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RESEARCH NOTES AND COMMUNICATIONS:

RELATED AND UNRELATED DIVERSIFICATION AND THEIR EFFECT ON HUMAN RESOURCE MANAGEMENT CONTROLS

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This paper examines the link between related and unrelated diversification and human resource management (HRM) controls. The paper presents a model proposing that the type of corporate (macro) controls used by related or unrelated firms implies a relative emphasis on either flexibility or fit among HRM practices in that related firms emphasize flexibility and unrelated firms emphasize fit. This emphasis on flexibility or fit, in turn, has implications for the use of HRM (micro) controls such as clan, behavior, and outcome controls such that related firms exhibit the use of all three types of HRM controls, while unrelated firms exhibit a relative emphasis on the use of outcome controls. © 1997 by John Wiley & Sons, Ltd.

One of the more influential strategic choices in recent years has been that of diversification. Several authors (Rumelt, 1984; Hoskisson, 1987) have developed theoretical research and performed empirical research to explain the diversification phenomenon and its effect on many aspects of a firm. The research conducted by Hoskisson and his colleagues has led to the understanding that diversification has a major impact on firm performance (Hoskisson, 1987), R&D investment (Baysinger and Hoskisson, 1989), managerial commitment to innovation (Hitt, Hoskisson and Ireland, 1990), managerial risk taking (Hoskisson, Hitt, and Hill, 1991), and cooperation vs. competition among divisions (Hill, Hitt and Hoskisson, 1992).

The effects of diversification on these variables are generally through the macro (corporate) controls that are imposed upon divisional units by corporate headquarters. However, these corporate controls also influence micro controls (Simons, 1995) within divisions in a manner that affects innovation, risk taking, and performance. Unfortunately, the effects of diversification and corporate controls on micro areas and their controls have not been thoroughly explored.

One of the micro areas that is conspicuous by its absence is the human resource management (HRM) function and the effect of diversification on HRM controls. Thus, the purpose of this paper is to conceptually examine the link between diversification and the micro controls imposed through the HRM function at the divisional level. This is an important area of research for strategy and HRM scholars given the recent surge in the HRM research stream that seeks to integrate the HRM function with strategy formulation and implementation (Wright and McMahan, 1992).

Key words: macro controls; micro controls; HRM controls; fit; flexibility

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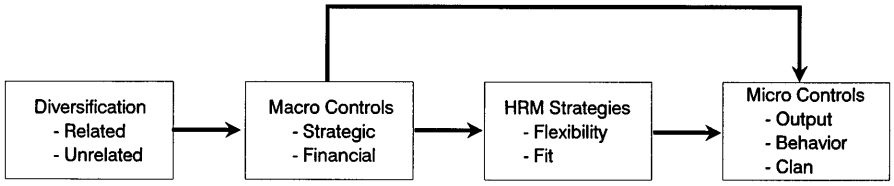

Figure 1. A model depicting the link between diversification and HRM control systems

Figure 1 illustrates the basic model we propose regarding the conceptual links between corporate diversification (related vs. unrelated) and micro controls (behavior vs. output vs. clan).

In examining the link between corporate diversification and micro HRM controls, the paper briefly describes the evolution of the M-form firm, and defines related and unrelated diversification. Second, the paper distinguishes between strategic and financial controls. Third, the paper discusses fit and flexibility in an HRM context, and explores the effects of diversification on the divisional HRM strategies of fit and flexibility and on divisional HRM controls. The last section is a brief discussion of the performance implications of the model depicted in this paper.

The M-form Firm and Diversification

The foundation for the study of corporate diversification is the concept of the M-form organization. The M-form structure is a multidivisional structure (Williamson, 1985) that enhances strategic decision-making at the corporate and international levels while allowing operational decision-making at the division and country levels. In the last two decades, the M-form has replaced the U-form[1] and become the predominant structural organizational form (Hoskisson, Harrison, and Dubofsky, 1991).

Williamson (1975) posited that use of the M-form overcomes the problems of loss of control and loss of direction inherent in U-form firms as they become larger. In addition, he argued that the M-form would enable firms to: (a) identify divisions; (b) give operating responsibility to these divisions; and (c) establish a corporate office at which overall strategic and financial controls would be centralized. Finally, Williamson (1975) suggested that the M-form structure allows corporate managers to concentrate on overall strategic direction and resource allocation, while divisional managers concentrate on operational issues (Hoskisson and Hitt, 1988). This division of labor allows corporate managers to achieve higher levels of diversification. Two levels of diversification will be discussed in this paper: related and unrelated.

