**CHAPTER Four**

**INTERNAL ASSESSMENT**

* 1. **The Nature of Internal Audit**

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. All organizations have strengths and weaknesses in the functional areas of business. No enterprise is equally strong or weak in all areas. Internal strengths/weaknesses, coupled with external opportunities/threats and a clear statement of mission, provide the basis for establishing objectives and strategies. Objectives and strategies are established with the intention of capitalizing upon internal strengths and overcoming weaknesses.

Internal audit creates an environment of coordination and understanding among managers from all functional areas. Internal audit is parallels process of external audit. It gathers & assimilates information from:

* Management
* Marketing
* Finance/accounting
* Production/operations
* Research & development
* Management information systems
  1. **Key Internal Forces;**

It is not possible in a business policy text to review in depth all the material presented in courses such as marketing, finance, accounting, management, computer information systems, and production/operations; there are many sub areas within these functions, such as customer service, warranties, advertising, packaging, and pricing under marketing. 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 may be even into distinctive competencies. Some researchers emphasize the importance of the internal audit part of the strategic-management process by comparing it to the external audit.

* 1. **The Process of Performing an Internal Audit**

The process of performing an internal audit closely parallels the process of performing an external audit. Representative Managers and employees from throughout the firm need to be involved in determining a firm's strengths and weaknesses. The internal audit requires gathering and assimilating information about the firm's management, marketing, finance/accounting, production/operations, research and development (R&D), and computer information systems operations.

Compared to the external audit, the process of performing an internal audit provides more opportunity for participants to understand how their jobs, departments, and divisions fit into the whole organization. This is a great benefit because managers and employees perform better when they understand how their work affects other areas and activities of the firm. For example, when marketing and manufacturing managers jointly discuss issues related to internal strengths and weaknesses, they gain a better appreciation of issues, problems, concerns, and needs in all the functional areas. In organizations that do not use strategic management, marketing, finance, and manufacturing managers often do not interact with each other in significant ways. Performing an internal audit, thus, is an excellent vehicle or forum for improving the process of communication in the organization. Communication may be the most important word in management. Performing an internal audit requires gathering, assimilating, and evaluating information about the firm's operations. Critical success factors, consisting of both strengths and weaknesses, can be identified and prioritized in the manner discussed later chapters. The development of conclusions on the 10 to 20 most important organizational strengths and weaknesses can be, as any experienced manager knows, a difficult task, when it involves managers representing various organizational interests and points of view. Developing a 20-page list of strengths and weaknesses could be accomplished relatively easily, but a list of the 10 to 15 most important ones involves significant analysis and negotiation. This is true because of the judgments that are required and the impact which such a list will inevitably have as it is used in the formulation, implementation, and evaluation of strategies.

Strategic management is a highly interactive process that requires effective coordination among management, marketing, finance/accounting, production/operations, R&D, and computer information systems managers. Although the strategic-management process is overseen by strategists, success requires that managers and employees from all functional areas work together to provide ideas and information. Financial managers, for example, may need to restrict the number of feasible options available to operations managers, or R&D managers may develop such good products that marketing managers need to set higher objectives. A key to organizational success is effective coordination and understanding among managers from all functional business areas. Through involvement in performing an internal strategic-management audit, managers from different departments and divisions of the firm come to understand the nature and effect of decisions in other functional business areas in their firm. Knowledge of these relationships is critical for effectively establishing objectives and strategies. A failure to recognize and understand relationships among the functional areas of business can be detrimental to strategic management, and the number of those relationships that must be managed increases dramatically with a firm's size, diversity, geographic dispersion, and the number of products or services offered. Governmental and nonprofit enterprises traditionally have not placed sufficient emphasis on relationships among the business functions. For example, some state governments, utilities, universities, and hospitals only recently have begun to establish marketing objectives and policies that are consistent with their financial capabilities and limitations. Some firms place too great an emphasis on one function at the expense of others.

