Understanding Competitive Advantage

Fredrik Nilsson · Birger Rapp

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The Importance of Strategic Congruence and Integrated Control

With 44 Figures

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Preface

The link between strategies and control systems – and how it ultimately affects the competitiveness of firms – is an area that is attracting the attention of practitioners and scholars. There is a need to discuss which combinations of strategies and control systems can be assumed to contribute to competitive strength. In this book we have chosen to highlight the role of management control and manufacturing control in this respect. For a long time these two types of control systems were regarded as more or less separate subjects of research and study. However, the differences between management control and manufacturing control are diminishing, a tendency that we support. The book is written in this spirit of approval.

The models and hypotheses advanced in the book were developed over a long period of time. They are based on research and have been published and otherwise presented in a variety of different circumstances (see, for example, Jansson et al., 2000; Kald et al., 2000; Nilsson, 1994, 1997, 2002; Rapp et al., 2000). Our colleagues have stimulated our thinking and have contributed to further refinement of the thoughts presented in the book. We would like to thank Professor Leif Appelgren, Professor Thomas Falk, Professor Nils-Göran Olve, Professor Rolf Rundfelt, Professor Bengt Savén, Associate professor Vivian Vimarlund and Assistant professor Alf Westelius for their valuable comments and inspiration.

Our interaction with graduate students at our department has also helped to make this a better book. Many thanks to Petter Ahlström, Linda Askenäs, Fredrika Berglund, Åse Bäckström, Magnus Kald, Andreas Käll, Carl-Johan Petri and Stefan Svarén. We would also like to thank Associate Professor Jan Lindvall and the graduate students in the "Modern Management Control Systems" course, who critically read an earlier draft of the manuscript. A previous draft has also been used as course literature at the University of Gotland. We would like to thank these students for all their comments, which have contributed to the clarity of the message in this book. Finally, we wish to express our gratitude to Dr. Werner A. Mueller at Springer-Verlag GmbH & Co. KG for publishing the book. Åsa Ericson has done an impressive job in the final preparation for publication. Richard Wathen deserves a special word of thanks for his prompt and efficient language review of several manuscripts.

Our ambition is continue to develop the models and hypotheses presented in the book. We would highly appreciate your recommendations and thoughts about it. Your views on the content would be welcome, as would your calling our attention to any specific error or omission. If you have any comments, please contact Professor Fredrik Nilsson or Professor Birger Rapp at Economic Information Systems, Department of Computer and Information Science, Linköping University, SE-581 83 Linköping, Sweden. E-mail: freni@ida.liu.se or birra@ida.liu.se.

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Prologue

Today's firms face the challenge of designing and using new strategies and control systems to maintain existing competitive advantages and to create new ones. In this book, a framework for addressing this challenge is developed from theories, as well as practical experience, in the fields of strategy, management control and manufacturing control.

1 Introduction

This book provides an analysis of ways for the individual firm to create competitive advantage on its own market. Our theoretical starting-point is that the alignment of strategies and control systems affects the firm's chances of successfully positioning itself in its chosen arena of competition. The firm is in a better position to concentrate on activities that create value for the customer if its strategies and control systems are mutually consistent and adapted to expected external demands. This book is thus a contribution to the literature that treats competitive advantage on the basis of the match between the environment and internal resources. Our ambition has been to provide additional knowledge in the area through a comprehensive discussion on co-ordination and integration of strategies and control systems. This chapter is intended to introduce the reader to the theories and basic concepts considered in the book.

