Chapter 2: Assessing Organizational Performance

2.1 Introduction

2.2 Vision, Mission, and Goals

2.3 Assessing Organizational Performance

2.4 Competitive Advantage

2.5 Conclusion

Learning Objectives

After reading this chapter, you should be able to understand and articulate answers to the following questions:

1. What are organizational vision, mission, values, and goals, and why are they important to organizations?
2. How should executives analyze the performance of their organization?
3. What is competitive advantage and how is it calculated?

2.1 Introduction

The foundation of strategic management is for an organization to answer three questions:

1. Where are we?
2. Where are we going?
3. How are we going to get there?

Organizations answer the first question by assessing their organization. Often this is by looking at financial data, reviewing historical trends, and comparing the financial performance to other benchmarks such as industry averages or competitors' performance. But financial indicators are not the only assessment measures to determine where a company is in relation to the marketplace. Other **organizational performance indicators** are also reviewed, such as quality measures, productivity measures, human resource indicators such as staff satisfaction and retention rates, and customer satisfaction and retention. A multitude of different measures from different perspectives allow a firm to determine how it is doing.

Organizational leadership provides the answer to the second question; where are we going? In collaboration with other stakeholders, leadership sets the **vision** for the firm. The vision is what the organization aspires to be, that big goal it wants to accomplish. The vision is developed within the organization's **mission**: its purpose for being. The vision must also be aligned with the organization's **core values**: the principles that are important as it carries out its mission and vision.

The third question, how are we going to get there, speaks to the heart of strategic management. An organization develops **strategies** to work toward achieving its vision. These are developed after much assessment is performed to determine the best road map to advance the organization in the marketplace.

2.2 Vision, Mission, and Goals

Questions Are Brewing at Starbucks

March 30, 2011, marked the fortieth anniversary of Starbucks's first store opening for business in Seattle, Washington. From its humble beginnings, Starbucks grew to become the largest coffeehouse company in the world while stressing the importance of both financial and social goals. As it created thousands of stores across dozens of countries, the company navigated many interesting periods. The last few years were a particularly fascinating era.

STARBUCKS COFFEE
스타벅스커피
SK Teleco

Figure 2.1: Starbucks's global empire includes this store in Seoul, South Korea

In early 2007, Starbucks appeared to be very successful, and its stock was worth more than $35 per share. By 2008, however, the economy was slowing, competition in the coffee business was heating up, and Starbucks's performance had become disappointing. In a stunning reversal of fortune, the firm's stock was worth less than $10 per share by the end of the year. Anxious stockholders wondered whether Starbucks's decline would continue or whether the once high-flying company would return to its winning ways.

Riding to the rescue was Howard Schultz, the charismatic and visionary founder of Starbucks who had stepped down as chief executive officer eight years earlier. Schultz again took the helm and worked to turn the company around by emphasizing its mission statement: "to inspire and nurture the human spirit–one person, one cup and one neighborhood at a time" (Starbucks). About a thousand under-performing stores were shut down permanently. Thousands of other stores closed for a few hours so that baristas could be retrained to make inspiring drinks. Food offerings were revamped to ensure that coffee–not breakfast sandwiches–were the primary aroma that tantalized customers within Starbucks's outlets.

By the time Starbucks's fortieth anniversary arrived, Schultz had led his company to regain excellence, and its stock price was back above $35 per share. In March 2011, Schultz summarized the situation by noting that "over the last three years, we've completely transformed the company, and the health of Starbucks is quite good. But I don't think this is a time to celebrate or run some victory lap. We've got a lot of work to do" (Starbucks, 2011). Schultz retired a second time in 2017 and was replaced by the COO, Kevin Johnson. Starbucks has continued its dominance, opening its 30,000th store in March, 2019, in Shenzhen, China. During the COVID-19 pandemic of 2020, Starbucks and Johnson were praised on how the organization handled the crisis. Phase 1: Mitigate and Contain, was implemented, limiting access to only drive-thru and delivery. Employees were paid whether they worked or not. Then Phase 2: Monitor and Adapt was implemented, with the gradual reopening of stores. The decision to open stores was made locally, not by corporate headquarters. Johnson emphasized the principles of prioritizing the health and well-being of its staff and customers and playing a positive and constructive role with the communities and government officials where they serve.

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The Importance of Vision

“Vision animates, inspires, transforms purpose into action.” – Warren Bennis

Knowledge, skills, and abilities separate effective strategic leaders like Howard Schultz from poor strategic leaders. One of them is the ability to inspire employees to work hard to improve their organization’s performance. Effective strategic leaders are able to convince employees to embrace lofty ambitions and move the organization forward. In contrast, poor strategic leaders struggle to rally their people and channel their collective energy in a positive direction.

