The Internal Factor Evaluation Matrix

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 the Competitive Profile Matrix (CPM) described in **Chapter 3**, 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 20 internal factors, including both strengths and weaknesses. List strengths first and then weaknesses. Be as specific as possible, using percentages, ratios, and comparative numbers. Recall that Edward Deming said, "In God we trust. Everyone else bring data." Include *actionable* factors that can provide insight regarding strategies to pursue. For example, the factor "Our Quick Ratio is 2.1 versus industry average of 1.8" is not actionable, whereas the factor "Our chocolate division's ROI increased from 8 to 15 percent in South America" is actionable. Also, be as *divisional* as possible, because consolidated data oftentimes is not as revealing or useful in deciding among strategies as the underlying by-segment or division data.
2. Assign a weight 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 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 3 or 4 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.

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 20 key factors. The number of factors has no effect on the range of total weighted scores because the weights always sum to 1.0.

When a key internal factor is both a strength and a weakness, the factor may be included twice in the IFE Matrix, and a weight and rating assigned to each statement. For example, the Playboy logo both helps and hurts Playboy Enterprises; the logo attracts customers to *Playboy* magazine, but it keeps the Playboy cable channel out of many markets. Be as quantitative as possible when stating factors. Use monetary amounts, percentages, numbers, and ratios to the extent possible.

An example IFE Matrix is provided in **Table 4-8** for a retail computer store. The table reveals that the two most important factors to be successful in the retail computer store business are "Revenues from repair/service in the store" and "Employee morale." Note that the store is doing best on "Average customer purchase" amount and "In-store technical support." The store is having major problems with its carpet, bathroom, paint, and checkout procedures. Note also that the matrix contains substantial quantitative data rather than vague statements; this is excellent. Overall, this store receives a 2.5 total weighted score, which on a 1 to 4 scale is exactly average/halfway, indicating there is definitely room for improvement in store operations, strategies, policies, and procedures.

Table 4-8 Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			

Table 4-8 Sample Internal Factor Evaluation Matrix for a Retail Computer Store

Key Internal Factors	Weight	Rating	Weighted Score
Strengths			
1. Inventory turnover increased from 5.8 to 6.7.	0.05	3	0.15
2. Average customer purchase increased from $97 to $128.	0.07	4	0.28
3. Employee morale is excellent.	0.10	3	0.30
4. In-store promotions resulted in 20% increase in sales.	0.05	3	0.15
5. Newspaper advertising expenditures increased 10%.	0.02	3	0.06
6. Revenues from repair/service in the store up 16%.	0.15	3	0.45
7. In-store technical support personnel have MIS college degrees.	0.05	4	0.20
8. Store's debt-to-total assets ratio declined to 34%.	0.03	3	0.09
9. Revenues per employee up 19%.	0.02	3	0.06
Weaknesses			
1. Revenues from software segment of store down 12%.	0.10	2	0.20
2. Location of store negatively impacted by new Highway 34.	0.15	2	0.30
3. Carpet and paint in store somewhat in disrepair.	0.02	1	0.02
4. Bathroom in store needs refurbishing.	0.02	1	0.02
5. Revenues from businesses down 8%.	0.04	1	0.04
6. Store has no website.	0.05	2	0.10
7. Supplier on-time delivery increased to 2.4 days.	0.03	1	0.03
8. Often customers have to wait to check out	0.05	1	0.05
Total	**1.00**		**2.50**

The IFE Matrix provides important information for strategy formulation. For example, this retail computer store might want to hire another checkout person and repair its carpet, paint, and bathroom problems. Also, the store may want to increase advertising for its repair/services, because that is a really important (weight 0.15) factor to being successful in this business.

An actual IFE Matrix for Forjas Taurus S.A. is provided in Table 4-9. Headquartered in Porto Alegre, Brazil, Taurus manufactures and sells military and civilian pistols, submachine guns, rifles, ammunition, bulletproof vests, motorbike helmets, and more. Note that the total weighted score of 2.53 is barely above the average of 2.50. Note, too, that the most important factor in the industry (Weight = 0.09) is price, and Taurus does excellent (Rating = 4) in selling low-priced firearms.

Table 4-9 An Actual IFE Matrix for Forjas Taurus S.A.

Strengths	Weight	Rating	Weighted Score
1. Taurus offers low prices for pistols and small arms in the USA.	0.09	4	0.36

Table 4-9 An Actual IFE Matrix for Forjas Taurus S.A.

