



Towards One Philips Program

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Executive Summary

Philips China Group has witnessed increased growth through Merges & Acquisitions (M&A) and Joint Ventures (JV) since it was founded as a lamp factory in 1891. The company is organized into a matrix structure around its five product divisions, with one corporate division supporting the functions. This growth has effected the organization; profit margins have derailed in 2001 and 2002, there is lack of synergies among the units and a general loss of control and high administration costs.

Double line reporting, ineffective governance (or control) structure, lack of responsibility accounting, goal incongruence, lack of communication, personnel and cultural controls problems are some of the control problems that exist in Philips China Group. The main causes of these control problems, we believe, are cultural misfit resulting out of the increasing growth of Philips China, lack of any reporting structure, disparate systems and processes and enforcement of policies and/or strategies making the business units pursue their own opportunistic goals.

Mr. Pratt Hsu, the HR VP has been mandated to implement the corporate actions to deal with the challenges and handle the issues at hand: the TOP program to capture synergies and align business processes, HR challenges to improve cost efficiencies of HR services, motivate employees and make the HR competitive, and lastly corporate culture problems. The need for different organizational set up of the Chinese subsidiaries is therefore imminent for Philips Groups of Companies to capture real value. The following proposed solutions in line with the tasks given to Prat Hsu:

- ▶ TOP Program: Define a vision of a shared service in line with business goals, create a relevant governance model for the business units, incorporate TQM, Balance scorecard and other performance measurements like Key Performance Indicators (KPIs). This leads to mapping all processes, procedures, policies and consolidating them.
- ▶ Redefine HR: map all transactional/administrative and technical HR, restructure them into shared service centre and design appropriate management control system for each.
- ▶ Corporate Culture: increase training by transferring labour across regions, increase ownership to work processes and control in areas with high specific assets, and increase management control in value add activities for Philips China

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Introduction

The change in 1996, from a hierarchal structure to a matrix organisation, allowed the Philips units greater autonomy, acting like independent companies. The business units (BU) had a decentralised state of mind, had their own resources and were accountable to PD's at the higher level. The shift required a change in the BU's mindset in becoming more collaborative and required significant more control measures to lower opportunistic behaviour. However the vital management control measures, necessary to implement control and assess performance, were left out.

In 2001 the CEO of Philips, decided to pursue a centralisation strategy called "Towards One Phillips" (TOP) in creating synergy, cost efficiency, and co-ordination. A restructuring of this scale would required a major transformation in the operating functions and structure, cultural mindset and organisational behaviour.

Q1. Management Control Problems in Philips China

Management control is the alignment of people's behaviour and decisions with the organisation objective and strategy. **Roberts, H (2007)**

Philips believed that changing to a matrix organisation allowed improvement in the synergies between the businesses. Implementing a change is to improve a situation, not to set back an organization. In this case, it caused loss of structure and oversight unclear responsibilities and lack of accounting measures. The current problems before shifting to a more centralised strategy (TOP) are listed below:

- ▶ **No clear line of responsibilities** of the business units (accounting control) – decentralized units without coordination from the country corporate organisation.
- ▶ **The double line reporting** (from country PD to both regional PD and the country corporate organisation) imposed some problems in the responsibility such as who should assess performance and who should decide when the Regional PD and country organisation had different opinions?
- ▶ The country corporate organisation only act as a functional service provider responsible in deploying programs and policies. The PD's, who have their own budgets, answer to the higher level PD's and act in their own interest. This does not **allow the country corporate organisation to impose changes** and collaborate between the BU's in creating synergies between the units.
- ▶ **Goal Congruence ≠ Behavioural Congruence-** The different BU's strategies does not allow the organisation to pursue a common goal as the respective PD is acting on behalf of the regional PD's policies. The diversified units within each PD's could differ significantly resulting in units acting as independent companies with independent goals and strategies
- ▶ Philips was unable to capture, create and aligning a common culture within the organisation when growing through **Merges & Acquisitions (M&A) and Joint Ventures (JV)**.
- ▶ Corporate organisation **need to communicate**, educate and enable a feel of ownership to the processes within the PD's (Executives saw imminent need for integration but units did not)

- ▶ **Lack of Effective Governance structure.** Different types of control measurements used in different parts of the organization (amongst JV's and wholly owned foreign enterprises WOFE)
- ▶ **Organizational Coordination Problem** – as a direct result of the matrix organization (i.e. structure and work design) leading to lack of synergies and coordination among the business units and increase in internal transaction costs.
- ▶ **Lack of motivation** – caused by cultural misfit between the different organizations merging with Philips through M&As and JVs resulting in goal incongruence, i.e. unit's or personal goals different from organizational goals.
- ▶ **HR problems** – limiting the need for training, knowledge sharing and information processing → Low capability development to match increasing growth.

