The biggest levers you've got to change a company are strategy, structure, and culture. If I could pick two, I'd pick strategy and culture. – Wayne Leonard, CEO, Entergy

Weak leadership can wreck the soundest strategy. – Sun Zi
The Nature of an Internal Audit

Functional Areas of Business

-- Strengths
-- Weaknesses

Nature of an Internal Audit

Basis for Objectives & Strategies

- Internal strengths/weaknesses
- External opportunities/threats
- Clear statement of mission

Key Internal Forces

Functional Business Areas:

- Vary by organization
- Divisions have differing strengths & weaknesses

Key Internal Forces

Distinctive Competencies:

- Firm’s strengths that cannot be easily matched or imitated by competitors

Key Internal Forces

Distinctive Competencies:

- Building competitive advantage involves taking advantage of distinctive competencies

Key Internal Forces

Distinctive Competencies:

- Strategies designed to improve on a firm’s weaknesses and turn to strengths
Internal Audit

Parallels process of external audit

- Information from:
  - Management
  - Marketing
  - Finance/accounting
  - Production/operations
  - Research & Development
  - Management information Systems

Involvement in performing an internal strategic-management audit provides vehicle for understanding nature and effect of decisions in other functional business areas of the firm.

Key to Organizational Success

Coordination & understanding among managers from all functional areas

Number and complexity increases relative to organization size

Financial Ratio Analysis

Exemplifies complexity of relationships among functional areas of the business

Approach to Competitive Advantage

Internal resources are more important than external factors.
Resource Based View (RBV)

3 All Encompassing Categories

1. Physical resources
2. Human resources
3. Organizational resources

Resource Based View (RBV)

Empirical Indicators

- Rare
- Hard to imitate
- Not easily substitutable

Integrating Strategy & Culture

Organizational Culture

Pattern of behavior developed by an organization as it learns to cope with its problem of external adaptation and internal integration…is considered valid and taught to new members

Integrating Strategy & Culture

Organizational Culture

- Resistant to change
- May represent
  - Strength
  - Weakness

Integrating Strategy & Culture

Organizational Culture Can Inhibit Strategic Management

- Miss external changes due to strongly held beliefs
- Natural tendency to “hold the course” even during times of strategic change
Management

Functions of Management

1. Planning
2. Organizing
3. Motivating
4. Staffing
5. Controlling

Stage When Most Important

<table>
<thead>
<tr>
<th>Function</th>
<th>Stage When Most Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning</td>
<td>Strategy Formulation</td>
</tr>
<tr>
<td>Organizing</td>
<td>Strategy Implementation</td>
</tr>
<tr>
<td>Motivating</td>
<td>Strategy Implementation</td>
</tr>
<tr>
<td>Staffing</td>
<td>Strategy Implementation</td>
</tr>
<tr>
<td>Controlling</td>
<td>Strategy Evaluation</td>
</tr>
</tbody>
</table>

Planning

- Beginning of management process
- Bridge between present & future
- Improves likelihood of attaining desired results

Organizing

- Achieves coordinated effort
- Defines task & authority relationships
- Departmentalization
- Delegation of authority

Organizational design
- Job specialization
- Job descriptions
- Job specifications
- Span of control
- Unity of command
- Coordination
- Job design
- Job analysis
Management

Motivating
- Influencing to accomplish specific objectives
- Communication – major component

Management

Staffing
- Personnel management
- Human resources management

Management

Controlling
- Establishing performance standards
- Ensure actual operations conform to planned operations
- Taking corrective actions

Management

Leadership
- Communication
- Work groups
- Job enrichment
- Job satisfaction
- Needs fulfillment
- Organizational change
- Morale

Management

Wage & salary admin.
- Employee benefits
- Interviewing
- Hiring
- Discharging
- Training
- Management development
- Affirmative Action
- EEO
- Labor relations

Management

Quality
- Financial
- Sales
- Inventory
- Expense
- Analysis of variance
- Rewards
- Sanctions
Management Audit Checklist

• Does the firm use strategic management concepts?
• Are objectives/goals measurable? Well communicated?
• Do managers at all levels plan effectively?

Management Audit Checklist

• Do managers delegate well?
• Is the organization’s structure appropriate?
• Are job descriptions clear?
• Are job specifications clear?
• Is employee morale high?

