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STUDY & TECH NOTES/THE INSTITUTE/EVENTS

study notes

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Paper E3
Enterprise Strategy

Clear definitions exist for the terms "key performance indicators" and "critical success factors", yet many students still confuse the former with targets and seem unable to provide correct examples of the latter
By Adrian Sims

The E3 syllabus contains the following learning outcome: "Recommend appropriate control measures." Included in the indicative syllabus content for this outcome are "critical success factors: links to performance indicators and corporate strategy, and their use as a basis for defining an organisation's information needs".

The E3 exam featured questions on this topic in March 2013, May 2011 and May 2010. At the time of writing this article, the recently released Strategic level pre-seen material, based on the case of T Railways, also features numerous key performance indicators (KPIs) used by the organisation to monitor and assure the business's performance against its financial and non-financial goals.

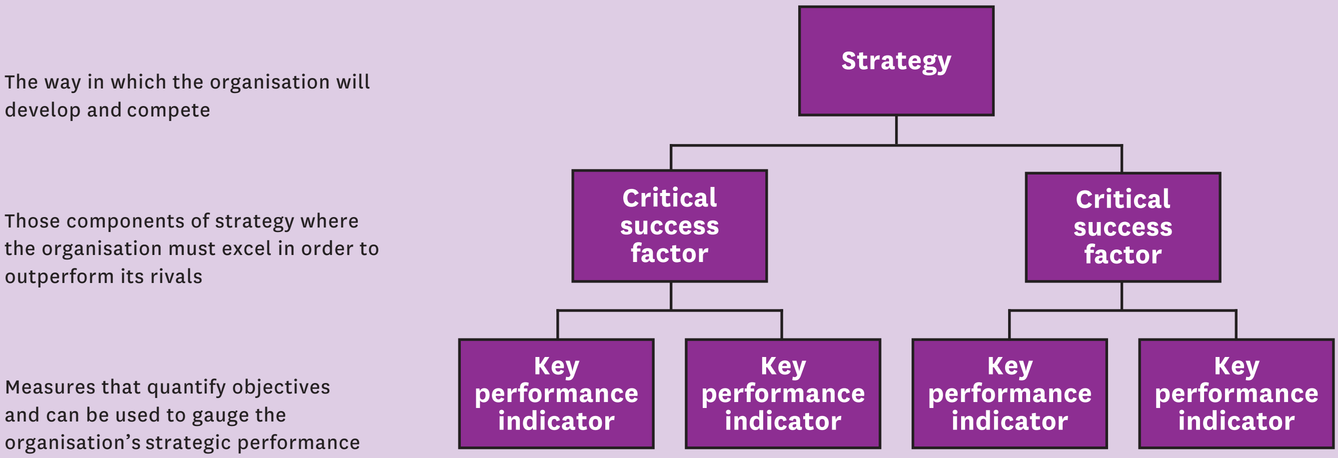
In the March 2013 post-exam guide the examiner states that candidates "do not seem to understand what a critical success factor (CSF) is. Many can write a correct definition but cannot apply this practically. Many of the CSFs presented weren't CSFs. Rather, they were outcomes of achieving a CSF, such as increased market share or profitability. This is an area where candidates must improve".

The institute takes a specific view of CSFs and KPIs, drawn from the work of Gerry Johnson, Kevan Scholes and Richard Whittington in *Exploring Corporate Strategy* (Pearson Education, 2008). In it the authors propose the following six-stage process for strategic management using CSFs and KPIs:

- Identify the CSFs for the strategy.
- Identify the skills that are needed to underpin the delivery of each CSF.
- Ensure that the organisation has sufficient competence in each factor to give it a competitive advantage.
- Identify KPIs. These are performance standards for each CSF that will enable the organisation to outperform its rivals.
- Ensure that competitors are not able to imitate or surpass the organisation's performance on these KPIs.
- Monitor the performance of the organisation, and that of its rivals, against each KPI to ensure that the competitive advantage is maintained.

The purpose of CSFs is to identify the factors that will make the organisation >

The relationship of business strategy with CSFs and KPIs



successful in the eyes of its main stakeholders – usually investors and customers. CSFs for public-sector organisations may relate to the requirements of regulators, the government or society at large.

