Strategic Control, Strategy, and Organizational Culture

What's the point of strategic control? Why is it important to learn how to build effective strategic control systems? Let's go directly to the bottom line: the point of strategic control is to allow the organization to make money!

Most organizations want to make money. They want to provide shareholders with value in the form of return on equity. Most managers agree that the most effective way of systematically achieving such returns is by gaining a sustainable advantage over their competition. That is the role of strategy.

Strategy

In order to start the process of understanding strategic control and understanding how systems can be built to establish strategic control, we first need to develop a common understanding of what we mean by the word strategy. Strategy can take on many guises. At one end of the spectrum, strategy is a theme or an attitude about how work will be done in an organization (e.g., “We’re about quality!”). At the other end of the spectrum, some people speak of strategy as the organization’s long-term plans (e.g., rolling out and expanding a new product line). There are established approaches to control that go with each of these two extremes, but the main body of what we consider strategy relates to a definition somewhere in the middle – strategy as competitive positioning.

Strategy at the business unit level means choosing target markets, defining what it is that the organization will provide for those markets, and specifying why those markets will want to buy what is offered (the customer value proposition). Obtaining a durable advantage over the competition requires the development and protection of the critically important resources that are necessary to the strategy. These resources can range from “accounting” assets (e.g., land, machinery or patents) to market advantages (like brand recognition, access to distribution channels or customer information) to skills and knowledge (such as research and development expertise, efficient logistics capabilities or a
highly effective sales force). Strategic management at the corporate level means creating, deploying and managing the organization’s portfolio of such sources of competitive advantage. But having a strategy and executing it are two entirely different things. This is where strategic control comes in. Strategic control means making the strategy happen and signaling the need for a strategy to change when conditions require it.

We can characterize business unit strategy as a hypothesis about how a company can create value and capture some of it (Nanni, et al. 1992; Kaplan and Norton 1996; Simmons 2000). If the strategy works, the benefits accrue to the firm. In order to determine the validity of the strategic hypothesis, an organization must first execute its strategy effectively and efficiently. Only then will the management be able to assess the value of the strategy. In this sense, strategic control is like “experimental control.” It fosters the required effective and efficient execution of the strategy.

No organization knows, at the outset, whether it has crafted an effective strategy. In a sense, the strategy is a “bet” that a particular value proposition, aimed at a particular market and executed well, will successfully lead to the accumulation of wealth for the firm and its owners. However, the organization cannot know with certainty what cards the competition holds. Nor can the organization know whether the deck is stacked against it in terms of changing customer preferences, economic conditions, emergent substitutes, et cetera. Nonetheless, the organization can influence the game’s outcome by building critical strengths, purposefully eradicating weaknesses, and craftily signaling its potential moves. The analogy breaks down here, however. Unlike a card player, an organization is comprised of many members. In order to play the game well, all those decision-makers have to act in concert. It is unlikely that an organization’s strategic bet will pay off unless each member of entire team understands the strategy and the role he or she plays in executing it. Only when that unity of purpose and complementarity of action occurs can we say that the organization is executing the strategy and only then can the strategy’s success or failure be assessed.
From this perspective, the strategic control system can be seen to be inextricably intertwined with the organization’s culture. Understanding the strategy is the easy part of the process of creating a strategic control system. Integrating the strategic objectives into the firm’s infrastructure and thought patterns is a never-ending process. Strategic control systems must be woven into the fabric of an organization, and that means that the organization’s culture is both a critical aspect of the context of the strategic control system as well as an active component of that system.

**Philosophy of Control**

In many situations, the term “control” takes on a negative implication – control is the removal of freedom. However, the primary objective of strategic control is to make corrections for deviations from the strategy. It is not about loss of freedom as much as unity of purpose. Often, the thermostat in your home is used as an example of a classic control mechanism. You set the temperature parameters for high and low to regulate the heating and cooling. The thermostat then monitors the ambient room temperature and, if the temperature varies from your settings by a critical amount, it switches on the corrective response (i.e., furnace or air conditioning system). Measurement and feedback about deviations from a desired state are central to control. However, strategic control is much more complicated than a thermostat. Thermostats are completely mechanical and do not involve anything remotely as complicated as human behavior.

Strategic control requires influence over human behavior and motivation for actions and decisions. In fact, strategic control is all about behavior. What the members of the organization do determines whether the organization is “under control.” An organization’s *effective* strategy is the one *inherent in its actions*. In practice, this inherent strategy does not always turn out to be the intended strategy. The organization’s actions are mediated by the organizational culture, by what the members of the organization believe is important and how they approach the priorities established in their minds by those shared beliefs and norms. When the things those decision-makers believe and do align with
the intended strategy, strategic control exists. Strategic control, then, is not a carefully elaborated strategy statement, a list of measures, or even the result of having those things. Strategic control is a state of being for the organization, a harmony between the strategic direction and current values, beliefs, and actions.