Related diversification exists when a firm owns a number of different business units, all of which are related in some way (e.g., similar businesses, or businesses representing different places in the product stream). Under related diversification inputs are shared or used jointly by related businesses in the same firm. In addition, both tangible and intangible relationships exist across the different business units (Porter, 1985). Finally, related diversification allows for reciprocal information flow from corporate managers to divisional managers. This information is of a process, behavioral nature as well as of a financial nature. This reciprocal information flow means that corporate managers know substantially more about each division's operations than that known by corporate managers in firms which are unrelated.

Under unrelated diversification the firm diversifies into substantively different areas that have little in common with each other. This results in corporate managers treating divisions as if they were part of a portfolio. In addition, it allows firms to pool cash flows from divisions and reallocate cash to divisions in accordance with financial criteria. Williamson (1975) suggested that unrelated diversification allows firms to set up an internal capital market. Given these characteristics of related and unrelated diversification, the level of diversification a firm achieves can have a profound impact on the types of macro controls used.

Diversification and Macro Controls

Substantial recent research has demonstrated that diversification influences the macro controls used

[1] A U-form is one where the firm has a functional structure.

by the corporate office to monitor divisional (SBU) performance (Hill *et al.*, 1992). Several authors (Goold, Campbell, and Alexander, 1994; Baysinger and Hoskisson, 1989) argue that this is because there must be a fit between a firm's level of diversification and its macro controls. Baysinger and Hoskisson (1989) posit that related firms emphasize strategic controls to achieve superior performance. Conversely, they argue that unrelated firms emphasize financial controls to achieve superior performance. This means that firms use the macro control system that better aids them in achieving the better performance.

Although several researchers (Govindarajan and Fisher, 1990; Simons, 1995) have discussed macro controls, we describe the two types suggested by Hoskisson and Hitt (1994): financial and strategic. Financial controls entail evaluating divisional performance solely on the basis of objective financial performance. This requires defining, *a priori*, the levels of financial return required as well as specifying financial budgets.

On the other hand, strategic controls entail seeking to control divisional performance through specifying and evaluating the types of activities in which the division is engaged and will engage. However, implementing strategic controls means that the information-processing capability of a firm is quickly inundated and even if a firm wants to utilize strategic controls, it is able to utilize only financial controls once it diversifies past a certain level (Hill and Hoskisson, 1987). Jones and Hill (1988) describe some of these information-processing requirements as 'bureaucratic costs'. Jones and Wright defined bureaucratic costs as 'the negotiating, monitoring, evaluating, and enforcement costs associated with managing human resources when an authority relationship exists' (1992: 274). It is these costs that provide a link to micro level controls, because many HR (or micro) controls are designed to reduce these costs.

While the link between diversification and corporate controls is well established (Hill *et al.*, 1992), little attention has been paid to the effect of diversification and corporate controls on HRM practices at the divisional level and the consequent micro controls. In order to explore these relationships, the next section examines the competing HRM strategies of fit and flexibility within divisional HRM functions.

Fit and Flexibility

Wright and McMahan (1992) defined strategic HRM as 'the pattern of planned human resource deployments and activities intended to enable an organization to achieve its goals.' The SHRM perspective seeks to integrate macro-level theories and concepts with those at the micro level to examine the influence of configurations of HRM practices and activities on organization-level performance outcomes (Arthur, 1994). Given this approach, multiple strategies can be identified as being relevant to the HR function in organizations. However, for the purpose of this paper, we explore only the stratgies of fit and flexibility in HRM practices.

The concept of 'fit' in behavioral research refers to the structure of relationships among variables involved in a theory of organizations. In this study, fit is conceptualized as internal consistency among a set of underlying, theoretically related variables (Venkatraman, 1989). For example, Milliman, Von Glinow, and Nathan (1991) argue that fit, as it relates to HRM, concerns the relationships among HRM practices and means that various HR practices, such as selection, training, performance appraisal, and compensation, complement and support each other.