As the quote from Warren Bennis suggests, a **vision** is one key tool available to executives to inspire the people in an organization (Table 2.1). An organization’s vision describes what the organization hopes to become in the future and helps guide its strategies. Well-constructed visions clearly articulate an organization’s aspirations. Avon’s vision is “to be the company that best understands and satisfies the product, service, and self-fulfillment needs of women—globally.” This brief yet powerful statement emphasizes several aims that are important to Avon, including excellence in customer service, empowering women, and the intent to be a worldwide player. Like all good visions, Avon sets a high standard for employees to work collectively toward. Perhaps no vision captures high standards better than that of aluminum maker Alcoa. This firm’s very ambitious vision is “to be the best company in the world—in the eyes of our customers, shareholders, communities and people.” By making clear their aspirations, Alcoa’s executives hope to inspire employees to act in ways that help the firm become the best in the world.

The results of a survey of 1,500 executives illustrates that creating an inspiring vision creates a tremendous challenge for executives. When asked to identify the most important characteristics of effective strategic leaders, 98% of the executives listed “a strong sense of vision” first. Meanwhile, 90% of the executives also expressed serious doubts about their own ability to create a vision (Quigley, 1994). Not surprisingly, many organizations do not have formal visions. Many organizations that do have vision statements find that employees do not embrace and pursue the visions. Having a well-formulated vision employees embrace can therefore give an organization an edge over its rivals.

That aspirational goal of what the company wants to become is the driver for the strategies that are developed. Accomplishing the strategies and goals drives the organization toward achieving its vision. Thus, there should be alignment between the vision of the company, its mission, values, structure, culture, and the strategies its leaders’ select. As discussed in later chapters, for example, certain structures are better for achieving organizational objectives.

An organization’s vision describes what the organization hopes to become in the future. Visions highlight the values and aspirations that lay at the heart of the organization. Although vision statements have the potential to inspire employees, customers, and other stakeholders, vision statements are relatively rare and good visions are even rarer. Some of the visions being pursued by businesses today are offered below.

Table 2.1 The Big Picture: Organizational Vision

Company	Vision
Alcoa	To be the best company in the world—in the eyes of our customers, shareholders, communities and people.
Avon	To be the company that best understands and satisfies the product, service and self-fulfillment needs of women—globally.
Chevron	To be the global energy company most admired for its people, partnership, and performance.
Google	To provide access to the world's information in one click.
Kraft Heinz Foods	To be the best food company, growing a better world.
Proctor and Gamble	Be, and be recognized as, the best consumer products and services company in the world.

Mission Statements

In working to turn around Starbucks, Howard Schultz sought to renew Starbucks's commitment to its mission statement: "to inspire and nurture the human spirit—one person, one cup, and one neighborhood at a time." A **mission** such as Starbucks's states the reasons for an organization's existence, its purpose. Well-written mission statements effectively capture an organization's identity and provide answers to the fundamental question "Who are we?". While a vision looks to the future, a mission captures the key elements of the organization's past and present (Table 2.2).

Organizations need support from their key stakeholders, such as employees, owners, suppliers, and customers, if they intend to be successful. A mission statement should explain to stakeholders why they should support the organization by making clear what important role or purpose the organization plays in society. Google's mission, for example, is "to organize the world's information and make it universally accessible and useful." Google pursued this mission in its early days by developing a very popular internet search engine. The firm continues to serve its mission through various strategic actions, including offering its internet browser, Google Chrome, to the online community, providing free e-mail via its Gmail service, and making books available online for browsing.

The organization's mission is an umbrella under which all strategic management functions occur. If strategies and goals do not align with the firm's mission, purpose, and vision, they need to be dropped, modified, or the mission needs to be revised.

While a vision describes what an organization desires to become in the future, an organization's mission is grounded in the past and present. A mission outlines the reasons for the organization's existence and explains what role it plays in society. A well-written mission statement captures the organization's identity and helps to answer the fundamental question of "Who are we?". As a practical matter, a mission statement explains to key stakeholders why they should support the organization. The following examples illustrate the connections between organizations and the needs of their key stakeholders.

Table 2.2 Missions

Company	Mission Statement
Harley Davidson	We fulfill dreams through the experiences of motorcycling, by providing to motorcyclists and to the general public an expanding line of motorcycles and branded products and services in selected market segments.
Internal Revenue Service	Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.
Starbucks	To inspire and nurture the human spirit – one person, one cup, and one neighborhood at a time.
Netflix	We promise our customers stellar service, our suppliers a valuable partner, our investors the prospects of sustained profitable growth, and our employees the allure of huge impact.
Nike	To bring inspiration and innovation to every athlete in the world.
Walmart	To save people money so they can live better.

Mission statements are often short and concise. Years ago, mission statements might have been several paragraphs long. The problem that companies encountered was that employees could not remember or verbalize the mission. In the evolution of mission statements, they have become short and easier to remember. Knowing and living their organization's mission helps employees' engagement and satisfaction.

