

## **Governing lateral relations in a transforming manufacturer**

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A case study of the governance of interdependent lateral relations

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**Abstract:** The purpose of this study is to theoretically and empirically explore how lateral and interdependent relations are governed. The governance of lateral relations remains relatively unexplored and this paper therefore aims to contribute to this area of research by performing an in-depth case study. The case study was performed at a Swedish manufacturing company that has transitioned from product to service orientation and, as part of this transition, has separated the service division from the manufacturing division. The study explores the lateral relation between the service division and the related manufacturing divisions and finds that the lateral relation to a large extent resembles what theory and previous research suggests. Two elements of governance, the vertical and the lateral, were identified both in previous research and in the case study. The role of the vertical superior was found to be consistent with theoretical suggestions of acting enabling and providing a structural context for the lateral parties to act within. The lateral parties were thus granted significant room to maneuver and the lateral relation was therefore characterized by self-governance, which is also consistent with theory. In addition, the study finds that an additional factor affects the governance of a lateral relation in this setting. We term this factor the historical context and argue that this affects both the vertical and lateral elements of governance.

**Keywords:** Lateral relations, Lateral vs vertical relations, Governance, Governance practices, Self-governance, Trust, Information sharing

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# 1. Introduction

The former Chairman and CEO of General Electric Jack Welch once said *"The old organization was built on control, but the world has changed. The world is moving at such a pace that control has become a limitation. It slows you down. You've got to balance freedom with some control, but you've got to have more freedom that you ever dreamed of."* (Nixon & Burns, 2005) This quote is in line with the concern that many scholars have voiced during the 21st century, of the existing management control frameworks needing to be updated. As the world develops and the environment that companies operate in with it, management control frameworks will also need to develop (Nixon & Burns, 2005).

When globalization and increased competition places added pressure on companies, management control is also affected (Dent, 1996). Companies must nowadays manage a variety of tensions (Busco *et al*, 2008). The business environment has developed to become more complex, and this has spurred a shift within organizations, moving away from traditional top-down relations to networks of organizational members with power distributed among themselves and relations formed both vertically and horizontally (Ostroff & Smith, 1992; van der Meer-Koistra & Scapens, 2008). Joyce *et al* (1997) refer to these new organizations as lateral organizations. Chenhall (2008) describes what he calls the horizontal organization as a response to a need for lateral integration in order to be able to achieve customer focus. As both terms coined by these two studies imply, much of the cooperation and information flows occur laterally in these new forms of organizations.

Traditional, vertical relations granted decision-authority to one party and allowed for control to be exercised over subordinates. In these new, lateral relations there is a need to consider the dispersion of power among its members. The developments results in an organization riddled by interdependencies and negotiations which make it challenging to, among other things, measure the individual performance of a division. Hence, control systems need to consider not only control of subordinates but also the cooperation, coordination and integration of relatively equal parties (Busco *et al*, 2008), which requires a new set of control systems compared to traditional, vertically oriented organizations (Berry *et al*. 2009; Dossi *et al*, 2010; van der Meer-Koistra & Scapens, 2008).

In defining lateral relations, we make use of the definition suggested by van der Meer-Koistra & Scapens (2008), who refers to them as organizational arrangements where managers work primarily with other managers on similar hierarchical levels as themselves. In such a setting, control is often not granted to either party and this, according to van der Meer-Koistra & Scapens (2008), brings an additional layer of complexity to the relation. These relations are often characterized by high levels of interdependency (van der Meer – Koistra & Scapens, 2008), which can be defined as “*the extent to which departments depend upon each other and exchange information and resources to accomplish their respective tasks*” (Macintosh & Daft, 1987). The focus of lateral relations is on cooperation and coordination instead of the command and control that is typically associated with vertical relations.

van der Meer–Koistra & Scapens (2008) suggest that in a setting where lateral relations are prevalent, there is a high degree of self-governance in the control of the relations as the parties negotiate their cooperation. They use the term governance instead of control to highlight the fact that in a lateral, intraorganizational relation there are elements of both traditional, top-down control and lateral self-governance.<sup>1</sup> We will in this study follow van der Meer – Koistra & Scapens logic and discuss how lateral relations are *governed* as opposed to *controlled*.

Terms such as horizontal organizations and lateral relations have been discussed by academia (Chenhall, 2008; Joyce *et al*, 1997; van der Meer–Koistra & Scapens, 2008). These discussions are helpful in creating a theoretical expectation of the setting that lateral relations exist within and how these relations can be governed. However, the amount of in-depth case studies exploring empirically how the lateral relations are governed remains scarce. With this thesis, we therefore aim to empirically explore how such relations are governed. To do this, we have identified an emerging and suitable setting where lateral relations are and will increasingly play an important role.

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<sup>1</sup> The article by van der Meer-Koistra & Scapens (2008) also considers lateral relations *between* organizations, i.e. interorganizational relations. While this is an interesting area of research that shows many similarities with intraorganizational relations, the focus of this thesis is nevertheless on the management of lateral relations *within* an organization.

Parallel to the development above, the manufacturing industry has seen developments in what has been called the transformation from product to service orientation, or the *servitization* (Baines *et al*, 2009). This transformation has been widely discussed and implemented among practitioners and eventually also received focus from researchers (Ibid). Many companies have been more or less forced to take the step towards a full-service provider instead of simply manufacturing products. The reasons for doing so are often the same; increased revenue potential from the higher margins on service, together with more stable revenue streams. Also, customers are often more demanding today and might pressure companies to offer services as well. Finally, services offer a new way of gaining competitive advantage and are often more difficult for competitors to imitate. (Oliva & Kallenberg, 2003)

As services become more important for many companies, researchers have been recommending companies to consolidate their service offering in a separate division with profit & loss responsibility (Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003). In many companies the manufacturing business and the traditional sale of goods has been seen as the key component to the business (Oliva & Kallenberg, 2003). As a result, the service offering has been included in the different manufacturing divisions but considered secondary to the product itself. The recommended change to create a separate service division therefore leads to a new organisational setup which needs to be handled, where the service division is an organizational equal to the producing division. The resulting organization will depend on the cooperation, coordination and performance of two divisions on the same hierarchical level. As mentioned previously, many scholars agree that the management of organizations where lateral relations are prevalent require control, or even governance, of a different sort than traditional, primarily hierarchical, organizations (Berry *et al*, 2009; Dossi *et al*, 2010; van der Meer-Koistra & Scapens, 2008). The emerging relation between the aftermarket division and the producing division will be characterized by a need for information sharing and have several functions where the interdependency between the two divisions is high. For example, the level of service that the aftermarket will be able to supply at the release of a new product is likely to be contingent on information sharing and cooperation between the two divisions in the development phase. From the viewpoint of the producing division, the amount of returning customers is likely to be affected not only by the quality of the product but also by

the level of service the customer received after the initial purchase. From the customer's perspective, the two divisions represent the same organization, and we argue that the relation between the service division and the producing division is of the utmost importance both in the pursuit of customer satisfaction and profitability.

We further argue that emphasising focus on the service, with a following move to start a separate service division, is creating a new lateral relation that needs to be governed. On the one hand companies want each division to pursue their respective goals to the best of their abilities, but it is equally important that the relation with the other division is governed in a productive way to ensure that the company-level performance does not suffer. How do the divisions govern this lateral relation when neither of the business areas is in charge of the other? The amount of studies of how organizations characterized by horizontal or lateral relations are governed have been called limited (Chenhall, 2008). While a study such as van der Meer-Koistra & Scapens (2008) have examined the governance of lateral relations through a case study, the area remain relatively unexplored and by conducting a study in this specific setting we hope to find additional aspects of the governance of lateral relations.

In this thesis we therefore investigate how the relation between producing divisions and a related service division is governed. We argue that this lateral relation is characterized by a high level of interdependency and hence a significant need for cooperation and coordination. This is an area with little previous research and we hence hope to explore the field of governance within lateral relations. It is also within a specific setting that is likely to be of increasing importance as manufacturing companies continue their move towards a focus on the service offering, and we therefore hope to contribute with more knowledge into this emerging theme of industrial business.

*Given the above, the purpose of this paper is to theoretically and empirically explore how lateral and interdependent relations are governed.*

The thesis is operationalized through an in-depth case study performed at a Swedish industrial MNC called ManuCo and more specifically how the lateral relation between its largest service division, SERVdiv, and the manufacturing divisions, CAPdivs, within the same



business area are governed. ManuCo is a Swedish MNC that has been praised for its ability to consistently deliver above industry average margins. By performing a single in-depth case study, with primary data coming from 17 semi structured interviews within the manufacturing and the service divisions and with employees from different countries and in different roles, we hope to gain a holistic view of how the lateral relation is governed.

The rest of the thesis is outlined as follows. In Section 2 below, a review of the previous research in related areas will be presented. This includes a review of both the governance of lateral relations and of the business setting within which the research will be conducted, namely the servitization in manufacturing companies. This section ends with a proposal for what we can expect in our case study given the previous research as well as a specification of research questions given what we have found in the previous research. Section 3 will present the method that we have chosen in order to operationalize our research and give the reader insight into how that research has been conducted. In Section 4, we present the empirical findings of the case study at ManuCo, which has been gathered mainly through interviews and internal documentation. Section 5 contains a discussion of the findings from the case study and how they relate to the findings and proposals of previous research as outlined in section 2. Section 6 summarizes our conclusions drawn from the research. The thesis ends with Section 7 containing a discussion of the limitations and practical implications of the thesis, along with suggestions for future research.

## **2. Theory**

This section reviews previous research related to the field of research within this study. The aim is to provide the reader with an insight into the previous research within governance of lateral relations as well as within the servitization of manufacturing companies. The governance of lateral relations is an area where theoretical concepts and discussions can be found but where the empirical research on the actual conditions within an organization remains scarce. We start by providing a background to the terms vertical and lateral relation and try to sketch out what separates the two, especially in terms of governance. After that we dig deeper into the previous research more specifically oriented towards the governance of lateral relations. This section is divided into two parts. The first part covers the vertical governance of a lateral relation while the second part considers the governance that occurs laterally between two equals. The latter is further divided into one part discussing the important factors that are deemed necessary for a well-functioning lateral relation and one part devoted to which governance practices that previous research has found to be of use in achieving these important factors. We then move on with theory related to the area of manufacturers shift in focus from production to services. We provide a background to the area, as well as the steps outlined as important in order to succeed in such a shift and find that there is a strong link between this area and the area of governing lateral relations. Finally, we summarize the theoretical findings where we try to add the previous research related to lateral relations to the previous research within the field of manufacturers becoming more service oriented. From this, we form our theoretical expectations, specify our purpose into two research questions and identify which governance practices that we, based on previous research, can expect to find in the lateral relations between manufacturing and service divisions.

### **2.1 Vertical vs. Lateral relations**

First, it is necessary to determine the meaning of the terms lateral and vertical relations. The traditional vertical relations are the relations between a decision-making authority and its subordinate. Control is exercised over the members of the organization, and the relation has an imperfect balance of power (van der Meer-Koistra & Scapens ,2008). Oftentimes, the

discussion of control in vertical relationships has been dominated by the relation by headquarters and subsidiaries (Busco *et al*, 2008; Dossi & Patelli, 2008; Dossi & Patelli, 2010). Also, focus has been placed on the management control practices put in place by managers to control the organization. These practices involve many formal mechanisms with a focus on control and command of the organization (van der Meer-Koistra & Scapens, 2008). Examples of frameworks developed for the study of this type of control systems are the four levers of control by Simons (1995) as well as Otley (1999) and Otley & Ferreira (2009). In contrast to the hierarchical relationship, a lateral relationship puts pressure on alternate ways of controlling (van der Meer- Koistra & Scapens, 2008).

As mentioned in the introduction, in defining lateral relations, we make use of the definition suggested by van der Meer-Koistra & Scapens (2008), who defines them as organizational arrangements where managers work primarily with other managers on similar hierarchical levels as themselves. In such a setting, control is often not granted to either party and this, according to van der Meer-Koistra & Scapens (2008), brings an additional layer of complexity to the relation. The focus of lateral relations is on cooperation and coordination instead of the command and control that is typically associated with vertical relations (Ibid).

Complexity and desire for flexibility in the business environment has meant a shift from traditional, hierarchical relations to more complex networks where power is distributed among the members of the network (Ostroff & Smith, 1992). Joyce *et al*. (1997) label these new organizations lateral organizations. They strive to become flatter and less bureaucratic, with organizational setups designed to increase the ability to process information under conditions of high-task interdependence, complexity and uncertainty. While vertical relations allowed for one party to dictate the terms of the cooperation, the more complex lateral relations of organizations require control systems to take the power dispersion and previously mentioned need for cooperation, coordination and integration into account (Busco *et al*, 2008). The lateral organizations violate what Joyce *et al*. (1997) refer to as classic management principles, such as unity of command, controllability and measurability of performance. For these reasons, it is argued by several scholars that the management of organizations characterized by lateral relations will require a different set of control systems

compared to traditional, vertically oriented organizations (Berry *et al.*, 2009; Dossi *et al.*, 2010; van der Meer-Koistra & Scapens, 2008).

van der Meer-Koistra & Scapens (2008) use the term governance, as opposed to control, to signify the difference between lateral and vertical relationships and how they are managed. The term is used to highlight the fact that there are multiple interests and that achieving balance between these interests and powers is vital to a successful relation. It is also argued that the term can be used when discussing relations where hierarchical superiors lack knowledge and subordinates are therefore expected to govern their own lateral relations, with support rather than directives from senior levels.