Q2. Causes of the management control problems and how they affect performance?

Growth and Decentralization of the companies led to:

At a guest lecture at Kingston University; Jan Oosterveld, the former CEO of Philips Asia Pacific, explained: *The main problem of Philips, in the past, was the great diversification into both related and unrelated business areas.* Many of the business units were running major deficits and the decentralisation made it difficult to create synergies across the organisation and capture the innovation as the business units was very autonomous. Philips decided to restructure its business by selling off unrelated businesses and businesses who not yielding any profits. In the past, the divisions did not contribute much to the organisation in sharing the innovation so they created a common R&D centre, an area of expertise, bundled together with the rest of the organisation.

By growing and diversifying significantly, Philips decentralised the decision making in the supporting functions of the value chain (i.e. finance, HR, procurement etc). Especially the decentralising the budgeting processes made it difficult for Philips to control the overall cost, as each country specific PD had its own budget. Centralising the supporting functions to country HQ, indicates that the PD will loose autonomy over its operations. The operational processes and culture within the

respective PD's differed widely making job sharing (transfer) and utilisation across business units increasingly difficult. *Oosterved. J (2005)*

The Matrix Structure - The sudden change of organization without bringing along the business at all levels is the main cause the problems. The matrix organization failed to align the business units with the organization's goal, allowing them to pursue their own individual goals. I.e., when implementing changes, there should be a clear agenda of what to achieve, but also careful consideration should be taken into the existing parts of the organization that perform well. The pre-change situation should be evaluated and measured before the alterations and after implementation of the changes. The desired effects should be measured and followed by organizational adjustments.

Lack of Direction for the business units - Lack of effective cultural and personnel controls lead to general lack of direction for the business units. There was no commitment or motivation from top management and employees on the ground floor to match growth with capabilities.

Growth through M&A's - Philips China had grown through M&As and JVs and particularly increased mode of entry via JVs. This growth strategy facilitated loss of control because lack of proper control measures incorporated by Philips. The result was the BU culture did not fit with the overall Philips culture due to differing goals and strategies. Philips growth through M&A's, not imposing any performance measurements, made it difficult to capture the synergies and evaluate performance of these units.

Vision and Goals - Not having a common vision, hindered Philips to pursue one unified goal for growth. The respective business units have different SWOT's, but there are some commonalities that could be utilised. As there are no common way on how to measure performance, it is difficult to control the respective business units on how well they perform and furthermore improve their performance. Additionally, it is impossible to create synergies between the units functions. People within the organisations have not seen the importance of implementing performance measurement systems. The lack of ownership and support from management, at all levels, made it hard to implement changes in the past. It is core that they manage this through educating and training. There is a lack of a clear governance structure creates problems in reporting.

Responsibility centres - There seems to be no clear responsibility centres and hence no sense of responsibility, accountability and costs allocation. The result was that opaque traceability of costs, which might have incurred elsewhere.

Performance Measurement Systems - It was vague in the case if Philips had any performance measurements at all. Performance measurements like KPIs to quantify financial and non-financial performance, and TQM to increase and/or sustain quality were absent in all of the Philips units. This made it difficult to benchmark performance and control activities.

Q3. What can be done about these problems?

Distinguish between short-term and long-term solutions, and indicate where these problems are located.

The problems faced by Philips China mentioned earlier are the main reasons why the company is in trouble and showing losses for the years (2001-2002). According to this analysis there has been located areas where a specific problem exists and proposed the following solution for the respective problem:

Double line reporting

The double line reporting oppose serious issues and creates problems like, slowing processes, complex decision making, unclear responsibilities in terms of evaluation and finally control. The problem lies at both the country and the regional level.

The old hierarchical structure allowed a clear reporting line but the new matrix organisation complicated the situation and grew out of control with further expansion. Reporting lines with clear responsibilities and ownership must be defined and allocated with proper reporting systems in the units. This is to create transparency and to avoid opportunistic behaviour from the respective business units. In the Chinese context, this is especially important since the mindset of the workers- and management familiarity of clear instructions and hierarchical structures from SOEs. Introducing control systems will enable the employees to assess themselves, their work processes and procedures. Furthermore this performance measurement may enhance efficiency and quality, and continuously improve on all levels.