This means that strategic control is “all in your head.” The trick is to get all of the decision-making heads to have the same thing in them and for that same thing to be the organization’s intended strategy. Control involves aligning the group objective with the individual objectives. This is one of the major roles of performance measures. Performance measures are the major formal means that the organization has at its disposal to direct attention, establish priorities, and provide feedback on strategic execution. However, performance measures are not especially well suited to creating an understanding of the strategy or at preventing unintended consequences. Performance measures generate attention and we shall discuss how they can be used to create strategic alignment within an organization. Other kinds of control are also needed to complete an organization’s strategic control infrastructure.

**Building Blocks of the Control Infrastructure**

If control is behavior, then a control system is a process for influencing behavior. Most managers immediately think of this process in terms of performance measures and the associated system of outcomes to which those measures are attached. However, think about how we influence behavior outside of the business environment. We usually see other means of influence over people’s behavior. Our behavior is constrained or motivated, for example, by our attitudes and beliefs, by the norms of our society, peer groups and family, by and legal and ethical boundaries. Each of us can find examples in our own lives of making a decision or taking an action because we wanted to be like other people. Conversely, in some situations, we have each acted in a particular way in an attempt to stand out among other people. In some cases we act to be like a role model. In others we act to avoid being like someone whose behavior we find unpleasant. We act to be recognized by others, to gain financial rewards, to minimize undesirable risks, to avoid punishment, or to prove something to
ourselves. It is important to recognize that these other means of influencing behavior apply to human behavior across the board, including within the business environment. Thus, they need to be considered in the development of a strategic control system.

**Types of Controls**

Strategic control can be executed in a variety of very different ways. The culture of an organization will place a unique pattern of emphasis over the various control mechanisms employed. Successful implementation of a strategic control system is highly dependent upon context. The appropriate design of the control system depends on the organization’s strategy, its values, its people, and various aspects of its current competitive situation.

One way to understand strategic control is to look at the various types of control mechanisms. Every organization has an array of types of controls available from which to build its strategic control portfolio. Each will choose the ones to make up its portfolio based on the nature of the business, its strategy, and its context. The mix of the various types of strategic controls in the portfolio will be unique to each enterprise. Each strategic control portfolio should fit the specific needs of the firm. Often, the root causes of recurring business problems can be traced directly to an ill-fitting strategic control portfolio.

We classify controls into three major types: results controls, action controls, and resource controls. In the sections below, we describe these various types of control and then discuss the risks and benefits of using each of these types.

**Results controls**

Results controls are primarily motivators – they help direct managers’ attention and provide some impetus for achieving desired strategic results. They focus attention on outcomes of decisions and actions. Results-oriented control is the most common type of control in situations where there are clear measures of unit outputs and individual performance. Companies have an array of operational and financial performance measures that directly guide the training and development of the people in their organization. Typical results control
measures include metrics like targeted sales level, return on investment (ROI), profit, number of defects, and number of on time deliveries. The dimensions of the measured results can be precisely defined and the standards of expected performance are typically established on a regular basis.

Results controls are important because they are often the primary measures by which management is formally judged. Optimally, an array of parameters should be used to judge a manager’s output performance. Maximum score in one area does not necessarily indicate the best overall performance. For example, a division attaining its annual ROI goal may have a number of underlying problems (i.e. declining market share) not captured in this results measure. A single overall measure or even a set of measures may not effectively lead to strategic goal attainment. Results controls produce the most desired outcome when used in conjunction with other types of controls.

**Action controls**

Action controls are the form of control through which management most directly ensures that individual actions conform to organizational standards. Formal action controls typically take the form of organizational policies and procedures. Action controls define who has the authority to make decisions, how decisions should be made and actions taken, and what actions are prohibited altogether. Decision-making authority within the organization is established through delegation of authority. Formal specifications of that authority are action controls. For example, a company policy might specify the job title and level of authorization required to sign checks or contracts, thus establishing the level of individual authority. Generally speaking, increased organizational complexity requires greater distribution of authority to ensure that each unit can function and can react to changing conditions. Conversely, greater distribution of authority requires increased specificity in defining the scope and scale of each manager’s authority.

Action controls can be formal or informal. The formal versions are intended to set the firm’s management tone. They serve as the referenced ethical and compliance standards. However, they seldom achieve the desired
result when high-level managers act in ways that are inconsistent with the stated policies. Rather, such behavior typically undermines formal action controls. This demonstrates the power of the informal form of action controls.

