportation and marketing of oil and BPCL is strong in transportation and marketing, with a marginal presence in refining. Essar Oil and Reliance are in refining

Exhibit 4.11 Porter's generic value chain For MANUFACTURING ORG



while IBP is in marketing only. Obviously, each of these companies has a set of strengths and weaknesses contributing to their organisational capability. Each has a defined strategic advantage and a specific competitive advantage in the oil industry with respect to each other.

The value chain analysis requires:

- Identifying the activities that make up the organisation's value chain and classifying them into primary and support activities
- Identifying the things done in those activities that contribute to providing value for the customer
- Identifying how the value contribution can be increased so that it costs less to provide the same or more value, thereby increasing the profit margin for the organisation
- Identifying how the value configuration could be improved by innovatively reconfiguring or recombining activities

The value chain analysis is a useful method for organisational appraisal as it helps in providing clarity about the areas where the strengths and weaknesses of the organisation reside. In general, the activities that can be provided in a manner that they create more value to the customer at less cost, are strengths. Those activities that provide less value at more cost are weaknesses. In such a case, it would be better for the organisation to outsource those activities to external parties who could perform them better. Those areas where the organisation is strong should be retained as they are the competencies.

The technique of value chain analysis has some limitations:

- The technique is deceptively simple but difficult to implement.
- It applies to industrial organisations and needs to be adapted for application to service organisations.

- The concept of value is hazy. It is difficult to say what constitutes value for the customer. Value remains a theoretical construct until the customer is actually willing to pay what the organisation determined its value to be.
- The determination of cost cannot rely on traditional cost accounting methods. Activity-based costing is required to assess the correct estimates of costs.
- The analysis requires collecting data from varied sources. The periodicity of the sources of information needs to be common. Where figures of costs, for instance, are not available for the same period, it becomes difficult to make the analysis.
- The application of information technology upsets the calculations in the value chain analysis as often, it results in increasing value and reducing costs simultaneously.

3. Quantitative Analysis Relying on numbers is a popular technique for assessing the performance of an organisation. Among the numbers are the financial figures, which are most often used for performance evaluation as well as an assessment of strengths and weaknesses. But financial figures alone are not the sole basis. There are other numbers too which can be relied upon. We see here first a financial analysis and then the non-financial quantitative analyses.

(i) Financial Analysis The traditional methods used for evaluating financial performance, cover various types of activities in different functional areas within an organisation.

A technique such as the financial *ratio analysis* assesses the liquidity, profitability, leverage and activity aspects of any organisation. It can be used for analysing strengths and weaknesses and provides valuable data that can be used in an organisational appraisal. It has an added advantage in that the existing accounting systems and procedures can be used for generating information for organisational appraisal. Ratio analysis is used on the basis of the reasonable assumption that ratios cover nearly all the important aspects of an organisation's activities and provides a selective approach to measuring effectiveness and efficiency. The details regarding the techniques of ratio analysis are covered well in almost any book in the finance area, so they will not be provided here. It should, however, be pointed out that though ratios have been in use for a long time and managers are aware of the technique as well as its applications, its use in strategic management is limited.

Only if financial ratio analysis is used with due care, can it realistically serve the purpose of organisational appraisal. The precautions which need to be taken include a realisation of the limitations of ratio analysis, taking sufficiently long-term data to extrapolate trends, applying subjective analysis to numerical results by strategists, considering the data within an industry and across industries and supplementing the financial analysis with an appraisal in other areas such as marketing, technology, etc.

Apart from the traditional and popular techniques such as the ratio analysis, certain other newer and improved techniques have also been devised to offset the limitations inherent in the older ones. We refer to two such techniques here. First, there is the *economic value-added (EVA) analysis.* Used to determine the wealth of a company, EVA is a popular technique devised by Stern Stewart & Company of the USA. EVA is defined as the system of corporate management that defines profitability in terms of the returns on capital above the cost of servicing the capital employed. EVA is the wealth an organisation creates for its owners and is expressed as the difference of after-tax operating profits and the total cost of capital. In other words, EVA is the representation of the simple idea that an organisation needs to earn more from a business than the cost of the capital invested in it. The calculation of EVA offers a yardstick to an organisation to assess whether it has the required capability to take a strategic action and whether the potential returns from such an action are likely to be greater than the cost of capital required to take it.

The second technique that we talk about here is that of *activity-based cost (ABC) accounting* that attempts to do away with some of the limitations of the traditional cost accounting. ABC identifies the major activities in the value chain within a firm and keeps a tab on the costs within each activity. This helps in identifying the factors that determine cost (known as cost drivers) and the areas where costs are actually incurred. From the perspective of analysing strengths and weaknesses, ABC, as well as EVA, helps in locating the areas where these lie within an organisation.

In sum, financial analysis offers a convenient and reliable basis for organisational appraisal, provided it is used with appropriate modifications and with a complete understanding of the limitations of financial statements in any long-term assessment of organisational performance.

ii. Non-financial quantitative analysis The obvious advantage of financial analysis is that all numbers can be expressed in terms of a common monetary unit such as rupees, pounds or dollars. But not everything that goes on in an organisation can be best expressed in monetary units. It might not even be desirable to do so. For instance, many of the operational parameters are best expressed in physical terms. Quantification of intangibles such as goodwill or employee morale may be possible, but it is not desirable to do so in monetary terms. Here, the non-financial quantitative analysis can help an organisation in appraisal. Examples of non-financial quantitative measures are: employee turnover, absenteeism, market ranking, rate of advertising recall, total cycle time of production, inventory units used per period, service call rate, number of patents registered per period, etc.

