

**Risk-Control Strategy,
Management Controls,
and Performance**

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The Objectives of the course

- Primary objective is strategy implementation, and
- Secondary objective: how management control systems help in evaluating the success of strategy, and
- How performance measures (benchmarks) are integral to a well-functioning control system.
- Remember: In most organizations, strategy implementation and control system implementation and functions are simultaneous.

"Concentration — that is, the courage to impose on time and events his own decision as to what really matters and comes first — is the executive's only hope of becoming the master of time and events."

— Peter Drucker, The Effective Executive

Strategy

- Does your management have a vision, a set of goals, objectives, a direction to the destination they are trying to get to? Or
- Are they working towards short-term survival?
- How would one know that the company you work for has a vision, goal, or objectives?
- Or, does the fact that your organization is surviving indicates strategic accomplishment.

Strategic goals and objectives

- Identify the goals first; make a list.
- Set specific targets for each strategic imperative. "Improving customer satisfaction," "reengineering key processes," or "changing the culture" is in everyone's list. Set concrete measurable goals – e.g. actual number of dissatisfied customers; product defects).
- Don't hide behind percentages.

What indicates strategic vision as opposed to also-ran?

- ① Is your company a market leader?
- ① How influential is your company in setting the rules of competition or is it just a follower of the pack?
- ① Is the company entering new markets, innovative, a trend-setter?
- ① Does it challenge existing industry practices and industry partners?

Indicators of management success

- Is senior managers aware of the major risks facing their industry?
- What plans do they have to deal with the changing risk profile?
- Do managers spend more time on learning about and assessing the changes in the external environment? Or,
- Are they more concerned about payroll processing, cost allocations, and meeting regulatory requirements?

One-time industry leaders from the U.S.

- ⦿ Sears
- ⦿ General Motors,
- ⦿ Westinghouse
- ⦿ American Motors
- ⦿ Du Pont chemicals

What made these firms lose their leadership position?

- Companies had managers but not necessarily strategic leaders
- Could not react to changes in technology, demography, customer preferences, and non-traditional competitors.

Look at the industry leaders of today from both the U.S. and India

- What makes these firms successful?

- Wal-Mart

- General Electric

- Microsoft

- The Tatas

- The Mittals

- Reliance

What made these firms different and successful?

Reasons for Success:

- Each of these firms have a mission and a strategy.
- They knew where they wanted to go, and
- They chalked out a plan to get there.

What differentiated the successful ones from the declining ones

- ⦿ Both prepared financial statements.
- ⦿ Both Measured profits, costs, depreciation allocations.
- ⦿ Both were aware of changes in market share, technological changes, etc.
- ⦿ But, they reacted differently.
- ⦿ The declining ones resorted to restructuring – lay offs, cost-cutting, etc. while
- ⦿ The successful ones made plans for how do we do things differently and successfully and implemented strategies that would take them there.

See these two sets of questions

1. What successful products do we offer now?
2. Who are our competitors today?
3. How skilled are our employees today?
4. What is our market share today?
5. What markets do we focus now?

1. What successful products do we offer five years from now?
2. Who would we compete with five years from now?
3. What skills do we need in our employees 5 years from now?
4. What should be our market share in future? How do we get there?
5. What markets should we focus in future?

Take a look at Reliance – converting its mission into strategy

“Reliance enjoys global leadership in its businesses, being the largest polyester yarn and fiber producer in the world and among the top five to ten producers in the world in major petrochemical products.”

- ⦿ Become market leader in fiber and petrochemical products.
- ⦿ Continued new product introduction.
- ⦿ Highest customer satisfaction rating
- ⦿ Lowest employee turnover and highest employee satisfaction.
- ⦿ Expand global reach.

Some of the steps Reliance is taking to convert the strategy into realized performance

- ⦿ New product introduction every two years
- ⦿ More investment in R & D
- ⦿ Reduce manufacturing cost through outsourcing and automated manufacturing techniques.
- ⦿ Employee Training and compensation packages

Now to an alternative view on
corporate strategy

“Our past is not easy to understand, nor is our future so easy to predict, and in both enterprises we benefit from looking beyond the superficial explanations.”

Now that you had read the quote, I have a few questions for you

- ⦿ When a company is performing very well for the past 10 years, does that imply that it has a great and successful strategy?
- ⦿ If you wrote a novel and 15 publishers rejected it, does that mean your novel was terribly written?
- ⦿ If you use past data or some other computational approach and bought a lottery ticket and it won a big prize, does that mean your strategy was good?
- ⦿ Does continued success mean you are a genius?