Specifically, Baird and Meshoulam (1988) examined HR practices in the context of the developmental phase (i.e., the life cycle stage) of the practices, and argued that fit among practices is the extent to which all the practices are at the same stage in the life cycle (internal fit) and that the practices should be at the same developmental stage as the organization. According to Baird and Meshoulam if fit does not exist, 'money, time, and energy are wasted' (1988: 123). They cite the example of a firm whose '... strategic planning for managing human resources failed because management did not understand or use the information provided' (1988: 123). Thus, if an HR practice is developed beyound the level of the others, either it will fail because the others are not developed to a level to support it or the organization will have to engage in large amounts of information processing taking place to find a way to keep the practice from failing.

For example, an organization can develop narrow rigid job descriptions which make it quite easy to develop selection, training, appraisal and compensation systems which all become tightly

coupled together (i.e., they 'fit'). However, once these become coupled, to innovate in any one set of practices makes for significant problems in the other practices. Information processing is required to gain insight into the nature of the innovation, the impact of that innovation on the other practices, and the feasibility of adapting the other practices to the innovation. By maintaining fit among HR practices (through stifling innovation), the firm reduces information-processing requirements (a requirement for unrelated firms), and thus, decreases bureaucratic costs. It is important to note that this view of fit does not suggest that the HR function in all of a firm's divisions is at the same level of development. Rather, it suggests that fit among HRM practices is emphasized within each division's HRM function.

Flexibility is the ability of an entity to quickly and easily change its policies, practices, or procedures to meet the diverse or changing demands of the environment. Milliman *et al.* (1991) define HRM flexibility as the capability to facilitate a firm's ability to adapt effectively and in a timely manner to diverse and changing demands from within the firm itself and/or from its environment. It requires a willingness to use innovative HRM practices that differ from the status quo and results in one HRM practice being further advanced than other HRM practices within each division to meet unanticipated changes. Thus, the requirement for quickly changing HR practices, to meet diverse and changing demands, entails a significant increase in information-processing requirements (a characteristic of related firms). This makes for a more chaotic atmosphere in the HR function, and is better handled by managers with a mindset that is open to risk and uncertainty. In fact, Wolfe (1995) explored the implementation of HRM innovations in a large sample of organizations and found a significant number of failures. He noted that implementation success was contingent upon (a) whether the organization's context was supportive of the innovation, and (b) the existence of a powerful champion for the innovation.

Many authors recognize the potential trade-off between fit and flexibility within their definitions of these concepts. Fry and Smith (1987) argue that strategy researchers have assumed that fit among a firm's functions leads to effectiveness. Baird and Meshoulam (1988) posit that an HRM unit functions best when components are at the same stage of development. On the other hand, other authors (Lengnick-Hall and Lengnick-Hall, 1988) argue that this emphasis on fit is counterproductive from a competitive perspective because it restrains innovativeness and restricts the firm's repertoire of skills. Milliman *et al.* (1991) argue that, while fit may enhance organizational effectiveness, fit does not guarantee firm success, and some firms achieve effectiveness without fit.

Our view is that flexibility and fit are two distinct concepts and not opposite ends of one continuum. However, in a world of limited resources available to firms, most firms seek to devote relatively greater resources toward the attainment of one or another set of goals. Thus, our examination of the impact of diversification on micro controls rests on the recognition that different levels of diversification tend to encourage firms to emphasize either fit or flexibility (see Figure 2), particularly because of the different information-processing and bureaucratic costs associated with the choice of diversification strategy. The next section explores the relationships among diversification, macro controls, and the fit/flexibility trade-off.

Fit, Flexibility, and Diversification

If, as past research demonstrates, diversification has implications for macro-level controls, then it may also have implications for the types of micro-level controls utilized within divisions. In essence we propose that diversification is related to a relative emphasis on fit or flexibility as depicted in Figure 3. As past research indicates (Baysinger and Hoskisson, 1989; Goold *et al.*, 1994), if the firm's overall strategy is related, then strategic controls are implemented; however, if the firm's overall strategy is unrelated, then financial controls are imposed.

Thus, we propose that the implementation of strategic controls leads to flexibility being the predominant HRM strategy; whereas, the imposition of financial controls leads to fit being the predominant HRM strategy. These relationships are discussed below. In a later section we examine the last link in the model in Figure 3, i.e., the impact of diversification on micro-level controls.