* 1. **The Resource-Based View (RBV)**

Some researchers emphasize the importance of the internal audit part of the strategic management process by comparing it to the external audit. Robert Grant concluded that the internal audit is more important, saying:

In a world where customer preferences are volatile, the identity of customers is changing, and the technologies for serving customer requirements are continually evolving, an externally focused orientation does not provide a secure foundation for formulating long-term strategy. When the external environment is in a state of flux, the firm’s own resources and capabilities may be a much more stable basis on which to define its identity. Hence, a definition of a business in terms of what it is capable of doing may offer a more durable basis for strategy than a definition based upon the needs which the business seeks to satisfy.

The Resource-Based View (RBV) approach to competitive advantage contends that internal resources are more important for a firm than external factors in achieving and sustaining competitive advantage. In contrast to the I/O theory presented in the previous chapter, proponents of the RBV view contend that organizational performance will primarily be determined by internal resources that can be grouped into three all-encompassing categories: physical resources, human resources, and organizational resources. Physical resources include all plant and equipment, location, technology, raw materials, machines; human resources include all employees, training, experience, intelligence, knowledge, skills, abilities; and organizational resources include firm structure, planning processes, information systems, patents, trademarks, copyrights, databases, and so on. RBV theory asserts that resources are actually what helps a firm exploit opportunities and neutralize threats.

The basic premise of the RBV is that the mix, type, amount, and nature of a firm’s internal resources should be considered first and foremost in devising strategies that can lead to sustainable competitive advantage. Managing strategically according to the RBV involves developing and exploiting a firm’s unique resources and capabilities, and continually maintaining and strengthening those resources. The theory asserts that it is advantageous for a firm to pursue a strategy that is not currently being implemented by any competing firm.

When other firms are unable to duplicate a particular strategy, then the focal firm has a sustainable competitive advantage, according to RBV theorists.

For a resource to be valuable, it must be either (1) rare, (2) hard to imitate, or (3) not easily substitutable. Often called empirical indicators, these three characteristics of resources enable a firm to implement strategies that improve its efficiency and effectiveness and lead to a sustainable competitive advantage. The more a resource(s) is rare, non-imitable, and non-substitutable, the stronger a firm’s competitive advantage will be and the longer it will last.

Rare resources are resources that other competing firms do not possess. If many firms have the same resource, then those firms will likely implement similar strategies, thus giving no one firm a sustainable competitive advantage. This is not to say that resources that are common are not valuable; they do indeed aid the firm in its chance for economic prosperity. However, to sustain a competitive advantage, it is more advantageous if the resource(s) is also rare.

It is also important that these same resources be difficult to imitate. If firms cannot easily gain the resources, say RBV theorists, then those resources will lead to a competitive advantage more so than resources easily imitable. Even if a firm employs resources that are rare, a sustainable competitive advantage may be achieved only if other firms cannot easily obtain these resources.

The third empirical indicator that can make resources a source of competitive advantage is substitutability. Borrowing from Porter’s Five-Forces Model, to the degree that there are no viable substitutes, a firm will be able to sustain its competitive advantage.

However, even if a competing firm cannot perfectly imitate a firm’s resource, it can still obtain a sustainable competitive advantage of its own by obtaining resource substitutes.

The RBV has continued to grow in popularity and continues to seek a better understanding of the relationship between resources and sustained competitive advantage in strategic management. However, as alluded to in Chapter 3, one cannot say with any degree of certainty that either external or internal factors will always or even consistently be more important in seeking competitive advantage. Understanding both external and internal factors, and more importantly, understanding the relationships among them, will be the key to effective strategy formulation. Because both external and internal factors continually change, strategists seek to identify and take advantage of positive changes and buffer against negative changes in a continuing effort to gain and sustain a firm’s competitive advantage. This is the essence and challenge of strategic management, and oftentimes survival of the firm hinges on this work.

1. **MANAGEMENT**

The functions of management consist of five basic activities: planning, organizing, motivating, staffing, and controlling.

