

4 The Internal Assessment

CHAPTER OBJECTIVES

After studying this chapter, you should be able to do the following:

- 1. Explain how the nature and role of chief marketing officer has changed.
- 2. Be able to work out breakeven analysis business problems.
- 3. Describe how to perform an internal strategic-management audit.
- 4. Discuss the resource-based view (RBV) in strategic management.
- 5. Discuss key interrelationships among the functional areas of business.
- 6. Identify the basic functions or activities that make up management, marketing, finance and accounting, production and operations, research and development, and management information systems.
- 7. Explain how to determine and prioritize a firm's internal strengths and weaknesses.
- 8. Explain the importance of financial ratio analysis.
- 9. Discuss the nature and role of management information systems in strategic management.
- 10. Develop an internal factor evaluation (IFE) matrix.
- 11. Explain cost/benefit analysis, value chain analysis, and benchmarking as strategic-management tools.

ASSURANCE OF LEARNING EXERCISES

The following exercises are found at the end of this chapter.

- **EXERCISE 4A** Apply Breakeven Analysis
- **EXERCISE 4B** Comparing Priceline.com with Expedia.com
- **EXERCISE 4C** Perform a Financial Ratio Analysis for PepsiCo
- **EXERCISE 4D** Construct an IFE Matrix for PepsiCo
- **EXERCISE 4E** Construct an IFE Matrix for Your University

This chapter focuses on identifying and evaluating a firm's strengths and weaknesses in the functional areas of business, including management, marketing, finance and accounting, production and operations, research and development (R&D), and management information systems (MIS). Relationships among these areas of business are examined. Strategic implications of important functional area concepts are examined. The process of performing an internal audit is described. The resource-based view (RBV) of strategic management is introduced as is the value chain analysis (VCA) concept. Priceline.com does an excellent job using its strengths to capitalize on external opportunities. Priceline is showcased in the opening chapter boxed insert.

The Nature of an Internal Audit

All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Maytag, for example, is known for excellent production and product design, whereas Procter & Gamble is known for superb marketing. Internal strengths and weaknesses, coupled with external opportunities and threats and clear vision and mission statements, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing on internal strengths and overcoming weaknesses. The internal-audit part of the strategic-management process is illustrated in [Figure 4-1](#) with white shading.