Johnson, Scholes and Whittington present CSFs chiefly as "performance differentials" – things that will enable an organisation to win customers or supply the market more efficiently. They didn't invent the term and other writers refer to CSFs more broadly to include any element essential for a strategy to be successful. This means that external occurrences, such as economic growth or the passing of a favourable law, may also be CSFs. But it's not recommended that you include these as CSFs when answering E3 questions.

The purpose of KPIs are the same as those of any performance measure. These were neatly summed up by Andy Neely in *Measuring Business Performance* (The Economist Books, 2010) as the "four CPs" of measurement:

- Check position. They enable control by allowing managers to see where the organisation is in relation to its plans and its competitors.
- Communicate position. They are used to report performance internally and to the organisation's external stakeholders.
- Confirm priorities – i.e. the crucial factors on which managers must focus.
- Compel progress. Because performance against KPIs is used to evaluate managers and staff, this ensures that every employee will want to achieve them.

Well-known measurement systems, such as the Balanced Scorecard proposed by Robert Kaplan and David Norton in 1992, can be seen as a development of KPIs. Kaplan and Norton present the four famous perspectives of the Balanced Scorecard as questions:

- Financial perspective: "If we succeed, how will we look to our shareholders?"
- Customer perspective: "To achieve my vision, how must I look to my customers?"
- Internal perspective: "To satisfy my customers, at what processes must I excel?"
- Learning and growth perspective: "To achieve my vision, how must my organisation learn and improve?"

It is very tempting to see CSFs as the answers to these four questions.

Kaplan accepts that organisations used KPIs long before the advent of the Balanced Scorecard. He believes that the main contribution of the balanced scorecard is that it enables managers to group KPIs into four key perspectives that will work together congruently.

Past E3 exams have tested students' ability to do one or both of the following: advise managers on CSFs that can be derived from the organisation's strategy; and advise on KPIs that can be used to monitor CSFs.

Beware of confusing KPIs with targets, because this would cost you marks in the exam. A target proposes a certain level of achievement – e.g.: "The company must reduce its costs by 20 per cent in a year." This is not a KPI. A KPI monitors the performance of the organisation against that of its rivals. Using the same example, the KPI would therefore simply be "relative cost". So, if you're attempting any question on CSFs and KPIs, be careful to avoid suggesting any level of desired performance for a KPI.

Question 1 of the March 2013 exam was based on pre-seen material concerning a holiday company called V. It contained the following 12-mark requirement: "Recommend, with your justifications, one critical success factor that V should consider implementing for each of the four holiday products of Package, Adventure, Prestige Travel and the proposed V-eco holiday product."

The pre-seen material had made it clear that V was operating in a highly competitive market. It provided details of the three types of holidays already offered. The unseen material issued on exam day provided the following information about the four holiday types (I have added italics for emphasis):

- "While good customer service is expected by V's Package customers, most are mainly interested in receiving *good value for money*."
- "Adventure holiday customers have stated that they value *the number of destinations and activities* offered by V."
- "V has an excellent reputation in the prestige holiday market for quality of service. V's Prestige Travel holiday customers value *the level of customer service* very highly and many prefer to book in a branch for a more personalised service, rather than online."
- "The operations director estimates that V-eco holidays could become operational from the start of July 2013, but V would *have to secure contracts* with hotels, transport organisations and other specialist companies before then." >

The examiner therefore wanted the candidates to recommend four CSFs, one for each holiday type. The allocation of 12 marks would suggest one mark for each CSF, which should describe a component of strategy in which V must excel to outperform its rivals, and two marks for each justification.

The examiner would have given credit for any sensible CSF that would help to deliver the specific things that customers valued about Package, Adventure or Prestige holidays, or that would enable the successful launch of V-eco holidays in July 2013.

For example, Package customers want "good value for money". The following CSFs could help to deliver this:

- Prices that are at least as low as those of V's rivals for the same experience (the examiner's own solution cites this CSF).
- Clearer promotion of Package holidays as providing good value for money.