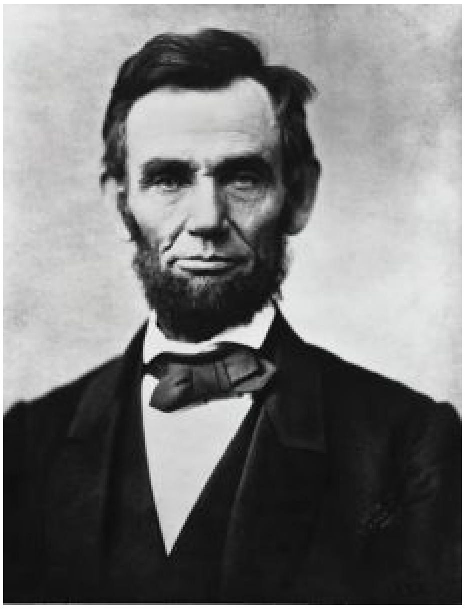

Figure 2.2: Many consider Abraham Lincoln to have been one of the greatest strategic leaders in modern history.

One of Abraham Lincoln's best-known statements is that "a house divided against itself cannot stand." This provides a helpful way of thinking about the relationship between vision and mission. Executives ask for trouble if their organization's vision and mission are divided by emphasizing different domains. Some universities, for example, have fallen into this trap. Many large public universities were established in the late 1800s with missions that centered on educating citizens. As the twentieth century unfolded, however, creating scientific knowledge through research became increasingly important to these universities. Many university presidents responded by creating visions centered on building the scientific prestige of their schools. This created a dilemma for professors: should they devote most of their time and energy to teaching students, as the mission required, or on their research studies, as ambitious presidents demanded via their visions? Some universities continue to struggle with this trade-off today and remain houses divided against themselves. In short, an organization is more effective to the extent that its vision and its mission target employees' effort in the same direction.

Pursuing the Vision and Mission through SMART Goals

An organization's vision and mission offer a broad, overall sense of the organization's direction. To work toward achieving these overall aspirations, organizations also need to create goals—narrower targets that should provide clear and tangible guidance to employees as they perform their work on a daily basis. The most effective goals are those that are specific, measurable, attainable, realistic, and time-bound. An easy way to remember these dimensions is to combine the first letter of each into one word: **SMART** (Table 2.3). Employees are put in a good position to succeed to the extent that an organization's goals are SMART.

While missions and visions provide an overall sense of the organization's direction, goals are narrower aims that should provide clear and tangible guidance to employees. The most effective goals are those that are SMART (specific, measurable, attainable , realistic, and time-bound). SMART goals help provide clarity, transparency, and accountability. As detailed below, one SMART goal is Coca-Cola's aim to "improve our water efficiency by 20%, compared with a baseline year."

Table 2.3 Creating SMART Goals

S	**Specific:** Coca-Cola is seeking to improve its water efficiency by a specific amount—20%. In contrast, goals such as "do your best" are vague, making it difficult to decide if a goal is actually reached.
M	**Measurable:** Water efficiency can be calculated, so Coca-Cola is able to track its progress relative to its 20% target. If progress is slow, more resources can be devoted to achieving the goal.
A	**Attainable:** A series of research studies have established that performance is strongest when goals are challenging but attainable. Reaching a 20% improvement will require aggressive work by Coke, but the goal can be reached.
R	**Realistic:** If Coca-Cola's water efficiency goal was 95% improvement, Coca-Cola's employees will probably react with surprise. Reaching a goal must be feasible in order for employees to embrace it. Unrealistic goals make most people give up and basing goals on impossible clichés, such as "give 110%" creates confusion.
T	**Time-bound:** Coca-Cola is seeking to achieve its 20% improvement. Some universities, such as Texas Tech University, provide incentives, including preferred scheduling for students who sign contracts agreeing to graduate on a four-year schedule. Deadlines such as these are motivating and they create accountability.

Many of the principles for effective organizational vision, missions, and goals apply to individuals too. Here are some ideas that might help you think differently about your own aspirations and how you are working to reach them.

Table 2.4 Be SMART: Vision, Mission, Goals, and You

Vision	Young children often have grandiose visions, such as "I want to be the president of the United States." Now that you are in college, what do you aspire to become? Is your education setting the stage for you to reach this vision?
Mission	Is your mission in life simply to accumulate as much wealth as you can? Or do you also place value on your role in a family and as a member of society?
Specific	Do you create explicit rather than vague goals for yourself? This can help you to target your energy toward what is important.
Measurable	Quantifying your goals allows you to track your accomplishments over time and can help reduce stress. For example, meeting a goal of "write a page every day" might prevent panic the night before an important project is due.
Attainable	Creating challenging, but attainable educational goals (e.g. maintaining a 3.5 GPA) is likely to lead to higher performance than minimal goals (e.g., pass all my classes).
Realistic	To better understand your prospects in the job market, consider researching what kinds of jobs are common for your major and experience level.
Time-Bound	Time management is a challenge in today's world. If you tend to procrastinate, setting interim deadlines for yourself might help you to stay on schedule.

Figure 2.3: Americans landed on the moon eight years after President Kennedy set a moon landing as a key goal for the United States.