## **2.2 The vertical element of lateral relations**

It would be an oversimplification to state that an organization can be characterized by either vertical or lateral relations. In this thesis, we focus on the intraorganizational relations that are on the same hierarchical level. Nevertheless, in these organizations there are elements of vertical relations involved, since there is a management team which ultimately has responsibility. This means that in contrast to inter-organizational lateral relations, the intraorganizational lateral relations are both governed by the parties that constitute the relation but also by the party that is in charge of the parties constituting the lateral relations, making this an equation with dual elements. Therefore a study of intraorganizational lateral relations automatically includes vertical as well as lateral elements (Van der Meer-Koistra & Scapens, 2008). The role of the superordinate of the lateral relation is according to Bartlett & Ghosal (1993) to develop and nurture corporate values and strategies which enable communication and cooperation within the lateral relation. Rather than controlling the relation, the role of the superordinate is to provide a framework for the parties in the organization to operate within. In Bartlett & Ghosal (1993) this framework is referred to as a *structural context*, defined as “*the set of organizational forces that influenced the processes of definition and impetus*”. Linking this to Simons (1995) levers of control framework, the role of the superordinate party is to provide a clear belief system and clear boundaries within which the parties constituting the lateral relation should act, rather than to provide them with

specific guidelines and control the relationship. This kind of reasoning is developed by Van der Meer-Koistra & Scapens (2008) in the concept of *minimal structures*.

The concept of minimal structures initially developed for the management of product innovation by Kamoche & Kunha (2001) is argued by van der Meer-Koistra & Scapens, (2008) to be applicable to the governance of lateral relations. In their article, Kamoche & Kunha (2001) describe the concept of minimal structures by using a jazz band as an analogy. The music is improvised and unplanned, yet relies on a set of minimal structures such as roles and simple melodies to create circumstances for music to be created. The lack of rules was not considered to create chaos but to invoke creativity and allowed the group to jointly produce music as they play by creating wide room for maneuverability for the musicians. Applying this logic to the governance of lateral relations, then, van der Meer-Koistra & Scapens (2008) argue that the challenge in both the management of product innovation and in the governance of a lateral relation is the balance between flexibility and firmness. By establishing minimal structures the firmness can be balanced by a considerable flexibility for the parties in the lateral relation.

Within the context of the minimal structures in a lateral relation, the parties can exercise their autonomy and pursue their goals. These structures provide a framework within which governance practices can be considered and designed, or emerge. Minimal structures, it is argued, are needed to create the boundaries within which work can be performed. The structure is needed to focus the efforts and define responsibilities while also giving the organizations members enough maneuverability to adapt to changes and handle complexity (van der Meer-Koistra & Scapens, 2008). Chenhall (2008) further emphasizes the role of the hierarchical superior as the enabler, arguing that it is the role of the superior to empower lower levels of the organization and provide them with the support they need to execute the tasks at hand. Senior levels of management are also responsible for the successful coordination of strategic decisions, innovation and learning on an organization-wide level (Chenhall, 2008). They can encourage the cooperative behavior by establishing incentive systems designed to reward this (van der Meer-Koistra & Scapens, 2008). Björkman *et al* (2004) also show that the senior management can support and stimulate cooperation and knowledge-sharing between the lateral parties by establishing shared goals and values.

In summation, this section has shown that the superordinate party is responsible for providing a structural context to the lateral relation. Previous literature on the role of the superordinate party in the control of an organization with lateral relations have focused on senior managements role in enabling the parties involved in the lateral relation and creating circumstances where cooperation is achieved. Practices used to enable members of the organization and create minimal structures where cooperation between divisions takes place include establishing and nurturing shared values and strategic goals, enable employees and grant power to managers.

## **2.3 Lateral governance of lateral relations**

As established above, the focus of previous literature considering the role of senior management in controlling lateral relations have been on the enabling of organizational members. Even though companies have become more complex, and today involve many lateral relations the management accounting research has not shifted its focus to the same extent. There have been only limited empirical insights into how a lateral relation is governed, which was noted as early as 1996 (Hopwood, 1996) but which still in many ways holds true today. This means that the practices with which lateral relations is governed is not an area that has been extensively explored by academia. However, we will in this section review the factors that have been highlighted as the important ones for successful cooperation and coordination within a lateral relation, as well as which practices that can potentially be used in the governance of this relation.

### **2.3.1 The important factors – Trust and information sharing**

A lateral relation needs to achieve cooperation and coordination in order to function efficiently. As mentioned in previous sections both the complexity of lateral relations, as well as the need for cooperation and coordination instead of command and control means that traditional, formal governance procedures are not enough (Chenhall, 2008; van der – Meer Koistra & Scapens, 2008). To a large extent, managing lateral relations involves self-governance between parties on the same hierarchical level where neither party is granted power over the other. Structured and formal practices and procedures are neither flexible

enough, nor easily implemented given the absence of absolute authority to one party in the relation. Instead, the complexity of a lateral relation requires practices and processes that focus on collaborative efforts (van der Meer-Koistra & Scapens, 2008). In our review of previous research we have identified two factors which can be considered key determinants in the achievement of cooperation and coordination; trust (Busco *et al*; 2008; Frow *et al*, 2005; van der Meer – Koistra & Scapens, 2008; Van Helden *et al*, 2001) and information sharing (Frow *et al.*, 2005; van der Meer-Koistra & Scapens, 2008). Trust and information sharing can be seen as determining factors that affect the level of cooperation and coordination that is achieved within the lateral relation.

It has previously been argued by some that trust and information sharing are complementary, uncertainty absorbing mechanisms with a negative relationship (Wicks *et al.* (1999) as referenced in Tomkins (2001)). However, as Tomkins (2001) notes, the creation of trust can occur through information sharing activities and vice versa, which implies a more complex relationship between the two. Tomkins (2001) goes on to argue that whatever the level of trust, information has to be shared in order to plan a collaborative future for the involved parties. We argue that the lateral relation as defined in this thesis demand information sharing for the collaborative future of the two parties, and as such, creates a need both for trust and information sharing (Ibid). The term trust can be used to indicate both confidence in the other party's capability to perform the given task, and trust in the other parties willingness to work towards a joint objective (van der Meer-Koistra & Scapens, 2008). This is similar to the definition used by Tomkins (2001), and highlights that trust essentially involves believing without complete information and that where there is a need for trust there is also a considerable freedom to breach that trust.

Since formal processes and procedures have been deemed insufficient to govern lateral relations, there is a need for trust (Busco *et al*, 2008; van der Meer-Koistra & Scapens, 2008). As mentioned, the trust needed in a lateral relation is twofold; trust in the other party's capability to perform the task at hand in a proficient manner; and trust in that the other party will work towards a joint benefit and not behave opportunistically (van der Meer-Koistra & Scapens, 2008). In a vertical relationship, the superior party controls the subordinate and can demand certain actions to be undertaken. In the context of a lateral relation between equals,

where there is a lack of both hierarchical superiority and formal processes and procedures each party will be free to act in any way they choose. For the relation to function in an efficient manner and not become contaminated with monitoring activities, the parties involved need to be able to trust the other party (Tomkins (2001). Several studies have argued for the importance of trust in establishing efficient lateral relations (Busco *et al*; 2008; Frow *et al*, 2005; Van Helden *et al*, 2001;van der Meer – Koistra & Scapens, 2008). The act of establishing trust is performed over time and cannot be designed or inserted into a relation at inception. Rather, the development of trust will occur within the relation as it evolves. Governance practices can be implemented that allow and encourage the emergence of trust (van der Meer-Koistra & Scapens, 2008). As we will see, trust also facilitates the information sharing between parties engaged in a lateral relation.

The need for information sharing in lateral relations has been emphasized in previous research (Frow *et al*., 2005; van der Meer-Koistra & Scapens, 2008). Information sharing in lateral relations can be driven by a number of factors, including the need for information on end customers to be distributed through the organization (van der Meer-Koistra & Scapens, 2008), a timely and flexible response to changing circumstances (Ibid), and/or a need for information and knowledge in an innovation process (Frow *et al*. 2005). Essentially, the lateral relation depends upon the exchange of information between members as one of the primary objectives of the laterally oriented organization is to enable information that exists within the organization to be readily available where it is most needed (Joyce *et al*. 1997). The implication for the governance of lateral relations is that it needs to encourage and facilitate the sharing of information through governance practices.

To summarize, previous research has found that in a lateral relation where much of the governance occurs laterally in the form of self-governance, trust and information sharing are important factors for the relation to function efficiently. Trust is needed since it is implausible to formally structure the relation in an efficient manner, making it necessary to have trust in the other parties' willingness and ability. As lateral relations are designed to enable knowledge to be available where needed, there is a need for information to be shared across boundaries. Below, practices and procedures which have been found to facilitate the emergence of trust and information sharing will be described.



### **2.3.2 Governance practices**

It has been established that trust and information sharing between the lateral parties are important factors for an efficient governing of a lateral relation (Van der – Meer Koistra & Scapens, 2008). The practices used to govern the relation can therefore be seen as practices put in place for the facilitation and establishment of information sharing and trust, which in turn serves to achieve cooperation and coordination. As discussed Section 2.2, actions by the vertical superior will also contribute towards this end by creating a structural context for the parties to act within. However, as has been mentioned, a significant part of the governance in the lateral relations which are the focus of this thesis occurs between the equal parties, and the practices can both be established and emerge over time (Ibid). In this section we will describe the practices that have been found in previous research to stimulate the emergence of trust and information sharing and which are implemented through joint efforts between the lateral parties in the relation.

The study by van der Meer-Koistra & Scapens (2008) provides a rare empirical insight into the governance of a lateral, intraorganizational relation. The case study considers a steel producer that reorganized its operations to respond to changes in consumer demand. The resulting structure contained five business units with profit and loss responsibilities that were highly interdependent. Due to the need for integrated efforts, the coordination between the units was pivotal for the success of the company as a whole. The relation between the units was found to be governed by a package of practices that could be divided into hierarchical, relationship and market practices. Examples of hierarchical practices were the goals set by senior management for the units, as well as determining responsibilities for the units. Relationship practices included the use of incentives based on company-wide performance, joint projects etc. Meanwhile, market practices referred to the gathering and accommodation to customer needs. It was concluded from the case study that the governance practices were used to govern a relation between equals and that practices might need to transcend organizational boundaries between units. Also, in the case company, van der Meer-Koistra & Scapens (2008) argues that the focus of the practices were clearly on cooperation as opposed to competition, as efforts were focused on attaining results that were good on a company-wide level. As mentioned, besides van der Meer-Koistra & Scapens (2008) few real case

studies on the governance of lateral relations have been made. However, there are still studies that offer theoretical advice on lateral governance practices and we will discuss the governance practices that have been found in previous literature below.

Face-to-face social interaction between individuals can help build trust in others (Frow *et al.*, 2005). In lateral relations, trust is needed between people from different divisions within the same organization. Creating circumstances where these individuals can interact thereby supports the emergence of trust. Studies have argued for the use of shared offices (van der Meer-Koistra & Scapens, 2008) as well as trips and conferences (Martinez & Jarillo, 1989) in the process of building social ties that generate trust. Formal structures and processes can also be helpful in this process as they help provide a setting for the creation of trust. By establishing formal meetings and other structural initiatives, people are forced to interact and can build trust. When new initiatives are being considered that have elements of overlapping accountability, allowing the affected parties to interact and participate in the implementation process can generate trust both in the system and in its participants (Busco *et al.* 2008; van der Meer – Koistra & Scapens, 2008). The process of meeting and evaluating the suggested initiative can sometimes be of an even greater value than the actual initiative as it can clarify responsibilities and make visible areas of interdependency (van Helden *et al.* 2001). While social interaction and informal relations build trust, it has also been proven to have a positive effect on communication and information sharing (Tsai, 2002).

A well-functioning information system is necessary to allow information sharing to take place in a timely manner (Bhartlett & Ghosal, 1993). A well-developed information system allows users to extract information from others as it is needed. There are some indications, however, that the greatest constraint when it comes to information sharing is not the availability of information but rather the capacity to process and make use of the information available (Galbraith, 1973; Gupta & Govindarajan, 2000). Social interactions and informal relations can play a role in the process of information sharing by complementing formal structures such as information systems. Through contacts with other individuals, the processing of information available through these systems is made possible (Gupta & Govindarajan, 2000). To encourage networking, secondments whereby staff is transferred on a temporary or permanent basis to other divisions can be used (Dent, 1996).

Further, the establishment of cross-functional roles that are given responsibility for the cooperation between divisions can facilitate information sharing and trust-building while also acting as a mediator when conflicts occur (Busco *et al.* 2008; Galbriath, 1973). HR-practices have also been held forth as an effective way of achieving coordination between units. These practices include job-rotations such as the secondments mentioned above but also performance measurements that evaluate and reward performance that contribute to the organization-wide objectives (Chenhall, 2008; Galbriath 1973; 2002).

In addition to the practices mentioned above, there are also traditional management accounting practices with lateral elements, including such tools as the balanced scorecard and activity based costing (Chenhall, 2008). Supporters of these practices would argue that they help provide a value-chain focus to managing and connect cause and effect within an organization in a lateral manner (Ibid). The importance of cost and profitability captured through such practices is acknowledged, but is also considered a source of potential distraction when pursuing business opportunities in the changing environment where lateral organizations are present (Ibid). Also, standardized accounting information and management accounting information has been dubbed insufficient means of information sharing by several scholars in lateral, complex relations (Chenhall, 2008; Macintosh & Daft, 1987; van der Meer-Koistra & Scapens, 2008). Other practices can then be used to encourage more flexible information sharing and distribution. Granting equal responsibilities, shared accountability and incentive systems has been argued to entice information sharing between members engaged in joint projects (Busco *et al.*, 2008; van der Meer-Koistra & Scapens, 2008). A key aspect of how governance mechanisms are used in lateral organizations compared to vertical is the interactive aspect. Systems and tools are often used more as a starting point for discussion and negotiation rather than as a source of information. Actual systems are given relatively little emphasis in comparison with the process of implementation, evaluation and consultation that occur as members of the organization process the information in the system. This interactive use of traditional measures can be found in previous research and consider mechanisms like transfer pricing (van der Meer-Koistra & Scapens, 2008), budgets (Ibid) and profit allocation schemes (van Helden *et al.*, 2001).