Positive informal action controls can be very effective, but they are not easily established or maintained. People’s behavior can be constrained by social and group norms or by “leading by example.” Although such informal standards of behavior are a critical part of the organization’s strategic control system, we prefer to think of them as part of the internal control environment.

*Resource controls*

Resource controls are an often invisible source of strategic control. Because their control implications are often overlooked or misunderstood, they are often misused. Thus, it is important to know how to recognize and utilize these kinds of controls.

When resource controls are set too tight, insufficient resources are available to be applied to strategic activity. As a result, the organization is unable to make satisfactory progress or reach major milestones. When resource controls are too loose, the organization can progress, but inefficiently. Excess capacity to do the strategic work results in excessive costs.

Probably the most obvious resource control is the functional or departmental budget. While the organization-wide budget is primarily a planning tool used to project and test future financial results, departmental or work-group budgets are often used as spending limits. Thus, they inherently constrain managers’ options for action. Similar limits can be established in other “budgets.” For example, resource control can be established through time budgets, rather than spending budgets, *per se*. Another manifestation of resource control is limiting available worker skills and/or attention. In many businesses, the word “resources” is synonymous with the term “available personnel.”

When thinking about resource controls, it is useful to consider them from the perspective of production bottlenecks. If we are trying to gain the most results from our management system, we need to open the bottlenecks.
Resource controls should be focused on allocating sufficient work capacity to strategic bottlenecks. Resource controls should also be focused on limiting the amount of capacity created in non-bottleneck areas. This means that traditional management reaction to poor financial performance – across the board budget cuts – may be the worst strategic reaction possible.

**Strategic Control as a System**

Strategic control is the result of the organization’s decision-makers acting in concert with the strategy. How do we get from a list of control mechanism types to an effective control system? That is not a simple process and well beyond the scope of this note. Nonetheless, at this juncture, we can say a few basic things about establishing control through a system of results, action, and resource controls.

Figure 1 outlines a conceptual model of the strategic control system. Choosing and establishing specific components of a strategic control system requires sensitivity to the context in which those controls will operate. Certainly, that context includes factors like the structure of the organization, the objectives for the business unit or subunit to be controlled, and the nature of the markets in which the business unit competes. However, it also includes the general internal decision-making environment.

Wrapped around the portfolio of controls in a company’s strategic control system are the social norms and group values of the organization, its culture. This social system determines how groups of personnel, whether they are stand-alone or part of a larger set, interact based on their shared values and objectives. The norms of behavior limit the likelihood of some managerial actions and encourage other kinds of thought and action. Thus, the organization’s norms and values create a kind of control system themselves. Ouchi (1978) calls this clan control.
Under pressure, the common values will guide the actions of a group. This can be a very potent form of control. The behavioral norms of the organization both define what results are desirable and what actions are off-limits. In fact, “clan” control is probably the primary (if not only) form of control in many small business and entrepreneurial operations. Even within a large corporation, however, it is the filter through which specific controls are interpreted.

Social norms and organizational culture evolve in an “organic” fashion. This does not seem to have stopped managers from trying to manipulate social norms through direct methods of intervention such as formal discussions, publications, speeches and mottoes. Nonetheless, culture may be subtly and slowly shaped and reshaped through real changes in organizational design and action. In order to instill “six-sigma quality” values at GE and Motorola, the associated language and concepts have been actively cultivated and regularly discussed for decades. Managers there are expected to walk the talk of quality improvement.
Specific performance measures and standard operating procedures must be in harmony with the shared belief system of the organization in order for them to be effective. In some cases, this requires the control systems designers to define measures in terms that are consistent with the organizational norms. In other cases it requires action controls to be explained or justified in terms of shared beliefs. In some cases it might mean that no specific control is necessary — the social norms already make an undesirable behavior extremely unlikely. Sometimes, however, it means that the current culture is a barrier to the strategic goals.

Within the context established by the organization’s norms and values, resource controls affect the inputs to the process of business operations. The management style of the organization’s leadership is one of the primary means available to influence the organization’s shared culture and beliefs. Management style affects the amount of weight that can be effectively placed on the different types of control. Our experience and our research both tell us that management style is a very powerful force that directly influences the effective (or ineffective) implementation of strategic controls. To be effective, the control system should be compatible with the leader’s personal management style.

In the end, we want a portfolio of specific controls that will direct attention to the problems and eliminate undesirable actions from consideration, but otherwise leave the details of the actions to the imagination and ingenuity of the members of the organization.