The period after an important goal is reached is often overlooked but is critical. This is an opportunity for a strategic decision: will an organization rest on its laurels or will it take on new challenges? The US space program again provides an illustrative example. At the time of the first moon landing, *Time Magazine* asked the leader of the team that built the moon rockets about the future of space exploration. “Given the same energy and dedication that took them to the moon,” said Wernher von Braun, “Americans could land on Mars as early as 1982” (Time, 1969). No new goal involving human visits to Mars was embraced, however, and human exploration of space was deemphasized in favor of robotic adventurers. Nearly three decades after von Braun’s proposed timeline for reaching Mars expired, President Barack Obama, in 2010. set a goal of creating by 2025 a new space vehicle capable of taking humans beyond the moon and into deep space. This would be followed in the mid-2030s by a flight to orbit Mars as a prelude to landing on Mars (Amos, 2010). Time will tell whether these goals inspire the scientific community and the country in general (Table 2.4).

Corporate Values

In addition to constructing vision and mission statements, firms also develop corporate **value statements**. These are explicit principles that the company endorses and lives by, and expects their employees to embrace. Values related to integrity, diversity, and customer service are often seen on company websites. An information technology company might include innovation as one of its values. Manufacturers may also have sustainability or ecology related values.

Why are values statements important for a firm? They demonstrate to their employees and other stakeholders the important principles that the organization lives by. Employees who do not uphold corporate values may see their employment short-lived at the company. Values also show customers and potential customers what the firm stands for. Some customers may choose a company based on how its values resonate with theirs.

What do values statements have to do with strategic management? An organization should seriously consider their values statement when developing its strategies and goals. If a potential strategy conflicts with one of its values, they need to drop or modify that strategy to ensure the company conforms to their corporate values as they move their organization forward.

Table 2.5 Values Statements from Various Companies

Walmart
Guided by good: service to the customer, respect for the individual, strive for excellence, act with integrity
Harley Davidson Motorcycles
Integrity, be accountable, encourage creativity, inspire teamwork, individuality, and diversity
Facebook
Be bold, Focus on impact, Move fast, Be open, Build social value
Starbucks
• Creating a culture of warmth and belonging, where everyone is welcome. • Delivering our very best in all we do, holding ourselves accountable for results. • Acting with courage, challenging the status quo, and finding new ways to grow our company and each other. • Being present, connecting with transparency, dignity, and respect.

Section Video

A Simple Intro to Mission, Vision, and Values [03:08]

The video for this lesson explains the relationship of mission, vision, values, and strategies/goals.

You can view this video here: https://youtu.be/7mWQh_7fK3U.

Key Takeaway

- Strategic leaders need to ensure that their organizations have four types of aims. A vision states what the organization aspires to become in the future. A mission reflects the organization's past and present by stating why the organization exists and what role it plays in society. Goals are the more specific aims that organizations pursue to reach their visions and missions. The best goals are SMART: specific, measurable, attainable, realistic, and time-bound. Corporate values are key principles that a company endorses and lives by.

Exercises

1. Take a look at the website of your college or university. What is the organization's vision, mission, and values? Were they easy or hard to find?
2. As a member of the student body, do you find the vision, mission, and values of your college or university to be aligned with the decisions the university makes? Are they motivating and inspirational? Why or why not?
3. What is an important goal that you have established for your career? Could this goal be improved by applying the SMART goal concept?

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Figure 2.2: Gardner, Alexander. "Abraham Lincoln" Public Domain. Retrieved from https://commons.wikimedia.org/wiki/Abraham_Lincoln#/media/File:Abraham_Lincoln_O-77_matte_collodion_print.jpg.

Figure 2.3: Armstrong, Neil. "Buzz Aldrin removing the passive seismometer from a compartment in the SEQ bay of the Lunar Lander." Public Domain. Cropped. Retrieved from https://en.wikipedia.org/wiki/File:Apollo_11_Lunar_Lander_-_5927_NASA.jpg.

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2.3 Assessing Organizational Performance

Organizational Performance: A Complex Concept

Organizational performance refers to how well an organization is doing to reach its vision, mission, and goals. Assessing organizational performance is a vital aspect of strategic management. Executives must know how well their organizations are performing to figure out what strategic changes, if any, to make. Performance is a very complex concept, however, and a lot of attention needs to be paid to how it is assessed.

To illustrate this complexity, consider a scenario: suppose that we offered a $10 bet on a coin toss. If it lands on heads, you win $50. If it lands on tails, you lose your $10 bet. If you lost, was the decision a bad one? Well, of course not. You had a 50% chance of winning $50 and a 50% chance of losing $10. In this case, the expected value (EV) of your bet would be $20, ($50 * 50%) – ($10 * 50%). Thus, the decision to bet was a good one, but still led to a poor outcome (or performance). In short, while one can generally expect good decisions to lead to good performance, it is not always the case. The point of this scenario is to highlight that there are situations where good strategies lead to bad outcomes, especially when low probability crises occur. In the case of COVID-19, for example, solid strategies selected several years ago could lead to poor performance because of unexpected conditions.