The Importance of Strategies and Control Systems

To understand how competitive advantage is created is critical to the development of a firm. In the long run, inadequate knowledge of the factors affecting business competitiveness can have repercussions on the economy of entire countries. An example is provided by Hayes and Abernathy in their paper for the *Harvard Business Review* entitled "Managing our Way to Economic Decline" (Hayes and Abernathy, 1980). The authors discuss extensively the reasons why American industry lost its competitive advantage during the 1970's. From their own experience as researchers and consultants, one of their conclusions was that American firms at that time were deficient in strategic planning and follow-up. The explanation was that senior executives, who often had backgrounds in finance and accounting, lacked adequate knowledge of their business at the operational level. Consequently, strategic planning was far too general and probably failed to consider the complex relationships between different organizational levels. Follow-up, or the evaluation of performance in relation to strategies, tended to have a similar focus. According to the authors, there was heavy dependence on short-term financial measures like return on investment (ROI). Although long-range planning was abandoned at many companies in the early 1970's, the formulation of strategies remained largely an activity for top management. Thus, the link between high-level strategy and tactical and operational decision-making was tenuous.[1]

In many respects, the article by Hayes and Abernathy is still relevant today. An ever-larger number of Western firms are now finding it increasingly difficult to maintain their competitive strength. With globalization, firms are confronted with new arenas of competition, as well as new demands: a broader product range, higher quality, more reliable delivery, and lower prices (Cooper, 1996). To improve their responsiveness to these kinds of requirements, many firms have tried to make their organizations more flexible and adaptable. Seeking to come closer to their markets and customers, they have resorted to management by objectives and highly decentralized decision-making (Dent, 1996). By comparison with the situation described by Hayes and Abernathy, there was a shift in the 1980's and 1990's from more "detached" strategic planning to greater emphasis on the tactical and operational levels (*cf.* Johnson, 1992).

In cases where the focus on tactical and operational planning and follow-up has been carried too far, however, there is a danger that corporate activities will be inadequately co-ordinated. This shortcoming is often evidenced by ill-considered changes in corporate, business, and manufacturing strategies. For example, many well-known companies have been forced to make abrupt adjustments like drastically downsizing money-losing units within their core businesses. These firms are often characterized by far-reaching decentralization and a very large number of fairly small business units. In such circumstances, it is very difficult to achieve consistency among strategies and control systems and to assure that they are adapted to expected external demands.[2] One major challenge is thus to grant business units sufficient freedom in tactical and operational decision-making while maintaining well-functioning overall co-ordination of different corporate activities.

Bridging Economic Theory and Management Practice

One perspective on the creation of competitive advantage is found in research based on economic theory. Studies of this type are frequently devoted to explaining the effect of declining competitiveness on the development of national economies. Here, interest-rate levels, and the government budget balance are examples of conditions considered to determine a country's competitive strength. The success of a country in a specific industry is explained in terms of production factors like labor and natural resources (Porter, 1996, p. 155 ff). However, some economists maintain that these theories are not sufficiently sophisticated to explain clearly how competitiveness develops over time. One of these scholars is Porter (ibid, p. 161), who has contended that instead of focusing on the economy as a whole, we must analyze and understand industries and their different segments. From his perspective, upgrading national productivity results from the efforts of thousands of firms to achieve competitive advantage in their industry. In this context, and according to Porter's reasoning , it is especially important to analyze the rivalry among existing firms, the threat of new entrants, the threat of substitute products and services, the bargaining power of suppliers, and the bargaining power of purchasers. This five-force framework, introduced by Porter in the 1980's (Porter, 1980, p. 4 ff), was intended to help managers to analyze different industries in terms of competition level and profit potential. For corporate management it is especially important to understand how the forces in the framework affect each and every business unit, in order to formulate a strategy that successfully positions the products on the markets chosen.[3]