To summarize, in previous research we have identified a number of practices that are used in lateral relations to stimulate trust and information sharing. These two areas are intertwined and efforts in one will likely have an effect on the other. Trust in a lateral relation will need to emerge over time, but practices can be put in place to facilitate this process. The focus of these practices is on the social interaction of individuals through channels which are both formal and informal. These practices are also found to facilitate the sharing and ability to make use of information in the relation. By establishing relationships across the organizational boundaries, formal efforts to improve information sharing can be complemented by informal contacts. More traditional management accounting practices have also been found in the governance of lateral relation, where they were used in a more interactive way to encourage communication and flexibility.

## **2.4 Governance elements and practices - a theoretical summation**

Previous research has allowed us to identify two elements in the governance of a lateral relation, the vertical and the lateral element. Figure 1 summarizes our review of previous research on the governance of a lateral relation. The vertical superior, i.e. senior management, has been shown to provide a structural context, through governance practices, within which the parties involved in the lateral relation are to cooperate and coordinate (their activities). The vertical superior thereby acts in an enabling way which allows for the parties in the relation, i.e. the divisions, to operate with considerable freedom and room to maneuver. The lateral relation between the two divisions, as is shown in Figure 1, has been argued to be governed also in the form of self-governance as the parties are on the same hierarchical level and are given considerable freedom by the vertical superior. This holds true as long as the vertical superior gives them the freedom through enabling governance practices as the previous research prescribes.

The objective is for the lateral parties to achieve a cooperation and coordination of the interdependent activities. In order to achieve this, trust and information sharing has been identified as determining and important factors. Without trust and without information sharing, it is difficult to achieve a well-functioning cooperation and coordination. Governance practices are used laterally in a self-governing manner to facilitate trust and information

sharing between the lateral parties which has been broadly identified as two key determinants in the pursuit of cooperation and coordination. This is summarized in Figure 1 while Table 1 summarizes more specifically which practices that previous research have found to be used within lateral relations, both from the vertical party and by the lateral parties. For the vertical party, practices found in previous research to enable the lateral parties and establish the structural context include the establishment of shared- values, objectives, strategy and incentives etc. For the lateral parties, practices that have been shown to facilitate trust and information sharing include among others social interaction, informal relations, information systems and cross functional roles.

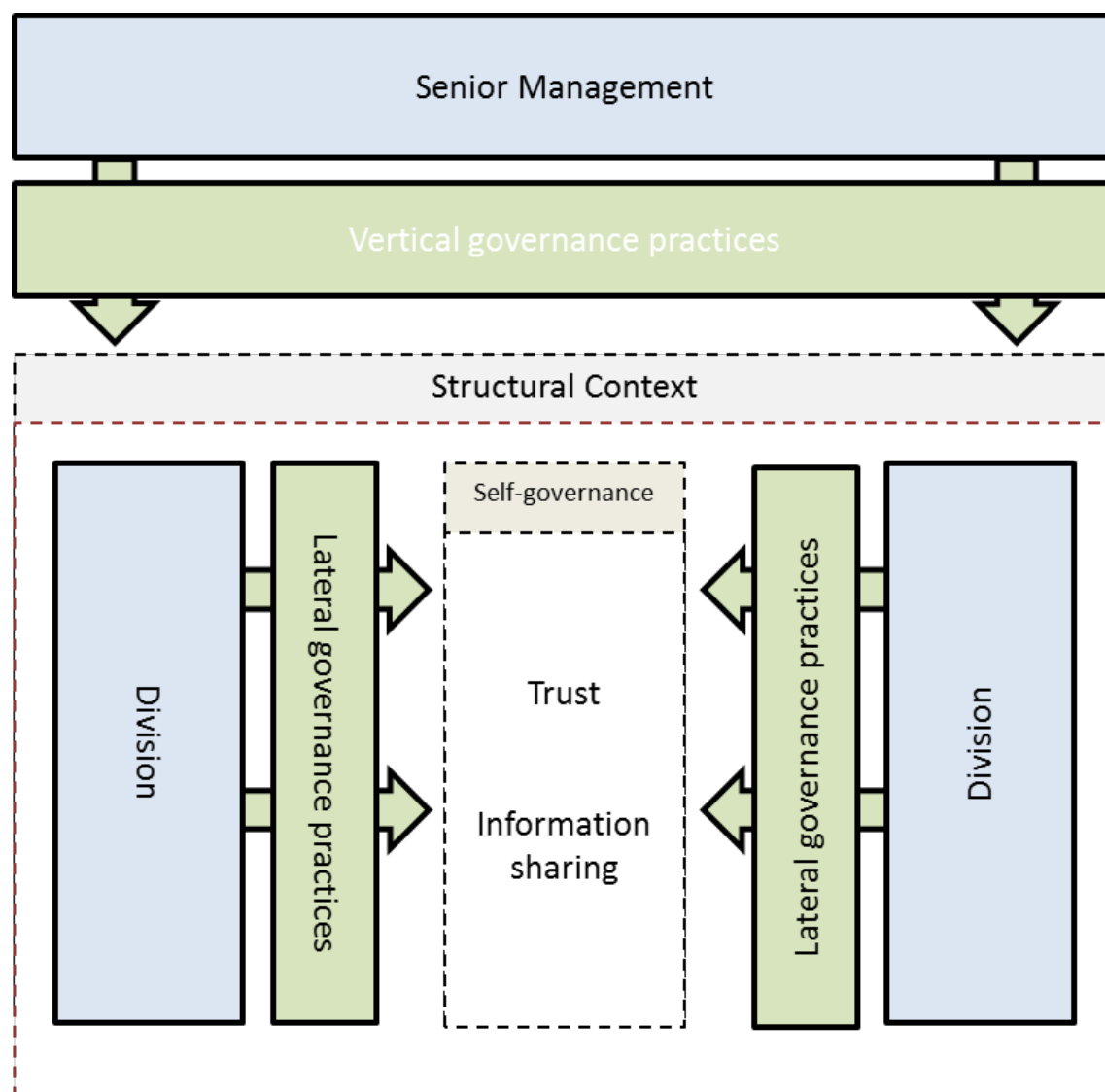


Figure 1. The elements of governance

Vertical governance practices	Lateral governance practices
<ul style="list-style-type: none"> <li>• Shared values</li> <li>• Shared objectives</li> <li>• Common strategy</li> <li>• Empowerment</li> <li>• Support</li> </ul>	<ul style="list-style-type: none"> <li>• Social interaction</li> <li>• Informal relations</li> <li>• Information systems</li> <li>• Cross-functional roles</li> <li>• Secondments</li> <li>• Shared accountability</li> </ul>

Table 1. The governance practices

## 2.5 Manufacturing firms becoming more service oriented and its implications for management control

Below, previous research on the transition from product to service orientation, called servitization, and the implications for management control will be discussed. More specifically, we will go through three themes found in previous research; the separation of the service and product divisions, the focus on selling solutions instead of products and the development and protection of the installed base.

As we have mentioned in the introduction to this thesis, the competitive landscape for manufacturing companies and especially for industrial manufacturers is shifting. Higher competitive pressure from new markets makes manufacturers turn to new sources of revenue (Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003). The concept of servitization is in line with this step and can be described as creating value by adding services to a product (Baines *et al*, 2009). This area has seen a growing interest from academia (Ibid), and there seem to be consensus in the idea that a move towards servitization is a way to create more value for traditional manufacturing firms (Ibid). More specifically, three separate reasons for why manufacturers would do well to increase their service focus have been laid out. They can be divided into financial, strategic and marketing reasons. The financial reasons are the increased stability of income coming from the less volatile services, as well as higher profit

margins. Services are also a way of differentiating the offering and is said to be more difficult for competitors to imitate, which is the strategic reason. Finally, the marketing reasons are that services can influence sales of more products as well as the fact that many customers are more demanding today. (Baines *et al*, 2009; Gebauer *et al*, 2006; Oliva & Kallenberg, 2003).

Even though this is an area which has gained attention from academia and business literature, the organizational aspects of a servitization have not been prioritized (Windahl & Lakemond, 2006). There have been studies researching the general transformation challenges when moving towards servitization (Beauvillard *et al*, 2009; Brax, 2005; Oliva & Kallenberg, 2003; Wise & Baumgartner, 1999) while less focus has been on traditional management control issues. However, the studies have concluded and come up with some general characteristics of companies that have succeeded in their servitization transformation and hence provided practical guidelines.

Researchers seem to agree on the fact that the transformation to become more service oriented has much to do with culture (Baines, 2005; Beauvillard *et al*, 2009; Brax, 2005; Oliva & Kallenberg, 2003). Companies with technically advanced products tend to have a culture focusing on the production process and it is a challenge to convince people in the organization of the potential in services (Oliva & Kallenberg 2003). Many manufacturing companies have historically had services as an add-on to their products, but it has been viewed as a necessary evil rather than as a value adding activity (Baines *et al*, 2009). When changing the culture to gain a higher focus on services throughout the organization, one of the recommended activities is to distinguish the services from the products through the creation of a separate service unit with a profit & loss responsibility (Beauvillard *et al*, 2009; Brax, 2005; Gebauer *et al*, 2006; Oliva & Kallenberg, 2003). The separate service division should also be monitored with metrics with a service focus and specific service KPIs, helping to achieve a service culture in a quicker manner (Beauvillard *et al*, 2009). The general idea is that a separate unit with profit and loss responsibility helps in creating accountability and focus on the importance of services within the organization (Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003; Windahl & Lakemond, 2006). If the company does not separate the services from the manufacturing divisions, services runs the risk of continuing being perceived as something secondary (Oliva & Kallenberg, 2003). It has also been argued that it is of great

importance that the separate service division should be on the same hierarchical level as the manufacturing divisions. The reason is that for the service culture to gain an impact, it cannot be subordinated the other divisions (Beauvillard *et al*, 2009).

A second theme that has been highlighted in previous literature is the focus towards selling solutions instead of products (Gebauer *et al*, 2004; Oliva & Kallenberg, 2003; Windahl & Lakemond, 2006). An example could be for a mining company to sell drilling hours instead of selling drilling machines. This implies a more customer centric approach and is also something that would mean a tight coordination between the producing divisions and the service divisions. It further highlights the importance of establishing a service culture that thinks in terms of customer processes and not simply products (Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003).

The third area of focus which previous research have considered in the move towards servitization is to develop and protect the installed base (Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003). In other words, this means to reap the synergies of selling services to the outstanding machine fleet. To be able to do this in a successful way, and not lose market share to imitators and competitors that only focus on the services, it is important to make use of the competitive advantage and know-how from the manufacturing divisions in the service (Oliva & Kallenberg, 2003). This indicates that a close collaboration is needed between the service divisions and the manufacturing divisions even though they have been divided into separate units. Lakemond & Magnusson (2005) discusses this tension between differentiation and integration and state that an increased organizational differentiation may serve the purpose of strengthening the service business, but also creates a necessity to take additional measures to coordinate the activities of the different organizational units.

To summarize, the literature on the organizational aspects on servitization is quite scarce. What has been highlighted is the need to transform from a culture based on quality manufacturing, to a culture that is more focused on customers and service and possibly also thinking in terms of customer solutions and processes (Beauvillard *et al*, 2009; Brax *et al*, 2005; Gebauer *et al*, 2004; Oliva & Kallenberg, 2003). To be successful in changing the culture, researchers have recommended a new organizational setup where the services are put in a



separate unit with profit and loss responsibility (Beauvillard *et al*, 2009; Brax, 2005; Gebauer *et al*, 2006; Oliva & Kallenberg, 2003). This unit creates a greater differentiation between the manufacturing- and services units which is said to be needed to achieve a higher focus on the services. However, to achieve economies of scale, competitive advantage and to reap the synergies from the different divisions it is of utmost importance to also achieve a tight integration (Windahl & Lakemond, 2006). This reflects a tension that needs to be managed. On the one hand the company needs to differentiate to give more power to the service division and to achieve a stronger service culture. On the other hand it needs to tightly integrate the divisions and need them to cooperate to be able to gain synergies and provide solutions that make the customers satisfied. The next subsection will consider what we can expect to find in our research given what we know about the governance of a lateral relation and the servitization development of manufacturing companies.

## **2.6 Synthesis and theoretical expectations**

From previous research on the governance of lateral relations in an intraorganizational setting it is found that there are two elements of the lateral relation. There is both the superordinate party dictating the terms of the lateral relation, as well as the actual lateral relation between the parties on the same hierarchical level. The general role for the superordinate party is to act as an enabler, providing a structural context and minimal structures for the parties in the lateral relation to act within. A lateral relation is in need of flexibility and hence cannot be controlled in the same sense as a classical hierarchical relationship. (See for instance van der Meer-Koistra & Scapens ,2008). Examples of vertical governance practices include shared objectives and values.

Further on, the relationship between the parties within the lateral relation is characterized by cooperation and coordination rather than command and control. This is due to the fact that the parties lack the authority to command and control the other parties. Because of this lack of control, formal control practices are not as significant and it is rather factors such as trust and information sharing that plays a key role in the successful coordination of a lateral relation (See Frow *et al* (2005), van der Meer-Koistra & Scapens (2008) and Tsai (2002)). Examples of governance practices to achieve the trust and information sharing necessary to

be able to cooperate and coordinate are the creation of a cross-functional role, shared and overlapping accountability, information systems and interactive use of performance management systems that foster dialogue and learning.