Decentralized business units & responsibilities centres

A short term goal for Philips should be to establish central or regional hubs to capture the synergies between the business units. This would be absolutely core in creating and maintaining future key success factors. The rapid growth together with matrix organisation has created problems as there is no alignment between the business units. Philips has not been able to capture the value added activities since the business units have been acting as independent companies. All the PDs should be aligned with each other in some respect so that they understand the common goal of the company. This will enhance the knowledge sharing among various units and promote innovation and collaboration leading to a long term competitive advantage.

For example, when there is integration among the units and knowledge sharing, then they can benefit from their collaborate experiences. Problems lies in the individual PDs, which are decentralized, working as independent units and not connected or coordinated with each other.

Cultural problem due to M&A's and JV's

After moving towards a matrix organisation, Philips was less able to impose direct control, on its acquired subsidiaries and JV acting as individual companies. Furthermore, the cultures differed significantly within the different units. It was difficult to align a common management control system. The mindset of the employees working in various PDs needed to change and focussed towards one common objective so that they understand what China office expects from them. It is important to find commonalities between the units' strategies and build on these. Furthermore, Philips should impose stronger control measures on the high specific assets. Philips must involve the top management in conveying the vales and goals of the company to the employees and make them recognize its importance by initiating a two way communicating (i.e. internet, company newspaper, corporate meetings etc). Additionally it is important creating belonging and ownership for the processes to make them work easier. Changing this culture is time-consuming, if including high degree of involvement, and should be seen as a long term strategic process

Ineffective governance structure

The matrix does not allow for a clear line of reporting compared to the old hierarchical structure. The double line reporting allows the units to potentially bypass one of the principals in pursuing an opportunistic approach. PD's are pursuing JVs and M&As strategies in pursuing growth and they take their in house control structure

to the resulting subsidiary, further aggravates the problems. All of this is happening due to the lack of an effective governance structure. Philips should apply different control measurement to different ownership structure, i.e. Bilateral (2 party) control structure for JVs and unified control model for WFOEs.

It is believed that is a short term solution to the overall problem of governing the PDs, JVs and M&As.