The Process of Strategic Control

It is important to recognize that control systems derive their effectiveness from being dynamic. Many cases of failed strategy implementation can be traced to the use of controls that either did not fit with the strategy or that were employed in a strictly bureaucratic, compliance-driven way. Strategic controls systems are not like “set and forget” thermostats.

One idealized view of the strategic control process is illustrated in Figure 2. Figure 2 illustrates the strategic control process as a cross built of two components. The main horizontal depicts the rationalized notion of strategy
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formulation and execution. Most of us tend to think about strategy implementation as the simple left-to-right sequence shown in that horizontal bar. The strategy is formulated and then implemented, resulting in the desired performance. Note, however, that the arrows are two-way. The ease or difficulty of implementation may send management back to the drawing board to tweak the strategy design. Similarly, intermediate performance outcomes will influence the decision-makers involved in the implementation.

The vertical bar in Figure 2 represents the control system. The control system monitors internal and external outcomes and, through management decisions and actions, corrects the implementation, assuring the desired performance. The bi-directional arrows here are easy to understand. Resource and action controls (as well as social norms and values) directly affect how the strategy is implemented. Furthermore, results controls monitor the outcomes and prescribe adjustments to the implementation effort.

Note, however, that Figure 2 shows two-headed arrows connecting all of the components, including diagonal relationships. These arrows reflect the fact that strategic control requires constant balancing and alignment among all of the parts. Obviously, strategy formulation will affect the choice of controls, as shown in the diagonal connections on the left side of Figure 2, but the relationship flows in the opposite direction, too. Control choice determines what the realized strategy is. The realized strategy is the one inherent in the actions actually taken. This effect on strategy formulation is often unintended. The monitoring process can have intentional influences over strategy formulation, too. For example, monitored results may show high levels of competence in certain dimensions, leading to a reformulation of strategy to take advantage of those strengths. Occasionally, even the attempt to find appropriate controls for a new strategy can reveal inconsistencies in the strategy, itself. If the control process is not open to react to such information, it will be less effective.
Figure 2
The Strategic Control Process

External Monitoring
- Benchmarking
- Customers
- Competition
- Strategic Audits
- Economic Trends
- Key Success Factors
- Measurement

Implementation
- Action Plans
- Project selection
- Rewards

Internal Monitoring
- Financial Results
- Operational measures
- Key success factors
- Measurement

Strategic Formulation

Performance
The diagonal relationships in the right side of Figure 2 are a bit less obvious. While controls are designed to influence strategy implementation, the global effect of controls is organizational performance. The old phrase “you get what you measure” is absolutely true. In fact, “what you measure” even affects “what you see.” Thus, the control system often defines what the organization’s perception of performance is. On the other hand, organizational performance can have interesting effects on the system of controls. Either very bad or very good performance can make individual performance measures obsolete. For example, a company pursuing a strategy of time-based competition may make great strides in improving delivery performance as reflected in measures of on-time delivery, where “on-time” is defined as “shipping by the date promised.” However, the performance reality may be that the promised date is notably later than the customer’s request date. If so, 100% on-time delivery as measured by that results control does not reflect achievement of the true strategic goal. As delivery performance improves, the control measure becomes obsolete and must be redefined.

**Dynamic use of controls**

The dynamism of the control process is not confined to the relationships among the components. Part of the dynamics is captured in the ways in which the controls are employed. Controls address symptoms of important cause-and-effect relationships that determine behavior. Some of these symptoms are like blood pressure or body temperature, with well-understood consequences and treatments. Others are more like disturbing dreams – they need to be psychoanalyzed. Robert Simons (1995) describes the associated ways of using results controls as diagnostic uses and interactive uses.

Sharing information and monitoring progress is critical to the strategic control process. Managers in organizations regularly meet to discuss internal developments, status of various projects, and changes in the external environment. The best example of interactive control is a firm’s monthly performance review meeting. The results, financial and operational, are presented and discussed. Additionally, the management team will review the
internal trends along with external market forces influencing the company. Production data, demand levels, and market share attainment are discussed. Many companies use this forum to search for meaningful patterns or signals of potential underlying problems. Measures are used interactively to aid in organizational learning – both about performance and about the strategy, itself. As the learning occurs, what was once vague becomes well-understood. As this happens, the measures tend to be used more for diagnostic purposes, coupled with standard responses.

Interactive use of controls normally involves multiple levels of managers in a forum for feedback and adjustment of company targets. This feedback results in organizational learning, allowing organizations to adjust to the changes in their environment. Many managers employ measures interactively as a way to both signal and advance change. It is a technique to trigger revised actions to deal directly with strategic uncertainties. Interactive control allows a dynamic internal and external assessment and offers a forum for feedback, a critical element of management control.

