Highlighting blind spots

Troubled companies often have flawed strategies. Tony Grundy looks at why you should audit your strategy

While the practice of the financial audit is very well established in organisational thinking, and absorbs significant resource and cost, the idea that your company's strategy should itself be subjected to an audit may seem both new and unnecessary. But in this article it is argued that some kind of audit of your strategy is actually essential – for not only ensuring that economic value is added by it, but also to minimise politics, and to meet governance concerns too.

When a company runs into deep financial trouble it is frequently because the quality of its strategy has gone down – and despite how hard management tries to improve the numbers this is to little avail. It therefore seems sensible, if not imperative, to do a strategy audit.

So what is it?

The concept of a strategy audit is not unlike having a private healthcare check-up. While not implying that one necessarily needs to shake up one's entire lifestyle, having a health-check means identifying practices that can be tightened up, specific weaknesses that need dealing with, etc. Doing a strategy audit involves not necessarily signalling any full-scale strategic review but is just a good and valuable, regular or one-off practice.

A strategy audit can now be defined as 'the systematic, structured and comprehensive and detailed review of your strategy and strategic processes, to identify weaknesses, blind spots and areas where potentially far more value can be added'.

A strategy audit can (and should) be conducted at a variety of levels, including:

- corporate strategy
- business strategy
- financial strategy
- cross-functional strategy
- supporting processes/skills.

But why should the financial director/senior accountant be concerned about this thing?

A tailored audit

For a start, in the July 2007 issue (p54), it was argued that FDs could and should add much more value to the business. To plan, co-ordinate or merely to participate in a strategy audit process is a most interesting opportunity to execute a more strategic role.

Secondly, planned financial performance can easily not match up to expectations and this may be very much tied up with the quality of the strategy and its supporting processes and skills. In addition, where the strategy audit highlights potential blind spots like new entrants/fast competitor imitation, then this can help to remove fundamental blind spots.

To give you a quick example of what a (tailored) strategy audit might look like, in terms of guidelines/questions, let us now focus on three aspects of competitive positioning:

- customers
- competitors
- cost base.

Customers

- To what extent do you know how customers perceive how much value you add to them, and the characteristics within your products and services that distract from this, and by segment?
- Do you have a very clear idea of what is most important to them (in terms of these turn-ons and turn-offs, and by segment)?
- To what level do you know what the buying criteria

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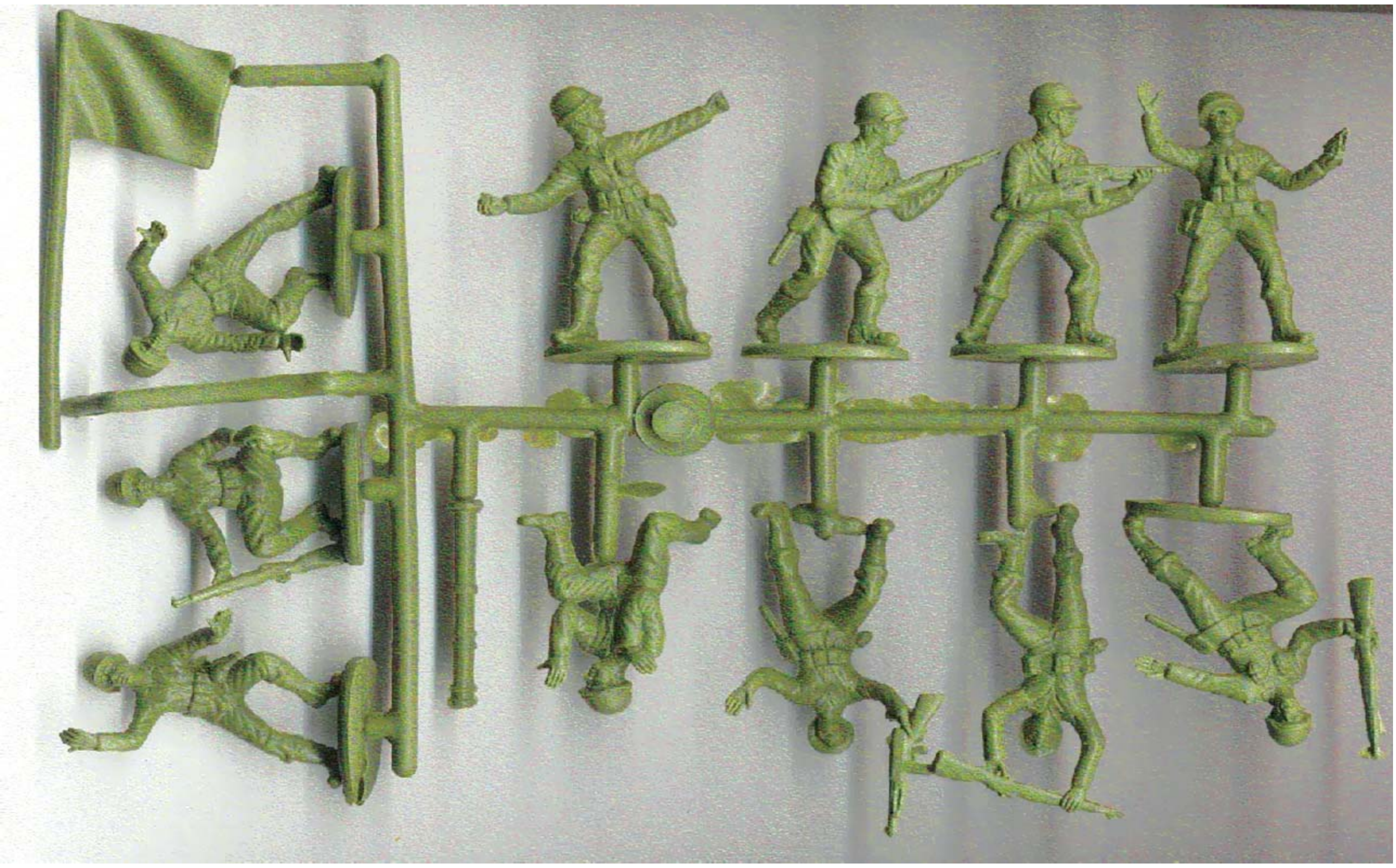

and buying process of your customers are (and who influences this), and what their buying psychology is?