Management Audit Checklist

• Is employee absenteeism low?
• Is employee turnover low?
• Are the reward mechanisms effective?
• Are the organization’s control mechanisms effective?

Marketing

Customer Needs/Wants for Products/Services

1. Defining
2. Anticipating
3. Creating
4. Fulfilling

Marketing Functions

1. Customer analysis
2. Selling products/services
3. Product & service planning
4. Pricing
5. Distribution
6. Marketing research
7. Opportunity analysis

Marketing

Customer surveys
Consumer information
Market positioning strategies
Customer profiles
Market segmentation strategies
Marketing
Opportunity Analysis
1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm’s market share been increasing?
4. Are the distribution channels reliable & cost effective?
5. Is the sales force effective?
6. Does the firm conduct market research?
7. Are product quality & customer service good?
8. Are the firm’s products/services priced appropriately?
9. Does the firm have effective promotion, advertising, & publicity strategies?
10. Are the marketing planning & budgeting effective?
11. Do the firm’s marketing managers have adequate experience and training?

Finance/Accounting
Finance/Accounting Functions
1. Investment decision (Capital budgeting)
2. Financing decision
3. Dividend decision

Basic Financial Ratios

<table>
<thead>
<tr>
<th>Ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm’s ability to meet its short-term obligations</td>
</tr>
<tr>
<td>Current ratio</td>
</tr>
<tr>
<td>Quick (or acid test) ratio</td>
</tr>
</tbody>
</table>

Liquidity Ratios
Basic Financial Ratios

**Extent of debt financing**
- Leverage Ratios
  - Debt-to-total assets
  - Debt-to-equity
  - Long-term debt-to-equity
  - Times-interest earned

**Effective use of firm’s resources**
- Activity Ratios
  - Ratios
    - Inventory-turnover
    - Fixed assets turnover
    - Total assets turnover
    - Accounts receivable turnover
    - Average collection period

**Effectiveness shown by returns on sales & investment**
- Profitability Ratios
  - Ratios
    - Gross profit margin
    - Operating profit margin
    - Net profit margin
    - Return on total assets (ROA)
  - Profitability Ratios (cont’d)
    - Return on stockholders equity (ROE)
    - Earnings per share
    - Price-earnings ratio

**Firm’s ability to maintain economic position**
- Growth Ratios
  - Ratios
    - Sales
    - Net income
    - Earnings per share
    - Dividends per share

**Finance/Accounting Audit**
- Where is the firm strong/weak indicated by financial ratio analysis?
- Can the firm raise short-term capital as needed?
- Can the firm raise long-term capital as needed through debt and/or equity?
Finance/Accounting Audit

- Does the firm have sufficient working capital?
- Are capital budgeting procedures effective?
- Are dividend payout policies reasonable?
- Are the firm's financial managers experienced & well trained?

Production/Operations

Production/Operations Functions

- Process
- Capacity
- Inventory
- Workforce
- Quality

Production/Operations

Process
- Facility design
- Technology selection
- Facility layout
- Process flow analysis
- Facility location
- Line balancing
- Process control

Capacity
- Forecasting
- Facilities planning
- Aggregate planning
- Scheduling
- Capacity planning
- Queuing analysis

Inventory
- Raw materials
- Work in process
- Finished goods
- Materials handling

Workforce
- Job design
- Work measurement
- Work standards
- Motivation techniques
Production/Operations

Quality

Quality control
Sampling
Testing
Quality assurance
Cost Control

Production/Operations Audit

• Are quality-control policies & procedures effective?
• Are facilities, equipment & machinery in good condition?
• Are inventory-control policies and procedures effective?

Research & Development

Research & Development Functions

• Development of new products before competitors
• Improving product quality
• Improving manufacturing processes to reduce costs

Research & Development Audit

• Are the R&D facilities adequate?
• If R&D is outsourced, is it cost effective?
• Are the R&D personnel well qualified?
• Are R&D resources allocated effectively?
Research & Development Audit

• Are MIS and computer systems adequate?
• Is communication between R&D & other organizational units effective?
• Are present products technologically competitive?