The purpose of this thesis is to explore theoretically and empirically how lateral relations are governed. The setting of the study is a manufacturing company that can be considered a part of what is referred to as the servitization process. From the previous research within the field of companies moving from product to service orientation, termed servitization, there are a few key points relevant to this study. The most important factor for success according to the research is to shift the culture within the company to be more service oriented. This shift should be achieved by moving out the services to a separate division with profit and loss responsibility, a move that will lead to a higher focus on the importance of services throughout the organization (see for instance Baines *et al*, 2009; Beauvillard *et al*, 2009; Oliva & Kallenberg, 2003). However, it is also argued that a tight integration between the service division and the manufacturing divisions are needed to achieve exchange of know-how and to leverage from each other's competences to gain economies of scale and synergies (Ibid). This creates a tension between differentiation and integration. On the one hand a lateral relation is created through the start of a separate service organization. On the other hand, there is also a need for tight integration and information exchange (See for instance Windahl & Lakemond, 2006)

The first thing we can infer from the previous research within these fields is that a manufacturing company going through a servitization can be expected to create a new lateral relation between the manufacturing divisions and the service division. It is also a lateral relation where the parties have a high interdependence and a strong need to cooperate. The governance of such a relation would therefore be expected to resemble the governance of a lateral relation as described in Section 2.5. However, the research within the field of how to govern the lateral relation between a service division and a product division in a manufacturing company is currently unexplored, even though it is an area that is highlighted to be of great importance for manufacturing companies of today. Therefore we aim to fulfill this theoretical gap by studying the governance of a lateral relation in this specific context. Since the research on how lateral relations are governed in general remains relatively

unexplored as well, we expect our findings to also contribute to the broader field of governance of lateral relations.

Given the specific servitization setting of our case study, we expect there to be an emphasis on trust building activities. This is due to the potentially different cultures embedded in the manufacturing divisions compared to the service division as described in the literature review within the field of product to service orientation. These differences in cultures would possibly be an obstacle in the cooperation. Therefore, practices to build trust between the parties, maybe to an even larger extent than what previous research within governance of lateral relations tells us, can be expected. There is also a potential for a more formal framework provided by the hierarchical party in the lateral relation to try to steer this, as well as a strong focus on communicating shared values and culture. If there are different cultures, the effects of these could also be mitigated by formal cross-divisional incentive systems. Given the high interdependencies and need for integration, information sharing is also expected to be of significant importance

Given this theoretical exploration within the field of governance of lateral relations and servitization, we are able to specify two research questions for this study. The research questions are based on the second part of the purpose of this study which is *the empirical exploration of how lateral and interdependent relations are governed*. The first research question is as follows:

*Research question 1: How are lateral and interdependent relations governed?*

Given this we are also interested in exploring the dynamics of the governance and which factors that affects how the relation is governed.

*Research question 2: Which factors are affecting the governance of a lateral relation?*

Our analysis will be made by using specifically the two elements of governance that we have identified in the previous research, namely the vertical element and the lateral element.

### **3. Method for research**

This thesis will make use of a single in-depth case study in the pursuit of understanding how lateral relations are governed. This section will present arguments and motivations for the choices we have made in designing our study, considering both their merits and what limitations they imply. The section will begin by explaining the choice of method for operationalizing the study, the single in-depth case method. Following this, we will provide motivation for choices regarding case company and interview objects. We will also describe the interview process and how we worked to ensure the validity and reliability of the study.

#### **3.1 Empirical method – A single case study**

We have chosen to use a qualitative approach to our research within this study. Since our aim is to explore and find new insights within the area of lateral relations, a qualitative approach is a good choice (Saunders *et al*, 2009). Given that the field of governance of intraorganizational lateral relations is relatively unexplored, a qualitative study is better suited since it is more exploratory in its nature (Merriam, 1994). Finally, a qualitative research approach also enables a deeper understanding of the factors affecting the complex area of governance in a lateral relation (ibid).

Further, we have chosen to study the governance of lateral relations by adopting a single, in-depth case study method as it has been argued to be suitable in an exploratory setting (Otley & Berry, 1994). The single, in-depth case study method is recommended when attempting to understand complex social phenomena (Yin, 2003) and the lateral relations of an organization has been described as complex by several scholars (Joyce *et al*, 1997; Van der Meer-Koistra & Scapens, 2008). Yin (2003) argues that case studies are suitable when attempting to answer “how” questions such as our first research question. “How” questions tend to be explanatory in that they try to illuminate certain decisions and explain their reasoning, impact etc. (Yin, 2003). In our study, we aim to explain how the lateral relation is governed and the case study can provide us with this answer. The case study method also allows us to make use of several forms of data and observe multiple factors of interest which is important to our study. We are also able to benefit from the research conducted by others

in collecting our data and conducting our analysis (Yin, 2003). For instance, the propositions described in Section 2.6 are helpful in guiding us in our data collection. As suggested by Yin (2003), the propositions guide our data gathering towards certain aspects of the relation between the divisions engaged in the lateral relation that is the subject of our study.

This study is considering the current governance of lateral relations at ManuCo. Two years before work on this thesis was conducted, ManuCo and specifically the business area within ManuCo that is the setting for this thesis was restructured. Prior to the restructuring, the service division was part of the manufacturing divisions. After the restructuring, the service division is on the same hierarchical level as the manufacturing divisions and it is this relation (i.e. the relation between manufacturing divisions and the service division) that will be studied in this thesis. The structural setting will be elaborated on further in Section 4.1. An interesting alternative to our study would therefore be a longitudinal study that also incorporates the evolvement of the relation over time, as the relation matures and roles are defined. This type of study, however, was not possible to conduct for us given our limited time frame. Also, we chose not to focus on the before and after effect of the restructuring on governance since we would not be able to establish an objective view of the organization prior to the separation. The study should therefore be considered in its appropriate context, i.e. in a period of two years after a significant structural change. Instead of seeing this as a limitation, we argue that the time frame adds a layer of complexity that is both interesting and something which future research can build on, by performing similar studies in more/less mature lateral relations of a similar type.

### **3.2 Choice of case company - ManuCo**

The choice of ManuCo as our case company was made taking several factors into consideration. First, the company fit the profile of a manufacturing company that had made the transition from product to service focus with the recommended separation of the aftermarket division to a separate profit & loss responsible division. Second, the structure of the company was such that the aftermarket division and the manufacturing divisions were on the same hierarchical level which allowed us to conduct the study in the type of interdependency setting that we consider most interesting. Third, geographical factors and

one author's previous employment with ManuCo provided us with an opportunity to gain the type of unusual research access which Yin (2008) addresses. Together, these factors made us believe that we would be able to conduct an interesting and in-depth case study on ManuCo.

While one author's former employment at ManuCo was important in gaining access and support for our research, it can also potentially affect the outcome of interviews due to the historical connection between the author and the interviewee and political considerations of what to divulge. To limit this impact, the interviews were conducted primarily with people whom the author had not worked together with during his time at ManuCo. Also, the anonymity of each interviewee was emphasized and it was made clear that this would also apply within ManuCo.

### **3.3 Data collection**

In gathering data for analysis to understand the governance of the lateral relations, key persons from several divisions within ManuCo have been interviewed. These interviews constitute the primary source of empirical data in line with Yin (2003) recommendations, although additional empirics have been gathered which will be discussed below. In planning the interviews, we strived to find individuals that complemented each other, and thereby managed to attain a group of interviewees that represents all hierarchical levels that exist within the divisions. In the choice of interview object, we consulted our main contact at ManuCo, a person with a senior position within SERVdiv and a wide network within ManuCo. Together, we pinpointed several key individuals in varying positions that were believed to have insight into the workings of the lateral relation between the divisions. These key individuals were then interviewed and several of them, in turn, recommended additional interview objects. This reflects an open-ended nature of the interviews as discussed in Yin (2003) and has given the interviewees the role as informants rather than respondents which are often critical to the success of a case study (Ibid).

Position	Division
Management position	SERVdiv
Management position	SERVdiv
Management position	SERVdiv
Middle management position	SERVdiv
Middle management position	SERVdiv
Middle management position	SERVdiv
Employee	SERVdiv
Employee	SERVdiv
Employee	SERVdiv
Employee	SERVdiv
Employee	SERVdiv
Management position	CAPdiv
Management position	CAPdiv
Management position	CAPdiv
Middle management position	CAPdiv
Middle management position	CAPdiv
Employee	CAPdiv

**Table 2 Interview objects**

A total of 17 interviews were carried out with employees from different divisions as is shown in Table 2 above. Given one of the author's previous employment within ManuCo and the division we have chosen to call SERVdiv, this is where we have had the highest access for interviews. Since the SERVdiv division is involved in all the lateral relations compared to the different CAPdivs it is natural that SERVdiv accounts for at least half of the interviews. However, out of 17 interviews, 11 have been held with SERVdiv employees which are a higher number than optimal but is explained by a limited access to the other divisions. Given the 6 interviews held at the different CAPdivs we strived to have a higher proportion of interviews held with employees representing management, due to their higher knowledge of the overall

picture. We have chosen not to separate among the CAPdivs and instead refer to them as one. Both the research made within this study, as well as one of the author's previous knowledge from his employment told us that within the context of the lateral relations, the results for the relation between SERVdiv and a CAPdiv are similar for all the different CAPdivs.

The interviews were conducted in a semi-structured manner, where key topics and themes were identified beforehand and used to direct the interview. Follow-up questions and asking the interview objects to clarify were techniques employed to enable us to gain comprehensive understanding of the perspective of each interviewee. The emphasis on topics and detail richness varied with each interviewee according to his or her role and expertise. Interviews were held in person or via telephone conference when geographical distances did not permit meeting in person. Interviews lasted 30 to 90 minutes with the majority of interviews close to one hour in length. We were asked not to record interviews in order to allow employees at ManuCo to speak their mind about the relation between the two divisions and give unbiased answers. In addition, we granted the interviewees complete anonymity which further heightened the level of discretion. Together, we believe these measures have contributed to the completeness of the data gathered since the interviewees would not have to consider their comments appropriateness or otherwise present an image not consistent with their experience. In order to avoid misunderstandings and misinterpretations, both authors were present at all interviews and took individual notes which were compared and discussed immediately after each interview. On several occasions, we contacted interviewees after the interview to ask for clarification or pose additional questions in order to ensure understanding and avoid misinterpretation.

In addition to the primary data gathering through interviews, several other sources of data have been incorporated in the empirical study. Internal documentation has been gathered both from the internal network and IT-systems, and we have also been provided with additional documentation from several of our interviewees following the interview. As most of the work on this thesis has been performed on-site at one of the regional offices of ManuCo, we have also been allowed to take part in office activities such as meetings and social events. Contacts made through these channels have proven beneficial in clarifying organizational settings and have been very helpful when gathering data from internal sources,



for instance. Also, spending considerable time on-site has provided us with insight and understanding of corporate culture, jargon etc. which has increased our ability to understand interviewees and their perspective. It has also given us the possibility to make direct observations (Yin, 2003) which helps us in providing additional information to confirm or oppose findings from other sources. Further we were able to participate in a full day international strategy conference within one of the divisions. In addition to these data sources, one author's previous employment provided us with extensive background knowledge that in many cases were deemed relevant also within the context of our research topic. The additional data was considered very useful in establishing what practices and structures that were formally in place and the conditions of these practices. Finally it also enabled us to do a thorough triangulation of the data (Yin, 2003) making our findings more convincing (Ibid).

### **3.4 Analysis of the gathered data**

The data gathered from the interviews and through additional sources have been coded and analyzed using the body of knowledge provided by previous research as outlined in the previous research section. The information gathered from interviews has been considered and structured with the theoretical expectation as a starting point. Immediately after each interview we summarized and discussed the main findings and related it to the theoretical expectations as well as the previous interviews. This enabled us to find patterns and discrepancies in the data in line with what Miles & Huberman (1994) recommends. We also continuously reviewed our empirical data gathered both from interviews and additional sources and wrote down our reflections

### **3.5 Quality of the study**

The choice of a single in-depth case study was made in order to investigate a complex social phenomenon by attempting to answer a "how" question (Yin, 2003). For the reader of this study to be able to evaluate the quality of it, we will in this section go through the concepts of validity and reliability, which have been addressed as important elements of quality for a case study. There are three types of validity: construct validity, external validity and internal validity (Yin, 2003) which we will address first, before moving on to reliability.

Yin(2003) recommends three activities to be undertaken in case study research in order to sustain the construct validity of the research, which refers to the appropriateness of measures taken in the research process. First, the use of multiple data sources is recommended in order to allow data triangulation. We have gathered data from interviews, internal documentation and meetings and also by spending considerable time on-site at a regional office of ManuCo. We have thereby been able to confirm observations and investigate differences, making the research inclusive of multiple forms and sources of data.

The second recommendation by Yin (2009) refers to the establishment of a chain of evidence that allows the reader of the research to understand how the conclusions presented are drawn and what observations they are based on. In order to allow the reader of our thesis to understand the chain of evidence, we have incorporated a list of the interview objects along with summarizing tables throughout the thesis. Whenever possible, we have also attempted to use direct quotes to illustrate our findings in order to give the reader the possibility to determine the appropriateness of any conclusions drawn.

The last recommendation by Yin (2009) refers to the review by key informants to ensure that the researchers analysis is based on accurate observations and not misinterpretations. Reviews where the structure and analysis of the thesis were discussed have been conducted both with ManuCo representatives and with our tutor to ensure the quality of the analysis and minimize misinterpretations.

The external validity refers to the extent to which the results of the study are generalizable beyond the case study itself (Yin, 2003). The results of this thesis are aimed at analytical generalizability rather than statistical, and thereby aim to provide insights into aspects of a theory. Through our review of previous research we have identified theoretical suggestions which we aim to investigate in the hope of providing analytical generalizability in those areas that the thesis concerns. Internal validity, on the other hand, refers to the extent to which the results of the study reflect the actual circumstances of the studied phenomenon. As with any case study, the observations and analysis made by the authors are subjective and the interview objects are subjective in their depiction of reality (Merriam, 1994; Yin, 2003). To

enhance the internal validity of the study we have interviewed people from many different organizational levels as well as from both SERVdiv and the different CAPdivs. This has made it possible to triangulate and confirm results, as well as to make sure that we have received a holistic view of the situation. We have also clarified and repeated the answers received from our interviewees to make sure that we have understood the things said in a correct way.