**Dynamic formality of controls**

Another dimension of flexibility in strategic control systems is the ability to adjust the level of formality of controls. From the perspective of systems design, formal controls – utilizing written policies, official measures and data recording, and written reports – is preferable to informal controls. Nonetheless, a significant amount of strategic control can be achieved through informal controls based on organizational norms, values, and associated behavior patterns. Over time, the consistent utilization of either formal or informal controls becomes embedded in the organizational culture. The organizational culture is the repository of expectations about the types of control that are deemed most effective, even legitimate, in a company. Therefore, organizational culture has the unique trait of being both a means of control and a limit on the flexibility of a control system.

The creation of formal controls is demanding and exacting. It is challenging to compose complete, exhaustive, and clear policies and procedures. Results-oriented performance measures are even more
problematical. Because people will modify their behavior in order to increase their measured score, managers must constantly concern themselves with measuring the proper items in order to stimulate the desired actions. They want to balance the short term and long term efforts to insure compatibility.

Performance measures are not natural. They drive specific behaviors, but the behavior they drive is increasing the “score.” If improvements in the measures do not equal improvements in real organizational performance, the measures fail.

Given the difficulties of creating effective measures, it is not surprising that many effective managers utilize less formal, if not less powerful, approaches to establishing strategic control. A highly-focused form of informal control via norms and values is personal control. Personal controls, established on a one-on-one basis with specific subordinates, leverage an individual’s basic desire to do a good job and the collective desire to conform to group norms and standards. Effective leaders capitalize on the individual’s internal motivation, and personal pride or professionalism. Whether these individual relationships can be scaled into group social controls is another matter. Social controls are internalized, and they are the outcome of the interplay among a number of factors, only a few of which the leader can directly control. One method leaders tend to rely upon in the quest to establish personal control is careful selection of individuals to fill key positions in the organization. Attitude, style and degree of trust are critical. A leader often views this as his or her most critical task. Often, a new leader will bring in his or her “own people.” These are subordinates who are well-known and trusted. Otherwise, upon assuming a new position, a leader will often spend considerable time training and evaluating the key players in his or her organization.

The Power of Measurement

The appropriate use of performance measures and a structured feedback loop can have a very strong influence on individual behavior and collective unit performance. If the measures used in control are clear this will in turn cause specific actions and decisions. If the emphasis on certain measures is changed, this will also alter behavior. Managers realize that they can use their control
system to move the organization in a new direction or reinforce a new set of values. We see strategic control systems as the basis of the learning organization and used extensively as an accelerator of change.

Performance measure design has proven to be very influential in supporting organizational change. The control system provides a set of measures and targets deemed important by the firm. Employees see these as tangible evidence of the strategic direction and respond. The planning and control systems can be designed to promote curiosity and experimentation. Alternatively, the control system can concentrate on improving efficiency and productivity. It signals the actions and behaviors that are important to the firm. The use of cost-of-quality information can support a firm's new emphasis on quality of outputs. Product costing and benchmarking serve to open minds and build a greater awareness of competitive parameters.

If new performance measures can help reorient and change behavior in a firm, then they can also help accelerate improvement in existing strategic directions. The feedback loop of the strategic control system is a very powerful learning device. The comparison of planned to actual results with a solid analysis of the deviations provides an excellent learning opportunity. This is often focused on operational problem solving, but the technique can also play a role in detecting and solving problems caused by environmental change. The system will reveal if the existing goals and processes no longer match external challenges and signal a need for a new strategy.

Finally, the powerful effects of good performance measures can be enhanced by linking them to organizational rewards. The rewards can be formal or informal, tangible or intangible. It is clear that a control system works best when the individuals are rewarded for accomplishments both specific and apparent to other members. Positive reinforcement has proven to be a strong motivator. Bonus systems, however, have a tendency to pressurize any measurement system. Bonuses amplify the degree to which measures are required to generate only desired results. They also raise the stakes for any latitude managers have to “game” the system. Additionally, reward systems
create a situation where individual gains are often placed before collective gains, limiting goal congruency between the individual and the organization.

**Conclusion**

There are clear linkages between control and achieving strategic results. These connections are made possible by the influence that the three types of control have on human behavior. In order to insure that the desired behavior is obtained, managers need to understand both how the context influences behavioral reactions to specific controls and how strategic control systems can be used dynamically. There is not a single, universal set of “good measures.” Rather, managers must carefully select the controls and system characteristics that fit their organization, their chosen strategy, their management style, and the nature of their personnel.

**References**