Baysinger and Hoskisson (1989) argue that if unrelated firms are to realize better firm perform-

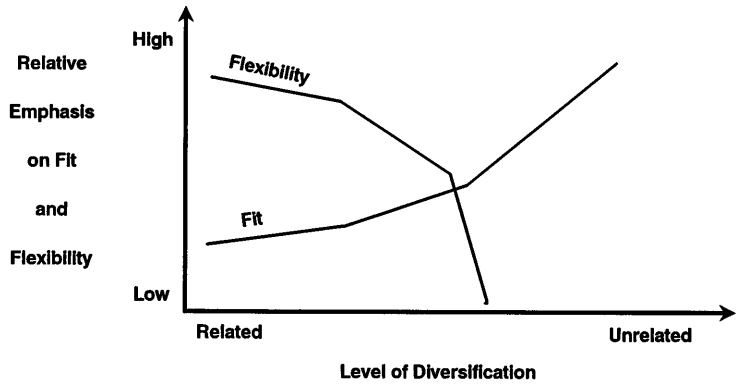

Figure 2. Diversification strategy and the relative emphasis on fit and flexibility

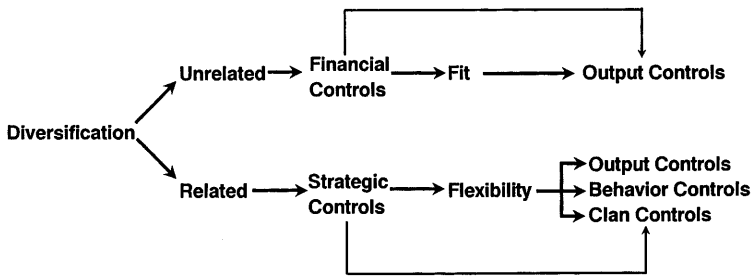

Figure 3. An expanded model depicting the link between diversification, fit and flexibility, and HRM control systems

ance they must use financial controls. These firms are generally characterized by corporate/divisional managers with a least cost behavior approach, a focus on short-term efficiency and risk avoidance, a superficial knowledge of business-level operations by corporate/divisional managers, a focus on short-term ROI/cash flow/growth/market share, competition among divisions, and the evaluation of divisional managers by short-term financial criteria at the corporate level. In addition, divisions within the firm exhibit decreased spending on R&D, market research, employee training, and capital investment (Hoskisson and Hitt, 1994).

The short-term focus associated with unrelated firms produces an emphasis on fit in the HRM function within each of the unrelated divisions resulting from the desire to decrease information-processing requirements and thus, bureaucratic costs. Again, this does not imply that all divisions have HR functions that are at the same stage of development across divisions. Rather, HRM practices are at the same level of development within a division and no one HRM practice leads or lags others within that division.

The focus on fit, because of the imposition of financial controls, occurs for several reasons. First, once fit is achieved, cost-conscious managers are reluctant to invest money in new and innovative ideas. Their mindset is to save money to make the 'bottom line look good.' Given the findings that unrelated firms engage in less risk and exhibit lower levels of investment in R&D (activities that are closely tied to value creation) (Hoskisson and Hitt, 1994), they are less likely to be innovative in HRM practices (activities usually perceived by managers to be unrelated to value creation), thus leaving those practices at similar levels in their developmental cycles. Second, unrelated firms tend to buy and sell businesses more, and are not, therefore, interested in making a long-term investment in HRM for the benefit of a possible competitor. Third, just as unrelated diversification leads to increased information-processing requirements which can be reduced by moving toward financial controls, these information-processing requirements can similarly be reduced by an emphasis on fit. Lengnick-Hall and Lengnick-Hall (1988) argued that a strong emphasis on growth that leads to higher

levels of diversification is conducive to maximal fit. Finally, corporate managers who manage unrelated firms are generally more risk averse (Hoskisson and Hitt, 1988) and tend to prefer stable industries where fit is more appropriate.