Strengths	Weight	Rating	Weighted Score
1. Taurus offers low prices for pistols and small arms in the USA.	0.09	4	0.36
2. Taurus had a 15.7% increase in net revenue.	0.07	4	0.28
3. Taurus has 51% market share in Brazil's motorcycle helmet industry.	0.06	3	0.18
4. Taurus has reduced the percentage of sales devoted to income tax from 3.11% to 2.82%.	0.06	3	0.18
5. Taurus produces a diverse range of products in different markets.	0.05	3	0.15
6. Taurus is a qualified supplier of products to Brazil's armed forces.	0.05	4	0.20
7. Taurus and ammo-maker Companha Brasileira de Cartuchos dominate Brazil's small arms industry.	0.04	4	0.16
8. Taurus provides weapons for Brazil's military, state, and civil police.	0.03	4	0.12
9. Taurus has good brand recognition within the USA.	0.03	4	0.12
10. Taurus's employee morale is good.	0.02	4	0.08
Weaknesses			
1. Adjusted EBIT is down 23%.	0.08	1	0.08
2. Total revenue in the domestic market is down 10.5%.	0.08	2	0.16
3. Gross margin fell from 38.1% to 29.9%.	0.07	1	0.07
4. Taurus's stock price has plummeted to less than 1.0.	0.07	1	0.07
5. Revenue from products in the metallurgy and plastics segment, excluding helmets, is down 7%.	0.04	2	0.08
6. Taurus has very little presence in Europe and Asia.	0.04	2	0.08
7. Taurus has a reputation for poor customer service.	0.04	2	0.08
8. There was a recent 23.6% increase in operating expenses.	0.03	1	0.03
9. Taurus reported a net income loss of over $32 million.	0.03	1	0.03
10. Taurus has poor quality control—a Taurus pistol discharged in Sao Paulo without pulling the trigger.	0.02	1	0.02
TOTALS	**1.00**		**2.53**

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. Be as divisional as possible when developing a corporate IFE Matrix. Also, in developing an IFE Matrix, do not allow more than 30 percent of the key factors to be financial ratios, because financial ratios are generally the result of many factors, so it is difficult to know what particular strategies should be considered based on financial ratios. For example, a firm would have no insight on whether to sell in Brazil or South Africa to take advantage of a high corporate ROI ratio.

Implications for Strategists

Figure 4-9 illustrates [redacted] must formulate

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Implications for Strategists

Figure 4-9 illustrates that to gain and sustain competitive advantages, a firm must formulate strategies that capitalize on internal strengths across all its products, services, and regions, and continually improve on its internal weaknesses. This must be done in a cost-effective manner, even though large outlays of human and financial capital may be required for various strategies deemed best to pursue. Thus, long-term commitments often accompany a given strategic plan. Breakeven analysis, value chain analysis, and the IFE Matrix are especially useful strategic planning tools in formulating strategies, especially in performing the internal assessment. Coupled with the vision/mission and external audit, the internal audit must be performed methodically and carefully because survival of the firm could hinge on an excellent strategic plan being created. Strategists should follow the guidelines presented in this chapter and throughout this book to help assure that their firm is heading in the right direction for the right reasons, and rewarding the right people, for doing the right things, in the right places.

Upstream versus Downstream Activities

The primary means for gaining and sustaining competitive advantages for most companies are shifting downstream. Recent research by Dawar reveals that in most industries today, **upstream activities** —such as supply chain management, production, and logistics—are being commoditized or outsourced by firms, whereas **downstream activities** related to consumer behavior are becoming the primary means for gaining and sustaining competitive advantage.[32] Dawar reports that the sources of competitive advantage are shifting away from production processes inside the firm to customers and markets outside the firm. Businesses are increasingly gaining competitive advantage by proactively shaping customers' point-of-purchase behavior, rather than firms using focus groups, surveys, and social media to determine what customers want. An early glimpse of this shift came a few years ago when Apple's Steve Jobs was asked how much market research led to the iPad. Jobs responded, "None. It's not the consumers' job to know what they want." Activities that attract customers by making it easier, compelling, and convenient for them to purchase the firm's products and services in many ways are leading to sustained competitive advantage much more so than altering internal mechanisms. Figure 4-10 illustrates this shifting source of competitive advantage in most industries.