Two important considerations are (1) **performance measures** and (2) **performance benchmarks** (Figure 2.5). A performance measure is a metric by which an organization's progress can be gauged. Most executives examine measures such as profits, stock price, and sales in an attempt to better understand how well their organizations are competing in the market. But these measures provide just a glimpse of organizational performance. Performance benchmarks are also needed to assess whether an organization is doing well. A performance benchmark is used to make sense of an organization's standing compared to its own or a competitor's financial measures and/or performance indicators. Suppose, for example, that a firm has a profit margin of 20% in 2019. This sounds great on the surface, but suppose that the firm's profit margin in 2018 was 35% and that the average profit margin across all firms in the industry for 2019 was 40%. Viewed relative to these two benchmarks, the firm's 2019 performance is cause for concern.

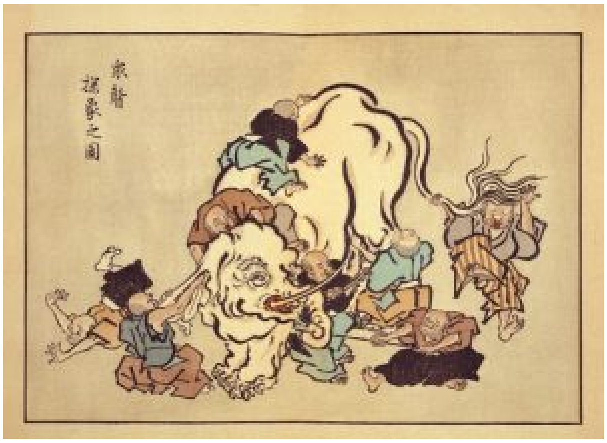

Figure 2.4: The story of the blind men and the elephant provides a metaphor for understanding the complexities of measuring organizational performance.

Using a variety of performance measures and benchmarks is valuable because different measures and benchmarks provide different information about an organization's functioning. The parable of the blind men and the elephant—popularized in Western cultures through a poem by John Godfrey Saxe in the nineteenth century—is useful for understanding the complexity associated with measuring organizational performance. As the story goes, six blind men set out to "see" what an elephant was like. The first man touched the elephant's side and believed the beast to be like a great wall. The second felt the tusks and thought elephants must be like spears. Feeling the trunk, the third man thought it was a type of snake. Feeling a limb, the fourth man thought it was like a tree trunk. The fifth, examining an ear, thought it was like a fan. The sixth, touching the tail, thought it was like a rope. If the men failed to communicate their different impressions they would have all been partially right but wrong about what ultimately mattered. The point is, an organization must consider organizational performance from various and multiple perspectives to achieve an accurate assessment.

This story parallels the challenge involved in understanding the multidimensional nature of organization performance because different measures and referents may tell a different story about the organization's performance. For example, Fortune 500 lists the largest US firms in terms of sales. These firms are generally not the strongest performers in terms of growth in stock price, however, in part because they are so big that making major improvements is difficult. During the late 1990s, a number of internet-centered businesses enjoyed exceptional growth in sales and stock price but reported losses rather than profits. Many investors in these firms who simply fixated on a single performance measure—sales growth—absorbed heavy losses when the stock market's attention turned to profits and the stock prices of these firms plummeted.

The number of performance measures and referents that are relevant for understanding an organization's performance can be overwhelming. For example, a study of what performance metrics were used within restaurant organizations' annual reports found that 788 different combinations of measures and referents were used within this one industry in a single year (Short & Palmer, 2003). Thus executives need to choose a rich yet limited set of performance measures and referents to focus on.

Table 2.6 How Organizations and Individuals Can Use Financial Performance Measures and Indicators

Types of Measures	Applications for Organizations		Applications for Individuals	
	Key Measure	Key Referent	Key Measure	Key Referent
Liquidity measures: Helpful for understanding if obligations can be paid when due.	Current ratio (Current assets/ Current liabilities)	A ratio of less than 1.0 suggests that the firm does not have enough cash to pay its bills.	Cash in your checking account.	Do you have enough cash to cover your monthly debts?
Leverage measures: Helpful for understanding if debt level is to high. The term leverage refers to the extent to which borrowed money is used.	Debt-to-equity ratio	Competitors' debt-to-equity ratios. The use of debt varies across industries. Auto companies, for example, tend to have high debt-to-equity because they must build massive factories.	Debt-to-income ratio (Monthly debt payments/ Monthly income)	If you have a debt-to-income ratio higher than 40%, you may be on the verge of becoming a credit risk.
Profitability measures: Helpful for understanding how much profit, if any, is really being made.	Net income (income after taxes)	Last year's net income. An increase shows the firm's profits are moving in the right direction.	Net income (income after taxes)	Are you making enough to cover your yearly expenses and save for retirement?

Section Video

What is Organizational Performance? [01:56]

The video for this lesson explains how some organizations assess their organizational performance.

You can view this video here: https://youtu.be/wLXuPgbagJY.