Related firms (Baysinger and Hoskisson, 1989) must use strategic controls if they are to realize better firm performance. These firms are characterized by corporate managers with an in-depth knowledge of divisions' operations, open communication between corporate/divisional managers, and the evaluation of divisional managers on the basis of an open, subjective appraisal of the quality of the process leading to financial outcomes. In addition, divisions within a related firm exhibit a long-term perspective, a willingness to accept risk, and greater spending on R&D, market research, capital investment, and employee development and training (Hoskisson and Hitt, 1994).

These characteristics at the macro level lead to more of an emphasis on flexibility than on fit at the micro level, although fit is still important (see Figure 2). The greater emphasis on flexibility, when firms use strategic controls, happens for several reasons. First, corporate managers know more about the divisions and their requirements. Consequently, they are more supportive of the investment required in HRM flexibility, because they know it is required for future strategic plans and the opportunities and threats each business faces. Second, they are more risk-oriented and have a mindset that allows them to invest in innovative HRM practices that are risky in the short term. Third, because divisional managers are evaluated subjectively (Hoskisson and Hitt, 1994), they are willing to recommend innovative HRM practices. Finally, related firms which use strategic controls generally have more organizational slack, which is usually associated with adaptation and innovation (Singh, 1986). Milliman *et al.* (1991) suggest that slack has an impact on flexibility in that unabsorbed slack is related to greater risk taking.

Thus, as depicted in Figure 3, being unrelated leads to financial controls and produces an emphasis on fit. Conversely, being related produces strategic controls and leads to a greater emphasis on flexibility while retaining some emphasis on fit.

Proposition 1: The use of financial controls in unrelated firms will produce an emphasis on fit among divisional HRM practices.

Proposition 2: The use of strategic controls in related firms will produce an emphasis on flexibility among divisional HRM practices.

However, the influence of diversification on HRM is not only limited to affecting the HRM strategies of fit and flexibility. As depicted in the model's final link in Figure 3, diversification is likely to affect the use of various HRM controls. This link from fit and flexibility to behavior, output, and clan control is important to conceptually complete the trek from diversification and the effect diversification has on HRM controls. The next section discusses this link from fit and flexibility to micro (HRM) controls.

HRM Controls

Types of HRM controls

Several researchers (Eisenhardt, 1985; Jaeger and Baliga, 1985; Snell, 1992) agree that control is important in a firm. Tannenbaum (1968) defined control as any process in which an organization, a group or an individual intentionally affects or determines what another organization, group or individual will do. Within an organization, control is necessary to ensure that members of the organization persistently direct their efforts towards the achievement of organizational objectives (Olsen, 1978). In addition, control is needed to ensure a stable structure of internal relations and stable mechanisms for structural adaptation and change (Jaeger and Baliga, 1985).

In this paper, micro controls are defined as methods used by one individual (typically a superior) to affect or influence what another individual (typically a subordinate) does. This is distinct from a control system which is defined as a process by which the method of control is implemented. There are different types of micro-level controls available to firms. In this paper we examine three: behavior control, output control and clan control. Behavior control is characterized by centralization, articulated procedures, close supervision, and behavior appraisal (Eisenhardt, 1985). Output control is characterized by decentralization, results criteria, and a performance–rewards link (Snell, 1992). Clan control is

characterized by rigorous staffing, training, development, and extensive socialization. Given this categorization of micro controls, we now assess the impact of HRM strategy (fit vs. flexibility) on the type of micro controls used in divisions.

Fit and HRM controls

An emphasis on fit, stemming from being unrelated and the consequent use of corporate financial controls, produces an emphasis on output controls in divisional HRM practices for several reasons. First, the use of output controls within the division is encouraged through an act of imitation. As already discussed, behavior control is difficult across unrelated divisions due to the lack of knowledge of means–ends relationships (Snell, 1992). This lack of knowledge of means–ends relationships encourages the use of financial rather than strategic controls for assessing divisional performance within unrelated firms (Baysinger and Hoskisson, 1989), and the use of financial controls means that divisional managers generally use outcome controls. Ouchi and Maguire (1975) found a strong tendency for subordinates to emulate their superiors in the use of output control. They found that department managers who receive much output control from their superiors, use much output control in supervising their subordinates. It is likely, then, that divisional managers who are subject to financial controls use output controls in their divisions.