**Planning-** Planning consists of all those managerial activities related to preparing for the future. Specific tasks include forecasting, establishing objectives, devising strategies, developing policies, and setting goals. Strategy Formulation

**Organizing-** Organizing includes all those managerial activities that result in a structure of task and authority relationships. Specific areas include organizational design, job specialization, job descriptions, job specifications, span of the control, unity of command, coordination, job design, and job analysis.

**Motivating-** Motivating involves efforts directed toward shaping human behavior. Specific topics include leadership, communication, work groups, behavior modification, and delegation of authority, job enrichment, job satisfaction, needs fulfillment, organizational change, employee morale, and managerial morale. Strategy Implementation

**Staffing-** Staffing activities are centered on personnel or human resource management. Included are wage and salary administration, employee benefits, interviewing, hiring, firing, training, management development, employee safety, affirmative action, equal employment opportunity, union relations, career development, personnel research, discipline policies, grievance procedures, and public relations Strategy.

**Controlling-** Controlling refers to all those managerial activities directed toward ensuring that actual results are consistent with planned results. Key areas of concern include quality control, financial control, sales control, inventory control, and expense control, analysis of variances, rewards, and sanctions. Strategy Evaluation

**Management Audit Checklist of Questions**

The checklists of questions provided below can help determine specific strengths and weaknesses in the functional area of business. An answer of no to any question could indicate a potential weakness, although the strategic significance and implications of negative answers, of course, will vary by organization, industry, and severity of the weakness. Positive or yes answers to the checklist questions suggest potential areas of strength.

1. Does the firm use strategic-management concepts?

2. Are company objectives and goals measurable and well communicated?

3. Do managers at all hierarchical levels plan effectively?

4. Do managers delegate authority well?

5. Is the organization's structure appropriate?

6. Are job descriptions and job specifications clear?

7. Is employee morale high?

8. Are employee turnover and absenteeism low?

9. Are organizational reward and control mechanisms effective?

2) **MARKETING**

**Marketing** can be described as the process of defining, anticipating, creating, and fulfilling customers' needs and wants for products and services.

There are seven basic functions of marketing:

(1) Customer analysis,

(2) Selling products/services,

(3) Product and service planning,

(4) Pricing,

(5) Distribution,

(6) Marketing research, and

(7) Opportunity analysis.

Understanding these functions helps strategists identify and evaluate marketing strengths and weaknesses.

**Customer Analysis**

Customer analysis—the examination and evaluation of consumer needs, desires, and wants—involves administering customer surveys, analyzing consumer information, evaluating market positioning strategies, developing customer profiles, and determining optimal market segmentation strategies. The information generated by customer analysis can be essential in developing an effective mission statement. Customer profiles can reveal the demographic characteristics of an organization's customers. Buyers, sellers, distributors, salespeople, managers, wholesalers, retailers, suppliers, and creditors can all participate in gathering information to identify customers' needs and wants successfully. Successful organizations continually monitor present and potential customers' buying patterns.

**Selling Products/Services** Successful strategy implementation generally rests upon the ability of an organization to sell some product or service. Selling includes many marketing activities such as advertising, sales promotion, publicity, personal selling, sales force management, customer relations, and dealer relations. These activities are especially critical when a firm pursues a market penetration strategy. The effectiveness of various selling tools for consumer and industrial products varies. Personal selling is most important for industrial goods companies, and advertising is most important for consumer goods companies. Determining organizational strengths and weaknesses in the selling function of marketing is an important part of performing an internal strategic management audit. With regard to advertising products and services on the Internet, a new trend is to base advertising rates exclusively on sale rates. This new accountability contrasts sharply with traditional broadcast and print advertising that bases rates on the number of persons expected to see a given advertisement. The new costper- sale online advertising rates are possible because any Web site can monitor which user clicks on which advertisement and then can record whether that consumer actually buys the product. If there are no sales, then the advertisement is free. The most popular type of Internet advertisement is the banner. However, many people just ignore online banner advertisements.