The Balanced Scorecard

To organize performance measures, Professor Robert Kaplan and Professor David Norton of Harvard University developed a tool called the balanced scorecard. Using the scorecard helps managers resist the temptation to fixate on financial measures and instead monitor a diverse set of important measures (Table 2.7). Indeed, the idea behind the framework is to provide a "balance" between financial measures and other measures that are important for understanding organizational activities that lead to sustained, long-term performance. The balanced scorecard recommends that managers gain an overview of the organization's performance by tracking a small number of key measures that collectively reflect four perspectives: (1) financial, (2) customer, (3) internal business process, and (4) staff learning and growth (Kaplan & Norton, 1992).

Because the concept of organizational performance is multidimensional, wise managers realize that understanding organizational performance is like flying a plane. Pilots must be on track in terms of altitude, air speed, and oil pressure and make sure they have enough gas to finish their flight plan. For tracking organizational performance, assessing how the organization is doing financially is just a starting point. The "balanced scorecard" encourages managers to also monitor how well the organization is serving customers, managing internal activities, and setting the stage for future improvements. This provides a fast but comprehensive view of the organization. As shown below, monitoring these four dimensions can also help individuals assess themselves.

Table 2.7 Beyond Profits: Measuring Performance Using the Balanced Scorecard

Scorecard Point	Definition	You could ask yourself…
Financial measures	Such as return on assets and stock price—relate to effectiveness and profits.	How can I improve my personal wealth? Measures might include cash, savings account, and retirement.
Customer measures	Such as number of new or repeat customers and percentage of repeat customers—relate to customer attraction and satisfaction.	How strong is my social network? The number of new contacts you make over time might reflect this dimension.
Internal business process measures	Such as speed at serving a customer and time it takes to create a new product and get it to market—relate to organizational efficiency.	Am I getting better at my current job? Tracking improvements in personal efficiency such as the time needed to complete a task can be helpful.
Learning and growth measures	Such as the average number of new skills learned by each employee every year—relate to the future and emphasize that employee learning is often more important than formal training.	What skills should I develop now for the future? Although the acquisition of new skills is hard to measure, the attainment of specialized licenses or earning of a graduate degree are tangible benchmarks.

Financial Measures

Financial measures of performance relate to organizational effectiveness and profits. Examples include financial ratios such as return on assets, return on equity, and return on investment. Other common financial measures include profits and stock price. Such measures help answer the key question, "How do we look to shareholders?"

Financial performance measures are commonly articulated and emphasized within an organization's annual report to shareholders. To provide context, such measures should be objective and be coupled with meaningful referents, such as the firm's past performance. For example, Starbucks's 2019 annual report highlights the firm's performance in terms of net revenue, operating income, and cash flow over a five-year period.

There are three approaches that organizations use to perform quantitative analysis: financial, market-based, and general.

Financial Analysis: This is basically ratio analysis; being able to make "apple to apple" comparisons between firms or annual trends that account for variable volumes, sales, expenses, and profits. Using ratios allows a direct comparison no matter the size of the firm. Table 2.8 provides basic financial ratios organizations use to compare against benchmarks.

Table 2.8 Key Financial Ratios

RATIO	FORMULA	PURPOSE
Profitability Ratios		
Gross Margin	Gross Profit /Total Revenue	Proportion of revenue related to direct costs (COGS, sales commissions, etc.)
Net Profit Margin	Net Profit /Net Revenue	Profit earned per dollar of revenue
Return on Equity	Net Profit (or Income)/ Shareholder Equity	Profitability in relation to stockholders' equity; i.e. how well you use equity financing
Return on Assets	Net Profit (or Income)/Total Assets	Efficiency in using assets to generate profit
Efficiency Ratios		
Inventory Turnover	COGS /Average Inventory	Efficiency of inventory management
Accounts Receivable Turnover	Net Credit Sales/ Average Acct Rec.	Efficiency of AR management
Leverage Ratio		
Debt Ratio	Total Liabilities/Total Assets	Proportion of assets financed through debt
Liquidity Ratio		
Current Ratio	Current Assets/ Current Liabilities	Ability to pay short term debts with short term assets like cash & inventory
Market Capitalization	Outstanding shares X share price	Market value of the firm

Market-Based Analysis: This analysis helps determine how the firm compares to its competitors in the market. there are two measures to analyze a firm's position in the market:

1. Market Share = Firm's Total Product Revenue / Total Revenue in the industry or market

This measures the percentage of the market that a firm has. For example, if Apple's revenue from selling iPhones is 25% of all the revenue generated from smartphone sales, Apple's market share is 25%.

2. Price-Earnings (PE) Ratio = Stock price / Earnings per Share (EPS)

The Price-Earnings Ration determines how much it costs to invest in the company to receive $1.00 in earnings. For example, if one share of stock costs $10, and it produces $2 annually in earnings, the PE ratio is 5, meaning it costs a $5 investment in this company to receive $1 in earnings. The lower the PE ratio, the better, as far as a simple interpretation goes. However, a higher PE Ratio may indicate the market's belief that the company is a strong performer and will be growing the stock price.

General Quantitative Analysis: There are other types of data sets that can provide useful information. For example, trend analysis is used to determine how much volumes are changing each year, or extrapolate economic data to make predictions. There most likely is industry-specific data to analyze and use as a comparison for firms.