Second, emphasizing fit in HR practices leads to an overemphasis on current plans rather than concern with strategic adaptation. This causes inflexibility and ossification (Jaeger and Baliga, 1985). When this happens, managers in divisions tend to rely more on output controls. Ouchi (1977) argues that output controls are less flexible and less adaptable. Finally, the ability of a firm to use clan controls often entails a strong organizational culture. The use of financial controls combined with the differences in culture across businesses argues against the potential usefulness of clan controls when firms are unrelatedly diversified. The implication is that an emphasis on fit causes a greater emphasis to be put on output control.

Proposition 3: An emphasis on fit produces an emphasis on output controls in divisional HRM practices.

One could argue that an emphasis on fit, while encouraging the use of one type of control (i.e., output, behavioral, or clan) to the exclusion of others, does not necessarily lead to the use of output controls. For example, if an unrelated firm acquires another firm which subsequently becomes one of its divisions, it seems reasonable to assume that the new division will retain the controls that were in place before being acquired even if these were clan or behavior controls. Given the divisional manager's existing knowledge of means–ends relationships within the division, there is no reason to believe that output controls will be implemented immediately. However, we argue that while this may be what happens in the short term, in the long term a shift occurs to the use of output controls.

If division managers are being subjected to financial controls one of the consequences is short-term expectations of better financial results. These expectations encourage division managers to cut spending on R&D, advertising, capital investment and human resource management, all investments without a direct short-term impact on the bottom line. The cut in human resource management causes a decrease in spending on recruiting, selection, socialization, and training and development and this produces a decrease in the emphasis on clan control. Clan control is achieved primarily through extensive investments in selection, training, and socialization of employees (Eisenhardt, 1985; Snell, 1992). If money for these activities is cut from the budget to achieve short-term results, we would argue that in the long-term even a clan control system is eroded and eventually becomes an output control system.

In a similar manner, behavior control requires that superiors have knowledge of cause and effect or means/end relationships (Snell, 1992). This means that managerial development and worker training are both important to behavior controls. Under a short-term financial results orientation, we argue that money for managerial development and worker training is cut quickly, with the former being cut first as was observed by Smith-Cook and Ferris (1986). In fact, Arthur (1994) found that steel minimills that emphasized a cost–leadership strategy (a strategy consistent with outcome controls) were characterized by HR systems which consisted of low investments in training, low employee participation, and out-

come controls such as incentives tied to performance.

This leads to a predominant emphasis on output control developing in the long term even if divisions initially had an emphasis on behavior or clan control when they were acquired. These arguments, combined with the previously discussed findings that managers use the controls by which they are managed (Ouchi and Maguire, 1975), support our argument that a greater emphasis on output controls develops over time.

In fact, we would argue that exactly this effect was observed with Electronic Data Systems (EDS) following its acquisition by General Motors (GM). Under Ross Perot, EDS developed a strong set of behavioral and clan controls. These controls resulted in a strong organizational identification that was almost cult-like. However, after being acquired and managed by GM, the existence of these controls has diminished in favor of more outcome-based controls.

Flexibility and HRM controls

In contrast to an emphasis on fit, an emphasis on flexibility produces an organization that utilizes behavior, output, and/or clan (socialization) controls. Snell (1992) argued that the advantages and disadvantages of the three types of controls suggest their combined use in HRM. However, given the differences between related and unrelated firms in their use of corporate (macro) controls, this utilization of several types of controls is only appropriate for related firms; that is, only firms which are capable of using, and use strategic controls, and, consequently, are more flexible in their imposition of HRM controls. Several researchers agree that some firms use elements of socialization, output, and behavior controls (Jaeger and Baliga, 1985; Snell, 1992).

This is not surprising in related firms given the mindset that managers in these highly interconnected firms have. Managers in these firms have a long-term perspective and they are more open to taking risks. In addition, they are not as concerned with the bottom line. Consequently, they tend to invest more in selecting, training, and developing new employees (socialization). Also, corporate managers know more about the divisions and support the divisional managers in innovative, flexible HRM practices.

Further, divisional managers know more about their own businesses and can ensure high goal congruence. This allows them to be able to use behavior, output or clan controls (Eisenhardt, 1985; Jaeger and Baliga, 1985; Snell, 1992). Additionally, if there is high knowledge of cause/effect relations (Snell, 1992), as there is in related firms, behavior control is the recommended control system (Eisenhardt, 1985; Snell, 1992). Finally, the use of clan controls often is accomplished through the development of a strong organizational culture that is more easily maintained among related divisions where there is high goal congruence (Eisenhardt, 1985). Thus, having the capability of being flexible in HRM practices may be more advantageous than striving for fit in related firms.