The term reliability refers to the objective of being sure that a later investigator that follows the same procedures as described in this case would arrive at the same findings and conclusions (Yin, 2003). The goal is to minimize the errors and biases in a study (Ibid). To make our study reliable we have tried to document our research process as much as possible. We have stored everything from interview templates and notes from the interviews to the internal documentation that we have received access to. One possible limitation to the reliability in our study is that we have not recorded the interviews and hence trust must be placed in our notes from the interviews. However, as described above we have taken this into consideration and argue that not recording the interviews has had a positive impact on this study.

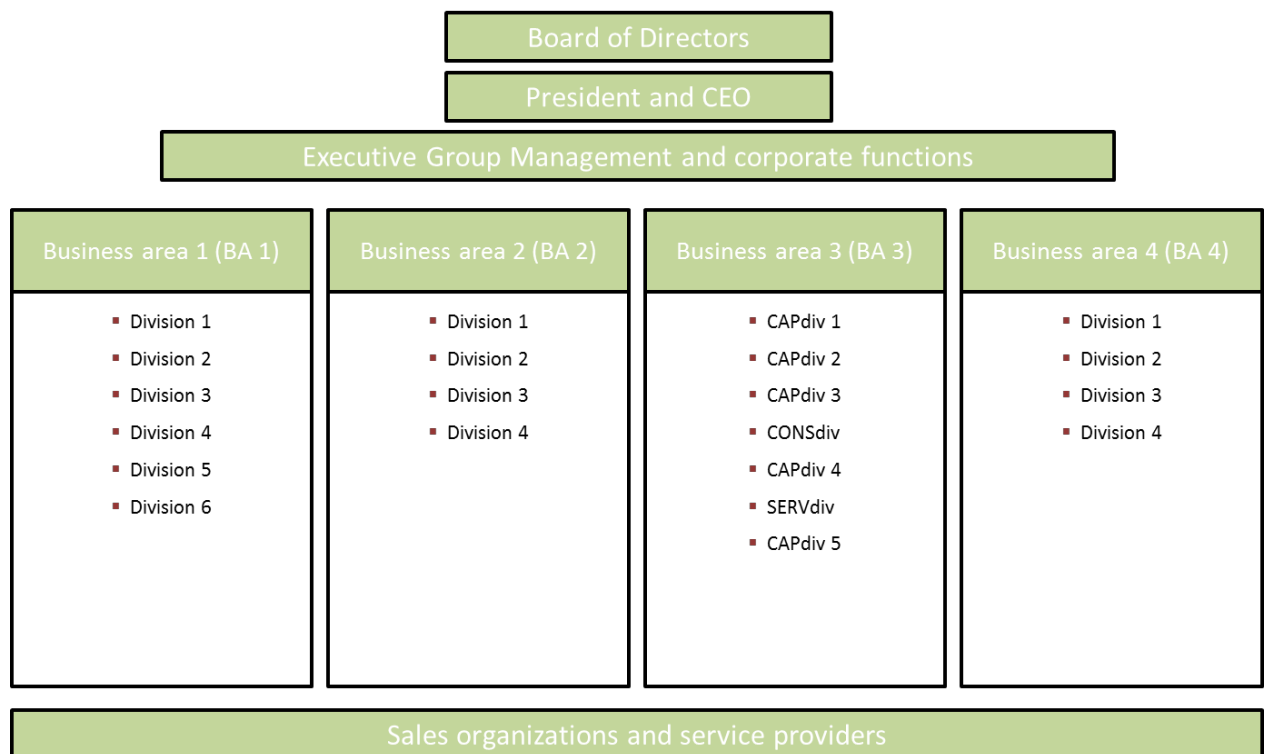
## **4. Case analysis**

Within this section we will provide the reader with the case research gathered at the company ManuCo during the spring of 2013. The section starts with a background to the case company and the different areas within the organization deemed relevant for a thorough understanding of the further case research. The case research is then divided into the two main theoretical components found in the previous research of lateral relations, namely the vertical and lateral governance elements of the lateral relation.

### **4.1 Case background**

#### **4.1.1 ManuCo and BA 3**

ManuCo is a profitable industrial company that is known for consistently delivering margins above the industry average. With a turnover in the range of 80-100 BN SEK and operations in more than 170 countries it can be characterized as a multinational company. The company is Swedish, and listed on the Stockholm stock exchange and with its headquarters based in Stockholm, Sweden. Besides being profitable, it is also a popular employer and is continuously among the top-ranked employers in rankings. The latest years, three factors have been outlined according to the annual report as strategically important for the ManuCo group; organic and acquired growth, innovations and continuous improvements and a strengthened aftermarket service.

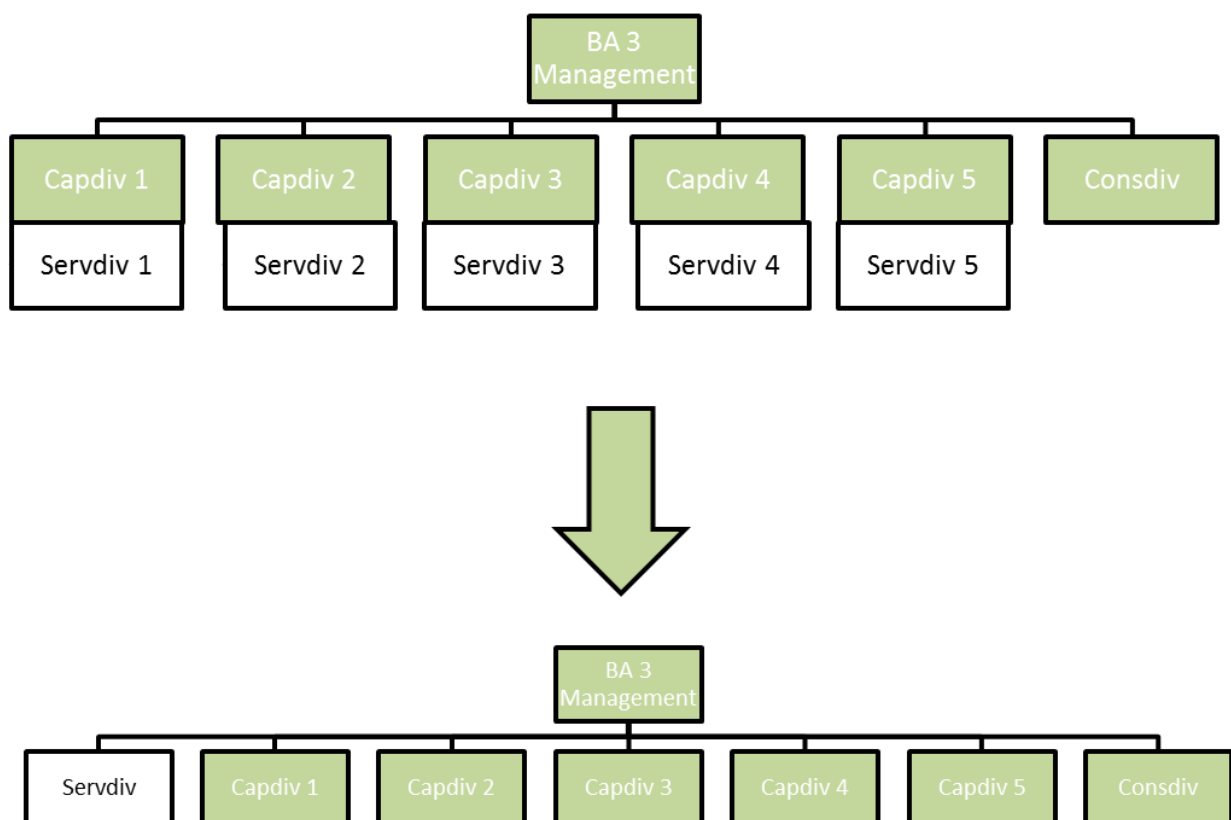


**Figure 2. Organizational structure of ManuCo**

Figure 2 show the organizational structure of ManuCo. Beneath the CEO and executive group management, ManuCo consist of 4 separated business areas. Together with national sales offices covering each of the 170 countries that the company operates within, they make up a global matrix structure. This case study is performed at the business area that we have chosen to call business area 3 (BA 3).

BA 3 is the second largest of ManuCo's business areas with yearly revenues of around 25-35 BN SEK. ManuCo is a company that is characterized by a high level of decentralization throughout its four business areas and more than 170 countries. This means that there is a continuous struggle to manage the global integration and coordination, with local adaption. The amount of different data and ERP systems used troughout ManuCo is substantial and this holds true even within BA 3. Despite the decentralized structure, there are some common values that are emphasized across the organization. There is a high focus on sustainability, innovation as well as being the first choice among customers, which is conceptualized through different internal slogans.

BA 3 is comprised of seven divisions. These divisions can be characterized in three different ways. Five of the divisions produce machines to the mining sector, one of the divisions produce and sell consumables and another division sell service, training and spare parts to the existing customers. Within this thesis we call the service division SERVdiv, the consumables division CONSdiv and the divisions producing machines CAPdivs. In October 2011, SERVdiv was formed as a way of emphasizing the aftermarket. Before this separation, each of the CAPdivs had handled its own service, training and sales of spare parts as is shown in Figure 3 below. This reorganization is in line with how the rest of the organization has acted. BA 2 was the first to separate the aftermarket division in 2008 and the rest of the business areas have followed.



**Figure 3. Organizational structure of BA 3 before and after the separation of service divisions**

The reorganization has led to a new relation being formed as is illustrated in Figure 3. Previously the CAPdivs and the SERVdivs worked together under common divisions. CAPdiv 1

and SERVdiv 1 made up division 1 and CAPdiv 2 and SERVdiv 2 made up division 2 etc. Since the formation of SERVdiv there is now a lateral relation between hierarchical equals comprising the CAPdivs on the one hand and SERVdiv on the other. The relationship between the CAPdivs and the SERVdiv is characterized by a high level of interdependence. In its simplest form the CAPdivs need the SERVdiv to provide customers with good aftermarket service, to receive returning and new customers, while the SERVdiv needs the CAPdivs to sell machines, to be able to provide aftermarket service to them. This interdependence is recognized by all the employees that were interviewed as well as in internal documentation.

#### **4.1.2 SERVdiv**

SERVdivs revenues stems from especially three specific areas. The largest component is the sale of spare parts to customers owning a machine produced by one of the different CAPdivs. Besides the sale of spare parts, SERVdiv also offer training in handling the machines sold by CAPdivs, as well as service for the machines. Since the formation of SERVdiv in 2011, the division has set up a strategic goal of doubling the revenue over a three-year period indicating a compound annual growth rate of 26%. SERVdiv employs over 6000 individuals globally, with the majority of them working in the sales organizations as field service technicians. More than 5000 of the 6000 employed work with customer service in one way or another in any of the sales organizations. The remaining people work in one of SERVdiv's nine so called "hubs" which are strategically located at places where CAPdivs have production. The SERVdiv management consists of a vice president (VP) for the entire SERVdiv, along with one VP for each of the so called functional units, e.g. supply chain, marketing, technical etc., in the organization.

#### **4.1.3 CAPdivs**

The five CAPdivs vary in size and have different backgrounds. One of the CAPdivs was acquired a few years ago while most have been in the company for a long time. All of the CAPdivs handled the spare part sales, service and training- for their machines prior to the start of SERVdiv. The difference in size makes the organizational setups of the CAPdivs differ to some extent. In general, their employee distribution is similar to that of SERVdiv with a large sales force in the Sales organizations and the rest working at one of the production sites

around the world. The management teams, as within SERVdiv, consist of a VP for the whole CAPdiv with support from different functional unit VPs. An add-on that most CAPdivs have compared to SERVdiv is the VP of Mergers & Acquisitions.

The next section contains our case research of how the lateral relation is governed including both the hierarchical and the lateral element of governance between the CAPdivs and the SERVdiv.

## **4.2 The governance of lateral relations within ManuCo**

### **4.2.1 Vertical governance of the lateral relation**

On the levels above the SERVdiv and the CAPdivs there are three hierarchical elements with the possibility to exercise control and influence the lateral relations. These are the BA 3 management, ManuCo group management and the board of directors as is shown in Figure 2 in Case background. Out of these three it is especially the BA 3 management that is actively involved in strategic decisions concerning the different divisions within BA 3. However, the initiative to separate the service divisions from all the CAPdivs into SERVdiv came all the way from the board of directors according to a senior manager of SERVdiv.

Throughout a year there are regular meetings between the management of BA 3, SERVdiv and the CAPdivs called BA 3 management meetings (Internal governance structure documents). The management of BA 3 also has regular meetings with the group management of ManuCo and the other business areas. From these meetings, the strategies, plans and targets are communicated further down to the SERVdiv and the CAPdivs. According to many of the interviewees, consistent with ManuCo's decentralized structure, the BA 3 management exercises little control and pushes decision-making downwards in the organization. However, there are some issues that are decided upon on a higher organizational level, including guidelines for the corporate culture.

ManuCo is characterized by a strong corporate culture which the group management and the BA 3 management communicate downwards in the organization, according to a number of the interviewees. The ManuCo culture is communicated through three core values focused on



interaction, innovation and commitment which are further broken down into internal slogans referring to how a ManuCo employee should behave in various situations. In summation the culture can be described as very focused on the customer, innovation and to be sustainable. Not only has the culture been brought up during interviews, we have also noticed it from the meetings and internal conferences that we have been participating in.