- Do you understand your customers' external environment and pressures – their competitive position and their own strategic options and how well?

With customer benchmarking (as above), it is important to check this out, at least on a sample basis with some objective market/customer research.

Competitors

- Do you really know who your competitors are, and their relative size and resources?
- To what extent do you understand how customers perceive your competitors' value-added potential, especially in relation to what your value-added services are to them?
- To what degree do you understand your competitors' cost advantage(s)/ disadvantage(s) relative to you?
- Do you know which competitors pose the most serious threats to you, and why?

Cost base

- To what extent do you have a very clear idea of the main drivers of your cost base (cost drivers), and how they can be managed optimally?
- To what extent have you targeted your unit costs medium and longer-term (one to five years), rather than traditionally (one year), and to what degree are these supported by viable strategies to reach these?

Each of the questions is scored, semi-quantitatively between a 'one' and a 'five'.

Overall scores can be compiled for each section of the audit and then either weighted or left unweighted, and perhaps then added up to give a final total score.

To achieve a more detailed and objective test of views it is essential to challenge scores. The results can be challenged by asking questions like:

- Why do we say this?
- What evidence do we have/consider to support this?
- If we were customers or competitors etc, how would they rate these scores?

They can also be challenged by perhaps (albeit highly selectively) conducting some limited, external research.

Another possibility is to use some visual matrices to debate overall strategic positioning, for example, by scoring existing strategies almost as if they were new options, perhaps along the following five key criteria (as follows):

1. **Strategic attractiveness**
2. **Financial attractiveness**
3. **Implementation difficulty**
4. **Uncertainty and risk**
5. **Stakeholder acceptability**

And scoring:

✓✓✓ being 'highly attractive'
✓✓ being 'moderately attractive'
✓ being 'low attractiveness'

(with implementation difficulty/uncertainty and risk obviously scoring a single ✓ if these are 'high'.)

Planned financial performance can easily **not match up to expectations** and this may be very much tied up with **the quality of the strategy**

Figure 1: THE STRATEGIC OPTION GRID

CRITERIA	OPTION 1	OPTION 2	OPTION 3	OPTION 4
STRATEGIC ATTRACTIVENESS				
FINANCIAL ATTRACTIVENESS*				
IMPLEMENTATION DIFFICULTY				
UNCERTAINTY AND RISK				
ACCEPTABLE (TO STAKEHOLDERS)				

Score: 3 = very attractive, 2 = medium attractive, 1 = low attractiveness
***Benefits less costs; net cashflows relative to investement**

Again, behind these scores it may be necessary to support this either with further analyses (eg, Porter's five competitive forces, such as customer bargaining, suppliers' power, rivalry from substitute products) – as a part of 'strategic attractiveness', or by further detailed questionnaire diagnostics, or by both. Once again some (selective) empirical justification of your judgments may be necessary – rather than relying on opinion. For example, do competitors actually say you are/are not strong at something – or is it just your personal opinion?

Process-wise, the strategy audit can be implemented in a wide variety of ways, for example:

- Across the business versus one particular area
- For existing or evolving strategies
- By the FD on his/her own, with the CEO, with the top team, or rolled out throughout management. By internal management or by external advisers (like auditors or merchant bankers/venture capitalists)
- As a 'quick and dirty' or with much more rigour
- With or without quantifying the potential financial effect of making remedial/offensive changes
- With or without much new external/internal empirical research.

An example of the results of a strategy audit is seen below.

Mini case: the strategy audit in a utilities company

A utilities company was concerned that its present strategy 'had missed one or two big things'. It applied 180 strategy audit questions, and the ones on 'cost base' identified that the present challenge to its unit costs had not been perhaps pushed far enough. Also, the questions on 'external environment' suggested that the regulator's intent had not been modelled deeply enough. Putting two and two together, an internal team decided to establish what cost breakthroughs might be needed to keep the regulator at bay – leading to major change both operationally and organisationally saving many millions of pounds.

Finally turning to the economic value added from a strategy audit, this might reside in:

- Its having a protective, 'insurance' kind of value – ensuring that any major blind-spots are discovered and addressed.
- It might actually identify some major areas for high-value, strategic development.
- It can help to cut out unnecessary bureaucracy/inappropriate emphasis in strategic business planning – and control processes.
- It can make the top team much more self-confident and able to press ahead rapidly – and decisively – with a robust strategy.
- It will make the top team's (and the FD's) orientation more strategic and a good deal less narrowly functional.
- It can help to reduce or dispute unhelpful organisational politics.
- In a nutshell, the strategic audit concept can help both internal and external accountants to add – and be seen to add – a lot more economic value.

Perhaps to get started, think about one area of the business/your client and draft some questions that you might feel need answering, and then pilot answering them with some scores.

In summary, from many perspectives a strategy audit seems a very helpful, if not essential, ingredient of good corporate housekeeping and governance. It has many similarities to a financial audit, but is perhaps different in being more wide ranging. The accountant – whether internal or external – is ideally placed to help to put this in place. Not only are there plenty of benefits to the CEO and other stakeholders, but doing this ought to reduce governance tensions too.