**Product and Service Planning** Product and service planning includes activities such as test marketing; product and brand positioning; devising warranties; packaging; determining product options, product features, product style, and product quality; deleting old products; and providing for customer service. Product and service planning is particularly important when a company is pursuing product development or diversification. One of the most effective product and service planning techniques is test marketing. Test markets allow an organization to test alternative marketing plans and to forecast future sales of new products. In conducting a test market project, an organization must decide how many cities to include, which cities to include, how long to run the test, what information to collect during the test, and what action to take after the test has been completed. Test marketing is used more frequently by consumer goods companies than by industrial goods companies. Test marketing can allow an organization to avoid substantial losses by revealing weak products and ineffective marketing approaches before large-scale production begins.

**Pricing**

Five major stakeholders affect pricing decisions:

* Consumers,
* Governments,
* Suppliers,
* Distributors,
* Competitors.

Sometimes an organization will pursue a forward integration strategy primarily to gain better control over prices charged to consumers. Governments can impose constraints on price fixing, price discrimination, minimum prices, unit pricing, price advertising, and price controls. Competing organizations must be careful not to coordinate discounts, credit terms, or condition of sale; not to discuss prices, markups, and costs at trade association meetings; and not to arrange to issue new price lists on the same date, to rotate low bids on contracts, or to uniformly restrict production to maintain high prices. Strategists should view price from both a short-run and a long-run perspective, because competitors can copy price changes with relative ease. Often a dominant firm will aggressively match all price cuts by competitors.

**Distribution**   
Distribution includes warehousing, distribution channels, distribution coverage, retail site locations, sales territories, inventory levels and location, transportation carriers, wholesaling, and retailing. Most producers today do not sell their goods directly to consumers. Various marketing entities act as intermediaries; they bear a variety of names such as wholesalers, retailers, brokers, facilitators, agents, middlemen, vendors, or simply distributors. Distribution becomes especially important when a firm is striving to implement a market development or forward integration strategy. Some of the most complex and challenging decisions facing a firm concern product distribution. Intermediaries flourish in our economy because many producers lack the financial resources and expertise to carry out direct marketing. Manufacturers who could afford to sell directly to the public often can gain greater returns by expanding and improving their manufacturing operations. Even General Motors would find it very difficult to buy out its more than eighteen thousand independent dealers. Successful organizations identify and evaluate alternative ways to reach their ultimate market. Possible approaches vary from direct selling to using just one or many wholesalers and retailers. Strengths and weaknesses of each channel alternative should be determined according to economic, control, and adaptive criteria. Organizations should consider the costs and benefits of various wholesaling and retailing options. They must consider the need to motivate and control channel members and the need to adapt to changes in the future. Once a marketing channel is chosen, an organization usually must adhere to it for an extended period of time.

**Marketing Research** Marketing research is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services. Marketing research can uncover critical strengths and weaknesses, and marketing researchers employ numerous scales, instruments, procedures, concepts, and techniques to gather information. Marketing research activities support all of the major business functions of an organization. Organizations that possess excellent marketing research skills have a definite strength in pursuing generic strategies.

**Opportunity Analysis**

The eighth function of marketing is opportunity analysis, which involves assessing the costs, benefits, and risks associated with marketing decisions. Three steps are required to perform a cost/benefit analysis:

* Compute the total costs associated with a decision,
* Estimate the total benefits from the decision, and
* Compare the total costs with the total benefits. As expected benefits exceed total costs, an opportunity becomes more attractive. Sometimes the variables included in a cost/benefit analysis cannot be quantified or even measured, but usually reasonable estimates can be made to allow the analysis to be performed. One key factor to be considered is risk. Cost/benefit analyses should also be performed when a company is evaluating alternative ways to be socially responsible.

**Marketing Audit Checklist of Questions**

Similarly as provided earlier for management, the following questions about marketing are pertinent:

1. Are markets segmented effectively?
2. Is the organization positioned well among competitors?
3. Has the firm's market share been increasing?
4. Are present channels of distribution reliable and cost-effective?
5. Does the firm have an effective sales organization?
6. Does the firm conduct market research?
7. Are product quality and customer service good?
8. Are the firm's products and services priced appropriately?
9. Does the firm have an effective promotion, advertising, and publicity strategy?
10. Are marketing planning and budgeting effective?
11. Do the firm's marketing managers have adequate experience and training?
12. **ACCOUNTING / FINANCE**

Financial condition is often considered the single best measure of a firm's competitive position and overall attractiveness to investors. Determining an organization's financial strengths and weaknesses is essential to formulating strategies effectively. A firm's liquidity, leverage, working capital, profitability, asset utilization, cash flow, and equity can eliminate some strategies as being feasible alternatives. Financial factors often alter existing strategies and change implementation plans.