Look at these real world successes (failures)

- ⦿ Universal studio initially rejected George Lucas' story "Star Wars" as unworthy of production. Eventually, Star Wars was produced on a budget of \$13 million and earned \$461 million.
- ⦿ John Grisham's "A Time to Kill" was rejected by 26 publishers before being published.
- ⦿ A guy who has never purchased a lottery ticket in his life purchases a ticket after computing the number for a ticket and it wins him \$100 M.

What did we infer?

- ⦿ There are two aspects to success.
- ⦿ There is the “genius” factor – a well-thought out strategy, work, or creation.
- ⦿ There is the “random” factor – events that we did not know about or did not anticipate and therefore, did not plan for.
- ⦿ That, often, strategic decisions are made far in advance of actual implementation that the strategy is subject to many unpredictable factors (positive and negative) that arise before they are implemented.

What can we learn from our inferences?

- ① You can neither ignore strategy nor randomness.
- ① You need to formulate a good strategy but plan for the effects of randomness as well.
- ① Without both, you are doomed to fail.
- ① Managing a business is not a coin toss where you win head sometimes and lose on tails other times.

Now, how are these discussions important to our discussions on strategy?

Therefore, to increase the probability of success for a strategy, managers must anticipate random factors or risk factors and prepare for them.

Dig a well before you are thirsty

A Chinese proverb

What is risk?

- ⦿ The simplest definition of risk is:
The possibility of loss, injury, disadvantage or destruction.
- ⦿ Risk management is the sum of all proactive management-directed activities within a program that are intended to “acceptably” accommodate the possibility of failures in elements of the program.
- ⦿ "Acceptably" is as judged by the customer in the final analysis, but from an organization's perspective a failure is anything accomplished in less than a professional manner and/or with a less-than-adequate result.

Examples of risk assessment

- ⦿ Identify the risk issues - Why is sales down?
- ⦿ Why is market share down?
- ⦿ What is the reason behind employee turnover?
- ⦿ Why is our new product recently introduced not doing well?
- ⦿ What are the reasons behind all the budget variances?
- ⦿ Are we charging the right price for products and services?
- ⦿ Are our cost centers and revenue centers functioning according to their set objectives?
- ⦿ Should we make investment in a new technology? Why? Why not?

**Let us take a Service industry firm –
e.g. BPO or an IT firm
(or banks or an automobile industry).**

**What are some of the operational risks a manager
must anticipate or deal with?
You need not offer solutions.**

What is management Control?

- Control: “the process by which managers influence other members of the organization to implement the organization’s strategies.”

Controls help with risk assessment and in mitigating risks.

A simpler interpretation of controls

- ⦿ Assume a corporation has a well-formulated strategy, do the managers know whether the strategy is working?
- ⦿ How would they know?
- ⦿ Have they identified the risk factors that affect strategy? And if so,
- ⦿ How do they know that the steps that they have taken to mitigate risks (controls) actually work?
- ⦿ How can senior managers share these responsibilities for strategy and risk management with other functional managers (again through controls) so that everyone is involved?

Management controls

- Is a very broad term and encompasses everything from:
- Management policies and procedures
- Management conduct
- Assigning of functional and other responsibilities
- Monitoring of everyday operations
- Periodic financial statements and cost reports
- Budgeting
- Performance analyses,
- And more.

Depending on their focus, we can classify management controls as follows:

- ⦿ Control that focus on basic operational and procedural routines and processes (Action Controls – e.g. verifying invoice prices).
- ⦿ Controls focusing on results based on a strategic policy (results control – e.g. financial performance)
- ⦿ Controls that measure both financial and non-financial performance indicators – e.g. customer satisfaction, cycle time)
- ⦿ Controls that encourage employees to do what is in the interests of the company and not their personal preferences (cultural controls – training, ethics).

What if a firm does not have a control system?

- ⦿ During early 1980s and 1990s, Apple Computer suffered major performance problems. Much of the blame was placed on Apples culture of “unharnessed and uncontrolled management.
- ⦿ The Wall-Street article blamed Apple for not having a well-organized strategic plan and for not directing its “technical wizards.” There were even questions whether Apple could survive as an independent company.
- ⦿ A firm without a control system is like an aircraft without a rudder; it is doomed to crash.

Now that we recognize the importance of both strategy and controls, let us discuss strategic leverage and then, management controls