However, to comprehend adequately what determines the competitiveness of the individual firm, one needs an even broader frame of reference. Porter (1985, p. 33 ff) argues that it is also necessary to examine the internal structures[4] of the firm and to eliminate activities that do not create value. For the configuration of the firm's value chain determines what opportunities will be available to the firm in positioning its services and products[5] on the market. Thus, if a firm is seeking a low-cost position (i.e. a cost-leadership strategy), quite different activities are brought into focus than if it is trying to establish its products as unique (i.e. a differentiation strategy). According to Porter (ibid, p. 11), management must therefore choose a clear – and preferably unique – strategy and then ensure that this strategy is reflected in the configuration of the value chain. If management proceeds in this fashion, they should be able to create a position which will enable the firm to achieve a good return even when the industry structure is not favorable (ibid, p. 3). By not limiting the discussion to the effects of industry structure on competitiveness, but also examining ways for an individual firm to compete successfully by adapting its strategies and structures, Porter has succeeded in bridging the gap between economic theory and management practice (*cf.* Rumelt et al., 1994). One of his contributions in this regard is highlighting the importance for a firm of establishing and maintaining a match between external variables (the environment) and internal variables (the structure) (Venkatraman and Camillus, 1984; Nath and Suharshan, 1994).

Matching Environment and Internal Structures

One central assumption in this book is that firms affect, and are affected by, their environment (*cf.* Venkatraman and Camillus, 1984).[6] In discussing the matching of environment and internal structures, we have been influenced by so-called contingency theory. Basically, this theory holds that "there is no one best way of organizing. The appropriate form depends on the kind of task or environment with which one is dealing" (Morgan, 1986, p. 49). For example, a form of organization based on centralized decision-making is not very appropriate in a turbulent environment with rapidly shifting demand.[7] The internal structures of the firm – organization, control systems and processes – must therefore be adapted to the external conditions under which the firm operates (Chandler, 1962).[8] We have assumed that the firm's environment affects the design and use of its internal structures; however, that influence is not exerted directly, but through the strategy formulated by management (Archer and Otley, 1991). This assumption is based on our view of strategy as the result of a deliberate choice, in which management seeks to match the environment to the internal structures of the firm (*cf.* Venkatraman and Camillus, 1984; Nath and Sudharshan, 1994). In many earlier contingency-theory studies, by contrast, the environment was considered to have a direct effect on the internal structures of the firm (see, for example, Burns and Stalker, 1961; Lawrence and Lorsch, 1967). According to Chapman (1997), the reason for this assumption was that strategy was difficult to describe since accepted typologies were lacking.

The prevailing view among many researchers in the field of strategy is that management is in a position to make strategic choices. It does not necessarily follow, however, that all strategies are solely a result of management intentions. Mintzberg and Waters (1985, p. 257) distinguish: "deliberate strategies – realized as intended – from emergent strategies – patterns of consistencies realized despite, or in the absence of, intentions." Thus, according to Mintzberg and Waters, a change of strategy may be planned, but it may also be the result of an emergent strategy. In almost all cases, a realized strategy is probably a combination of the two, i. e., of deliberate and emergent strategies. We therefore assume that management, at least to some extent, can influence whether the firm will operate in a turbulent or a stable environment. This standpoint, however, does not exclude the existence of situations where strategies can be imposed upon the firm. In their article, Mintzberg and Waters discuss this type of situation, where the firm is virtually forced by its environment to undertake a number of activities that in combination have major strategic significance. According to Mintzberg and Waters (1985), the clearest case is one in which a firm is compelled by an influential outside individual or group to follow a particular strategy. In one example, taken from Mintzberg's and Waters' article, a Canadian government minister gave Air Canada little choice but to buy a certain type of aircraft. The authors seem to view this type of strong direct influence as relatively rare; more often, the business environment may limit what the firm and its management can actually accomplish.

The extent of the strategic changes that management can bring about is also dependent on the time frame selected. The assumption in this book is that a firm's fundamental strategy is stable in the short run.[9] The reason is that the alignment of the environment, strategy, and internal structures requires comprehensive and relatively time-consuming co-ordination (Galbraith and Nathanson, 1978). This co-ordination is essential if the chosen strategy is to be successfully implemented. With constant changes in strategy, there is a danger that the firm will lose its bearings and that employees at all levels will find it hard to determine the activities on which to focus. It then becomes more difficult to configure the value chain, and thus to co-ordinate important functions like purchasing, production, and sales. However, the matching of external demands and internal resources must never be an end in itself, and the firm must regularly review its strategic position. According to some scholars, this review takes place successively as strategy – continually and little by little – is adapted to the firm's environment (Miles and Snow, 1978). Others hold that in the long run almost all firms are forced to implement radical strategic changes in order to remain competitive (Porter, 1980). We agree with the latter view.