Priceline.com, Inc.: EXCELLENT STRATEGIC MANAGEMENT SHOWCASED



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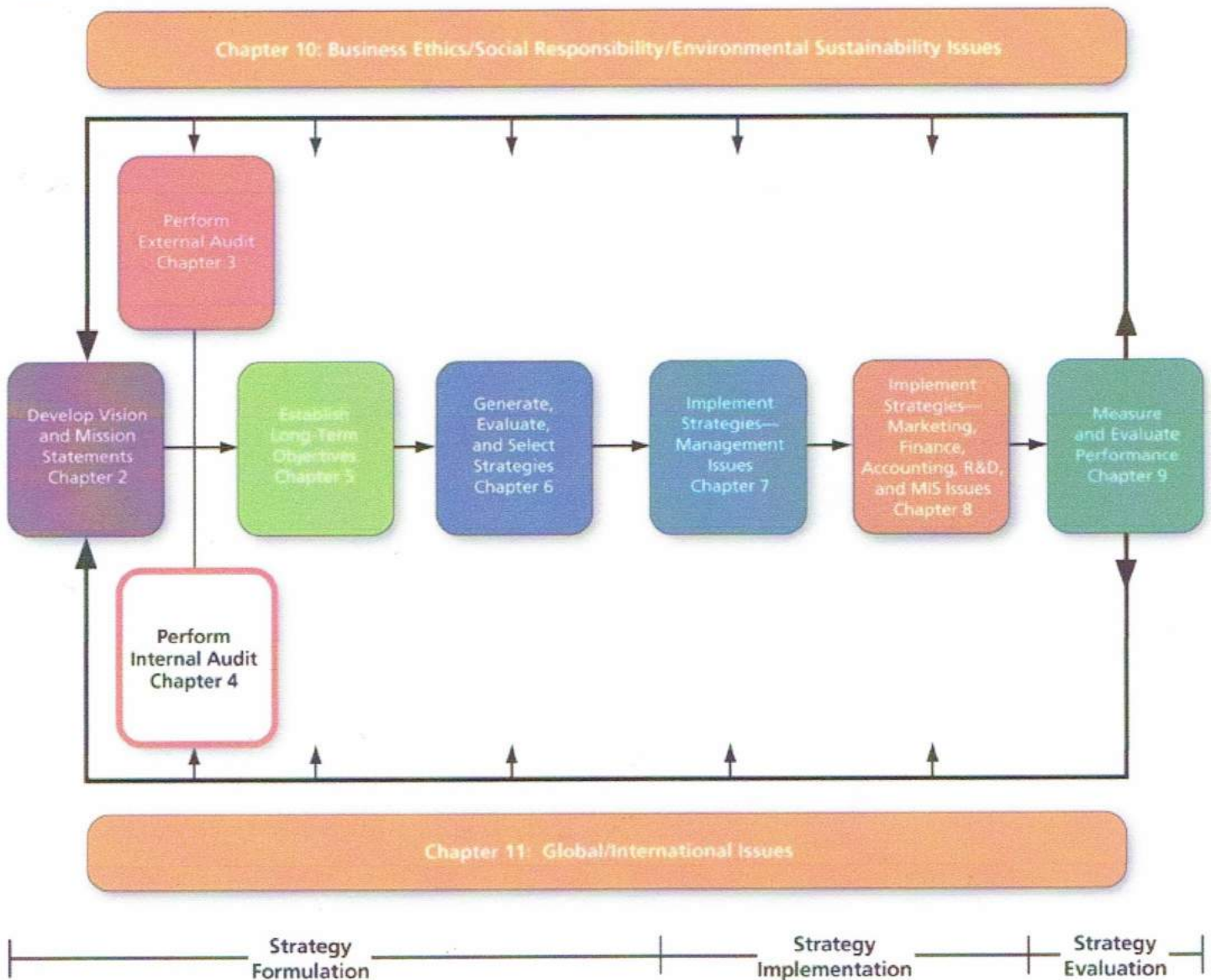
Do you prefer Priceline or Expedia to find low travel prices? Headquartered in Norwalk, Connecticut, Priceline.com Inc. is the leading online travel company where buyers “name their own price” for airline tickets, hotel rooms, rental cars, cruises, and vacation packages. Founded in 1997 with a patented business model, Priceline.com operates through the Booking.com, Priceline.com, TravelJigsaw, and Agoda brand names. Priceline.com uses excellent strategic management to dominate the online travel business. For example, the company generates annual sales of more than \$4 billion and has an EPS of more than \$30. Priceline’s common stock (PCLN) had the best five-year (2007–2011) performance of all companies in the S&P 500: a total return of 972 percent. Many analysts have a \$750.00/share price target for Priceline stock. In the last 12 months, PCLN’s return on assets was 23.08 percent, compared to its competitors Expedia (EXPE)’s 4.19 percent and Orbitz World Wide (OWW)’s 2.60. PCLN’s return on equity was 48.41 percent, much higher than EXPE’s 13.44 percent and Orbitz World Wide OWW’s negative 21.25. PCLN’s profit margin for the last 12 months was 25.58 percent, compared to EXPE’s 10.42 percent and OWW’s negative 4.83.

With more than 5,000 employees, Priceline’s customers can choose set-price options. For airline tickets and hotel reservations, Priceline.com generates sales on the margin, keeping the difference between the price paid by the individual and what Priceline.com paid for the ticket or hotel room. Priceline’s recent success has been especially driven by international travel, particularly to emerging market destinations. About 65 percent of Priceline.com hotel room bookings are expected to be non-European going forward, up from 42 percent the prior year.

Priceline provides price-disclosed hotel and rental car reservation services on a worldwide basis with approximately 185,000 hotels and accommodations in 160 countries. The company’s rental car services operate through its Name Your Own Price demand-collection system, as well as vacation packages consisting of airfare, hotel, and rental car components; cruise trips; and destination services, including parking, event tickets, ground transfers, and tours in the USA. Priceline provides an optional travel insurance package that covers trip cancellation, trip interruption, medical expenses, and emergency evacuation, as well as for loss of baggage, property, and travel documents for air, hotel, and vacation package customers; and collision damage waiver insurance for rental car customers in the USA.

Priceline’s major competitor, Expedia, was founded in 1996, a year before Priceline. Priceline has four times the volume of revenues of Expedia, but the two firms aggressively compete every day for customers worldwide.

