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Control Systems in Multibusiness Companies: From Performance Management to Strategic Management

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This article discusses the role of control systems in multibusiness companies. The focus is on formulation and implementation of corporate and business unit strategies. Three widely used categories of control models are discussed: (1) models for performance management, (2) models for value-based management, and (3) models for strategic management. The discussion is based upon central normative texts and examples from applications in Nordic companies. The description and discussion of the control models and their features should facilitate decision-making on the design and use of control systems in multibusiness companies. © 2001 Elsevier Science Ltd. All rights reserved.

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Introduction

The primary mission of management is to formulate and implement value-creating strategies. In a multibusiness company, with its many complex activities, that task is especially demanding, as was shown by several European firms that were compelled to change abruptly and drastically during the 1990s — among them BMW, British Aerospace and Ericsson. At these companies, corporate management was forced to downsize money-losing business units (BUs) within their core business. Low stock valuations have made other multibusiness companies prey for corporate raiders, resulting in divestitures and split-ups. Even economically successful multibusiness companies are now questioned by analysts and debaters in a way which formerly was unthinkable.

One explanation is that many multibusiness companies find it hard to adjust to the demands of globalization and increasing competition. According to Goold *et al.* (1994), many problems of adjustment are due to internal routines and processes. In particular, companies seem to find it difficult to formulate a value-creating corporate strategy and to co-ordinate their BUs so that the strategy is implemented and synergies are exploited. A multibusiness company and its corporate management thus face the challenge of creating a control system which aligns the capabilities of the BUs with the competitive marketplace as well as the corporate strategy.

Although the problems of many multibusiness companies have contributed to a renewed interest in the role of control systems in the formulation and implementation of strategies, these issues have been under discussion for a long time. One of the pioneers in this area is Robert N. Anthony; the framework which he presented in 1965 is still central today in defining the role of a control system (Anthony, 1965). Under the heading of 'Management Control', Anthony discussed the use of financially based models, with measures like Return on Investment (ROI) and Residual Income (RI), in establishing systems of planning and follow-up. In practice, however, it has proven difficult to use these models to create control systems for multibusiness management which further the long-term objectives of owners and the strategies chosen by corporate management. Critics have held that these models focus excessively on short-term financial performance and that for this reason management does not always act in accordance with the long-term interests of the owners.

Researchers with backgrounds in financial economics have reacted by elaborating on the original models and re-launching them under names like Economic Value Added (EVA)[1] and Cash Flow Return on Investment (CFROI). Any 'agent problems' are supposed to be handled by rewarding management through the use of so-called value-based models, which their proponents claim will accurately reflect the creation of shareholder value. In parallel with this development, a growing number of scholars are becoming highly skeptical of all types of financially oriented control models. According to these critics, the focus on financial measures provides a one-sided picture of corporate operations, making effective co-ordination difficult (Johnson and Kaplan, 1987). Models such as the Balanced Scorecard and the Performance Pyramid were developed partly to remedy this shortcoming by providing better co-ordination of corporate business through a combination of financial and non-financial measures. These measures, it is emphasized, are to be clearly linked to the corporate and business strategies of the firm and should thus be a valuable aid in its strategic management (Olve *et al.*, 1999).

The presentation will be based on the following three categories of control models for multibusiness management: (1) models for performance management, (2) models for value-based management, and (3) models for strategic management. All were advanced by scholars and practitioners as possible solutions to problems of co-ordination in complex organizations with multiple business units. Empirical studies have also shown that models of this kind have gained wide acceptance at multibusiness companies (Kald and Nilsson, 2000). The purpose of this article is to analyze the fundamental similarities and differences among the three categories of control models and the possible implications for multibusiness management.

Theoretical Background

Company goals are normally expressed as designations of the way in which value is to be created for owners, managers, employees and customers. In parallel with explicit goals, companies develop a multiplicity of views on why they exist and how they should develop. It is hard to imagine companies where owners and managers would refrain from exercising control and leave governance to internal market mechanisms. It is equally hard to imagine a company where knowledge and decisions would be concentrated to the corporate center. For a variety of reasons, structures involving control systems and decentralization initiatives will emerge (Mintzberg, 1979).

One of the most powerful internal structures for pursuing organizational goals and implementing strategies is the formal control system (Simons, 1995). This article addresses the role of control systems in multibusiness companies where long-term profit is the ultimate goal.[2] In these companies the co-ordination of activities, between different organizational levels and between different business units, is very complicated, and much is demanded of strategies, control systems and corporate management. The options available to corporate management in exercising control will be discussed in the sense described by Goold and Quinn (1990, p. 43):[3]

> The control system is the process which allows senior management to determine whether a business unit is performing satisfactorily, and which provides motivation for business unit management to see that it continues to do so. It therefore normally involves the agreement of objectives for the business between different levels of management; monitoring of performance against these objectives; and feedback on results achieved, together with incentives and sanctions for business management.

However, the control that corporate management exercises is not absolute, nor is their knowledge of the possibilities and preferences of all actors in the organization. Agreement of objectives and strategies must therefore be reached through communication about opportunities and preferences. Corporate management has the responsibility of making choices and the power and authority to provide the incentives and sanctions mentioned in the passage cited above. Although the company may display certain features of an internal market, it is primarily a planned economy (Coase, 1937). Thus, a company is based on both market dynamics and internal opportunities, which may be recognized by its management or implicit in its actions over time. The control system should be designed and used to increase the likelihood that all actors in the organization will contribute to the achievement of the company's goals (Anthony, 1965; Simons, 1995).

In the early 1970s many attempts were made to describe this quest for an appropriate control system in more formal terms. Jennergren (1971) used the analogy of mathematical decomposition of a complicated optimization problem in the case where there are no synergies and each BU is optimizing its own production function. Olve (1977) discussed the interaction of BUs in contributing to the overall success of the company, noting that communication between corporate management and the BU will be used to