In regard to the firm's internal structures and the manner of their adaptation to strategy, we have chosen to focus on the firm's control systems. As far back as 1965, Anthony advanced the view that management control is the principal tool of management for successfully implementing a chosen strategy (Anthony, 1965). Also highlighted early on was the importance of adapting manufacturing control to strategy (Skinner, 1969). Since the publication of these normative studies, substantial interest has been devoted to empirical study of the way in which a firm's strategy is reflected in the design and use of its control systems. In the area of management control, the matching of strategy and control, as well as its effect on competitive advantage, and ultimately performance,[10] has in most cases been tested in large-sample surveys. Although the findings have not always been clear-cut, it has often been possible to show a significant correlation between the variables studied (Langfield-Smith, 1997). The contribution of such surveys has been to provide a reasonably good explanation, for example, of the effect of a cost-leadership strategy (standardized, low-price products) on the management-control system at the business unit level.

One weakness of these studies is that comparisons of results are difficult owing to different definitions of the concepts of strategy and management control (Kald et al., 2000).[11] Another weakness is the lack of consideration given to the existence of strategies at several organizational levels and to the differences in management-control systems at different levels. According to Langfield-Smith (1997), many of the studies focus solely on the senior management level. Ittner and Larcker (2001), based on their review of the literature, note that the studies of management control at the operational level "typically ignore the higher-level strategic choices made by the firm, even though all of these choices are expected to influence accounting and control system design and organizational performance" (ibid, p. 364). Similar conclusions were drawn by Luft and Shields (2003) in their overview of 275 articles published in six leading management-accounting journals. Their review covers diverse streams of research and thus has a broad focus that is not limited to the relationship between strategy and control. The authors note that in the area of management accounting there are few, if any, cross-level studies, for example covering both the organization and organizational subunits.

On the basis of these reviews of the literature, it is reasonable to conclude that the alignment between strategy and control is often studied only in a selected and limited part of the company. We may assume that the interrelationship of strategy, control systems, and competitiveness is much more complex than suggested by the findings of these survey-based studies (*cf.* Mills et al., 1995; Luft and Shields, 2003). Thus, there is a need for detailed discussion of this interrelationship, and particularly of the ways in which large, complex organizations co-ordinate their strategies, and of the role of control systems in this regard. The present book is intended to provide a contribution to this discussion.

Strategic Congruence and Integrated Control

In the remainder of this presentation, we shall focus on two distinguishing features of strategy and control systems: strategic congruence and integrated control. Our discussion will start with two in-depth case studies of large and complex firms (Goold et al., 1994; Nilsson, 2002). The study by Goold et al. (1994) indicates that strategic congruence, defined as a consistency among different strategic levels, is a feature of many competitive companies. At such firms, acquisitions and divestitures are typically made for the purpose of focusing operations on what is considered the core business.[12] With a clearly defined core business, it should be easier to coordinate corporate, business, and functional strategies and thus to configure the value-creating activities of the firm (Skinner, 1974; Wheelwright, 1984; Porter, 1987).[13] For example, a company with a business strategy of being the low-cost producer in its industry will have to emphasize large-scale manufacturing of standardized products. It may also have to coordinate activities in the value chains of several business units in order to exploit economies of scale and thereby reduce the unit costs of company products (Porter, 1985, p. 326 ff).