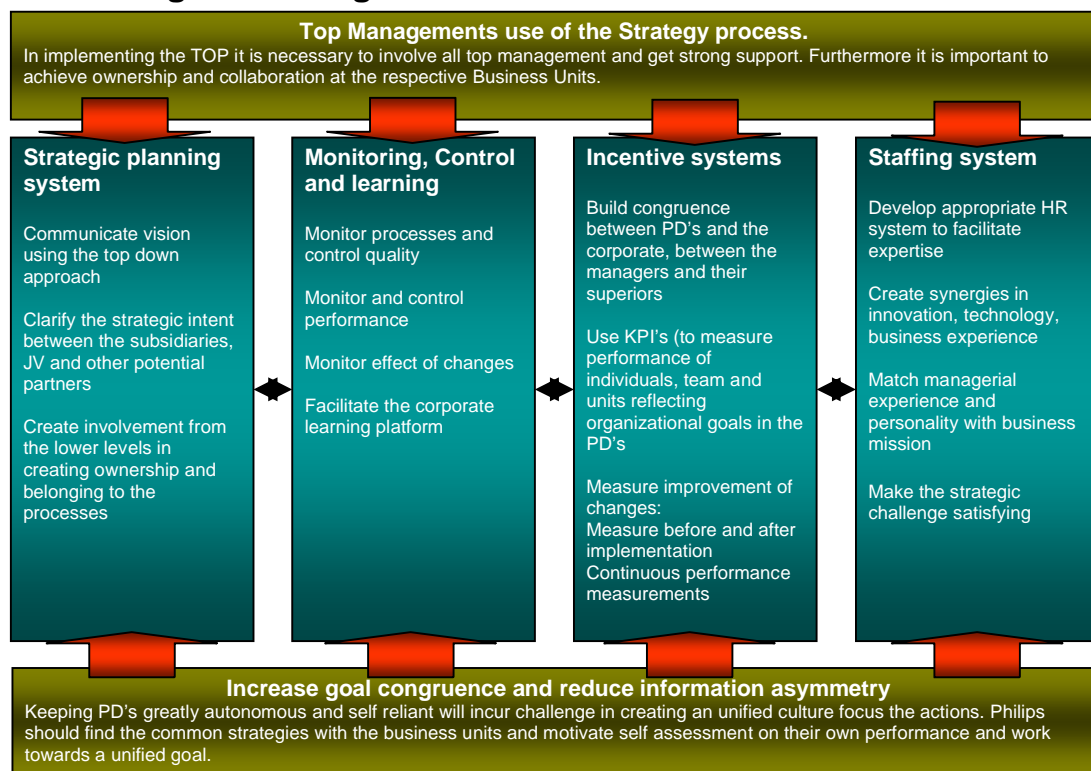
Cost inefficiencies

Philips should create cost centres; profit centres and investments centres, then define clear ownership of these responsibility centres. This will create high level of transparency due to easy traceability of costs. Key Performance Indicators (both for financial and non-financial) can be a possible tool to measure performance against corporate and industry targets. The KPIs will also help management to define areas for improvement. This could be a short term solution leading towards the elimination of problems in the long term.

Managing the strategy process

The strategy should be formed on behalf of the common visions and goals of the organisation. Then Philips should try to find commonalities in strategy with the respective PD's and from there together implement a top down approach of strategy thought the PD. The strategy implementation should go through the four phases as described in the figure (the strategic planning model) below and ensure that information flow runs through the organisation. Last it is important involve people, educate them and create ownership. This makes a better impact!

The Strategic Planning Model



Q4. Propose an action plan that Pratt Hsu can take with him to the Corporate Strategy Group meeting

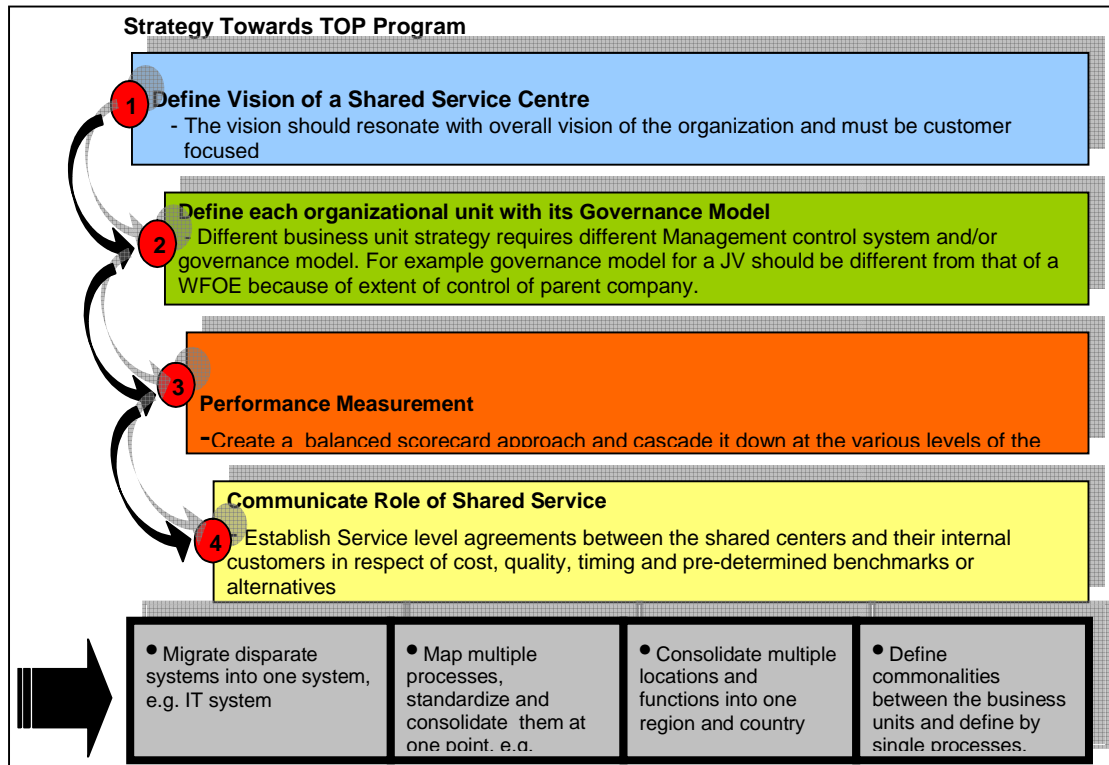
Pratt has considered tasks given by Management: the TOP program, re-definition of HR and Corporate culture issues. We propose an action plan for Pratt Hsu based on the main issues he is confronted with.