Adventure holiday customers want a range of destinations and activities. There are two things here, so don't try to find a single CSF to cover both. The following CSFs could help to deliver these:

- A wider range of destinations.
- A wider range of activities.
- Clearer promotion of Adventure holidays as providing a wider choice of destinations (or activities).

Prestige holiday customers value personalised service in V's branches. The following CSFs could help to deliver this:

- More personalised service in branches.
- Friendlier and more competent staff working in branches.
- Improved staff selection and training.

The V-eco holidays have to be ready by July 2013 and they need to be ecologically friendly. The examiner's solution emphasised the environmental credentials of these holidays, but a CSF that stressed launching them in time and before V's rivals market similar products would also have gained credit. Therefore the CSFs available here could include the following:

- Lower CO_2 emissions from the holidays.
- A reduced impact on the natural environment at the destinations.
- Clearer promotion of the ecological credentials of V-eco holidays.
- Contracts secured with hotels, transport operators and other partners before the July deadline.

The May 2010 exam had a more complex question in part B on CSFs and KPIs that was worth 20 marks. It concerned an international hotel group that had recently taken over a European educational institution called TDM. The requirements were as follows:

(i) Identify four CSFs that would be appropriate to use for TDM (*four marks*).

(ii) Recommend, with reasons, two KPIs to support each of the four CSFs you have identified (*16 marks*).

Note that the verb for requirement (i) is "identify" – a level-two verb in the CIMA hierarchy – indicating that only one mark is available per CSF identified. Requirement (ii) contains a higher-level verb, "recommend", and asks candidates to provide and justify eight KPIs. This suggests that two marks are available per KPI, with one mark for stating a KPI and the other for explaining how it relates to the CSF.

The unseen material issued on exam day provided the following information about TDM and its strategy (I have added italics for emphasis): "TDM is well established and has always traded profitably. It offers a variety of courses, including degrees, at both bachelor and master's levels, and professional qualifications. TDM has always concentrated on the *quality of its courses and learning materials*. It has never seen the need for market research, as it has always achieved its sales targets. Its students consistently *achieve passes* on a par with the national average. TDM has always had the largest market share in its sector, even though new providers continually enter the market. It has a *good reputation* and has not felt the need to invest significantly in marketing. In recent years it has experienced an *increasing rate of employee turnover*."

The examiner did not regard the profitability of TDM as a CSF because it is not a performance differential in the market – students don't choose to go to a college because it's more profitable than its competitors. Likewise, higher sales/enrolments/market share are the results of better CSF performance rather than CSFs themselves.

All this leaves the following as potential CSFs for TDM:

1. Better-quality courses or a superior learning experience.
2. Higher pass rates or higher-level degrees awarded.
3. A superior reputation in the market.
4. Better employee retention.

When formulating KPIs it can help to generate more ideas if we remember that there are three types of indicator:

- Lead indicators. These predict performance by monitoring the inputs that must be in place in order to make good things happen.
- Coincident indicators. These monitor whether things are actually happening now that will give good results.
- Lagging indicators. These are measures of actual performance that confirm that good things have happened.

The examiner required candidates to recommend two KPIs per CSF. I have suggested three for each here to illustrate the types of indicator.

1. Better-quality courses or a superior learning experience:

- The involvement of industry or leading academics in the design of courses (lead indicator).
- Student attendance levels on the courses (coincident indicator).
- Student satisfaction expressed in post-course questionnaires (lagging indicator).

2. Higher pass rates or higher-level degrees awarded:

- Entry grades of students joining the courses (lead indicator).
- Grades in course work and mock exams (coincident indicator).
- Pass rates and degree classes awarded (lagging indicator).

3. A superior reputation in the market:

- Retention of professional PR staff to communicate brand (lead indicator).
- Number of favourable mentions in the academic, commercial and student media (coincident indicator).
- Number of student applications by course (lagging indicator).

4. Better employee retention:

- Existence of staff consultation and development processes (lead indicator).
- Satisfaction levels expressed in staff surveys (coincident indicator).
- Staff turnover rate by grade and reason for leaving (lagging indicator).

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Further reading

CIMA Official Study Text – E3 Enterprise Strategy, CIMA Publishing, 2012.