As many interviewees mentioned, the BA 3 management does not play an active role in deciding upon how the SERVdiv and CAPdiv should behave and cooperate:

*“There are a lot of words, but less action”* (Employee, SERVdiv)

*“There is no formal steering or practical guidelines for how we are supposed to cooperate, it is encouraged but not written down”* (Employee, SERVdiv)

*“The BA 3 management makes almost no decisions”* (Senior Manager, CAPdiv)

The BA 3 management instead seems to use the corporate culture and the focus on providing the customers with the best possible solutions to lead the way for cooperation. Repeatedly, the interviewees discussed how the BA 3 management encourages cooperation but without providing guidelines on how to cooperate. Rather, they lift the corporate culture to the forefront and talk in meetings and in communicated messages about how they must be able to cooperate to provide the customers with the best possible solutions. Many of the interviewees at a senior or management level in both the SERVdiv and the CAPdivs express a positive attitude towards this less formal way of steering their actions. However, some of the employees working on a relatively lower level in the SERVdiv expressed concerns and also frustration towards the lack of formal initiatives. This frustration was especially pointed towards the scarce resources provided to SERVdiv by BA 3 management. One interviewee was frustrated by the BA 3 management’s lack of involvement, since it is difficult to gain support for joint efforts and projects if it is not on the BA 3 management’s agenda:

*“For the CAPdivs to engage in a joint effort it almost has to be the BA 3 president that explicitly tells them to do it”* (Employee, SERVdiv)

One formal initiative undertaken by the BA 3 management, however, is the hub structure described in the case background. The CAPdivs have production plants where they undertake the manufacturing of their products located all over the world. While it would have been a popular choice among many of the employees in SERVdiv to work at the HQ in Stockholm, Sweden, this did not happen. Instead, a decision was taken at BA 3 management level to create the hub structure where SERVdiv employees are placed at nine locations in the world where the CAPdivs production is undertaken (Internal strategy document). The aim of this organizational setup is to facilitate cooperation and information sharing between the CAPdivs and the SERVdiv. Instead of having the SERVdiv separated from the CAPdivs, people from different divisions were believed to be able to meet on a regular basis and coordinate their activities. In practice, this will in many cases only mean that the SERVdiv employees are located in the same town as the CAPdiv, not in the same building.

Further on, as described in the case background, ManuCo has a global range of sales organizations (around 90 in total) serving over 170 countries. This structure is an initiative taken from the group management of ManuCo and have been in place for a long time. The idea is that all the different divisions within BA 3 should have representatives in each local market. This means that not only in the hubs are the SERVdiv and the CAPdivs located together. In the sales organization they are often located in the same building and hence coordinate their activities on a daily basis. This is something that appears to stimulate the cooperation and bring forward a more consolidated thinking. As one employee working in a large sales organization for SERVdiv puts it:

*“In the sales organization it is easier to gain a group perspective since we meet on a daily basis”* (Employee, SERVdiv)

*“Here we think of it more as the performance of the sales organization than the performance of SERVdiv or CAPdivs”* (Employee, SERVdiv)

All the sales organizations are also incentivized from a more consolidated view than the employees working within the hubs. In the sales organizations the bonuses are based on the

specific divisional performance i.e. SERVdiv or one of the CAPdivs, as well as on the performance of the local sales organization as a whole. The incentive system for the sales organization is an initiative from the group management. The majority of the employees both from CAPdivs and SERVdiv working at one of the hubs or at a production plant are only incentivized by their own division's performance. The only joint effort within this area is the annual Net Promoter Score (NPS) which is based on the whole BA 3 performance and not divided by division.

#### **4.2.2 Lateral governance of the lateral relation**

For each of the divisions within BA 3, there is a divisional board consisting of the executives from each functional unit within the division. Functional units include for example supply chain, marketing, strategic purchasing, technical and HR. In addition, each functional unit has a unit-board. According to internal documentation, the responsibility for cross-divisional and cross-functional strategic decisions lies with these unit-boards, which then report to the divisional board. Boards within SERVdiv have the declared objective to, among other things, ensure that strategic decisions and objectives are aligned and agreed across divisions (Internal governance document). The unit-boards meet regularly on a monthly or quarterly basis, and participants include members from different functions. In addition to the communication that these meetings generate, there is much communication between managers across both divisions and functions that occurs ad-hoc through informal channels as issues arise according to a senior manager at SERVdiv.

Within the divisions in BA 3 there is an established meeting structure for various topics and tasks. These can be divided into three types of meetings; *cross-functional*, *cross-divisional* and *external*. Within SERVdiv for example, cross-functional meetings are aimed primarily at internal SERVdiv concerns and are manned by people from within SERVdiv. These meetings include project meetings and meetings addressing operational improvements. Cross-divisional meetings are hosted either by SERVdiv, one of the CAPdivs or a sales organization. These meetings are aimed at sharing practices and aligning decisions across divisions. From the viewpoint of SERVdiv, external meetings are hosted by CAPdivs, where SERVdiv has been invited to participate. These meetings cover many areas of the business, including product

development and design but also marketing and sales efforts. What characterizes these meetings, however, is that the cross-divisional meetings are mostly held on a management level and are not involving lower level employees. (Internal governance document)

An example of an external meeting where SERVdiv is invited to participate is the product development meetings at CAPdivs. Here, communication occurs through cross-divisional roles which are used to coordinate activities across divisions. When CAPdiv initiates a project to develop a new product, a project team is formed. One of the members of this team, which will meet regularly throughout the development process, is a project coordinator who officially belongs to SERVdiv but whose responsibilities are cross-divisional. It is the job of the project coordinator to raise concerns regarding the after-market effect of decisions in project team meetings, but also to relay information from the project team to the affected members of SERVdiv. This is done through weekly meetings where the project coordinator informs the units of SERVdiv and also receives feedback and progress reports. According to a middle manager at SERVdiv, a key objective in the project coordinator role is to enable communication to occur directly between the involved parties. If there is an issue in pricing, the interviewee explains, the optimal solution is for the pricing experts within SERVdiv and CAPdiv to talk directly to each other instead of through the project coordinator. The project coordinator works towards this by making the team structure on both sides transparent and easily accessible.

Another initiative to govern the relationship between SERVdiv and the CAPdivs is the setup of a new cross functional role called operations manager. The operations managers work under SERVdiv and there is one operations manager for each of the hubs. According to internal documentation the primary role for the operations manager is to:

*“Ensure local / regional focus and attention, including implementation of SERVdiv global strategy, fully integrated with local CAPdivs “*

While also having the responsibility to:

*“Ensure smooth cooperation / interface with other teams / people locally (within SERVdiv and with CAPdivs – in line with overall strategy for SERVdiv operations in the local Hub”* (Internal documentation)

The operations manager is also the main contact person for people from CAPdivs at the hubs with the goal of enhancing the efficiency of the cooperation at each hub. The role is not only used for the purpose of an informal contact person at the hubs, there is also a substantial amount of cross functional meetings included. The operations manager attends many of the meetings that the CAPdivs host at the hubs while also inviting people from the CAPdivs to attend meetings hosted by SERVdiv. The role was initiated by the SERVdiv management and their view of the importance of the operations manager is shown by the power it received. The operations manager is on the same level as the vice presidents of the SERVdiv and hence reports directly to the president of SERVdiv. A majority of the interviewees viewed the operations manager role as a way for SERVdiv to reach out a hand to the CAPdivs for cooperation, and were overall pleased with the initiative. The operations manager is also incentivized based on how well the cooperation with the CAPdivs is working, which except for the sales organizations is the only cross-divisional incentive system.

A common theme throughout the interviews has been the importance of personal contacts and informal networks. Many interviewees claim that the most efficient way to get things done or to gather information is to know the right people in the organization. As one interviewee puts it:

*“...the hub structure is good but it is more about informal networks”* (Employee, SERVdiv)

Several of the interviewees also agree with the notion that informal networks are important and a part of the culture of how things are done at ManuCo. Among the interviewees, particularly in more senior positions, it was common to have a long background within ManuCo that involved roles within different divisions. The network that this experience provided was considered valuable. It was argued that the people with experience from “both sides” (i.e. CAPdivs and SERVdiv) are able to make decisions that take into consideration both CAPdivs and SERVdivs interests to a larger extent than those who lack this experience.

Several of the interviewees confirmed the importance of trust in the other party for the cooperation to function efficiently, and that this trust needs to evolve over time. One CAPdiv senior manager mentions that there is a need to get people to meet and communicate, and that this will help build trust which in turn helps communication. He emphasized the managers' role in introducing people and getting them to talk.

The decentralized structure of Manuco is a source of pride amongst the members of Manuco according to one interviewee. This has consequences for information sharing which was recognized by one of the interviewees;

*"In (Manuco), there is one database per person", and therefore "... if information is exchanged without people involved you can miss important stuff"* (Senior Manager, CAPdiv)

Initiatives in terms of data management were underway at the time of our research but the consolidation and sharing of information, both across and within divisions, was considered a challenge as the data systems are so fragmented. It was recognized by many of the interviewees that this is a challenge for the individual, and that there exists a need to be able to ask questions to the correct person in order to be able to process and make use of information.

As mentioned previously, a customer satisfaction survey is part of an evaluation on both SERVdiv and the CAPdivs, and this is considered cross-divisional since it incorporates the performance, delivery and service of the machine. Performance is evaluated on divisional basis for almost all of the interviewees. An exception could be found at the Sales organizations where evaluation and rewards are based on both the performance of the Sales organization itself and of the division to which the person belongs. One employee at SERVdiv commented on the role of Sales organizations in driving cooperation, explaining that CAPdivs are often approached by people from Sales organizations with questions regarding the opportunities for after-market sales. In order to address these questions, CAPdivs must make contact with people from SERVdiv. The same interviewee claimed that the most common feedback from the Sales organizations was that the CAPdivs and SERVdiv need to cooperate

more and initiate joint campaigns etc. The decentralized structure, however, is also credited with giving the organization flexibility and allows divisions or even units within divisions to respond quickly to changing circumstances.

There is little in terms of cross-divisional incentive systems, and the research did not find indications of any traditional accounting information used to govern the cooperation amongst the divisions. In fact, there are no formal ways of measuring the cooperation or the joint performance other than the customer satisfaction survey and the consolidation of numbers for the quarterly reports according to several of the interviewees. There is however an ongoing joint project between SERVdiv and the CAPdivs to bring forward a common activity based costing system according to a senior manager at SERVdiv.

Even though the separation of the service division occurred two years prior, the history of the organization is present in the daily cooperation between SERVdiv and the CAPdivs. Several of the interviews held with people from SERVdiv confirmed the notion that even though SERVdiv accounts for a substantial share of profits and sales, it is the producing divisions that are in charge. Some even claim that SERVdiv is considered a support to the CAPdivs by people from the CAPdivs. It was expressed in several of the interviews both by people from SERVdiv and members of CAPdivs that most initiatives for cooperation come from the SERVdiv, with one SERVdiv senior manager conveying a level of frustration in saying:

*“Even though (SERVdiv) makes the most money, we have to come crying and begging to the (CAPdivs)”.* (Middle Manager, SERVdiv)

This was also recognized in conjunction with the previously mentioned operations manager role where some interviewees used the role as an example and confirmation of the strange power balance between the divisions. As mentioned above they thought it was odd that even though SERVdiv is the division that generates the highest profits it is the one that has to come up with all the initiatives for cooperation. As one employee phrased it:

*“...to use a metaphor – sometimes it feels as SERVdiv is the man that has to repeatedly persuade the sulky lady for a dance”* (Senior Manager, SERVdiv)

This could in part be explained by an irritation over the fact that the separation of service and production meant that a large part of profits was moved from the CAPdivs to SERVdiv. A person at SERVdiv expressed concerns over the ability to trust the other side, arguing that in some instances there is a need to check what the CAPdiv counterparty is doing since it is not a guarantee that SERVdiv would be informed of the developments. An employee with SERVdiv claimed that since the objectives are largely divisional, cooperation suffers. People from different divisions are asked to cooperate but are also driven by separate agendas that are not fully aligned, according to the interviewee.

When the separation occurred, the SERVdiv management placed great emphasis on establishing a strong SERVdiv culture according to a senior manager of SERVdiv. The focus was on establishing a common ground as the people in the SERVdiv came from many different divisions and had perhaps not worked together before. The senior management of SERVdiv works towards establishing a way of working that allows people to take charge of a problem and handle it at the appropriate level instead of escalating it. The cross-divisional problems, the senior manager at SERVdiv argued, should not be handled in meetings with senior managers but rather on the level where the technical expertise exists. Several of the interviewees confirm this image, saying that there are general guidelines and encouragement to cooperation across divisions but that there are limited formal processes. Many of the interviewees also claims that the internal focus on creating a unified SERVdiv has meant that cooperation with other divisions have suffered. This was argued by some to contribute to the feeling that it is SERVdiv that are now required to “reach out” to CAPdivs by initiating common projects and cooperative actions. However, managers from both CAPdivs and SERVdiv express an understanding for the interdependencies between the divisions. Many argued that the interdependence is unavoidable and that it is obvious that they must cooperate intensively.

The history is also present when it comes to the network of contacts and the possibilities to establish networks across divisions. Several employees refer to the “old” contacts and processes, that were in place prior to the separation and that these are very important. New geographical distances between people involved in the production at CAPdiv and people that



were part of a CAPdiv but which are now parts of SERVdiv makes contact more difficult. According to one employee;

*“Before, you just walked over and asked if you had a question. The distance creates a demand for processes.” ( Middle Manager, SERVdiv)*

### **4.3 Summary of empirical findings**

To summarize, our findings regarding the governance of the lateral relation between SERVdiv and the CAPdivs indicate that the top hierarchical levels of ManuCo focus on establishing a corporate culture and shared values throughout the organization. ManuCo is a decentralized organization which is evident in the limited amount of formal governance that takes place on high levels. Initiatives from the hierarchical levels above SERVdiv and the CAPdivs are limited to organizational structure and initiatives involving corporate culture and shared values. Interviewees agree that there is little in terms of formal processes and instructions on how to cooperate coming from the higher hierarchical levels regarding the relation between SERVdiv and CAPdivs

The divisions within BA 3 have established meetings where they are able to communicate and make strategic aligned decisions across divisions and functions. Certain roles have also been established to function in a cross-divisional manner and further aid the cooperation. Informal networks and social contacts are considered very important in the daily work which was linked to the decentralized structure of the organization. Most interviewees were evaluated on divisional rather than cross-divisional performance measures, the exception being the cross-divisional roles and members of the sales organization. Further, trust was confirmed by several interviewees to be of great importance. The history of the organization is still, two years after the separation, a factor in the daily work. The shared sentiment among SERVdiv and CAPdiv interviewees is that SERVdiv are the ones making suggestions for improved cooperation and that this to some extent could be explained by historical factors.