The TOP Program

As the company grows, the need for decentralization of business units is imminent as in Philips China group. The key issue however, is the control of the business units on profits margin and allocation of resources, e.g. 1) costs traceable to the division but not controlled by the division and 2) costs incurred elsewhere and allocated to the division. This is where design of responsibility accounting system comes in, i.e. well-defined responsibility centres in the organization with clear lines of responsibility and authority, with measurable indicators such as KPIs and other performance measurements. We therefore advise a re-design of internal reporting system into Segment Reporting which makes product division heads responsible and accountable

to the controllable resources and are able to trace uncontrollable expenses. Without that, implementation is impossible.

Found below (figure 2) is the strategy necessary to execute the TOP program.



HR Redefinition

The HR should be transformed and re-defined as a Shared Service as has already been proposed. However, we believe that the HR shared service should not function to just consolidate activities in one location, but they should be run as a business to the internal customers at cost, measured in terms of quality and efficiencies against pre-determined benchmarks and alternatives.

For Pratt to be able to deal with challenges (e.g. Consolidation, Cost efficiencies, talent building, motivation, competitive), the following thoughts (figure 3) will have to be considered before the HR shared service strategy we have proposed below is implemented:

Towards transformation of HR, some thoughts before strategy

| Define mission and vision of HR shared service | Review HR processes | Restructure shared service | Define MC systems for the center | Specify resources and delivery mode |
|---|---|---|---|--|
| <ul style="list-style-type: none"> •The mission and vision should reflect a full stakeholder perspective – employees and business unit leaders | <ul style="list-style-type: none"> •The processes should be goal – driven, i.e. towards customers and other stakeholders • Standardize processes and policies | <ul style="list-style-type: none"> •Organize shared centre to deliver business objectives e.g. Shared centre should be organized based on the # of people in the region, i.e. high relevance of regionalization in Asia Pacific as against globalization | <ul style="list-style-type: none"> •Define roles, responsibilities, and accountabilities and communicate throughout the units • Agree on performance measurements | <ul style="list-style-type: none"> •Specify use of either in-house resources for the shared centre or outsource elsewhere or a hybrid approach, i.e. outsource some functions and use in-house resources in other areas |

With these thoughts in mind, then the strategy emphasizing the roles of the HR shared service should executed as in the figure 4 below:

Strategy – Transformation of HR

| 1 Centralize Administrative HR | 2 Business HR | 3 Functional HR |
|---|--|---|
| <ul style="list-style-type: none"> • Map all processes, i.e. Transactional and administrative repetitive in nature, and Professional or technical processes • These transactional and administrative HR activities be standardized, e.g. pension, salary, claims, employee enquiry, job evaluation and pension should be standardized and consolidated in country • Technical processes like labour relations, Organizational development, training and development, etc should be standardized and regionalized with back office support at the local level | <ul style="list-style-type: none"> • Design different management control systems for business units with different strategies and asset specificity, e.g. High level of control and enforcement in WOFEs than in JVs, high level of negotiation for compliance and conformance in JVs, high level of control in performance measurements in WOFEs than in JVs, etc • Control systems will then align people with business objectives | <ul style="list-style-type: none"> •Standardize and globalize processes and practice •Communicate practices via regional shared service center •Consolidate dispersed systems within the business units to enhance learning •Encourage transfer of employees across units and regions to enhance knowledge transfer within the organization |

Corporate Culture

We believe that the corporate culture was compromised when the company grew through M&As and JVs. The following are the causes or sources of problems and their strategy associated with corporate culture in Philips China.

Sources of Corporate Culture Problems In Philips China Group

| Heterogeneity of merged companies | Governance/Control Structures | Extent of Growth |
|---|---|---|
| <ul style="list-style-type: none"> • People, Practices and Goals of companies that merged differ | <ul style="list-style-type: none"> • No relevant Governance or Control structures applied for both JVs and WFOEs | <ul style="list-style-type: none"> • Increasing level of growth in Philips China group has created loss of control system especially high number of JVs than WFOES |

Strategy to Instill Corporate Culture

- Increase ownership and control in JVs with high specific assets
- Evaluate all the JVs, define which ones are asset specific and set up control structure as per your evaluation and define lessons learnt for next venture.
- To achieve requirements towards "One Philips" culture, there is a need for training program to educate employees on vision, mission, goals, values and strategy.
- Pursue cultural controls by designing codes of conduct, encourage inter-organizational transfers to "brainwash" the employees and
- In order to create common ground for all the whole organization, it is important to have a proper communication strategy that will create consistency in employee behavior.

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