**Finance/Accounting Functions**

* Determining financial strengths and weaknesses key to strategy formulation
* Investment decision (Capital budgeting)
* Financing decision
* Dividend decision

According to James Van Horne, the functions of finance/accounting comprise three decisions: the investment decision, the financing decision, and the dividend decision.

Financial ratio analysis is the most widely used method for determining an organization's strengths and weaknesses in the investment, financing, and dividend areas. Because, the functional areas of business   
are so closely related, financial ratios can signal strengths or weaknesses in management, marketing, production, research and development, and computer information systems activities.   
The **investment decision**, also called **capital budgeting**, is the allocation and reallocation of capital   
and resources to projects, products, assets, and divisions of an organization. Once strategies are   
formulated, capital budgeting decisions are required to implement strategies successfully.

**The financing decision** concerns determining the best capital structure for the firm and includes examining various methods by which the firm can raise capital (for example, by issuing stock, increasing debt, selling assets, or using a combination of these approaches). The financing decision must consider both short-term and long-term needs for working capital. Two key financial ratios that indicate whether a firm's financing decisions have been effective are the debt-to-equity ratio and the debt-to-total-assets ratio.

**Dividend decisions;** concern issues such as the percentage of earnings paid to stockholders, the   
stability of dividends paid over time, and the repurchase or issuance of stock. Dividend decisions   
determine the amount of funds that are retained in a firm compared to the amount paid out to   
stockholders.

**Finance/Accounting Audit Checklist of Questions**

Similarly as provided earlier, the following finance/accounting questions should be examined:

1. Where is the firm financially strong and weak as indicated by financial ratio analyses?
2. Can the firm raise needed short-term capital?
3. Can the firm raise needed long-term capital through debt and/or equity?
4. Does the firm have sufficient working capital?
5. Are capital budgeting procedures effective?
6. Are dividend payout policies reasonable?
7. Does the firm have good relations with its investors and stockholders?
8. Are the firm's financial managers experienced and well trained?
9. **PRODUCTION/OPERATIONS**

The production/operations function of a business consists of all those activities that transform inputs into goods and services. Production/operations management deals with inputs, transformations, and outputs that vary across industries and markets. A manufacturing operation transforms or converts inputs such as raw materials, labor, capital, machines, and facilities into finished goods and services.

**Production/Operations Audit Checklist of Questions**

Questions such as the following should be examined:

1. Are suppliers of raw materials, parts, and subassemblies reliable and reasonable?
2. Are facilities, equipment, machinery, and offices in good condition?
3. Are inventory-control policies and procedures effective?
4. Are quality-control policies and procedures effective?
5. Are facilities, resources, and markets strategically located?
6. Does the firm have technological competencies?
7. **RESEARCH AND DEVELOPMENT**

The fifth major area of internal operations that should be examined for specific strengths and weaknesses is research and development (R&D). Many firms today conduct no R&D, and yet many other companies depend on successful R&D activities for survival. Firms pursuing a product development strategy especially need to have a strong R&D orientation. The purpose of research and development are as follows:

* Development of new products before competition
* Improving product quality
* Improving manufacturing processes to reduce costs. Organizations invest in R&D because they believe that such investment will lead to superior product or services and give them competitive advantages. Research and development expenditures are directed at developing new products before competitors do, improving product quality, or improving manufacturing processes to reduce costs.

