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Performance management and organizational strategy: How to design systems that meet the needs of confrontation strategy firms

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A R T I C L E I N F O

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A B S T R A C T

The link between organizational strategy and performance management system design has been examined in numerous studies. Invariably, strategy is conceptualized using archetypes developed in the 1970s and 1980s. Scholars have increasingly questioned the wisdom of relying on strategic archetypes that are plainly dated and conspicuously disconnected from the possibility of firms competing head-to-head, not out of choice but out of necessity. Cooper (1995) calls such a situation the undertaking of a confrontation strategy. Using an exploratory research design, this paper draws on nine qualitative case studies to examine how performance management systems are designed to meet and support the implementation of a confrontation strategy. Initially six firms, spanning a variety of what were expected to be mature, highly competitive industries likely to feature confrontation strategies, were recruited for participation. This initial study was then followed by a more concentrated examination of one particular industry: the banking industry. Findings from the total case study sample of nine firms lead to the presentation of an original table contrasting the unique performance management system designs associated with the three distinct strategies of cost leadership, differentiation, and confrontation. In particular, and in contrast to firms pursuing cost leadership or differentiation strategies, firms with confrontation strategies are likely to feature collaborative organizational cultures, lean organizational structures, and training and development programs that focus on developing empowered, multi-skilled teams of self-governing and coordinating employees. The exploratory intent of the paper, and thus its reliance on a small sample size of nine organizations, may limit the generalizability of the paper's findings. In spite of this limitation, the findings offer opportunities for researchers to move beyond the exploratory approach presently adopted and empirically test the confrontation strategy and performance management system linkages proposed. Additionally, practitioners are likely to benefit from a clearer understanding of the type of performance management system design needed to support confrontation strategies.

1. Introduction

Performance management systems embody the set of organizational activities employed by managers to focus employee attention and motivate behavior for the ultimate purpose of implementing the organization's strategy (Otley, 1999). As such, performance management systems are intended to help organizations plan and coordinate what they should do, provide accurate and timely feedforward and feedback on how they are doing, and encourage corrective behavior as and when needed (Anthony & Govindarajan, 2007). Some of the more typical organizational practices involved with performance management are strategic planning, budgeting, incentive compensation design, and organizational structuring.

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Different organizational strategies require different performance management systems. Various scholars, including Miller and Friesen (1982), Govindarajan and Gupta (1985), Simons (1987), and Anthony and Govindarajan (2007), have long argued that regardless of how one conceptualizes strategy – whether it be using Porter's (1985), Miles and Snow's (1978), the BCG, or some other model – different strategic orientations will require different approaches to strategic planning, budgeting, and incentive compensation. As an example, Anthony and Govindarajan (2007) contend that the performance management systems of cost leaders should consist of formal, financially-based strategic planning; short-term, output-focused budgeting; and formula-based, frequently determined and awarded incentive compensation. In contrast, firms that pursue a strategy of differentiation should design performance management systems that feature informal, qualitatively-based strategic planning; long-term, outcome-focused budgeting processes; and subjectively-based, infrequently determined and awarded incentive compensation.

Missing from the performance management literature is an inclusion of today's more highly evolved and contemporary understandings of organizational strategy. Several scholars, including Chenhall (2003), Kotha and Vadlamani (1995), Miller and Roth (1994), and Shortell and Zajac (1990), have questioned the utility of using strategic archetypes developed in the 1970s and 1980s for studying 21st century phenomena. As Chenhall (2003) so aptly notes, "Strategies are being complicated by the need for most organizations to be both low cost producers and to provide customers with high quality, timely, and reliable delivery."

Tushman and O'Reilly's (1997) concept of adaptive organizations, whereby organizations are capable of doing two very different things at once (thus giving rise to the title of their book *Ambidextrous Organizations*), is certainly in harmony with Chenhall's observations. Cooper (1995) recognizes this need, or what he more often refers to as a requirement, to excel on multiple product/service dimensions (e.g., cost, quality, functionality, and innovation) as part and parcel of a highly competitive business environment that features more of what Kim and Mauborgne (2005) call "red ocean" as opposed to their hoped for "blue ocean" strategies. Cooper (1995), for his part, calls such strategies "confrontation strategies."

The purpose of the present paper is to explore and describe the type of performance management system that is best suited for organizations pursuing confrontation strategies. No literature to-date exists on this topic. The paper draws upon nine qualitative case studies, all describing organizations familiar to the researcher and known to be pursuing a confrontation strategy. A main finding of the paper is that firms with confrontation strategies are likely to feature collaborative organizational cultures, lean organizational structures, and training and development programs that focus on developing empowered, multi-skilled teams of self-governing and coordinating employees. The paper's findings are likely to assist practitioners, who can benefit from a clearer understanding of the specific characteristics of the performance management system needed to support their organizations' confrontation strategies, as well as performance management scholars, who will have opportunities to undertake explanatory and predictive studies into the confrontation strategy and performance management system linkages proposed.

2. Performance management systems

Anthony (1956: 27), writing nearly 50 years ago, described performance management, what was then exclusively termed "management control," as "the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives." This definition would appear to encompass much more than what Horngren, Foster, and Datar (1994) proposed when they wrote, "A management control system is a means of gathering data to aid and coordinate the process of making planning and control decisions throughout the organization." In fact, most accounting scholars would argue that the definition of management control/performance management extends well beyond Horngren, Foster, and Datar's rather static and highly mechanistic definition. As Hopwood (1976) long ago pointed out, "The purposes, processes, and techniques of accounting, its human, organizational, and social roles, and the way in which the resulting information is used have never been static."

In fairness to Horngren, Foster, and Datar, later editions of their textbook add the dependent clause "and to guide the behavior of its managers and other employees" (2006). This updated definition, along with ones that have been advanced through the years by Emmanuel, Otley, and Merchant (1990), Merchant (1985), Simons (1995), and Garrison and Noreen (2000), match quite closely with Anthony and Govindarajan's (2007) relatively recent description of performance management as "… the process by which managers influence other members of the organization to implement the organization's strategy."

In seeking to describe the influence managers can exert on employee behavior, scholars have proposed various performance management taxonomies. Anthony, Dearden, and Bedford (1989) for example, dichotomized performance management into formal and informal controls. Ouchi (1979) used the categories of market, bureaucracy, and clan controls. Hopwood (1974) described the choices as administrative versus social controls; while Merchant (1985) offered a trichotomy of results, action, and personnel controls.

There are two main weaknesses associated with these various taxonomies. First, the language adopted is vague and indefinite, especially for practitioners. Second, while reference is made to human behavior, the expanded descriptions predominantly concentrate on accounting systems. As a result, the literature has failed to move beyond Anthony's (1956: 115) assertion that the center of a performance management system "must be a financial system."

Ferreira and Otley (2009) have recently presented a performance management framework that addresses the first stated weakness. In particular, Ferreira and Otley's framework uses plain, concrete, and practitioner-relevant language. Their control typology includes the setting of organizational mission and vision, the development of key performance measures and targets, and the use of performance evaluation and reward systems.