FIGURE 4-1 A Comprehensive Strategic-Management Model



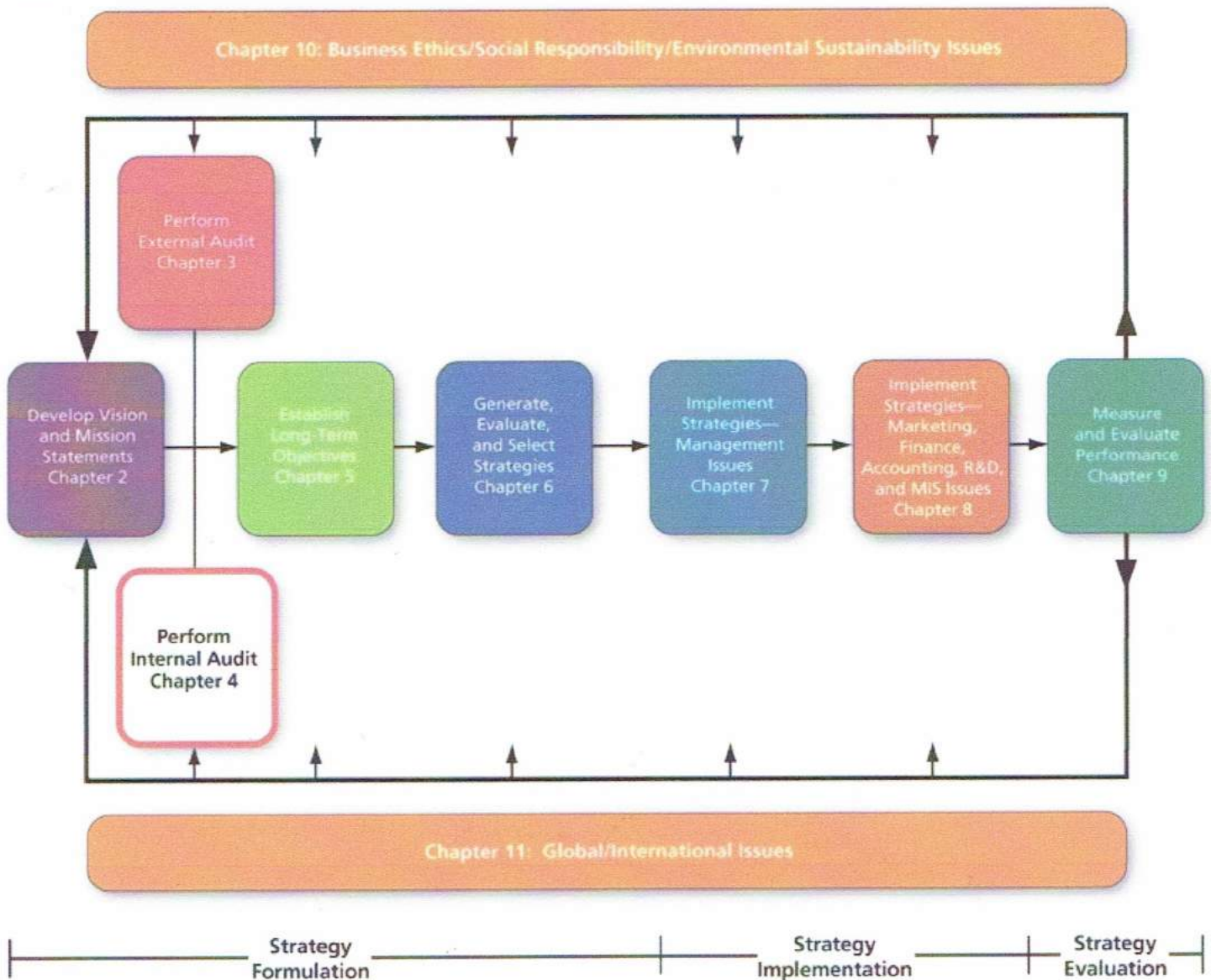
Source: Fred R. David, "How Companies Define Their Mission," *Long Range Planning* 22, no. 3 (June 1988): 40.

Key Internal Forces

It is not possible in a strategic-management text to review in depth all the material presented in courses such as marketing, finance, accounting, management, management information systems, and production and operations; there are many subareas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. But strategic planning must include a detailed assessment of how the firm is doing in all internal areas.

For different types of organizations, such as hospitals, universities, and government agencies, the functional business areas, of course, differ. In a hospital, for example, functional areas may include cardiology, hematology, nursing, maintenance, physician support, and receivables. Functional areas of a university can include athletic programs, placement services, housing, fund-raising, academic research, counseling, and intramural programs. Within large organizations, each division has certain strengths and weaknesses.

A firm's strengths that cannot be easily matched or imitated by competitors are called **distinctive competencies**. Building competitive advantages involves taking advantage of distinctive competencies. Strategies are designed in part to improve on a firm's weaknesses, turning them into strengths—and maybe even into distinctive competencies.



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