## 5. Discussion

In performing a case study of ManuCo and the relation between the SERVdiv and the CAPdivs, we have confirmed the existence of a lateral relation between interdependent divisions. The move to separate the after-market part of the operations of the producing divisions from the production of the machines has created a lateral relation between two parties which are on the same hierarchical level according to the organizational chart of ManuCo. In Section 2, we identified the vertical and lateral elements in the governing of this relation. We also identified cooperation and coordination as the key objectives for the governance of an interdependent lateral relation and found that to achieve this, there is a need for a high degree of trust and information sharing which in turn should be facilitated by governance practices. In this section, we will begin by discussing the vertical element of governance, followed by a discussion of the lateral governance. The section will end with a summation of our findings.

### 5.1 Vertical governance of the lateral relation – Providing a structural context

The case study reveals three hierarchical levels which exist above the parties involved in the lateral relation. The BA 3-management is a small organizational unit which includes the head of the BA 3 that all divisions studied in this case is a part of. The BA 3 - management is on an hierarchical level which implies authority over the parties in the relation, and can therefore be considered as the hierarchical superior as defined in previous research (Bartlett & Ghosal, 1993; Chenhall, 2008; van der Meer-Koistra & Scapens, 2008). There are, however, additional hierarchical levels through the group management of ManuCo and the board of directors. The case study reveals that each of these hierarchical levels inflicts some level of governance on the parties in the lateral relations. The initial move to create a separate service division was the board of director's decision. Meanwhile, group management influences the relation by creating shared values and goals through group-wide efforts in these areas, which is in line with what Bartlett & Ghosal (1993) and Björkman et al. (2004) discusses regarding the hierarchical part influencing the lateral relation through a structural context that is created by for example shared values and strategies. Hence, the internal slogans and the shared values

with a strong customer focus can be seen as a structural context put in place by the group management.

Another group management initiative which has been in place during a long period of time is the structure with Sales organizations in the countries that ManuCo operates within. This structure affects the cooperation between SERVdiv and the CAPdivs and can be seen as a minimal structure described by van der Meer–Koistra & Scapens (2008). The structure with the Sales organizations is not designed specifically to benefit the cooperation between SERVdiv and the CAPdivs, but is rather a structure which governance practices can be used within (Ibid) and which indirectly creates a cross-divisional link between the divisions. Incentives could be used to encourage cooperation according to van der Meer–Koistra & Scapens (2008). The incentive system of the Sales organization was considered cross-divisional in that members of the Sales organization were incentivized based on how the local sales office performed but also based on the performance of the division that each sales person belonged to. This incentive system was imposed by senior levels, but the incentives for divisional managers were not found to be dependent on the performance of other divisions. The use of incentives to promote cooperation was therefore limited which goes against what was discussed in previous research (Ibid).

The BA 3-management focused on encouraging cooperation, customer focus and a unified culture within the BA. They have formal meetings where they are regularly updated by the management of the different divisions. However, as can also be inferred from the case study, they provide the divisions with little formal guidelines on how to cooperate. Instead this is left almost entirely up to the divisions to handle. This is very much in line with the enabling role of the hierarchical party, as discussed by Chenhall (2008). In addition to the meetings with the divisional management team, the other formal initiative undertaken by the BA 3-management is the hub-structure. As stated in the empirics, this was an initiative from BA 3-management to encourage information sharing and cooperation between SERVdiv and the CAPdivs. While it is a tangible intervention and a way to try to steer the lateral relation it does not specify in detail how the cooperation should take form. The BA 3-management encourages cooperation and tries to stimulate it by structuring the divisions around hubs but it does not provide many formal guidelines on how to cooperate and coordinate. The hub

structure is hence in line with acting enabling (Ibid), and providing minimal structures to focus the efforts while leaving room to maneuver (van der Meer–Koistra & Scapens, 2008).

Previous literature suggests the hierarchical superior to act in an enabling way through the use of culture, shared values and objectives (Bhartlett & Ghosal, 1993). Interestingly, the enabling role does not fall on one hierarchical level but rather on several in this case. The enabling and empowerment of lower levels which Chenhall (2008) argues is the role of senior management is achieved through steps of enabling governance whereby responsibility for task achievement is pushed down in the organization. The board of directors was the group that first encouraged the creation of the SERVdiv division and is hence the founders of this lateral relation. Since then, they are not actively involved in the governance of it. The group management act enabling and puts trust in the BA 3–management to handle the relation, while providing little more than a shared culture and internal slogans. Finally the BA 3 – management created the hub–structure to encourage cooperation but do not provide many specific guidelines or tools for governing the lateral relation. In this way, all of the hierarchical parties can be said to act enabling, and hence in line with what previous research have recommended is needed to gain a well-functioning lateral relation.

As shown by the case study, many of the employees in SERVdiv and especially those at a higher level regarded the enabling role of the BA 3–management as something positive. However, many working at a lower level seemed to be frustrated by this way of acting. The frustration was especially focused towards two areas. The first was the feeling that SERVdiv was given unfair resources compared to the CAPdivs. The other was the feeling that the CAPdivs were not interested in cooperating if they did not receive orders to do so from BA 3–management. Clearer guidelines were therefore considered necessary to achieve a better cooperation. This feeling of frustration towards the enabling actions from BA 3–management might be linked to the move from product to service orientation. As stated by both Oliva & Kallenberg (2003) and Brax (2005) the move towards a higher service orientation has much to do with culture. The whole idea surrounding the start of a separate service division with profit & loss responsibility is to establish a service culture within the organization. In the case of BA 3 and SERVdiv it seems as though some of the SERVdiv employees do not consider the enabling actions of BA 3–management to be emphasizing the importance of service enough.

Their frustration is pointed both towards unfair resources compared to the CAPdivs as well as towards the limited set of formal guidelines on how to cooperate. Hence, it seems as though many of the employees in SERVdiv would have preferred more formal steering and guidelines of the lateral relation to make it both fairer as well as to ease the cooperation. This type of action, however, would not be consistent with what previous research prescribes (Bhartlett & Ghosal, 1993;Chenhall, 2008; van der Meer–Koistra & Scapens, 2008) and is also not what the BA 3-management has chosen to do.

## **5.2 Lateral governance of the lateral relation**

### **5.2.1 An enabling hierarchical party creates a need for self-governance**

Given the largely enabling role of the hierarchical superiors in the governance of the lateral relations between SERVdiv and the CAPdivs, a significant part of the governance of this relation could be considered self-governance according to van der Meer– Koistra & Scapens (2008). As Chenhall (2008) and van der Meer-Koistra & Scapens (2008) suggest, formal procedures concerned with control of subordinates were not frequent. The parties involved in the lateral relation are on the same hierarchical level and were hence not granted decision authority over the relation. With little formal processes and procedures coming from their common superior, it is up to SERVdiv and the CAPdivs to form their relation together.

The boards of SERVdiv, with similar opposing structures at the CAPdivs, have the declared objective to align objectives and strategic decisions across divisions. This strategic alignment achieved through joint efforts and discussed actions, is an example of the self-governance that the parties are involved in. The interviewees witness of intense communication between managers across divisions, often through informal channels and ad-hoc, as issues arise. This observation is consistent with van der Meer-Koistra & Scapen (2008) definition of a lateral relation. In this way, the divisions govern their own relation, acting within the structural context of considerable flexibility and freedom that group-management provides in order to align activities across divisional boundaries, which is what theory prescribes (van der Meer-Koistra & Scapens, 2008).

### **5.2.2 Practices used by the lateral parties**

As described in Section 4, the cross-divisional meetings between SERVdiv and the CAPdivs are mostly structured around communication on a management level. It can be said that the managements within the SERVdiv and the CAPdivs are enabling in its governance of the cooperation with other divisions. Because of this, employees at a lower level handle the cooperation mostly by informal contacts and by handling issues ad-hoc. Considering the interdependency between SERVdiv and the CAPdivs one could have expected a more formalized meeting structure even on a lower level in the organizations to build trust and understanding as described by van der Meer–Koistra & Scapens (2008). However, some of the lower level employees are engaged in some of the external meetings and joint projects between the divisions.

A hands-on governance practice undertaken by SERVdiv is the establishment of cross-functional roles. These include the role of operations manager, who serves as the head of operations at each of the hubs. The job description explicitly states that part of the role of the operations manager is to ensure smooth cooperation, which is achieved both informally through contacts at the hub but also more formally through attending CAPdiv meetings and inviting CAPdivs to participate in SERVdiv meetings. The role of operations manager is an example of the type of cross-divisional roles that Busco et al. (2008) and Galbriath (1973) argue can facilitate information sharing and trust-building. Since the operations manager works actively to both build social ties between the division and also establish meetings where information is shared, the operations manager can be seen as a facilitator for trust and information sharing.

In addition, the project coordinator acts cross-divisionally by representing the SERVdiv in product development teams at CAPdivs. The project coordinator works actively to ensure that information is shared across divisions, and in the interviews it was emphasized that the optimal solution is to make individuals talk to each other rather than through the project coordinator. The project coordinator both acts as a courier of information and as an initiator of communication, and can therefore also be considered a facilitator for trust and information sharing as Busco *et al.* (2008) and Galbriath (1973) described. Further, the use of a project

coordinator in product development teams can be seen as a confirmation of the need for information sharing in the innovation process (Frow *et al.* 2005).

Traditional measures of accounting information were not used frequently to govern the relation between the divisions. This finding is consistent with suggestions from Chenhall, (2008), Macintosh & Daft,(1987) and van der Meer-Koistra & Scapens, (2008) on the insufficiencies of traditional accounting information in lateral relations. In fact, there was little if any measurement of the cooperation and its success. Instead, the governance of the lateral relation seemed to rely on the notion of consolidated thinking. The enabler thus becomes even more important, as the instigator of shared values and corporate objectives, in the governance of the relation. The work on developing a common activity based costing system is however a general management accounting practice that is in line with what Chenhall (2008) describe as a more relevant tool to use in a lateral relation.

In addition to the lack of formal accounting measures, no formal cross-divisional incentive systems were used by the SERVdiv and the CAPdiv to govern their cooperation and coordination, with the exception of the sales organizations and the operations manager. The sales organizations incentive systems are however a vertically imposed incentive system from the BA 3 management as mentioned previously. The lack of formal incentive systems and any type of shared accountability is somewhat unexpected due to the strong interdependence and what could be inferred from previous research (Busco *et al.*, 2008; van der Meer- Koistra & Scapens, 2008).

The datasystems in ManuCo were described as fragmented, which was consistent with the decentralized structure of ManuCo. It was emphasized that there was a need to communicate in addition to sharing information to enable the receiving party to make use of the information. It could therefore be argued that the lateral relation was not governed through the use of a unified information system accessible to all parties (Bhartlett & Ghosal, 1993). Rather, the relation depended heavily on the role of social interactions and informal contacts as a complement to the dispersed and fragmented information structure. This complementing role was found in previous research by Gupta & Govindarajan (2000), and plays a significant part in the information sharing process between SERVdiv and CAPdivs. The need to

communicate in the information sharing process also lends support to the notion that capacity to make use of information is perhaps a greater constraint than access to information (Galbraith, 1973; Gupta & Govindarajan, 2000). In addition, interaction and informal relations has been associated with increased communication and information sharing (Tsai, 2002), and this was found to be true in ManuCo.

Informal contacts and communication were described by virtually all interview objects as vital in the cooperation. Going via informal networks was described as the most efficient way to gather information and get things done. The cross-divisional roles worked towards establishing contacts between individuals, the importance of which is shown by the fact that information sharing seemed to occur to a large extent through these contacts. Tsai (2002) found that social interaction and informal relations were associated with increased communication and information sharing, which is consistent with the findings at ManuCo.

### **5.2.3 Important factors affecting the cooperation and coordination**

The practices discussed above highlight the key factors that are important in order to achieve a good cooperation and coordination in the lateral relation. The interdependency between SERVdiv and the CAPdivs create a large need for information sharing among them, which is in line with what previous research found (Frow *et al*, 2005; van der Meer–Koistra & Scapens, 2008). This was also acknowledged by many of the interviewees, who needed information from other divisions almost on a daily basis in their work. The information sharing is in many instances driven by the end customer in line with van der Meer–Koistra & Scapens (2008) observations, but also by the need to achieve a cooperation to benefit the BA 3 as a group and minimize suboptimal decisions. The importance of information sharing is not supported by the current IT- and system landscape which is very fragmented and with limited possibilities to easily access information. However, as discussed above, this is part of the decentralized way of ManuCo which also seem to be a source of pride for many of the employees. Instead the need for information sharing was solved by informal communication and contacts, underpinned by the hierarchically imposed hub structure. This was especially important due to the less formalized meeting structure on lower levels.



People from both SERVdiv and CAPdiv confirmed the importance of trust for the cooperation between the two parties to function well. It was considered important in order to facilitate communication and as described in Section 4, one CAPdiv manager, when asked about trust, emphasized the need for people to meet as a way of building trust. Many also confirmed the notion of trust as evolving over time, in line with van der Meer-Koistra & Scapens (2008) idea of trust as an important factor that have to emerge but can be facilitated through governance practices. The decentralized structure of ManuCo, along with the largely enabling hierarchical guidance, created a setting where formalized processes were limited which is consistent with the idea of formalized processes as insufficient in the governing of lateral relations (Busco *et al*, 2008; van der–Meer Koistra & Scapens, 2008), and in this setting trust becomes an important factor. Many of the governance practices identified above are practices associated in previous research with the building of trust. This further confirms our expectation of trust as an important factor in the lateral relation between SERVdiv and CAPdiv.