Performance Indicators: As referenced earlier, financial measures alone will not provide sufficient insight into a firm's performance. While financial measures always have operational relevance, other performance indicators often provide strategic insight that may not be evident from the financial picture. This section provides some examples of the other kinds of performance measures helpful in strategic management.

Customer Measures

Customer measures of performance relate to customer attraction, satisfaction, and retention. These measures provide insight to the key question "How do customers see us?" Examples might include the number of new customers, customer satisfaction, and the percentage of repeat customers.

Starbucks realizes the importance of repeat customers and has taken a number of steps to satisfy and to attract regular visitors to their stores. For example, Starbucks rewards regular customers through a rewards program that allows customers to redeem the points they have accumulated for free drinks, bakery items, or merchandise. They also offer all customers free Wi-Fi access (Miller, 2010). Often, firms need external measures about their customers as well. For example, demographic data, taste preferences, or social trends.

Internal Business Process Measures

Internal business process measures of performance relate to organizational efficiency. These measures help answer the key question "What must we excel at?" Examples include the time it takes to manufacture the organization's goods or deliver a service. Another example of this type of measure is the time it takes to create a new product and bring it to market. Productivity and quality data are other measures often targeted for improvement.

Organizations such as Starbucks realize the importance of such efficiency measures for the long-term success of its organization. For this reason, Starbucks carefully examines its processes with the goal of decreasing order fulfillment time. In one example, Starbucks efficiency experts challenged their employees to assemble a Mr. Potato Head to understand how work could be done faster (Jargon, 2009). The aim of this exercise was to help Starbucks employees in general match the speed of the firm's high performers, who boast an average time per order of twenty-five seconds.

Learning and Growth Measures

Learning and growth measures of performance relate to the future. Such measures provide insight to ask the question, “Can we continue to improve and create value?” Learning and growth measures focus on innovation and proceed with an understanding that strategies change over time. Consequently, developing new ways to add value will be needed as the organization continues to adapt to an evolving environment. Employees may need additional training and skills to make a strategy achievable, or the firm may need to hire for the needed skills. An example of a learning and growth measure is the number of new skills learned by employees every year.

One way Starbucks encourages its employees to learn skills that may benefit both the firm and individuals in the future is through its tuition reimbursement program. Employees who have worked with Starbucks for more than a year are eligible. Starbucks hopes that the knowledge acquired while earning a college degree might provide employees with the skills needed to develop innovations that will benefit the company in the future. Another benefit of this program is that it helps Starbucks reward and retain high-achieving employees.

Measuring Performance Using the Triple Bottom Line

Ralph Waldo Emerson once noted, “Doing well is the result of doing good. That’s what capitalism is all about.” While the balanced scorecard provides a popular framework to help executives understand an organization’s performance, other frameworks highlight areas such as social responsibility. One such framework, the triple bottom line, emphasizes the **three P's**: people (making sure that the actions of the organization are socially responsible), planet (making sure organizations act in a way that promotes environmental sustainability), and traditional organization profits. This notion was introduced in the early 1980s but did not attract much attention until the late 1990s.

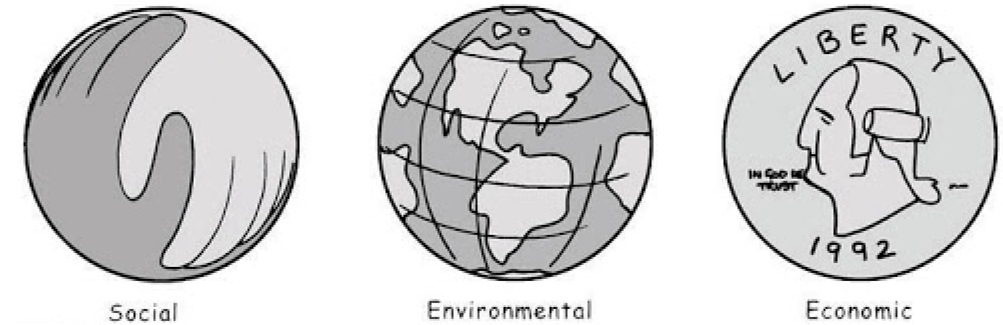

Figure 2.5: The triple bottom line emphasizes the three Ps of people (social concerns), planet (environmental concerns), and profits (economic concerns).

In the case of Starbucks, the firm has made clear the importance it attaches to the planet by creating an environmental mission statement (“Starbucks is committed to a role of environmental leadership in all facets of our business") in addition to its overall mission (Starbucks, 2011). In terms of the "people" dimension of the triple bottom line, Starbucks strives to purchase coffee beans harvested by farmers who work under humane conditions and are paid reasonable wages. The firm works to be profitable as well.