**Research and Development Audit Checklist of Questions**

Questions such as follows should be asked in performing an R&D audit:

1. Does the firm have R&D facilities? Are they adequate?
2. If outside R&D firms are used, are they cost-effective?
3. Are the organization's R&D personnel well qualified?
4. Are R&D resources allocated effectively?
5. Are management information and computer systems adequate?
6. Is communication between R&D and other organizational units effective?
7. Are present products technologically competitive?
8. **MANAGEMENT INFORMATION SYSTEMS**

MIS is a general name for the academic discipline covering the application of information technology to business problems. As an area of study it is also referred to as information technology management. The study of information systems is usually a commerce and business administration discipline, and frequently involves software engineering, but also distinguishes itself by concentrating on the integration of computer systems with the aims of the organization. The area of study should not be confused with computer science which is more theoretical in nature and deals mainly with software creation, or computer engineering, which focuses more on the design of computer hardware. IT service management is a practitioner-focused discipline centering on the same general domain. In business, information systems support business processes and operations, decision-making, and competitive strategies.

**Management Information Systems Audit checklist Questions**

* Do all managers in the firm use the information system to make decisions?
* Is there a chief information officer or director of information systems position in the firm?
* Are data in the information system updated regularly?
* Do managers from all functional areas of the firm 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?
* Is the information system user-friendly?
* Are computer training workshops provided for users?
* Is the firm’s system being improved?

**THE VALUE CHAIN ANALYSIS APPROACH:**

Value chain approach developed by Michael Porter, he wrote a book “Competitive Advantage” which identified the value chain approach of the organization. A value chain approach is a systematic way of viewing the serious activities of the organization that performs to provide a product to its customers. The value chain disaggregate an organization into its strategically relevant activities in order to understand the behavior of the organization’s cost and its existing or potential source of differentiation. An organization gains competitive advantage by performing primary and support activities, these activities are more important strategically.

Every organization can be viewed as value chain approach. Value chain approach as a collection of value activities that are performed to design, produce, market, deliver and support its product. The basic categories of value activities can be grouped into two broad types. They are as listed below:

1. Primary activities 2.Support activities

**Primary Activities:**

**Primary activities** are those involved in the physical creation of the product and service in the organization. Its delivery of goods and service and marketing to ultimate buyer and it’s providing after sales support to buyer. These activities are supporting to organization that provide inputs or infrastructure to the business. The goal of these activities is to create value that exceeds the cost of providing the product or service, thus generating a profit margin.

Identifying of the primary value activities requires the isolation of activities that are technologically and strategically distinct in the organization. They are five basic categories of the primary activities as listed below:

* **Inbound logistics** include the receiving, warehousing, and inventory control of input materials.
* **Operations** are the value-creating activities that transform the inputs into the final product.
* **Outbound logistics** are the activities required to get the finished product to the customer, including warehousing, order fulfillment, etc.
* **Marketing & Sales** are those activities associated with getting buyers to purchase the product, including channel selection, advertising, pricing, etc.
* **Service activities** are those that maintain and enhance the product's value including customer support, repair services, etc.

**Support activities:**

Support value activities arise in any one of four activities like procurement, technology development, and human resource management and organization infrastructure. These categories can be identified or disaggregated by isolating technologically or strategically distinct activities. Identifying support activities often overlooked as sources of competitive advantage. The primary value chain activities described above are facilitated by support activities. Porter identified four generic categories of support activities, the details of which are industry-specific. Support activities often are viewed as "overhead", but some firms successfully have used them to develop a competitive advantage, for example, to develop a cost advantage through innovative management of information systems.

* **Procurement -** the function of purchasing the raw materials and other inputs used in the value-creating activities.
* **Technology Development -** includes research and development, process automation, and other technology development used to support the value-chain activities.
* **Human Resource Management -** the activities associated with recruiting, development, and compensation of employees.
* **Firm Infrastructure -** includes activities such as finance, legal, quality management, etc.

**THE INTERNAL FACTOR EVALUATION (IFE) MATRIX**

In multidivisional firms, each autonomous division or strategic business unit should construct an IFE Matrix. Divisional matrices then can be integrated to develop an overall corporate IFE Matrix.   
Both external and internal evaluation together called SWOT analysis for any business firm.   
After reading this lecture you will be able to prepare IFE and EFE matrixes for any business planning.