In line with theory (Busco *et al*, 2008; Frow *et al*, 2005; van helden *et al*, 2001; van der Meer – Koistra & Scapens, 2008), both trust and information sharing have been recognized as important factors to achieve a good cooperation and coordination within the lateral relation between SERVdiv and the CAPdivs. Even though many practices are used to facilitate the achievement of these two factors by the divisions there were still issues in finding a well-functioning cooperation and coordination of the lateral relation. These issues were mostly highlighted by SERVdiv employees and were found to affect the trust and information sharing within the lateral relation. Some SERVdiv employees weathered the feeling that the CAPdivs had a reluctance to cooperate due to an irritation of the loss of profits stemming from the creation of SERVdiv. The quote from the senior SERVdiv employee using the metaphor of the CAPdivs as a sulky bride was reflected by many other interviewees' comments on the cooperation. The majority of the governance practices identified were also initiated by the SERVdiv indicating a lower willingness for cooperation from the CAPdivs. This even though the interviewees clearly state that the CAPdivs are dependent on the SERVdiv to the same extent as the SERVdiv is dependent on the CAPdivs. We argue that the issues prevailing within trust and information sharing is affected by what we term the *historical context*, which affects the governance in the lateral relation between SERVdiv and the CAPdivs.

We argue that the historical context of how things were before the restructuring is present in the cooperation between SERVdiv and CAPdivs. The increased focus on service suggested by previous literature, through initiatives such as a separate service division and focus on service culture, has been implemented on a top level by the enabling vertical authority. However, the daily work of the people within SERVdiv is still conducted using many of the contacts made prior to the separation, and processes are similar in their design. Meanwhile, there exists, at least according to employees within SERVdiv, a sense of irritation over the reduced profits at CAPdivs after the separation. With the added complexity of limited use of shared incentive systems or performance measurements, SERVdiv is required to come begging for cooperation even though it has been acknowledged to be in the interest of ManuCo.

We argue that this scenario is created by what we term the historical context of the lateral relation between SERVdiv and CAPdivs, and that the effect of the historical context could be found both in the vertical (e.g. insufficient resources provided to SERVdiv) and lateral (e.g. reluctant acceptance of cooperation) element of governance. We therefore argue that a central challenge in the governance of a lateral relation like the one observed in this thesis is the governance of this historical context. This is in line with the discussion by Windahl & Lakemond (2006) that the need for separation and establishment of a service focus can cause problems, since there is also a significant need for integration. ManuCo, on a group level, attempts to govern this through an emphasis on the aftermarket potential and importance by establishing the increased focus on the aftermarket as one of three strategic key objectives. It is also governed through the establishment of shared values and goals, and through strategic aligning on a division-management level. As discussed by van der Meer–Koistra & Scapens (2008) the establishment of trust is performed over time and cannot be built into a relation. Since our study is performed two years after the creation of the lateral relation it might be that we are witnessing an ongoing process to establish trust, where the historical context is an influencing factor on trust. The historical context affects the governance of the lateral relation and is therefore a feature that should be taken into consideration.

### **5.3 Governance elements and practices – a summation**

To summarize, the case study of the lateral relation between SERVdiv and CAPdivs within BA 3 of ManuCo has confirmed the idea that the governance of an intraorganizational lateral relation involves both a vertical and a lateral element of governance. The vertical superior in this context was found to consist of three hierarchical superiors who all in turn provided the lateral relation with a structural context. The hierarchical superiors acted enabling by providing shared values and objectives while allowing considerable room to maneuver for the parties involved, as theory prescribe. They provided encouragement to cooperate but little in the form of formalized procedures and processes. This enabling created a need for SERVdiv and the CAPdivs to exercise self-governance in their relation. This was achieved through strategic alignment between the divisions and intensive communication. Trust and information sharing between the divisions was confirmed to be important factors to achieve cooperation and coordination, and practices such as cross-divisional roles and meetings-structures were put in place to facilitate these factors. Social contacts and networks were highlighted as important for both information sharing and trust and a part of the decentralized structure of ManuCo. This means that Figure 4 and Table 3 found below, which summarizes the findings from the case research, to a large extent resembles the theoretical suggestions from Section 2.4. Further this means that the expectations from Section 2.6 were also confirmed to a large extent. However, we did not find evidence for a more formal framework imposed by the hierarchical superior to counter the differences between service culture and the traditional manufacturing culture.

The feature that is added in Figure 4, which was identified in the analysis of the case study, is the historical context which affected the governance. The historical context of the formerly product focused, now service focused ManuCo was found to affect both the vertical and lateral governance element. It was found to be an all-embracing feature which affected all elements of the governance, from the vertical to lateral. It also affected the trust and information sharing in the lateral relation, and is included in Figure 4 below as an extra layer around the whole figure, compared to Figure 1 from the previous research.

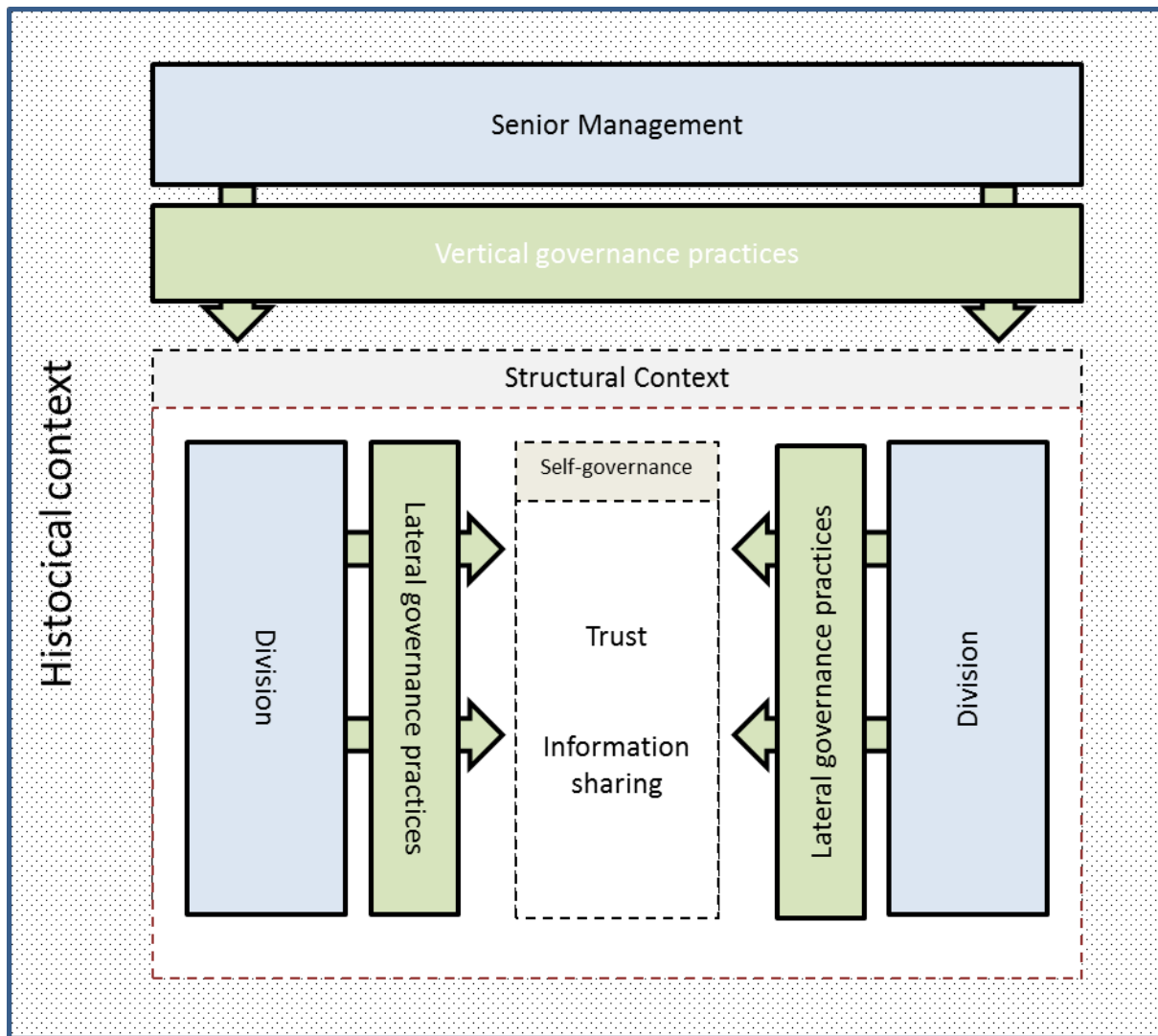


Figure 4. The governance of the lateral relation between SERVdiv and CAPdivs

Vertical governance practices	Lateral governance practices
<ul style="list-style-type: none"> <li>• Shared values</li> <li>• Group goals</li> <li>• Organizational Structure</li> <li>• Internal slogans</li> <li>• Culture</li> <li>• Encouragement</li> </ul>	<ul style="list-style-type: none"> <li>• Meetings</li> <li>• Cross-divisional roles</li> <li>• Social contacts</li> <li>• Informal networks</li> <li>• Ad-hoc communication</li> </ul>

Table 3. Governance practices found in the relation between SERVdiv and CAPdivs

## 6. Conclusion

This study has theoretically and empirically explored the governance of lateral relations. The theoretical exploration in Section 2 allowed for two research questions to be formed. The research questions consider how lateral and interdependent relations are governed, and which factors that are affecting the governance of a lateral relation. The research questions were empirically explored through an in-depth case study of a lateral relation in a current emerging setting between a service division and the related manufacturing divisions. The study contributes both to the intraorganizational management accounting literature by providing insights into the governance of a lateral relation. By doing this in the context of manufacturing divisions and the related service division it also contributes to the field of industrial management literature.

The study has taken its stance in the two elements of an intraorganizational lateral relation; the hierarchical governance of the lateral relation, and the self-governance of the lateral relation. In line with theory the hierarchical superior was found to act enabling and provide a structural context by which the lateral parties operated within. Thereby the lateral relation was characterized by and confirmed what van der Meer–Koistra & Scapens (2008) describe as self-governance. The case study confirmed many of the practices found in previous research, for example cross-divisional roles and informal networks. Also, both trust and information sharing was confirmed as important factors in achieving a cooperation and coordination within the lateral relations.

However, it was further found that the practices in place and the focus on trust and information sharing were not sufficient to describe the lateral relation. The term historical context was used to describe a new factor that was found to influence the governance of the lateral relation. It created circumstances in which the aftermarket division was forced to be the initiator and the driving part of the cooperation even though the divisions were dependent on each other and this was found to affect both trust and information sharing.

Altogether, for the management accounting literature our study confirmed the enabling use of governance practices by the hierarchical superior and the kind of self-governance by the lateral parties as argued by previous research. It further confirmed many of the previously found governance practices in lateral relations and highlighted the importance of trust and information sharing in a lateral relation. Additionally, the study revealed a new factor that affected the governance of the lateral relation, namely the historical context. Given the limited empirical research within governance of lateral relations it is possible that other features can be found by further empirical studies within this area.

To the industrial business literature this study highlights the importance of how the historical context of the aftermarket division and the manufacturing divisions continues to affect the relationship. This has to be taken into account before making the recommended move to create a separate aftermarket division since it can create obstacles in the future cooperation and coordination between the lateral parties.

## **7. Implications, Limitations and suggestions for future research**

### **7.1 Practical implications**

This thesis has investigated the governance of the lateral relation between a service division and the manufacturing divisions of an industrial company that has made the transition from product to service orientation. This section will suggest possible practical implications that can be concluded from the research conducted and which is especially directed towards the case company ManuCo.

First, it could be noted that, as theory suggest, the role of the vertical superior is largely enabling. While this caused certain individuals to complain about a lack of formalized procedures, it was generally considered positive and allowed individuals to feel empowered and able to respond to changes in a timely manner. We argue that practitioners should take care not to limit the flexibility of the parties in the relation by exhibiting excessive formal control.

Secondly, the authors observed a historical context that affected the relation and that caused friction in the cooperation. This historical context, particularly present in a manufacturing company attempting to increase focus on the previously secondary after-market, is necessary to govern in order to avoid limiting the success of the relation. As noted in the study, there was almost no cross-divisional incentive systems used. This could potentially be a way of governing the historical context. At present, the incentive systems does not fully support the idea of cooperation and creates somewhat of a mismatch between what is communicated by senior management and how people are incentivized.

Finally, both as theory states and as was found in the case, informal relations and networks is of great use in achieving trust and information sharing in this kind of setting. However, many of the informal contacts were built while the service division and the manufacturing divisions were still part of the same division. A potential risk is that as time goes by, these informal relations will get more blurred which will create a need for either more formal

communication and governance, or practices in place to facilitate networking across divisional borders.

## **7.2 Limitations**

As often is the case, a possible limitation in a case study like this is the number of interviews made. Within this case study we conducted 17 interviews together with many sources of internal documentation. Within the timeframe for this study we would have enjoyed and could have handled more interviews which we also think could have strengthened the study. However, many of the interviewees are busy with their daily work routines and when participating in this study it was made outside of their work time. Therefore we understand and are relatively pleased with the amount of interviews conducted and the depth we have received. Another possible limitation, as discussed in the methodology section is the number of CAPdiv employees interviewed as a share of the total number. Our aim was to have half of the interviews with CAPdiv employees and this was not achieved due to a lower access for us within the CAPdiv divisions. This could lead to a bias in our results towards a SERVdiv perspective but we have worked towards mitigating this through having a higher portion of senior managers in our sample of CAPdiv interviewees to gain as holistic picture as possible.

## **7.3 Suggestions for future research**

The study of governance in lateral relations is a complex and multi-faceted area where much remains to be explored. While this thesis studied the governance that was in place at a certain point in time, an interesting area for future research would be to study the development of the governance over time as practices are refined, to capture the emerging aspect of governance. This is especially true in the setting of this thesis, in a period after structural change, as the relation matures. As mentioned previously, in the context of servitization the lateral relation is born from the restructuring which, if studied longitudinally, could shed light on the implementation phase of lateral governance practices. More generally, studies of how lateral relations are governed in various settings would be helpful as it would allow distinguishing between context-specific characteristics and general characteristics of lateral relations.



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