Key Takeaway

- Organizational performance is a multidimensional concept, and wise managers rely on multiple measures of performance when gauging the success or failure of their organizations. The balanced scorecard provides a tool to help executives gain a general understanding of their organization's current level of achievement across a set of four important dimensions. The triple bottom line provides another tool to help executives focus on performance targets beyond profits alone. This approach stresses the importance of social (people) and environmental (planet) outcomes, as well as profit.

Exercises

1. Given your major, what sets of measures and indicators have you been trained to analyze and value?
2. How might you apply the balanced scorecard framework to measure performance of your college or university?
3. Identify a measurable example of each of the balanced scorecard dimensions other than the examples offered in this section.
4. Identify a mission statement from an organization that emphasizes each of the elements of the triple bottom line.

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Image Credits

Figure 2.4: Hanabusa, Itcho. "Blind monks examining an elephant." Public Domain. Retrieved from https://en.wikipedia.org/wiki/File:Blind_monks_examining_an_elephant.jpg.

Video Credits

Word Glossary. (2019, March 18). *What is Organizational Performance?* [Video]. Youtube. https://youtu.be/wLXuPgbagJY.

2.4 Competitive Advantage

While accounting measures and stock market returns provide a sense of how well a firm is performing, these indicators may not be ideal if the intent is to understand which firms perform well systematically over the long term. One limitation of those indicators is that they may reflect random perturbations in market outcomes. A firm may have a stroke of good luck that leads it to capture exceptional profits, even if the strategic position of its business is poor. A firm may also have a stroke of bad luck that leads it to have underwhelming profits, even if the strategic position of its business is healthy. A second limitation of these indicators is that firms are not always attempting to carry profits on their books. For example, there are several publicly traded firms that rarely earn profits but are considered healthy, and even thriving, because they use much of their "would be" profits to invest in further improving their businesses.

At a conceptual level, strategic management scholars are often less concerned with specific accounting and stock market performance indicators and more concerned with the idea of **competitive advantage**. Before offering a formal definition of competitive advantage, it is useful to recall the more familiar concept of economic value creation. Economic value creation (EVC) is the difference between what a customer is willing to pay **(**WTP**)** for a product and the cost incurred to produce the product.

EVC = WTP – Cost

The customer's WTP is also referred to as their reserve price—the maximum they are willing to pay for the product. In this equation, cost reflects the cost incurred by the producer, rather than the cost to the consumer of purchasing the product, which is referred to instead as the price of the product.

Economic value creation may vary across firms. Firms that sell the same product may each incur a different cost of production. Further, consumers may be willing to pay one price when purchasing the good from one firm, but willing to pay another price when purchasing the good from the firm's competitor. This all implies that the economic value created will differ from firm to firm.

With this in mind, we can now say that a firm has a competitive advantage over a competitor if it has a larger economic value creation than that competitor. For example, if we have two firms, A and B, A has a competitive advantage over B if the economic value created by A exceeds the economic value created by B. The magnitude of A's competitive advantage is given by the difference between the economic value created by each firm.

The concept of competitive advantage is useful for several reasons. First, unlike measures such as profits and stock price, competitive advantage does not change based on random perturbations. If a firm's competitive advantage increases, that means that either its economic value creation increased, or its competitor's economic value creation decreased. These changes, in turn, reflect relative shifts in the cost structure, or relative shifts in consumers' willingness to pay. Second, the notion of competitive advantage better reflects the strategic health of firms that reinvest in their business, and therefore are healthy, but do not observe profits. For instance, if firm A earns a profit of $100, but then re-invests $98 of that profit into the business to improve the product, then the accounting profits are $2, but the actual health of the company may have improved because the consumers willingness to pay for the product may have increased. Such a firm would still display a large economic value creation measure, and therefore may still hold a competitive advantage.

Section Video

What is Competitive Advantage? [07:58]

The video for this lesson further explains competitive advantage.

You can view this video here: https://youtu.be/PeCCT7CKpYA.

Video Credits

WolvesandFinance. (2018, February 11). *What is Competitive Advantage?* [Video]. YouTube. https://youtu.be/PeCCT7CKpYA.

2.5 Conclusion

This chapter explains several challenges that executives face in attempting to lead their organizations strategically. Executives must ensure that their organizations have visions, missions, values, and goals in place that help move these organizations forward. Measures and indicators for assessing performance must be thoughtfully chosen. A Balanced Scorecard is a tool that firms can use to measure their progress. When executives succeed at leading strategically, an organization has an excellent chance of gaining a competitive advantage and achieve of success.

Exercises

1. Divide your class into four or eight groups, depending on the size of the class. Assign each group to develop arguments that one of the key issues discussed in this chapter (vision, mission, goals, assessing organizational performance, entrepreneurial orientation) is the most important within organizations. Have each group present their case, and then have the class vote individually for the winner. Which issue won and why?
2. This chapter discussed Howard Schultz and Starbucks on several occasions. Based on your reading of the chapter, how well has Schultz done in dealing with setting a vision, mission, and goals, assessing organizational performance, and entrepreneurial orientation?
3. Write a vision and mission for an organization or firm that you are currently associated with. How could you use the balanced scorecard to assess how well that organization is fulfilling the mission you wrote?