Another possible conclusion from the case studies is that coherence in strategic planning and follow-up can help to facilitate the creation of competitive advantage (Nilsson, 2002).[14] Such a system of integrated control is intended to simplify the processes of formulation and implementation of corporate, business, and functional strategies. Particularly firms that are sometimes referred to as "world-class manufacturers" have shown an interest in integrated control systems (Nanni et al., 1992; Cooper, 1996). At these firms, manufacturing control, for example, has in some cases been integrated with the overall systems of planning and control (Yoshikawa et al., 1994). This integration provides a common frame of reference that facilitates communication both between corporate and business-unit management and between management and employees of business units. Uniform terminology and similar principles of control contribute to transparency in the processes of planning and follow-up, thus helping to interlink corporate, business, and functional goals and strategies. This leads to a better understanding of the effects of various activities in the value chain, separately and in combination, on the competitiveness and performance of the firm (*cf.* Argyris, 1977; Nilsson and Rapp, 1999).

Despite research results suggesting that the competitive advantage of a firm is affected by strategic congruence and integrated control, there are few studies, as far as the authors are aware, in which these two areas are discussed in conjunction. For example, in the field of strategy, the treatment of control systems appears relatively often to be at a general level. Our impression is that in these contexts control systems are not infrequently regarded as tools for applications in such areas as implementation of strategy and responsibility accounting. Researchers in the area of manufacturing have concentrated on strategies and control systems designed for the functional and business unit level, while relationship to the corporate level has been less frequently considered (see, for example, Kotha and Orne, 1989; Hill, 2000). Similarly, research in the field of management control has focused on the effects of strategies on traditional instruments of control like procedures for budgeting and capital expenditure. Especially in earlier studies, control of manufacturing has often been defined as operational control and has thus been considered to be of limited interest to researchers in management accounting (Anthony et al., 1989; Otley, 1994, 1999). In light of the above, we have decided to focus on the manufacturing function and the co-ordination and integration of its strategies and control systems with the rest of the firm. This means that planning and follow-up of other primary and secondary activities will be discussed only at a general level.

Purpose of the Book

As indicated in the Introduction, the creation of competitive advantage is a subject of considerable academic and practical interest. At the macro level, the focus is on the competitive strength of entire countries or regions. At the micro level, by contrast, the emphasis is on ways for the individual firm to create competitive advantage on its own market. This book focuses primarily on the micro level. Its purpose is to provide a comprehensive analysis of the creation of competitive advantage within the individual firm. The analysis is based on the premise that the alignment of strategies and control systems affects the possibilities of positioning the firm successfully in its chosen arena of competition. Two concepts that will receive special attention in this connection are strategic congruence and integrated control. By analyzing in detail how strategies are co-ordinated and how control systems facilitate this process, we can apply interesting perspectives on the ways in which a firm creates competitive advantage.

The two concepts chosen originate in established fields of research where a variety of theoretical perspectives have been claimed capable of explaining the competitiveness of firms. According to the overview by Fiegenbaum et al. (1996) of the literature on this subject, many of these perspectives focus either on external conditions or on internal organization.[15] Examples of theories in the first category are industrial economics, resource-dependence theory and institutional theory. In the second category, two examples from the review by Fiegenbaum et al. are motivation theory and resource-based theory. As previously indicated, our analysis has been strongly influenced by contingency theory, whose adherents have long emphasized the importance of a fit between the business environment, the strategy, and the internal structures (organization, systems and processes) of the firm. However, this choice has not ruled out using studies with other theoretical approaches to expand on our contribution and to position it.