Proposition 4: An emphasis on flexibility within a division leads to the utilization of behavior, output, and/or clan controls.

Which combination of these controls is used depends on the situation existing within each focal division. For example, a division characterized by a high knowledge of means–ends relationships might lean toward behavior control. A division characterized by a low knowledge of means–ends relationships might emphasize either outcome or clan control. However, what is important to note is that there is a greater variety of potential type(s) of control available to divisions within related firms relative to those in unrelated firms.

However, the previous analysis does not mean that the relationship between macro and micro controls is completely mediated by the HRM strategy used in divisions. There is the distinct possibility of a direct relationship between macro and micro controls such that divisional units mirror the types of controls by which each is being controlled (Ouchi and Maguire, 1975).[2] Thus, there might be a direct relationship between macro controls at the corporate level and micro controls at the divisional level in addition to the mediated relationship posited in this examination.

Proposition 5: The effect of macro controls at the corporate level on micro controls at the

[2] We especially wish to thank one of the reviewers for pointing this out.

divisional level is partially mediated by the type of HRM strategy used in divisions.

DISCUSSION

The effect that diversification has on divisional HRM functions has been posited in this paper. It is argued that divisions in an unrelated firm are influenced to implement output controls. On the other hand, firms which are related have more flexibility in that their divisions could use any or all of the HRM controls discussed in this paper. In this section we discuss some possible performance implications of our theory. This discussion is based on Barney's (1996) typology of firm performance.

Barney (1996) argues that firms may have below normal, normal or above normal performance. In addition, he suggests that unrelated firms can only have below normal to normal performance while related firms can have below normal, normal or above normal performance. We contend that the appropriate use of HRM controls is a contributing factor to which level of performance a firm achieves. We argue that unrelated firms, all else being equal, should achieve normal performance if they implement output controls and could achieve below normal performance if they try to utilize behavior and/or clan controls. These effects on performance need to be understood by corporate and divisional managers if they are to achieve optimum performance for their unrelated firms.

Regarding related firms, we argue, all else being equal, that these firms should achieve above normal performance if their divisions utilize an appropriate combination of output, behavior and/or clan controls. Our theory suggests that they are capable of this because they are related, use strategic controls and financial controls with the emphasis on strategic controls, are flexible with respect to their HR strategy and, therefore, are able to use an appropriate combination of controls. We want to note that, even though related firms may give divisions the opportunity to use output, behavior and/or clan controls, inappropriate use may lead to normal or below normal performance. Rowe and Nixon (1996) proposed that using behavior controls when professional (clan) controls were appropriate led to below normal performance. In addition, our arguments at the micro level are analogous to those of Baysinger and Hoskisson (1989) at the macro level. As mentioned earlier, they argued that for firms to achieve optimum performance required that related firms use strategic controls and financial controls with the emphasis on strategic controls and that unrelated firms utilize only financial controls. Similarly, and with all else being equal, we argue that divisions in related firms should use an appropriate combination of controls and that divisions in unrelated firms should use only output controls. Not doing this will lead to below normal or normal performance in related firms and below normal performance in unrelated firms.

Another important implication is that, while using output controls may be an effective short-term strategy for unrelated firms, it could have a negative long-term impact on the division's ability to compete in its own competitive market. There is a growing body of evidence that innovative HRM practices are associated with firm performance (e.g., Arthur, 1994; Huselid, 1994). Our theory implies that the benefits accruing from such practices may be more easily realized in related firms. While short-term efficiency is gained from an emphasis on fit, adopting these practices critical to the long-term viability of the enterprise is quite difficult, and counterproductive in a division owned by an unrelated firm. Thus, our analysis implies that in the long run divisions owned by unrelated diversifiers could be at a competitive disadvantage relative to their competitors which are either independent or owned by related diversifiers. Barney (1996) suggests that unrelated firms will probably achieve below normal performance in the long term. The emphasis on fit and output controls at the divisional level may be a contributing factor to this level of performance in the long term.

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