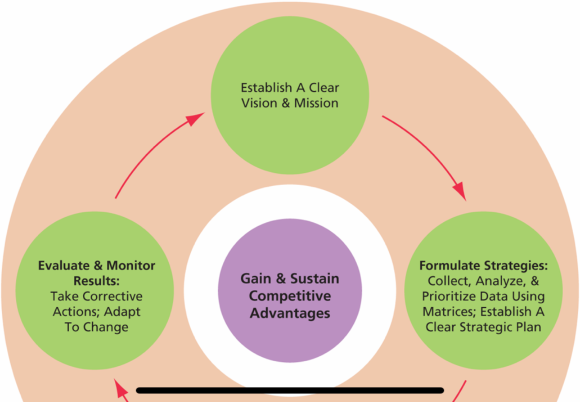

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Figure 4-9

How to Gain and Sustain Competitive Advantages

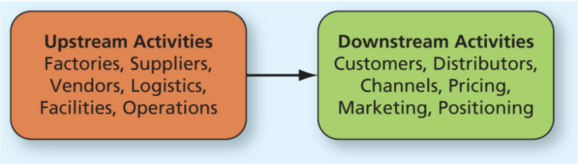

Figure 4-10

Figure 4-10

The Shifting Source of Competitive Advantage

Implications for Students

Gaining and sustaining competitive advantage is the essence or purpose of strategic planning. In the internal portion of your case analysis, emphasize how and why your internal strengths and weaknesses can both be leveraged to gain competitive advantage and overcome competitive disadvantage, in light of the direction you are taking the firm. Maintain your project's upbeat, insightful, and forward-thinking demeanor during the internal assessment, rather than being mundane, descriptive, and vague. Focus on how your firm's resources, capabilities, structure, and strategies, with your recommended improvements, can lead the firm to prosperity. Although the numbers must provide the basis for your analysis and must be accurate and reasonable, do not bore a live audience or class with overreliance on numbers. In contrast, throughout your presentation or written analysis, refer to your recommendations, explaining how your plan of action will improve the firm's weaknesses and capitalize on strengths in light of anticipated competitor countermoves. Keep your audience's attention, interest, and suspense, rather than "reading" to them or "defining" ratios for them.

Special Resources

Excellent free online and subscription (fee-based) resources for obtaining financial information about firms and industries are provided in **Table 4-10**. Some sources listed provide financial ratios. The free excel template at **www.strategyclub.com** calculates ratios and develops ratio trend lines, once students enter in relevant data.

Table 4-10 Excellent Websites to Obtain Information (Including Financial Ratios) on Companies and Industries

1. **Online Free Resources**

a. **http://morningstar.com**
b. www.hoovers.com
c. **http://globaledge.msu.edu/industries/**

2. **Online Subscription Resources (Likely Subscribed to by Your College Library)**
    a. Mergent Online: www.mergentonline.com
    At the Mergent Online website, search for companies with the same SIC or NAICS code, and then create a comparison financial ratio report. A number of different ratios can be used as comparison criteria to create a tailored report that can then be exported into a Microsoft Excel format. Alternatively, you can use the Competitors Tab in Mergent to build a list of companies and compare their ratios. Your college library likely subscribes to this service.
    b. Factiva: **http://new.dowjones.com/products/factiva/**
    At the Factiva website, first use the Companies & Markets tab to search for a company. Next, click "Reports" and choose the "Ratio Comparison Report" to get a company's ratios compared to industry averages. Your college library likely subscribes to this service.
    c. S&P NetAdvantage: http://www.standardandpoors.com
    At the S&P NetAdvantage website, company and industry ratios are provided in two different sections of the database: (1) the Compustat Excel Analytics section of a particular company's information page and (2) in the data from the S&P Industry Surveys. Your college library likely subscribes to this service.
    d. Onesource: **www.avention.com/OneSource**
    Onesource is a good source for financial ratio information. Search for a particular company and then click on the link for "Ratio Comparisons" on the left side of the company [redacted] your company against

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   b. Factiva: http://new.dowjones.com/products/factiva/
   At the Factiva website, first use the Companies & Markets tab to search for a company. Next, click "Reports" and choose the "Ratio Comparison Report" to get a company's ratios compared to industry averages. Your college library likely subscribes to this service.
   c. S&P NetAdvantage: http://www.standardandpoors.com
   At the S&P NetAdvantage website, company and industry ratios are provided in two different sections of the database: (1) the Compustat Excel Analytics section of a particular company's information page and (2) in the data from the S&P Industry Surveys. Your college library likely subscribes to this service.
   d. Onesource: www.avention.com/OneSource
   Onesource is a good source for financial ratio information. Search for a particular company and then click on the link for "Ratio Comparisons" on the left side of the company information page. The data in Onesource will compare your company against the industry, against the sector, and against the stock market as a whole.
   e. Yahoo Industry Center: http://biz.yahoo.com/ic/
   The Yahoo Industry Center is an excellent free resource that allows you to browse industries by performance rankings, including ROE, P/E ratio, market cap, price change, profit margin, price-to-book value, long-term debt, and more.

3. **Hardcopy Reference Books for Financial Ratios in Most Libraries**
   a. Robert Morris Associate's *Annual Statement Studies:* An excellent source of financial ratio information.
   b. Dun & Bradstreet's *Industry Norms & Key Business Ratios:* An excellent source of financial ratio information.

Source: Based on a variety of sources.