Management Information Systems

Purpose

• Improve performance of an enterprise by improving the quality of managerial decisions.

Management Information Systems

Information Systems

- CIO/CTO
- Security
- User-friendly
- E-commerce

Management Information Systems Audit

- Do managers use the information system to make decisions?
- Is there a CIO or Director of information systems position in the firm?
- Is data updated regularly?

Management Information Systems Audit

- Do managers from all functional areas contribute input to the information system?
- Are there effective passwords for entry into the firm’s information system?
- Are strategists of the firm familiar with the information systems of rival firms?

Management Information Systems Audit

- Is the information system user-friendly?
- Do all users understand the competitive advantages that information can provide?
- Are computer training workshops provided for users?
- Is the firm’s system being improved?
### IFE – Gateway Computers (2003)

#### Key Internal Factors

**Strengths**

1. Several new senior executive with world-class skills and leadership experience  
   Weight: 0.05  
   Rating: 4  
   Wtd Score: 0.20
2. Continuous decline in operating costs and cost of goods sold  
   Weight: 0.05  
   Rating: 3  
   Wtd Score: 0.15
3. Well-known brand name  
   Weight: 0.05  
   Rating: 3  
   Wtd Score: 0.15
4. Consumer Reports (Sept 2002) recommended Gateway 500X as #1  
   Weight: 0.10  
   Rating: 4  
   Wtd Score: 0.40
5. As a direct seller, Gateway holds high brand recognition  
   Weight: 0.05  
   Rating: 3  
   Wtd Score: 0.15

**Weaknesses**

1. High operating expense (22% of revenue vs. 10% for Dell)  
   Weight: 0.05  
   Rating: 3  
   Wtd Score: 0.15
2. Almost no budget for R&D vs. Dell’s 18% of revenue  
   Weight: 0.10  
   Rating: 1  
   Wtd Score: 0.05
3. Low return on assets ratio  
   Weight: 0.025  
   Rating: 1  
   Wtd Score: 0.05
4. No niche market  
   Weight: 0.025  
   Rating: 2  
   Wtd Score: 0.10

### IFE – Gateway Computers (2003)

#### Key Internal Factors

**Strengths (cont’d)**

6. Gateway is diversifying into non-PC products  
   Weight: 0.10  
   Rating: 3  
   Wtd Score: 0.30
7. Good relationship with its suppliers.  
   Weight: 0.05  
   Rating: 4  
   Wtd Score: 0.20
8. Economies of scale, the 6th largest PC maker in the world  
   Weight: 0.05  
   Rating: 4  
   Wtd Score: 0.20
9. Gateway retail stores excellent  
   Weight: 0.05  
   Rating: 3  
   Wtd Score: 0.15

**Weaknesses (cont’d)**

5. Shortage of cash due to successive losses  
   Weight: 0.10  
   Rating: 2  
   Wtd Score: 0.20
6. Limited number Gateway stores  
   Weight: 0.05  
   Rating: 2  
   Wtd Score: 0.10
7. Weak performance in overseas market  
   Weight: 0.10  
   Rating: 2  
   Wtd Score: 0.20

**TOTAL**  
Wtd Score: 2.85

### Key Terms & Concepts

- Activity Ratios
- Capital Budgeting
- Communication
- Controlling
- Dividend Decision
- Empirical Indicators
- Financial Ratio Analysis
- Financing Decision
- Functions of Finance/Accounting
- Functions of Management
- Functions of Marketing
- Functions of Production/Operations
- Cost/Benefit Analysis
- Cultural Products
- Distinctive Competencies
- Distribution
Key Terms & Concepts

- Growth Ratios
- Investment Decision
- Human Resource Management
- Leverage Ratios
- Internal Audit
- Liquidity Ratios
- Internal Factor Evaluation (IFE) Matrix
- Management Information Systems

Key Terms & Concepts

- Motivating
- Personnel Management
- Opportunity Analysis
- Planning
- Organizational Culture
- Pricing
- Organizing
- Product & Service Planning

Key Terms & Concepts

- Production/Operations Functions
- Selling
- Profitability Ratios
- Staffing
- Research & Development
- Synergy
- Resource Based View (RBV)
- Test Marketing

Key Terms & Concepts

- Value Chain Analysis (VCA)