What this Book Contributes

This book provides a contribution both within our academic field and beyond its bounds. One contribution within our field will be to provide additional knowledge on the creation of competitive advantage through strategic congruence and integrated control. We believe that further elaboration on the meaning of these two well-established concepts, and especially of their interrelationship, is very important for explaining a firm's competitiveness. The development of a tentative model is facilitated by the "knowledge synergies" created through integration of selected portions of research in strategy, management control, and manufacturing control. These areas have been large, well-established fields of research for a long time. Of course, we make no claim whatever that our review of them is exhaustive. Our ambition, rather, has been to highlight a number of central studies in each area and to show how in combination they can extend our knowledge and understanding of the influence of strategic congruence and integrated control on creating competitive strength. There are also a number of contributions in each of the three research areas covered in the book:

1. <u>Strategy:</u> Strategic congruence, strategic coherence, and similar terms were introduced long ago (Skinner, 1969; Hofer and Schendel, 1978). Since then many studies have devoted attention to this phenomenon (see for example, Nath and Sudharshan, 1994). Our review of different strategic typologies and their characteristics should contribute to more thorough discussion and analysis of the question which corporate, business and functional strategies may be assumed congruent.

2. <u>Management control:</u> How management control should be used in formulating and implementing strategies is a classic problem (*cf.* Anthony, 1965), but there is still disagreement on the way in which it should be resolved. One reason is the focus in earlier studies on tactical decision-making; here the role of management control in strategic planning and operational control was often neglected (Otley, 1994, 1999). Another reason is that research tends not to consider the interrelationship and

mutual influence of control systems at different organizational levels (Ittner and Larcker, 2001; Luft and Shields, 2003). If the scope of research in management control is extended to several levels of decision-making and organization, valuable insights can be gained.

3. Manufacturing control: In the area of manufacturing control, the focus in earlier research was on operational control and the functional level. Questions of overall strategy – especially corporate strategy – were often treated superficially (Kotha and Orne, 1989). Consequently, there is a need for research to concentrate much more than before on the link between manufacturing strategies, on the one hand, and business and corporate strategies, on the other (Hill, 2000, p. 28).

As for the contribution outside the scholarly field directly concerned, this book provides guidance on a question that has received considerable attention in public debate: what strategies create value, and why? Unfortunately, the discussion thus far has been overly concentrated on ways for firms to expand their operations – frequently through acquisitions. Surprisingly, there is seldom discussion on the fit between the strategies and control systems of the acquirer and those of the acquired firm. Nilsson (2002) contends that such matching can be advantageous. It should be noted, however, that Nilsson discusses the matching of management control between different organizational levels; he does not analyze in any detail manufacturing control and the link between it and financial planning and follow-up. Furthermore, his principal focus is on the matching of control systems; strategic congruence is touched upon more implicitly. A more thorough analysis of the effects of strategic congruence and integrated control on a firm's competitiveness would help management to determine what business the firm should be in and to find appropriate ways to influence the two relationships. Such an analysis would enhance the possibilities of creating value for owners, customers, and employees.

Target Readership

The academic debate on the creation of competitive advantage has been based largely on classic economic theory and industry analyses. We believe that it is time for students and scholars to recognize the importance of strategic congruence and integrated control, and especially the relationship between these two concepts, to the creation of competitive advantage. The book should be of interest to the following readers:

1. Advanced undergraduate students wishing to acquire a broader understanding of the ways in which competitive advantage is created. Particularly students interested in the interaction between business environment, strategies, and control systems, on the one hand, and the competitiveness and performance of the firm, on the other, should profit from this book. With its overall view of strategy, management control, and manufacturing control, the book is also an appropriate complement to the more specialized literature in each area.

2. Graduate students seeking to develop theories of managerial action as well as guidelines for designing and using internal structures to create competitive advantage. Since the tentative model presented broadens the base for further research in the field, the book should be of interest to more experienced scholars as well.

Organization of the Book

The subsequent presentation is divided into five chapters in addition to this one. Chapter 2 presents empirical research on the relationship between business environment, strategy, structure, competitive advantage, and performance. This review starts with the early classical studies leading to the breakthrough of strategy as a field in the early 1960's. Thereafter, we discuss the results of studies in which the authors have sought to find those combinations of strategy and structure that enable a firm to be efficient and competitive. The latest studies in this area, most of them published toward the end of the 1990's, share a strong focus on one particular structure: the control system. The chapter concludes by linking together the central concepts identified to provide a clear theoretical starting point and structure for the remainder of the book.