A summary step in conducting an internal strategic-management audit is to construct an Internal Factor Evaluation (IFE) Matrix. This strategy-formulation tool summarizes and evaluates the major **strengths and weaknesses** in the functional areas of a business, and it also provides a basis for identifying and evaluating relationships among those areas. Intuitive judgments are required in developing an IFE Matrix, so the appearance of a scientific approach should not be interpreted to mean this is an all powerful technique. A thorough understanding of the factors included is more important than the actual numbers. Similar to the EFE Matrix and Competitive Profile Matrix, an IFE Matrix can be developed in five steps:

1. List key internal factors as identified in the internal-audit process. Use a total of from ten to twenty internal factors, including both strengths and weaknesses. Always list strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. The list of all strength and weaknesses should consist of 10-20 factors.
2. Assign a weight (either in %age or in numerical value) that ranges from 0.0 (not important) to 1.0 (all-important) to each factor. The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Regardless of whether a key factor is an internal strength or weakness, factors considered to have the greatest effect on organizational performance should be assigned the highest weights. The sum of all weights must equal 1.0.
3. Assign a 1-to-4 rating (rating means what is the capability of the firm to meet its strength and weaknesses) to each factor to indicate whether that factor represents a major weakness (rating 1), a minor weakness (rating 2), a minor strength (rating 3), or a major strength (rating 4). Note that strengths must receive a 4 or 3 rating and weaknesses must receive a 1 or 2 rating. Ratings are, thus, company based, whereas the weights in Step 2 are industry based.
4. Multiply each factor's weight by its rating to determine a weighted score for each variable.
5. Sum the weighted scores for each variable to determine the total weighted score for the   
   organization.

Highest possible weighted score for the organization is 4.0; the lowest, 1.0. Average = 2.5. Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0, with the average score being 2.5. Total weighted scores well below 2.5 characterize organizations that are weak internally, whereas scores significantly above 2.5 indicate a strong internal position.

Like the EFE Matrix, an IFE Matrix should include from 10 to 20 key factors.

The number of factors has no effect upon the range of total weighted scores because the weights always sum to 1.0. An example of an IFE Matrix for XYZ Casino Enterprises is provided in Table. Note that the firm’s major strengths are its size, occupancy rates, property, and long-range planning as indicated by the rating of 4. The major weaknesses are locations and recent joint venture. The total weighted score of 2.75 indicates that the firm is above average in its overall internal strength.

**A Sample Internal Factor Evaluation Matrix for XYZ Casino**

|  |  |  |  |
| --- | --- | --- | --- |
| **Key Internal Factors** | **Weight** | **Rating** | **Weighted  Score** |
| **Internal Strengths** | | | |
| 1. Largest casino company in the United States | .05 | 4 | .20 |
| 2. Room occupancy rates over 95% in Las Vegas | .10 | 4 | .40 |
| 3. Increasing free cash flows | .05 | 3 | .15 |
| 4. Owns one mile on Las Vegas Strip | .15 | 4 | .60 |
| 5. Strong management team | .05 | 3 | .15 |
| 6. Buffets at most facilities | .05 | 3 | .15 |
| 7. Minimal comps provided | .05 | 3 | .15 |
| 8. Long-range planning | .05 | 4 | .20 |
| 9. Reputation as family-friendly | .05 | 3 | .15 |
| 10.Financial ratios | .05 | 3 | .15 |
| **Internal Weaknesses** | | | |
| 1. Most properties are located in Las Vegas | .05 | 1 | .05 |
| 2. Little diversification | .05 | 2 | .10 |
| 3. Family reputation, not high rollers | .05 | 2 | .10 |
| 4. Laughlin properties | .10 | 1 | .10 |
| 5. Recent loss of joint ventures | .10 | 1 | .10 |
| TOTAL | 1.00 |  | 2.75 |

XYZ Casino has a total weighted score of 2.75indicating that the firm is above average in its overall internal strength. .