4. Qualitative Analysis An organisational appraisal can be based primarily on quantitative analysis since it is possible to measure and compare on a numerical or financial basis. Yet, as most strategists are aware, quantification has its limitations. The quantitative analysis has to be tempered with a qualitative analysis. Such an analysis is based on informed opinion, judgement, intuition or hunch.

Many of the strengths and weaknesses of an organisation cannot be expressed in quantitative terms. For example, qualitative analysis can best be used to express the tenor of corporate culture, ability to absorb and assimilate knowledge or the level of morale among employees. A systematic qualitative analysis may use the survey approach to finding the status of organisational climate for instance. These factors do matter so far as the strengths and weaknesses of an organisation are concerned.

Qualitative analysis can also effectively supplement a quantitative analysis. Conversely, quantitative analysis could be used to support and reinforce a qualitative assessment. Most often, qualitative analysis is considered as 'soft' as compared to the 'hard' analysis based on numbers. But this does not mean that qualitative analysis is not meant to be rigorous or is based on emotions or fancy. Rather, such an analysis is hard-headed too as several other mental faculties are also involved, apart from the plain and simple number-crunching that goes into quantitative analysis.

Comparative Analysis

Recall how we defined the strengths and weaknesses of an organisation and its distinctive competencies earlier in this chapter. These were defined with respect to the competitors of an organisation. We said that strengths and weaknesses as well as distinctive competencies are not absolute, but relative. The relativity is based on the uniqueness and exclusivity of the strengths, weaknesses and the distinctive competencies of an organisation in comparison to its competitors. Comparative analysis thus forms the cornerstone of the assessment of the strengths and weaknesses of an organisation. It can be done in three ways: historical analysis, on the basis of industry norms and by benchmarking, each of which we describe below.

1. Historical Analysis One way to compare performance and identify strengths and weaknesses is to start with the historical analysis of one's own organisation over a period of time. Historical analysis is a good measure of how well or badly an organisation has progressed with respect to its own past performance. Frequently, we see that the performance of companies is shown in terms of comparative figures over the last year or for the same period in the past year. Such a practice is standard in presentation of balance sheets and profit and loss accounts in the annual reports of companies. This is an evidence of how the organisation has performed on the basis of some common parameters. Durable strengths or nagging weaknesses will certainly contribute to a good or bad performance respectively. Conversely, areas which show consistent good performance are an indicator of strengths in those areas and the reverse, i.e., areas that show repeated bad performance may be an indicator of weaknesses. Continuous improvement, which is an important objective, can be measured adequately through historical analysis.

Historical analysis has some limitations that should be kept in view. First, focus should not only be on areas of bad performance as it just shows where an organisation is lacking. The analysis should delve deeper to uncover the reasons for the bad performance so that corrective measures could be taken. This way, the weaknesses could be removed. Secondly, measurement of past performance on a small base could show dramatic improvements that could turn out to be illusory. Lastly, historical analysis is only meant to show up improvements with regard to one's own performance, while organisations should be more concerned with their performances in comparison to their competitors. Here enters the relevance of other comparison standards such as industry norms and benchmarking that we describe below.

2. Industry Norms The industry to which a business belongs is the most obvious choice for comparison with regard to a wide range of parameters. A company might check whether its cost structure is comparable to that of its competitors or the budget spending on advertising is equal to that of its nearest rival. In doing so, it is assumed that businesses in an industry operate under a similar relevant environment and a comparison could throw up significant information on the basis of which to assess where one stands with respect to others.

Rather than comparing oneself with all the firms in an industry, it would be more instructive to consider the firms that follow similar strategies. The concept of a strategic group is helpful here. 'Strategic groups are conceptually defined clusters of competitors that share similar strategies and therefore, compete more directly with one another than with other firms in the same industry.'[13] Though used for analysing competition in an industry, the concept of a strategic group is helpful in recognising the firms that fall into a similar category and could be referred to for comparative analysis.

Even with all their attendant benefits, industry norms have some limitations that have to be kept in view. First, comparisons based on industry norms aim at averages and so, could lead to erroneous conclusions regarding one's capability. What is important is to learn how to exceed the industry norms rather than simply conform to them. Secondly, industry norms are aggregated figures of several different types of firms in an industry. A firm should be more interested in comparing itself with only those firms that are of a similar nature. A classification based on strategic groups will be helpful here. Thirdly, industry norms are difficult to obtain as firms closely guard information which could be of use to their competitors. Yet, information sources that provide data regarding several parameters such as annual reports are available in public domain. These could be used for determining the industry norms.

All in all, industry norms provide a good idea to firms regarding the areas in which they excel or need improvements. This can help them in locating their areas of strengths and weaknesses.

3. Benchmarking A benchmark is a reference point for taking measures against. The process of benchmarking is aimed at finding the best practices within and outside the industry to which an organisation belongs. The purpose of benchmarking is to find the best performers in an area so that one could match one's own performance with them and even surpass them. The American Productivity and Quality Centre gives an interesting interpretation of the term benchmarking by saying that it is 'the practice of being humble enough to admit that someone else is better at something, and being wise enough to learn how to match and even surpass them at it'.[14]