Chapter 3 begins by defining the concept of strategic congruence and relating it to other important concepts in the research area of strategy. It continues with a detailed discussion of three principal levels of strategy: corporate strategy, business strategy, and functional strategy. Since both researchers and practitioners have attached their own meaning to each of these levels, a large number of strategic typologies have been developed. We have therefore chosen to limit ourselves to well-recognized, established typologies and to comment upon them thoroughly with regard to archetypes, features, and contributions within and outside the scholarly field directly concerned. Another limitation is that we discuss functional strategies as they relate to the formulation and implementation of manufacturing strategies. On the basis of this review, we have chosen a strategic typology for each strategic level; these typologies are used later on in the discussion of the tentative model in Chapter 5.

Chapter 4 starts by defining the concept of integrated control and relating it to other central concepts in the research areas of management control and manufacturing control. Special interest is devoted to the extension of research to more organizational levels and more decision levels than before. After this background review, we discuss management control and manufacturing control on the basis of procedures for strategic planning and follow-up. The purpose of this discussion is to identify and describe a number of central dimensions in the design and use of control systems. These dimensions are important as a starting point for the description of the tentative model in Chapter 5 and for identifying the conditions that must be fulfilled if integrated control is to be achieved.

In Chapter 5 the concepts developed in the preceding three chapters are integrated in a tentative model. On the basis of the firm's business strategy and manufacturing strategy, we identify four distinct positions and one intermediate position. For each position, the requirements for creating strategic congruence and integrated control are discussed in detail. In the second section of the chapter, this discussion is enlarged to include two distinct strategic positions at the corporate level.

Chapter 6 begins with a summary of some of the principal assumptions introduced in previous chapters. The summary serves as a basis for conclusions regarding the combinations of strategies and control systems that should facilitate the creation of competitive advantage. We also discuss the dynamics of fit and their probable effect on strategic congruence and integrated control. Finally, two kinds of implications are suggested: practical business implications and implications for future research.

Notes

1. In an article entitled "Japan – Where Operations Really Are Strategic," Wheelwright compares US and Japanese industry in regard to the formulation and implementation of strategies (Wheelwright, 1981). The conclusion is that Japanese firms have been more successful than their US counterparts in linking overall strategic planning to operational decision-making. According to Wheelwright (p. 69), "In Japan, the integrity of production system and strategic purpose comes first. But Japanese manufacturers also realize that decisions at the level of operations can, if handled in a wise and consistent manner, have a useful cumulative effect at the level of strategy. Experience has taught the Japanese the value of placing even short-term manufacturing decisions at the service of long-term strategy – a lesson that American companies have learned only imperfectly." How Japanese companies go about breaking down overall goals and strategies to the lowest organizational level has also been discussed by other writers, among them Bromwich and Bhimani (1994) and Yoshikawa et al. (1994).

2. Lindvall (2001, p. 97) contends that far-reaching decentralization of profit responsibility is becoming less common in Swedish business. The reason is that the freedom accompanying profit responsibility can also lead to major difficulties in co-ordinating corporate businesses, with problems of suboptimization as a result. As an illustration, Lindvall quotes an interview with former Ericsson CEO Lars Ramqvist in the Swedish newspaper *Dagens Industri*: "Far too many corporate units were given profit responsibility and immediately started to build up their own functions that cost enormous sums. Tendencies like these are clear, and we are dealing with them now" (Dagens industri, 1999).

3. In developing the five-force framework, Porter (1980) used concepts taken from industrial-organization (IO) economics. For further discussion, see, for example, Rumelt et al. (1994).

4. The concept of internal structures has been given several different definitions (see for example, Galbraith and Nathanson, 1978). In the present book we have chosen to define internal structures as consisting of organization, control systems, and processes.

5. For the purpose of simplifying the discussion and avoiding unnecessary repetition, the concept of "product" rather than "product or services" will be used from now on in this presentation.

6. There is no obvious answer to the question how to draw the line between a firm and its business environment. With a network approach the difficulties of defining the environment are clear (Castells, 1996). In Chapter 2 this discussion is further developed.

7. In an empirical study, Lawrence and Lorsch (1967) have shown how the uncertainty resulting from a turbulent sub-environment can be managed through a flexible and decentralized organization. By analogy, more centralized decision-making is appropriate when the environment is stable. Among other researchers presenting similar findings is Morgan (1986, p. 34), who maintains that centralized bureaucratic machinery is a superior form of organization for mass production in a stable environment.

8. One important mission for research in the field of contingency theory is to identify which factors are most relevant for explaining successful organizational solutions. In this connection, the business environment is usually held out as one major so-called contingency factor. Another significant factor is strategy, but as a variable intermediate between the environment and the internal structures of the firm. Examples of still other contingency factors are technology, industry, and size (Morgan, 1986, p. 48 ff).

9. What is to be considered short-run and long-run depends, for instance, on the type of business that the firm is in. IT consulting is an example of a business in which even a single year is hard to foresee. Quite a different example would be a company involved in oil drilling; such a company might use a time frame of several decades in its planning. Based on our own consulting experience, a common planning horizon is about three years, with planning horizon defined as the length of time for which the basic strategy of the firm is assumed to be stable.

10. In this book we have chosen to define performance on the basis of the degree to which value is created for employees, customers, and shareholders. Performance is further discussed in Chapter 2.

11. In Kald et al. (2000), the authors discuss in detail the possible consequences of superficial analyses that compare the findings of studies in which the variable of strategy has been operationalized in different ways. According to the authors, an analysis of the strategy variables used shows that they capture different dimensions of a firm's strategy. Therefore, ambiguous findings can be explained only through detailed efforts to relate strategy variables to one another.

12. "Heartland business" is a concept introduced by Goold et al. (1994, p. 278 ff) to denote the type of business where a firm can create high levels of net value. According to the authors, there should be a clear business logic for all corporate businesses included in a heartland. This logic may take the form of common critical success factors, though it need not be limited to a particular industry. Thus, and as shown in the case studies by Goold et al. (1994), even a conglomerate – that is, a corporate group with different businesses and therefore limited synergies – can create a distinct heartland. For a more detailed discussion, see Goold and Campbell (1987a) and Goold et al. (1994).

13. In three recent articles, Goold and Campbell (2002a, 2003a, 2003b) discuss the difficulties of balancing hierarchy, control and process. While clearly advocating decentralization, the authors also recognize that processes for co-ordination are often necessary. Especially in complex, interdependent corporate structures, according to Goold and Campbell (2002b, p. 222), the "parent" (broadly defined as the corporate center) "may play an active role in creating an integrated strategy that will be accepted throughout the company and may establish the policies and constraints that regulate the decisions of all the units." At the same time, they note that in such extremely complex structures the differences between the "parent" and the "operating units" may become fuzzy. According to the authors (ibid, p. 240), the reason is that the parenting responsibilities are delegated to several different organizational units.

14. Nilsson (2002) also considers how situations of misfit could be handled. In such a situation it is important to find a balance between integrated control and control based totally on the needs of the business unit. Thus, creating competitive advantage and achieving good performance are not ruled out in situations where a high degree of strategic congruence and integrated control is difficult to attain. However, special procedures will then be needed to manage any differences between the respective control systems of the acquiring and acquired

companies. Such procedures are discussed extensively in Nilsson's doctoral dissertation (Nilsson, 1997). One example is the use of alternative integration mechanisms which reduce the need for co-ordination through the management control system. With the aid of co-ordination groups and various kinds of joint projects, for example, it is possible to achieve a relatively high degree of business integration without far-reaching co-ordination of control systems.

15. A third perspective identified by Fiegenbaum et al. (1996) is time.